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Emerging Risks in the Design and Construction of Green Buildings

By Christopher Nutter – April 11, 2012

Although new design and construction in the United States may have dramatically slowed during the recent recession, the rate of change within the industry has not slowed at all. The last few years have seen the adoption of new building and energy codes as well as widespread incorporation of voluntary standards that are intended to produce less wasteful and more environmentally sensitive remodels and new construction. While these changes are generally heralded as positive steps, their collective impact on the building industry has not yet been fully evaluated in light of the new risks that come with these new materials, new construction methods, and new compliance requirements. However, one thing is certain—the new standards, voluntary or mandatory, are not going away. Here’s why.

- Public entities, representing the majority of construction dollars being expended today, are demanding improved environmental practices. Civic projects are thus defining current construction practices that will, over time, also alter the standard practices in the industry.
- Even when the standards are optional, a strong argument can be made for the direct economic benefits of sustainable design and construction, including decreased operating costs, increased building values, increased occupancies, and higher rents. CoreNet, *Global Survey on Corporate Real Estate and Sustainability*, (2009). Furthermore, for about the same cost as traditional design, (*Cost of Green Revisited* (Davis Langdon 2007)), a sustainably designed building consumes 26 percent less energy than a traditional building (GSA Public Buildings Service, *Assessing Green Building Performance* (2008)). As a result, private developers are clamoring for professionals with the experience to deliver this type of project.
- In many cases, design professionals are now obligated to present sustainable options to their clients, regardless of code requirements (see Canon IV of the 2007 AIA Code of Ethics & Professional Conduct), proving that professional ethics also drive change.

In fact, over the past few years, the legal and contractual requirements to comply with previously voluntary standards have become the rule rather than the exception in both private and public construction projects. But who is responsible for nailing down this moving target of laws and standards? What happens when the standards are not met? What are the risks, and how can they be avoided? If risks can’t be avoided, who is responsible? The answers to these questions require a brief review of the standards.

The Standards

The standards relevant to sustainable design and construction, also known as green building, vary widely, but they follow the same basic tenets—encouraging consideration of the siting of the building, the energy required to operate the building, the materials used in construction, the management and consumption of water, as well as the air quality, both inside and outside the building. Numerous competing and complementary standards were developed to evaluate these criteria, with revisions and updates continuing at a fairly rapid pace. Standards also vary state by state and country by country, with different methods for measuring success.

The Green Building Initiative's Green Globes, Build It Green's GreenPoint rating, the International Living Future Institute's Living Building Challenge, the National Association of Home Builders' Green Building, the Environmental Protection Agency's Energy Star, BRE's Environmental Assessment Method, and the U.S. Green Building Commission's Leadership in Energy and Environmental Design (LEED) certification are just a few of the currently published standards. LEED is the most widely known of these standards and the one most commonly cited when green building is being discussed. LEED is also a good example of the shifting nature of the standards as it went through significant revisions in 2009, with more planned for late 2012. To complicate matters further, referenced standards from independent organizations such as the American Society of Heating, Refrigerating and Air-Conditioning Engineers (ASHRAE), ASTM, and the American National Standards Institute (ANSI), which also undergo regular revision, are often incorporated into the basic requirements for these standards. This is certainly the case with LEED.

In an increasing number of states, model building codes and associated acts and statutes are being modified to incorporate new mandatory green building requirements. In California, CalGreen was enacted (effective January 1, 2011) as a firm requirement at the state level and is to be used in conjunction with existing building codes and other preexisting local greening requirements, regardless of their inherent incompatibility. For example, San Francisco had to reconcile the existing requirement for LEED certification of commercial buildings and Green Point ratings for residential projects with the new state-mandated building code. Other states, such as Maryland, have opted for a less complicated solution by directly adopting the International Green Construction Code, which was designed as a complement to the other International Code Council model codes already in place in Maryland. This reduced the likelihood of uncovering conflicting or incomplete provisions that can occur with uncoordinated standards.

The Risks

Given the widespread adoption of green design standards nationally, it may now be more accurate to refer to the risks associated with green design and construction simply as "current building risks." Many of these so-called green risks are very similar to issues traditionally associated with construction projects—uncoordinated drawings, construction delays, and noncompliant construction, just to name a few. But other risks can be specifically related to

sustainable design and construction practices primarily because of the use of green materials, systems, and procedures. Six of the top green risks are described in the matrix below, along with the likelihood of occurrence, the likelihood of associated litigation, the financial significance of the risk, and the party or parties typically held responsible for the issue. Discussion of the risks as well as examples follow the matrix.

#	Risk Categories	Occurrence / Likelihood	Correlated to Litigation	Financial Impact	Responsible Parties
1	Higher than anticipated operating expenses - excessive energy use, water use, and maintenance	high	high	high	owner / designer / contractor
2	Establishing conflicting standards and potentially unachievable project requirements	high	mid	mid	owner
3	Construction cost and schedule impacts associated with delivering a sustainable building	mid	high	high	owner / contractor
4	Failure to meet Green code or Green Certification requirements - during the original design phase, due to end user design changes, or during construction	mid	mid	mid	owner / designer
5	Employing materials and equipment with reduced lifecycles or immediate failure (aesthetic or performance)	mid	high	mid / high	owner / designer
6	Damage to environmental and professional reputation	low	low	mid	owner

1. Higher Than Anticipated Operating Expenses—Excessive Energy Use, Water Use, and Maintenance

It is a common expectation that long-term savings will be associated with a conservation-oriented design; the design will allow for less consumption, and less consumption must equal greater savings. Unfortunately, this is not always the case. For example, a Wisconsin public school, Northland Pines High, was granted a LEED Gold rating in 2006. Several years later, that rating was challenged, and the building was found not to be in compliance with the basic LEED requirements for heating, cooling, and ventilation (ANSI/ASHRAE 62.1-1999). Although it is generally believed that the problems have since been corrected, it was not without cost or impact, including \$40,000 expended by the school district to address the issues identified with its brand new school. Ken Anderson, [Pines High School to Stay at Gold Level, Says Green Council](#), Vilas County News-Review (Eagle River, Wis.), June 22, 2010. Also, although not quantified in this case, there is no doubt that the alleged improperly designed and improperly commissioned system consumed more energy than was intended before the issues were identified and corrected. Imagine that the problems were never identified; the actual energy use could have exceeded that of a traditional, inefficient building.

Regardless of the criteria that must be met to comply with state, county, city, or campus standards, the risk is that projections of cost savings, savings that are being invested in with increased construction costs and time, may not be present in the completed building or at least not at the anticipated levels. Or, even if savings are achieved, are there other costs to those savings? For example, the physical discomfort associated with poorly lit, heated, or ventilated spaces. These are not typically considered to be reasonable trade-offs for more efficient buildings.

Resource consumption is of interest in part because it typically represents a significant portion of a building's operating costs. It is also one of the mantras of sustainable design: Consume fewer resources. Therefore, the risk associated with unanticipated operating expenses does pose the greatest risk in green projects—it involves large dollar values; it is an issue in lawsuits that are already under way; and the burden of the risks falls to designers (engineers), contractors (subcontractors), and owners.

2. Establishing Conflicting Standards—Creating Unachievable Project Requirements

New standards are being developed and instituted in cities and counties at such a pace that it is unreasonable to expect that they will all be compatible, complementary, and coherent. Designs must be able to satisfy the basic code requirements, while also meeting the elevated requirements of LEED or any other standard adopted by a local government or state. What happens when the LEED standards do not mesh with existing design standards?

Even with review and consideration during the design process, some requirements are nearly impossible to establish in advance. In another LEED-based project, a dormitory for a private university in Georgia, the design professionals chose to top a required fire lane with a grass paving matrix. The paving was designed to support over 5,000 pounds per square inch, more than enough for a fire truck or any other emergency vehicle that might need access. The fire lane paving was also designed to increase the pervious nature of the site, which equates with additional LEED points. After completing the design and confirming that it satisfied the code as well as campus standards, the project was submitted to and approved by the planning department and the building department, and ultimately routed to the fire marshal for final approval. At the time of his final review, the fire marshal refused to approve the pervious fire lane and required it to be paved with concrete. The additional points for achieving a more pervious site were lost.

