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2020 Annual Summary
Construction | Procurement

We are pleased to offer this comprehensive summary of the major construction and procurement developments in 2020 that have an impact on public and private owners, contractors, design professionals and developers. Topics include:

- COVID-19 Issues
- Statute of Repose: Court of Appeals Rejects "Fraud" Exception; Contractor Protected by Repose Statute Notwithstanding Submission of False Documents Attesting to Work Completion
- Subcontractors: Court of Appeals Denies Recovery to Subcontractor in WSDOT Design-Build Project Based on Noncompliance with Section 1-04.5 and Inapplicability of Quantum Meruit
- Construction Defects/Liquidated Damages: Court of Appeals Clarifies Contractor Burden of Proof on Affirmative Defense to Owner's Defect Claim and Permits Apportionment of Liquidated Damages
- Termination: City Held Liable for Wrongful Termination of Public Works Contract; Not Entitled to Offset Credit for Costs to Repair Defective Work
- Public Works Lien Claims: Subcontractor's Bond and Retainage Claims Rejected by Court of Appeal Due to Untimely Filing
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A. COVID-19 Issues

We have yet to see any significant construction law court rulings in Washington State concerning the costs, delays and impacts due to the COVID-19 pandemic. In Washington and elsewhere, the first wave of litigation has instead tended to focus on issues such as rent abatement (*i.e.*, whether tenants are entitled to abate rent during the pandemic), insurance