Two other recent examples also relate to the problems that can occur when conflicting measures are adopted. In two separate litigation actions, one in Washington State and the other in Albuquerque, New Mexico, locally instituted requirements for the energy performance of new equipment in new construction were determined to be more stringent than what was allowed by federal law (*BIAW et al. v. Washington State Bldg. Code Council*, No. C09-5633RJB (*W.D. Wash.* 2011) and *AHRI v. City of Albuquerque*, No. 08-633 MV/RLP (D.N.M. 2010)). The circumstances in both cases arose out of a political decision to increase sustainability requirements regionally without fully understanding the legal implications of doing so. Other

public agencies may experience similar problems as they attempt to increase the sustainability of their own standards.

In many cases, conflicting standards can be addressed as they emerge. Standards can be brought into alignment with new codes, or orders of precedence among the standards can be established to make corrections automatically when identified. Where significant financial interests are at stake, as was true for the manufacturers involved in the Washington and New Mexico cases, litigation becomes a more likely possibility. If deeply conflicting standards or requirements exist at the time a project is undertaken and they are not identified and resolved until after construction is under way, the potential for delays, significant cost overruns, and accompanying litigation is heightened.

3. Construction Schedule and Cost Impacts Associated with Delivering a Sustainable Building

Delay is one of the most commonly litigated issues in construction and often represents the largest dollar values in a dispute. While construction contracts may lean toward liquidated damages as motivation to keep a contractor on schedule, the magnitude of the resulting damages often causes the dispute to end up in litigation. Obviously, delay is not a new green issue; however, the impact of delay on green projects may lead to unexpected results.

In one of the first and most publicly discussed green building cases, *Shaw Development v. Southern Builders*, No. 19-C-07-011405 (Cir. Ct., Somerset Cnty., Md. 2007), it was initially thought that the “Captain’s Galley” condominium construction was in dispute because it failed to meet the LEED Silver certification level set forth in the construction contract. In fact, the dispute was over a sizeable state tax credit that was lost because the project was delayed. While the delay in that case does not appear to have been specifically related to the sustainable nature of the project, the tax credit was a green incentive; therefore, it can be considered a green delay case.

Delay can also arise from a lack of availability of materials. In 2005, one of the key ingredients used as a sustainable concrete additive, fly ash, was running short. This supply shortage was further compounded by an overall shortage in concrete. Because the use of the fly ash waste product is associated with material and resource credits within LEED and because concrete is also a more sustainable material than steel and is credited accordingly, the concrete and fly ash shortage had the potential to substantially delay or derail a number of projects. While concrete or fly ash shortages may not be a problem in the future, it is likely that any other number of critical resources may fall in short supply and risk delaying projects with specific green material requirements.

There are other examples where seemingly unimportant design decisions related to finish materials in a project may result in delay. One of the considerations in a LEED project is the distance of the material supply source to the project site. If a local manufacturer and supplier do not have the necessary specified materials, it may not be an option to secure the materials from non-local suppliers without risking the loss of points or certification. Material supply holdups are



common in disputes involving construction delays, and by making the supply location-dependent, the risk of delay is increased.

Delay can also come from a lack of appropriate planning for and understanding of the steps required to complete a green project. In particular, commissioning of the building—thorough testing of the heating, ventilating, and air-conditioning systems, and the plumbing and electrical systems, among others—is a prerequisite for most sustainable designs and can be complicated and time consuming. If the contractor is not familiar with the required testing standards (e.g., ASHRAE 90.1) and has not adequately addressed the testing in the schedule, a delay may be inevitable.

As sustainable design processes and products become more common, designers, contractors, and owners will likely encounter fewer delays or supply issues that are green-specific. In the meantime, as construction specifications are refined to accommodate more supply options and as builders become more versed in the complexities of compliance with green standards, issues and disputes will continue to arise. When these issues compound time and dollars, such as delays that trigger liquidated damages and losses of tax credits, expensive litigation becomes more likely.

4. Failure to Meet Green Code or Green Certification Requirements—During the Original Design Phase, Due to End User Design Changes, or During Construction

Design and construction professionals have traditionally had an obligation to provide services that satisfy the requirements of the law as well as the additional requirements of their contracts. When those obligations are not met, there are consequences. Green design and construction is really no different except the standards are newer, and in many cases more complicated, and the expectations may be higher. In a recent case in Syracuse, New York, the developers of a shopping center, Destiny USA, received \$255 million in tax-exempt bonds for their proposal to reclaim a brownfield site and to LEED-certify at least 75 percent of the square footage of the new construction. Those commitments were not ultimately fulfilled. As a result, the Internal Revenue Service is currently seeking payment of back taxes, an action that will add significant construction cost to the project. In that case, not meeting the sustainable requirements turned out to be a very expensive error.

When considering the risk associated with not meeting green design standards, it is important to remember that most of the local enforcement agencies or entities—building departments and the U.S. Green Building Commission, for example—are not entirely inflexible. It is very rare that a certificate of occupancy is withheld due to a minor code infraction or that a narrowly missed LEED certification is not granted on appeal. Furthermore, if someone, such as a LEED-accredited professional, is tracking the anticipated credits for the project, changes to flooring or equipment would likely be identified as potential problems and could be corrected contemporaneously.

5. Employing Materials and Equipment with Reduced Life Cycles or Immediate Aesthetic or Performance Failures

Owners interested in green building have traditionally sought out the long-lasting and time-tested materials and equipment for their buildings—in other words, the most sustainable materials. With new codes and standards broadening the definition of “sustainable,” some of the obvious choices are changing. New products are launched regularly, with touted LEED points and sustainable performance. Some of these products are new to the market with only laboratory testing to confirm basic performance and code compliance, and without extensive field testing.

An example of this is oriented strand board (OSB). In an effort to develop processed wood products that do not affect air quality in buildings (a prerequisite of LEED), the formulation of the resins that hold the materials together has been altered, and formaldehyde has been eliminated. While this reconfiguration may not affect building materials like wall sheathing that are well protected, it does affect doors. The newer OSB-core doors are more expensive than their predecessors and are also more susceptible to impact and compression damage. In short, they will not last as long and will need to be replaced sooner. In this case, the reconstituted product is greener, but in other ways it may be considered less sustainable.

Maintenance and cleaning are also factors in the life span of green materials and equipment. Depending on composition, green materials may require more cleaning and maintenance than conventional materials and may also require the use of different cleaning products to preserve and protect less resilient finishes. Sustainable cleaning practices, which may be a requirement of a facility or may be tied to a particular green certification, typically call for the use of cleaning materials that are less toxic to people and to the environment. This may also factor into the lifetime appearance and performance of the project.

While product inadequacy or failure is not exclusively a green issue, it does appear that these types of claims will be on the rise as new products are rapidly developed, brought to market, and put into use. Depending on the areas affected, the embedded nature of the product (how easy is it to remove and replace), and the necessity of repair or replacement, green material and equipment failures could result in a wide range of cost impacts.

6. Damage to Environmental and Professional Reputation

The consideration of sustainability in building design and construction is often a priority that goes beyond purely economic decision making. Those who are making the extra effort and, in some cases, the extra investment for green building may be vocal about the commitment and may be judged on that commitment as well. If a green building falls short of the immediate expected goals of certification and energy savings, or the longer term performance goals, it could blemish the reputation of the company or person behind its commissioning. It could also affect the professional reputation of the project’s designers and contractors.

The issue of unmet promises surfaced in a green/LEED-related residential dispute at the Riverhouse in Battery Park City, New York. In the 2010 case, the developer of a LEED Gold-hopeful condominium building was alleged to have misrepresented the true sustainability of the building based on a variety of alleged construction defects, including the inadequacy of the “green” heating system and excessive air infiltration at the curtain wall (Craig Karmin, *Condo Owners Go for Green with Suit*, Wall St. J., May 29, 2010). This is yet another example of how green promotion and promises can be challenged publicly.

Mitigating Green Risk

Although the specific risks and impacts of green building vary, the best approach to mitigating all of these risks is to allocate them clearly and appropriately in advance of a dispute. While it is typically the owner and its architect/engineering professionals who will carry the most risk, it is still in the interest of all participating parties to clearly assign the risks before any work is performed.

In a green project, contracts should allocate all special compliance requirements that are associated with the work, including any specifics in the design, construction, commissioning, or documentation of the project. For example, if the project is slated to be LEED-certified at any level, proper documentation related to disposal of materials must be secured during the course of construction as it may not be possible to obtain it later. This may require the participation of the general contractor, several subcontractors, and a LEED consultant.

It is also very important to ensure that contracts for green construction projects do not provide guarantees, particularly guarantees to meet subjective compliance levels (e.g., guarantees of LEED Gold certification). While it may be the implicit, and perhaps explicit, requirement for the designer and builder to comply with building codes and regionally applicable statutes, offering guarantees or promises that the completed design or completed building will be certified at a particular level by an independent organization such as the U.S. Green Building Commission creates exposure that is not likely to be covered by a standard insurance policy. This would be the equivalent of an architect guaranteeing an owner planning commission approval for its project—impossible and imprudent. Model contract forms and language are available from a variety of industry groups, including the Associated General Contractors of America (Consensus Docs 310 Green Building Addendum) and the American Institute of Architects (Owner Architect Agreement B214-2007).

In addition to the consideration given to adopting appropriate contracts, consideration must be given to the makeup and leadership of the project team. If at all possible, team members should have experience with green design and construction and understand the new procedures and processes that are required. At the very least, project participants must be open to the type of required collaborative working environment. This has been consistently cited as the number one reason for success in green projects. Peng Wu & Sui Pheng Low, *Project Management and*



Green Buildings: Lessons from the Rating Systems, 136 J. Prof. Issues Eng'g Educ. Pract. 64 (April 2010). Collaboration minimizes risk.

Throughout the project, it is important to regularly revisit previously stated or defined sustainable design goals and to confirm adherence to those goals. This is true during both design and construction. For many professionals, this type of quality control review is already standard practice to ensure compliance with construction documents, with code, and with owner requirements. If not, it should be included as a contract requirement.

Finally, tight definition of roles and responsibilities for the project's green requirements must be established at the beginning to avoid any confusion as the project proceeds. For example, a single agent should be assigned to stay current on the federal, state, and local environmental laws that may have an impact on the project and to keep the other participants informed throughout design and construction.

Beyond the general strategies listed above, owners need to set priorities regarding green design in order to establish appropriate protections. If actual energy conservation and reduced water use are priorities, then rigorous monitoring and commissioning should be established regardless of the measures that are dictated by codes or by certification. If beautiful, durable, and sustainable buildings are important, it may be more prudent to use only tried and tested materials and systems; new is inherently riskier. In other words, it is essential that owners define the primary sustainable goals and work with the project teams to reduce risks throughout the design and construction process.

Keywords: litigation, construction litigation, LEED, CalGreen, sustainability, green code, green certification

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Construction Defects as an “Occurrence”: State Legislatures Weigh In

By Edwin L. Doernberger and Theresa A. Guertin – February 28, 2012

Commercial general liability (CGL) insurance policies are designed to insure a wide array of policyholders, from car manufacturers to ski resorts, farmers to landlords, and every sort of business in between. Due, in part, to the limitless variety of businesses that can purchase CGL coverage, the standard form policy strives to address every possible loss scenario without focusing specifically on any one type of policyholder. However, this mix of specificity and vagueness in policies has caused significant coverage issues for one particular brand of insured—the construction contractor.

A frequent and troublesome issue that has plagued construction industry policyholders is the availability of CGL coverage for claims arising out of defective or faulty workmanship, also known as construction defect claims. Courts across the country have taken a multitude of approaches to this issue. Many courts properly construe the standard CGL policy's insuring agreement as providing coverage for construction defect claims so long as the contractor did not actually intend to damage the project, even when those claims are asserted as a breach of contract claim.¹ These pro-policyholder courts typically hold that the term “occurrence” is ambiguous because the definition—an “accident”—is unclear;² and leave it to the exclusions to eliminate coverage where appropriate. Others courts have decided that such claims can never trigger coverage because they arise from foreseeable breaches of contract and, thus, do not constitute an “occurrence.”³ Citing the concern that providing coverage for defective construction under a CGL policy turns that insurance into a performance bond, these courts usually never reach an analysis of the exclusions and instead bar coverage by finding no “occurrence” in the first place.

As one court succinctly stated, the current state of the law concerning whether defective construction as an occurrence is an “intellectual mess.”⁴ Four state legislatures—Colorado, Arkansas, South Carolina, and Hawaii—have recently inserted themselves into this morass after courts in those states handed down decisions finding no “occurrence” in the context of construction defect claims. This article explores each of these state statutes in turn in an attempt to discern whether this so-called mess is on its way to being cleaned up or, alternatively, is just getting worse.

I. COLORADO LEADS THE PACK

In 2010, Colorado became the first state to pass legislation directly addressing whether defective construction is an “occurrence” in standard CGL policies. The promulgation of the statute was a direct response to the decision in *General Security Indemnity Co. v. Mountain States Mutual Casualty Co.*,⁵ in which the appellate court held that claims of defective construction were not an “occurrence” under the standard CGL policy.

The *General Security* case arose out of a housing construction project in Superior, Colorado. The homeowners association filed suit against the general contractor, D.R. Horton, Inc., for alleged faulty construction. D.R. Horton in turn filed a third-party complaint against its subcontractor, Foster Frames. Both the homeowners association's complaint and D.R. Horton's complaint alleged causes of action sounding in negligence, breach of contract, and breach of warranty. Foster Frames filed a fourth-party complaint against its sub-subcontractors, seeking indemnification if it were found liable to D.R. Horton. Foster Frames' CGL insurer, General Security Indemnity Company of Arizona ("General Security") defended its policyholder in the lawsuit filed by D.R. Horton but also brought a declaratory judgment action against the sub-subcontractors' insurers seeking contribution and indemnity. The trial court granted summary judgment in favor of the sub-subcontractors' insurers, finding that the insurers were not obligated to defend Foster Frames because the complaints did not allege an "occurrence" under the policies.

The Colorado Court of Appeals agreed with the trial court, holding that, based on the definition of the term "occurrence," there was no allegation in either complaint which triggered the sub-subcontractors' duty to defend Foster Frames. As in most policies issued after 1986, "occurrence" was defined in Foster Frames' policies as an "accident." The court explained that an accident is something "unintended and unforeseen," or "an unanticipated or unusual result flowing from a commonplace cause."⁶ Accordingly, an "occurrence" cannot arise from a claim for damages arising out of poor or faulty workmanship standing alone, regardless of the legal theory put forth by the plaintiff.⁷ The court identified this as the "majority rule" adopted by most jurisdictions and criticized the so-called minority rule for "unconvincingly conclud[ing] that defective work [that] is unforeseeable" is an accident constituting an "occurrence."⁸ However, the court also identified a "corollary" to the majority rule: whenever there is consequential property damage to third-party property, there is an "occurrence." Unfortunately for Foster Frames and General Security, the court found that there were no allegations of third-party property damage attributable to the work of Foster Frames' sub-subcontractors.⁹ Thus, the court affirmed the decision of the trial court, holding that "a claim for damages arising from poor workmanship, standing alone, does not allege an accident that constitutes a covered occurrence, regardless of the underlying legal theory pled."¹⁰

Only 15 months elapsed between the *General Security* decision and the legislative enactment of [Colorado Revised Statutes § 13-20-808.11](#) During the legislative hearings, "an insurance industry attorney and lobbyist testified . . . that *General Security* . . . [was] a 'shock' to the insurance industry and 'not the rule of law,' 'not the way courts have ruled in other jurisdictions,' and that the ruling[] 'took it too far.'"¹² The statute's legislative findings section makes it clear that the legislature also disagreed with the court's resolution of *General Security*, stating that "[t]he decision of the Colorado Court of Appeals in *General Security* . . . does not properly consider a construction professional's reasonable expectation that an insurer would defend the construction professional against an action or notice of claim contemplated [by this statute]."¹³

In light of the “vital importance to the economic and social welfare of the citizens of Colorado”¹⁴ that proper interpretation of insurance policies play, the legislature enacted the following provision:

In interpreting a liability insurance policy issued to a construction professional, a court shall presume that the work of a construction professional that results in property damage, including damage to the work itself or other work, is an accident unless the property damage is intended and expected by the insured. Nothing in this subsection (3): (a) Requires coverage for damage to an insured's own work unless otherwise provided in the insurance policy; or (b) Creates insurance coverage that is not included in the insurance policy.¹⁵

The statute also reaffirms other principles of policy interpretation, such as the rule that conflicting policy provisions should be construed in favor of coverage “if reasonably and objectively possible.”¹⁶

There has been surprisingly little judicial interpretation of § 13-20-808 since its enactment. The Colorado district court revisited its decision in *United Fire & Casualty Co. v. Boulder Plaza Residential, LLC*, which had relied heavily on *General Security* in finding no coverage, but the court determined it was unnecessary to delve into an interpretation of § 13-20-808.¹⁷ Several other opinions have mentioned the statute but have similarly avoided interpreting it in any significant fashion.¹⁸ The long-term, practical effect that the law will have on Colorado construction defect claims therefore remains to be seen.

II. ARKANSAS ANNOUNCES ITS ARRIVAL

Much like Colorado, the Arkansas legislature promulgated legislation clarifying the proper interpretation of CGL policies when claims of defective workmanship are alleged after several unfavorable decisions were handed down in that jurisdiction. Although the legislature does not refer to any decision by name, the statute was almost certainly enacted in response to the Supreme Court decision in *Essex Insurance Co. v. Holder*.¹⁹ The case centered on a dispute between a married couple, the Holders, and the contractor they hired to build a house, J&H Enterprises. The Holders sued J&H in state court, seeking damages in connection with J&H's alleged breach of contract, breach of warranty and negligence. J&H's insurer, Essex Insurance Company, denied its policyholder's demand for defense and indemnity and instead filed a declaratory judgment action against it in federal court.

The district court recognized that there was no controlling precedent in Arkansas addressing whether J&H's CGL policy should provide coverage for the Holder lawsuit and, therefore, certified the following question to the Arkansas Supreme Court: “Does defective construction or workmanship, including failure to complete work, delays in construction, or failure to procure qualified subcontractors, constitute an accident and, therefore, an “occurrence” within the meaning of commercial general liability insurance policies?”²⁰ The supreme court determined

that the term “occurrence” was not ambiguous and was consistently defined in state case law to mean “an event that takes place without one's foresight or expectation—an event that proceeds from an unknown cause, or is an unusual effect of a known cause, and therefore not expected.”²¹ With this definition in mind, the court ruled that a contractor's responsibility to repair or replace defective workmanship is not “unexpected,” and therefore such “faulty workmanship is not an accident.”²² Performance bonds, the court noted, exist to protect contractors against claims for repairing/replacing defective workmanship, and CGL insurance was not designed to cover the sort of claims asserted by the Holder's against J&H.

Essex was not the only pro-insurer construction defect case decided in Arkansas. Although procedurally *Essex* came up on a certified question from the Eastern District Court, the federal courts in that jurisdiction had not been reluctant to address defective construction insurance disputes. On at least two other occasions, in *Nabholz Construction Corp. v. St. Paul Fire & Marine Insurance Co.*²³ (discussed in *Essex*) and again in *Lexicon, Inc. v. ACE American Insurance Co.*,²⁴ the court interpreted the “occurrence” requirement to mean that there is no CGL coverage generally for faulty workmanship claims.²⁵

It was against this background that the Arkansas state legislature enacted § 23-79-155, entitled simply “Commercial general liability insurance,” which became effective July 27, 2011. The findings and purpose section of the statute (not codified, but important nonetheless) indicate disapproval of Arkansas court cases which “have caused uncertainty over whether the coverage provided to an insured under a [CGL] policy will include damages for faulty workmanship.”²⁶ Moreover, the legislature expressed its belief that “[a]n insurer should not be allowed to collect premiums to provide coverage against defects and then contest, deny, or fail to pay claims caused by faulty workmanship unless the insurer and insured have freely negotiated a specific exclusion from coverage.”²⁷ The statute itself provides:

- (a) A commercial general liability insurance policy offered for sale in this state shall contain a definition of “occurrence” that includes:
 - (1) Accidents, including continuous or repeated exposure to substantially the same general harmful conditions; and
 - (2) Property damage or bodily injury resulting from faulty workmanship.²⁸

In light of the recentness of this legislation, the state judiciary has yet to interpret § 23-79-155.

III. SOUTH CAROLINA TAKES A STAND

South Carolina took a more torturous path than Colorado or Arkansas, as the courts in that state initially took a strong pro-policyholder approach to insurance coverage for defective construction claims. Earlier this year, in the decision of *Crossman Communities of North Carolina, Inc. v. Harleysville Mutual Insurance Co.*,²⁹ the South Carolina Supreme Court explicitly overruled its decision in *Auto-Owners Insurance Co., Inc. v. Newman*,³⁰ wherein it held that although the defective application of stucco to a home's exterior “did not on its own constitute an occurrence,

the continuous moisture intrusion resulting from the subcontractor's negligence was an occurrence.”[31](#)

The *Crossman* court had before it a multimillion dollar dispute between a condominium developer and its CGL insurer, Harleysville. Crossman was sued by numerous homeowners who alleged that their condominiums were defectively constructed, leading to their decay and deterioration as a result of water infiltration. The trial court held that Harleysville had an obligation to its policyholder to indemnify it for the settlement, because there was property damage that resulted from the subcontractors' negligent work, and, therefore, the property damage was caused by an “occurrence.”

The supreme court analyzed the issue before it in light of nationwide case law concerning whether defective construction is an “occurrence.” It found the law to be an “intellectual mess.”[32](#) In its view, courts across the country have taken two positions on this issue: (1) a claim of faulty workmanship, standing alone, is not an “occurrence,” although coverage is triggered where faulty workmanship causes bodily injury or property damage to a third party's property; or (2) damage flowing from faulty work constitutes an “occurrence” regardless of the property injured so long as the insured did not intend or expect the result.

In light of its analysis, the court reversed the decision of the trial court holding that “where the damage to the insured's property is no more than the natural and probable consequences of faulty workmanship such that the two cannot be distinguished, this does not constitute an occurrence.”[33](#) Under this rationale, Crossman had not shown a covered “occurrence”—although the water intrusion may have been a continuous exposure to substantially the same harmful conditions, it was not an unexpected or unintended event because the natural consequences of Crossman's faulty work were the damage to the condominiums.

The decision did little to clarify the so-called mess. The court adopted the following example purportedly explaining the distinction between covered and uncovered losses:

Assume the insured is a general contractor that built an apartment building using various subcontractors to complete the work. Also assume a subcontractor installed all wiring in the apartment building. After the building is complete and put to its intended use, a defect in the building's wiring causes the building to sustain substantial fire damage. In such an instance, an occurrence would exist, the insurer could point to the “your work” exclusion, but then the “subcontractor exception” would provide an exception to the exclusion.[34](#)

According to the court, the example illustrates “fortuitous events that were caused by faulty workmanship” resulting in coverage.[35](#)

Thus, under *Crossman*, obtaining coverage for losses stemming from defective or faulty work would require a two-step analytical process that is not often found in other case law. First, the insured would have to show that the faulty work damaged something other than the faulty work itself, and second, the insured would need to demonstrate that the damage was fortuitous and not the “natural and probable” result of the faulty work.

It was due in large part to the *Crossman* decision that the South Carolina legislature inserted itself into the debate over coverage for faulty workmanship, introducing § 38-61-70 a mere two weeks after the case was decided. The statute's key provision states:

- (B) Commercial general liability insurance policies shall contain or be deemed to contain a definition of “occurrence” that includes:
- (1) an accident, including continuous or repeated exposure to substantially the same general harmful conditions; and
 - (2) property damage or bodily injury resulting from faulty workmanship, exclusive of the faulty workmanship itself.[36](#)

On August 22, 2011, after the enactment of § 38-61-70,[37](#) the supreme court re-heard the *Crossman* case and reversed its prior no-coverage decision.[38](#) The court highlighted the ambiguity in the definition of “occurrence” and clarified that consequential damages resulting from defective work is covered under a CGL policy. In the words of one commentator, however, “[t]he court's decision made no mention of the recently adopted South Carolina statute, except to say that it would make no mention of it.”[39](#) Like Colorado and Arkansas, observers will have to wait a while longer before obtaining any meaningful judicial interpretation of this statute.

IV. HAWAII MARCHES TO THE BEAT OF ITS OWN DRUM

Hawaii is the most recent state to enact legislation specifically aimed at the interpretation of insurance policies in the construction defect context. Its statute is markedly different from those enacted in Colorado, Arkansas and South Carolina and requires policyholders to determine the state of the law when their policy was issued with reference to the decision in *Group Builders, Inc. v. Admiral Insurance Company*.[40](#)

The *Group Builders* case grew out of a hotel construction project gone awry. Hilton Hotels Corporation hired Hawaiian Dredging to serve as general contractor for the construction of the Kalia Tower at the Hilton's Hawaiian Village in Waikiki. Hawaiian Dredging subcontracted the EIFS work to Group Builders, Inc. After the project was completed, the owner discovered extensive mold growth in numerous guest rooms. Testing and inspection revealed that defects in the design and construction of the Kalia Tower caused, or at the very least contributed to, the mold growth. Hilton Hotels filed a breach of contract suit against Group Builders for its faulty work. Group Builders' CGL carrier, Admiral Insurance, refused to provide coverage to its policyholder for the claims alleged in the Hilton Hotels suit. Group Builders commenced a declaratory judgment action against Admiral for its refusal to defend and indemnify it.

The trial court granted summary judgment in Admiral's favor, and Group Builders appealed. The appellate court correctly recognized that the mold damage, and the resulting loss of use of the guest rooms in Kalia Tower, constituted "property damage" under the policy. Therefore, the only issue before the court was "whether alleged faulty construction work, giving rise to contractual claims, constitutes an 'occurrence' under a CGL policy."⁴¹ The appellate court, using federal court precedent as a guide,⁴² determined that Hilton Hotels' breach of contract claims did not trigger coverage for Group Builders. A contractor should be responsible for the foreseeable consequences of breaching its contract by performing defective or sub-standard work, and to allow "recovery for disputes between parties in a contractual relationship over the quality of work performed would convert [a] CGL policy into a professional liability policy or a performance bond."⁴³ The court went so far as to hold that even claims "ancillary to the breach of contract claim" could not constitute an "occurrence" under a CGL policy, and warned other courts to carefully examine complaints to ensure that a negligence cause of action is not a breach of contract claim in disguise.⁴⁴ Thus, not only does the *Group Builders* case bar coverage for any defective construction claims brought against a policyholder in the form of a breach of contract action, but it also seems to preclude coverage for any consequential damages caused by the faulty workmanship.

In direct response to the *Group Builders* decision, the Hawaii legislature introduced House Bill 924. The Bill was signed into law by the governor in early June and will be codified as Hawaii Revised Statute § 431:1. The legislative findings make it very clear that the no-coverage position taken by the *Group Builders* court could prove not only devastating to the Hawaiian economy but also could negatively affect the public:

The legislature finds that in the event of a major incident involving a construction project that is affected by the *Group Builders* decision, a construction professional's uninsured liability for damages to people and property could result not only in the loss of millions of dollars and the closure of business for the construction professional and the construction project, but also to the absence of redress for individuals who may be harmed. . . . Most broadly affected by the *Group Builders* decision is the general public who use and enjoy publicly-accessible buildings and facilities and who, in the event of a catastrophic incident, will be denied remedy for potentially devastating consequences to their health and safety.⁴⁵

The solution put forth by the legislature in the form of § 431:1, however, does not seem to rectify this problem. The statute provides:

For purposes of a liability insurance policy that covers occurrences of damage or injury during the policy period and that insures a construction professional for liability arising from construction-related work, the meaning of the term

“occurrence” shall be construed in accordance with the law as it existed at the time that the insurance policy was issued.[46](#)

Thus, under the clear language of the statute, Hawaiian courts will have to evaluate a CGL policy's coverage in light of when it was issued with relation to the *Group Builders* case.[47](#) Whether this achieves the goals of reducing confusion and uncertainty and protecting the Hawaiian economy from devastating construction defect lawsuits remains to be seen.

V. HAS LEGISLATIVE INVOLVEMENT CLARIFIED THE “INTELLECTUAL MESS”?

Four state legislatures have joined the raging debate over whether defective construction constitutes an “occurrence” under standard form CGL policies. [Arkansas Code § 23-79-155](#) and [South Carolina Code § 38-61-70](#) represent similar approaches to the problem: both state statutes require that the definition of “occurrence” should be deemed to include defective construction claims. [Colorado Revised Statutes § 13-20-808](#), on the other hand, explicitly instructs the courts to presume that defective construction claims satisfy the “occurrence” requirement. Hawaii took a unique approach, instead requiring under § 431:1 that the term “occurrence” be interpreted in light of Hawaiian law on defective construction at the time of the policy's issuance.

Has legislative intervention done anything to clarify the “intellectual mess” of insurance coverage for construction defect claims? The answer, at least for now, is no. The courts of all four states have thus far expertly avoided interpreting or applying the statutes discussed herein despite their facial relevance. Presumably, this status-quo cannot last for long. State judiciaries will eventually be forced to take a hard look at what their compatriots in the legislative branch had to say about the issue. When this happens, South Carolina and Arkansas courts will probably have it the easiest when it comes to transitioning to a pro-policyholder stance because of the clarity of their respective state statutes. Colorado's law, on the other hand, may cause greater problems. It would not be surprising to see that statute challenged on constitutional grounds since it encroaches on what has traditionally been a judicial function: the interpretation of contractual language. Hawaii's statute will most certainly spark a wave a litigation; instead of clarifying the issue and decreasing the number of insurance coverage matters put in suit, the statute will likely drive more construction defect coverage disputes to the courthouse because judicial interpretation of the law *at the time of the policy's issuance* will be a tricky thing for insurers and policyholders to agree upon between themselves.

Whether defective construction qualifies as an “occurrence” under CGL policies has arguably been the most hotly contested coverage issue amongst construction professionals and their CGL insurance providers for the past 30 years. Two years ago, not a single state legislature had deigned to intervene. Now, in a short span of time, four state governments have pushed through legislation directly speaking to this issue. One thing is for certain—the debate will continue, more states legislatures may join the fray, and the courts will continue to analyze and re-analyze this important and complex question of policy interpretation.



Keywords: litigation, insurance, construction defects, state legislatures

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Endnotes

1 See e.g., *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, [979 So.2d 871](#) (Fla. 2007); *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, [242 S.W.3d 1](#) (Tex. 2007); *Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*, [673 N.W.2d 65](#) (Wis. 2004).

2 According to one court sitting nearly a half-century ago: “Everyone knows what an accident is until the word comes up in court. Then it becomes a mysterious phenomenon, and, in order to resolve the enigma, witnesses are summoned, experts testify, lawyers argue, treatises are consulted and even when a conclave of twelve world-knowledgeable individuals agree as to whether a certain set of facts made out an accident, the question may not yet be settled and it must be reheard in an appellate court.” *Brenneman v. St. Paul Fire & Marine Ins. Co.*, [192 A.2d 745, 747](#) (Pa. 1963).

3 See e.g., *Kvaerner Metals Division of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, [908 A.2d 888](#) (Pa. 2006); *Ohio Cas. Ins. Co. v. Williams*, [2003 ML 3341](#).

4 *Crossman Cmities. of North Carolina, Inc. v. Harleysville Mut. Ins. Co.*, No. 26909, 2011 WL 93716, at *3 (S.C. Jan. 7, 2011).

5 *General Security Indemnity Co. v. Mountain States Mutual Casualty Co.*, [205 P.3d 529](#) (Colo. App. Ct. 2009).

6 *General Security*, [205 P.3d at 534](#).

7 *General Security*, [205 P.3d at 535](#).

8 *General Security*, [205 P.3d at 536](#).

9 *General Security*, [205 P.3d at 538](#).

10 *General Security*, [205 P.3d at 534](#).

11 Note that during this time, the District Court of Colorado issued two decisions, *Greystone Construction, Inc. v. National Fire & Marine Insurance Co.*, [2009 U.S. Dist. LEXIS 73055](#) (D. Colo. Aug. 18, 2009) and *United Fire & Casualty Co. v. Boulder Plaza Residential*, [2010 U.S. Dist. LEXIS 14257](#) (D. Colo. Feb. 1, 2010), which “read *General Security* broadly as precluding coverage for, and any duty to defend arising from, property damage to the insured’s previously performed work arising from construction defects.” Ronald M. Sandgrund & Scott F. Sullan, *H.B. 10-1392: New Law Governing Insurance Coverage for Construction Defect Claim*, 39 Colo. Law. 89, 90 (Aug. 2010).

12 Sandgrund, et. al, *supra* note 11, at 90, *citing* House Testimony on H.B. 10-1394 at *21 (lines 2–11) (April 7, 2010) (Business Affairs and Labor Committee).

13 *Colo. Rev. Stat. Ann. § 13-20-808* (1)(b)(III) (2011); *see also United Fire & Cas. Co. v. Boulder Plaza Residential, LLC*, [663 F.3d 951](#) (10th Cir. 2011) (stating that the legislature “[e]xplicitly critiqu[ed] the restrictive interpretation of ‘accident’ adopted by the *General Security* court”).

14 *Colo. Rev. Stat. Ann. § 13-20-808*(1)(a)(I).

15 *Colo. Rev. Stat. Ann. § 13-20-808*(3).

16 *Colo. Rev. Stat. Ann. § 13-20-808*(5).

17 *See United Fire & Cas. Co.*, [633 F.3d 951, 957–58](#) (stating that it could “resolve the issues of whether [the insurer] owed [its additional insured] a duty to defend or duty to indemnify without reference to *General Security* or § 13-20-808” because the policy clearly excluded completed operations claims, which was the crux of the AI’s claim for coverage).

18 *See Cont’l W. Ins. Co. v. Shay Constr., Inc.*, No. 10-cv-02126-WDM-KLM, 2011 WL 3236102 (D. Colo. July 28, 2011); *Crossen v. Am. Family Mut. Ins. Co.*, No. 09-cv-02859-WDM-KLM, 2010 WL 2682103 (D. Colo. July 7, 2010).

19 *Essex Insurance Co. v. Holder*, [261 S.W.3d 456](#) (Ark. 2008).



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- [20 Essex](#), [261 S.W.3d at 466](#).
- [21 Essex](#), [261 S.W.3d at 460](#), citing *United States Fidelity & Guaranty Co. v. Cont'l Cas. Co.*, [120 S.W.3d 556](#) (Ark. 2003).
- [22 Essex](#), [261 S.W.3d at 459, 460](#).
- [23 Nabholz Construction Corp. v. St. Paul Fire & Marine Insurance Co.](#), [354 F. Supp. 2d 917](#) (E.D. Ark. 2005).
- [24 Lexicon, Inc. v. ACE American Insurance Co.](#), No.4:09CV00067JLH, [2010 U.S. Dist. LEXIS 1042](#) (E.D. Ark. Jan. 7, 2010), *aff'd in part & rev. in part* [634 F.3d 423](#) (8th Cir. 2011).
- [25](#) Although, on appeal, the Eighth Circuit reversed in part the holding in *Lexicon*, asserting that the district court interpreted *Holder* too broadly, and requiring that the insurer indemnify its insured for any damage to third-party property beyond the work itself. See *Lexicon, Inc. v. ACE Am. Ins. Co.*, [634 F.3d 423, 426-27](#) (8th Cir. 2011).
- [26](#) H.B. 1439, 88th Leg., Reg. Sess., § 1(a)(1) (Ark. 2011).
- [27](#) H.B. 1439, 88th Leg., Reg. Sess., § 1(a)(3).
- [28 Ark. Code Ann. § 23-79-155](#) (a) (2011).
- [29 Crossmann Cmtys. of N.C., Inc. v. Harleysville Mut. Ins. Co.](#), [2011 S.C. LEXIS 2](#) (S.C. Jan. 7, 2011).
- [30 Auto-Owners Insurance Co., Inc. v. Newman](#), [684 S.E.2d 541](#) (S.C. 2009).
- [31 Auto-Owners](#), [684 S.E.2d at 544](#).
- [32 Crossmann](#), 2011 S.C. LEXIS at *8.
- [33 Crossmann](#), 2011 S.C. LEXIS at *25.
- [34 Crossmann](#), 2011 S.C. LEXIS at *21–22.
- [35 Crossmann](#), 2011 S.C. LEXIS at *22.
- [36 S.C. Code Ann. § 38-61-70](#) (2011).
- [37](#) Section 38-61-70 was approved by the Governor of South Carolina on May 17, 2011.
- [38](#) See *Crossmann Cmtys. of N.C. v. Harleysville Mut. Ins. Co.*, [2011 S.C. LEXIS 277](#) (S.C., Aug. 22, 2011).
- [39](#) Randy J. Maniloff, *Sweet Carolina for Policyholders: Good Times Will Never Seem So Good for Construction Defect Claims*, Binding Authority (White and Williams LLP, Philadelphia, P.A.), Aug. 22, 2011, at 2, available at <http://www.whiteandwilliams.com/CM/Custom/Newsletters.asp>; see also *Crossman*, 2011 WL 3667598, at *4, n.6 (“In disposing of this appeal, we elect to adhere to our precedent in *Newman*. We do not address recent legislation that seeks in part to impose a construction on existing insurance policies in pending actions.”).
- [40 Group Builders, Inc. v. Admiral Insurance Company](#), [231 P.3d 67](#) (Haw. Ct. App. 2010).
- [41 Group Builders](#), [231 P.3d at 70-71](#).
- [42](#) See *WDC Venture v. Hartford Accident & Indem. Co.*, [938 F. Supp. 671](#) (D. Hawaii 1996); *Burlington Ins. Co. v. Oceanic Design & Constr., Inc.*, [383 F.3d 940](#) (9th Cir. 2004); *Burlington Ins. Co. v. United Coatings Mfg. Co.*, [518 F. Supp. 2d 1241](#) (D. Hawaii 2007).
- [43 Group Builders](#), [231 P.3d at 72](#).
- [44 Group Builders](#), 231 P.3d at 72.
- [45](#) H.B. 924, 26th Leg., 2011 Sess., § 1 (Hawaii 2011).
- [46 Haw. Rev. Stat. § 431:1](#) (2011).
- [47](#) See e.g., *State Farm Fire & Cas. Co. v. Vogelgesang*, [2011 U.S. Dist. LEXIS 72618](#) (D. Haw. July 6, 2011) (finding that § 431:1 did not apply to the interpretation of the insurance policies at hand, because the policies were issued after the cases relied upon by the *Group Builders* court, and so it was proper to rely on those cases in finding no “occurrence”).

Contractor Challenges “Adminis-lation” of Design-Build Procurement

By Edward B. Gentilcore – April 11, 2012

While it is not normally the approach of this publication to focus on one state as a microcosm of broader issues affecting the construction industry and construction litigation issues in particular, a series of case developments in Pennsylvania are notable because they reflect a bigger challenge in transforming traditional public procurement procedures to accommodate newer construction delivery methods. It has been said that necessity is the mother of invention. However, at least in the Commonwealth of Pennsylvania, that necessity has not yet translated into a fully innovated approach that can successfully embrace design-build project delivery on a broad level without the threat of controversy, challenge, litigation and, in the latest circumstance, permanent injunction.

For those not as familiar with the Keystone State, two notable points should be immediately considered. First, in the late 1990s, Pennsylvania took an enormous step to modernize its procurement processes by adopting a statewide Procurement Code. Pennsylvania’s Procurement Code not only implemented new statutory requirements for public contracting in the commonwealth, but also consolidated a number of different provisions in the Pennsylvania statutes that are implicated in public construction projects. Notwithstanding this cutting-edge development, at least by Pennsylvania procurement standards, no specific language made it into the final version of the Procurement Code that would directly address the prospect of widespread design-build project procurement and delivery in the state. A second key point is that Pennsylvania is, among other things, a state of bridges. The Pennsylvania Department of Transportation [describes](#) the situation as follows:

Despite a record level of investments since 2003, Pennsylvania has the largest number of structurally deficient bridges in the nation—nearly 6,000 statewide. . . . With 25,000 state owned bridges, Pennsylvania has the third largest number of bridges in the nation, but [leads] the nation in the number of bridges classified as ‘structurally deficient.’ The average age of bridges in the state system is 50 years old.

While this second key point would seem to set the stage perfectly for an accelerated approach to developing, designing, and constructing at least this facet of critical state infrastructure, it has not yet yielded a legislative embrace of design-build contracting as a means to expedite the repair or replacement of deficient bridges. There is still some disagreement over whether design-build contracting—without proper pre-design activity and development of an accurate and detailed scope of work—is all that beneficial or preferred over a traditional design-bid-build procurement model. However, enough success has been enjoyed with design-build contracting that its application and utility in areas such as highway and bridge repair and construction have been

viewed as sufficient to pursue this delivery approach on a wide array of public construction projects, including those in Pennsylvania.

The most recent chapter in Pennsylvania's efforts to pursue design-build delivery on public projects through "adminis-lation" hit a significant roadblock when the decision in *Brayman Construction Corp. v. Commonwealth of Pennsylvania Department of Transportation*, 30 A.3d 560 (Pa. Cmmw. Ct. 2011), was issued. On October 5, 2011, the Commonwealth Court of Pennsylvania, the tribunal most directly responsible for addressing matters involving governmental activities, announced its decision holding that the Department of Transportation (PennDOT) could not use the existing Procurement Code provisions regarding both design professional services and multistep sealed bidding to short-list the selection of general contractors as a part of an overall design-build approach, nor could the design-build delivery system be pursued as a "Best-Value" method to select construction contractors. This was not the first time that this particular best-value approach was before the courts of Pennsylvania, nor was it the initial circumstance on which the project at issue in this case was facing judicial scrutiny.

Appropriately enough, the matter involved PennDOT's efforts to award a contract for the replacement of a bridge along Interstate 90. PennDOT was seeking to proceed using a best-value process, which is best described as a two-step selection method whereby PennDOT advertised for design-build teams, analyzed statements of interest based on criteria set forth in the project advertisement, and then chose a few of these design-build teams for a short list. In the second step of this program, the short-listed teams would submit technical proposals, and an agreement would later be negotiated between PennDOT and the short-listed contractors, pursuant to which they would develop their more detailed project proposals. Ultimately, after evaluating the design professional, scope of work, and bid package submitted by the design-build contractor, PennDOT was looking to achieve what PennDOT considered to be the best value to engage the services for this and future projects.

This best-value approach came under almost immediate attack by the plaintiffs involved in this case, albeit in an earlier iteration of the proceedings. While PennDOT attempted to rely on the existing provisions of the Procurement Code to support the best-value process it had administratively developed, the Commonwealth Court concluded that the best-value approach violated the Procurement Code because "in seeking bids for single 'construction contracts,' PennDot was not allowed to short-list bidders or evaluate bids based on factors not enunciated in the invitation for bids." Having said that, however, the court observed that the bridges at issue were in need of immediate replacement and the public would be harmed if the contracting process was delayed by 12 to 18 months in order to revamp the project bidding, and for that reason, the court denied the preliminary injunction. The Supreme Court of Pennsylvania upheld this portion of the decision, stating that the Commonwealth Court properly denied the preliminary injunction preventing the current use of the procurement process because of the harm that the traveling public would suffer if PennDOT were required to start over in its procurement process for the project. *See Brayman Constr. Corp. v. Dep't of Transp. (Brayman*

II), 13 A.3d 925, 942 (Pa. 2011). The supreme court then remanded the matter back to the Commonwealth Court for further proceedings consistent with its decision and observations regarding PennDOT's best-value approach. In fact, this particular and latest chapter of the *Brayman* design-build series of cases came as a result of the plaintiffs seeking summary judgment on a permanent injunction relying on the supreme court's determination in *Brayman II*.

The plaintiffs took a double-barreled approach toward attacking the best-value process. They noted in the first instance that section 511 of Pennsylvania's Procurement Code mandated, among other things, that "[u]nless otherwise authorized by law, all Commonwealth agency contracts shall be awarded by competitive sealed bidding under section 512 (relating to competitive sealed bidding) except as provided in . . . Section 905 (relating to procurement of design professional services)." The Commonwealth Court embraced that approach and agreed with the plaintiffs that the exceptions argued by PennDOT could not overcome the language of the Procurement Code itself relating to procurement of construction contract services. The Commonwealth Court also sided with the plaintiffs and against PennDOT on PennDOT's contention that its short-listing process was authorized under a multistep sealed bidding procedure contained in section 512(h) of the Procurement Code. This section states that where it is considered impractical to prepare a procurement description initially to support an award on a price, an invitation for bids may be issued requesting unpriced bids followed by an invitation for bids requesting priced bids from responsible bidders from the first solicitation. PennDOT therefore argued that its multistep approach in the best-value process was consistent with the Procurement Code. The court disagreed, concluding that the competitive sealed bidding language prevalent in the Procurement Code prevailed over the approach suggested by PennDOT. Because "the Best-Value method of awarding contracts violate[d] all of those precepts [of bidding mandated by the Procurement Code for this type of work], the use of that method is illegal under the Procurement Code and justify[d] the . . . injunction." However, the Commonwealth Court gave a slim glimmer of hope for the future:

[E]ven if PennDot ha[d] proceeded under Section 512(h) for the Project, it still must use measurable criteria in developing the short-list of design-build teams, and all of those design-build teams chosen must be 'responsible bidders' who are capable of being able to fully perform the contract requirements in all respects and have the integrity and reliability to assure good faith performance. . . . For all of these reasons, the design-build best-value method used by PennDot is illegal because it permits subjective evaluation of construction contractors rather than using criteria that are objectively measureable.

Brayman, 30 A.3d at 567.

It is also interesting that in the concluding portion of its opinion, the court made reference to the ABA Model Procurement Code. Although the model code is the foundation document for Pennsylvania's Procurement Code, it uses different language under its version of the multistep



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sealed bidding process. In the ABA's version, the second step of bidding occurs with those "whose offers have been qualified under the criteria set forth in the first solicitation." *Id.* at 567 n.8 (citing section 3-202(8) of the ABA Model Procurement Code) (emphasis supplied by court).

The bottom line of the various opinions rendered in these cases is that this approach for procuring design-build project delivery services on public contracting projects in Pennsylvania will likely be going back to the drawing board in substantial respects. However, the importance of the latest *Brayman* decision is much broader than the Commonwealth of Pennsylvania's own boundaries. The case reflects in the first instance the importance of adopting legislation that is tailored toward the use of design-build and other similarly innovative procurement and delivery procedures. It also speaks to the essential watchdog function that litigation provides to make certain that legislative functions are not usurped or avoided by administrative interpretation.

Other states have undertaken much more comprehensive efforts to adopt legislation to embrace design-build delivery on a wide variety of public projects. Some of these states are also moving in the direction of public-private partnerships as another method of alleviating the public sector burden of maintaining deteriorating infrastructure within state borders. The [Design-Build Institute of America](#) tracks that legislation and provides advocacy in support of many of these initiatives. Perhaps the lasting legacy of the *Brayman* cases will be a message to public entities to proceed on a legislative basis to adopt more modern procurement and project delivery protocols as opposed to misinterpreting existing and perhaps out-of-date legislation that was not intended to support these innovative project delivery techniques when the legislation was initially adopted.

Keywords: litigation, construction litigation, Pennsylvania, procurement code, PennDOT, Brayman

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The *Spearin* Doctrine as a Defense to Defective Workmanship Claims

By Wally Zimolong – April 11, 2012

Construction defect claims are one of the fastest growing areas of construction litigation and a potential source of crippling liability for contractors. Contractors are aware that the contract specifications instruct the contractor what to build. However, the specifications may also hold the key to a successful defense to defective workmanship claims thanks to what is known as the *Spearin* doctrine. Successfully invoking a *Spearin* doctrine defense hinges on whether the specifications are “performance” versus “design” specifications. Because the distinction between the two is often nuanced, understanding the difference between a performance and a design specification is critical to a *Spearin* doctrine defense.

The *Spearin* Doctrine: Background and History

The *Spearin* doctrine’s roots and name come from a 1918 United States Supreme Court decision, *United States v. Spearin*, 248 U.S. 132 (1918), which held that a contractor will not be liable to an owner for loss or damage that results solely from defects in the plan, design, or specifications provided to the contractor. Effectively, *Spearin* created a doctrine whereby the owner impliedly warrants that the plans and specifications, if followed, will result in a functioning system. *Spearin* holds that if a contractor is required to build according to plans and specifications prepared by the owner (or the owner’s representative), then the contractor will not be responsible for the consequences of defects in the plan. As Justice Brandeis held in *Spearin*, “the insertion of the articles [in the contract] prescribing the character, dimensions and location of the [work to be performed] imported a warranty that if the specifications were complied with, [the work] would be adequate.” *Id.* at 137.

In *Spearin*, George B. Spearin sued to recover the balance due under a contract with the federal government to build a dry dock at the Brooklyn Navy Yard according to plans and specifications the government prepared. The work required Spearin to relocate a sewer main. The specifications “prescribed the dimensions, material and location of the section to be substituted.” *Id.* at 133–34. Spearin completed the relocation as specified.

About a year later a heavy rain and high tide caused the sewer to overflow before the dry dock was completed, causing the excavation of the dry dock to be flooded. An investigation revealed that an existing internal dam had diverted the water into a portion of the sewer that overflowed into the dry dock. The internal dam was an existing feature but was not shown on the plan and specifications the government gave to Spearin. Spearin and the government each claimed the other was responsible for the flood. Eventually, the government canceled Spearin’s contract and completed the work with a replacement contractor. At the time the contract was canceled, Spearin was not fully paid.

The Supreme Court ruled that Spearin had no responsibility for the flood because the internal dam was not shown on the plans and specifications that the government gave to Spearin, which specifically dictated how and where the sewer should be relocated. Thus, the government warranted the adequacy of the specifications, and the *Spearin* doctrine was born.

The Modern Doctrine: Design or Performance Specifications

Today, the modern approach to *Spearin* assigns responsibility for a defective construction according to whether the specification prescribing the construction is a performance or a design specification. See *PCL Constr. Servs., Inc. v. United States*, 47 Fed. Cl. 745 (2000). Because a contractor can invoke the *Spearin* doctrine only when it builds a system according to a design specification, it is important to understand the difference between the two. Moreover, it is important for contractors to be able to spot performance specifications because of the increased risk the contractor assumes when building according to a performance standard.

Performance specifications set forth an objective or general standard that is supposed to be achieved, and the contractor is “expected to exercise his ingenuity in achieving that objective or standard of performance, selecting the means and assuming a corresponding responsibility for the selection.” *Blake Constr. Co. v. United States*, 987 F.2d 743, 745 (Fed. Cir. 1993). Performance specifications specify the results to be obtained and leave it to the contractor to determine the best way to achieve the desired results. Therefore, the contractor not only warrants that the system will be constructed as planned but also that it will perform as intended.

Design specifications, on the other hand, precisely state how the work is to be performed. Design specifications describe in detail the materials to be used and the manner in which the work is to be executed. There is no flexibility allowed to a contractor’s approach and, as one court put it, the contractor is “required to follow [these specifications] as one would a road map.” *Id.* Here, the contractor does not warrant that the system will perform in any certain way.

Thus, the level of discretion that exists within a given specification is the key to courts’ analysis of the difference between design and performance specifications. “Discretion serves as the touchstone for assessing the extent of implied warranty and intended liability.” *Conner Bros. Constr. Co., Inc. v. United States*, 65 Fed. Cl. 657, 685 (2005). However, difficulties frequently emerge when determining whether a specification is a design or a performance, given that many specifications may combine elements of both.

A contractor that is claiming that a particular specification is design rather than performance must establish that the specification does not allow any kind of meaningful discretion in how the work is performed and, further, that the defective specification is the cause of the injury. *Id.* In other words, the contractor has to prove that he or she followed the design precisely and thoroughly and that any deviation was a result of the design itself, not the contractor’s work product.

Further, specifying a certain manufacturer or a product is not dispositive of whether a specification is design or performance, especially when a specification permits substitution of a product with an approved equal. Simply naming a specific product or manufacturer does not create a design specification in and of itself. *See W.G. Yates & Sons Constr. Co. v. United States*, 53 Fed. Cl. 83 (Fed. Cl. 2002); *Fla. Bd. of Regents v. Mycon Corp.*, 651 So. 2d 149 (Fla. Dist. Ct. App. 1995).

One way to determine whether a specification is a performance specification is to determine the “result to be obtained” from the work. For instance, if the work calls for all the windows in a building to be replaced and nothing further, then it is likely a performance specification. However, if the specification and plan call for certain windows to be replaced in a certain location of the building and for the replacement of the windows to be completed in accordance with a certain procedure, then the specification could be labeled a design specification. *A.G. Cullen Constr., Inc. v. State Sys. of Higher Educ.*, 898 A.2d 1145 (Pa. Commw. Ct. 2006). The degree of discretion rather than specificity itself is what helps determine what the specifications designation is, although specificity doesn’t hurt.

Importantly, the contractor must still show good faith. If a contractor builds a high-rise in strict compliance with the specifications and discovers upon completion that the building is structurally unsound, then the contractor must have acted in good faith and done all due diligence before the construction is complete. If the contractor had or should have had any knowledge that the plans and specifications were inaccurate or defective, then the contractor must notify the owner immediately. There is a duty to point out to customers deficiencies in the plans and specifications.

The Future of the *Spearin* Doctrine

The future of the *Spearin* doctrine is bright. Especially, as more buildings are constructed using green technologies that are often based on altruistic hopes rather than proven building science, claims for defective construction may well increase. Clearly, the *Spearin* doctrine will play an important role in deciding who is responsible for systems that fail to perform. If contractors are careful, honest, and thorough and if the specifications are defective, then the *Spearin* doctrine provides an excellent defense to claims of defective workmanship.

Keywords: litigation, construction litigation, defect claims, United States v. *Spearin*

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NEWS & DEVELOPMENTS

Improvement Repairs Do Not Toll or Extend Statute of Repose

The six-year statute of repose for claims of defective design and/or construction of an improvement to real property is neither tolled nor extended as to claims against the original contractor and/or original designer of the improvement by subsequent repairs to the improvement.

[Read the full case note.](#)

— [Alexander F. Guidry](#), *Mockbee Hall & Drake, P.A., Jackson, MS*

Subcontractor Not Liable after GC Approves Completed Work

A subcontractor is not liable for injuries occurring to a third person after the subcontractor has completed its work and the general contractor has accepted that completed work.

In *EMJ*, an injured worker brought suit against the general contractor and a subcontractor after falling from a steel roof ladder installed by the subcontractor. The general contractor filed a countersuit against the subcontractor because the subcontractor did not install non-slip surfaces on the ladder's steps.

[Read the full case note.](#)

— [Alexander F. Guidry](#), *Mockbee Hall & Drake, P.A., Jackson, MS*



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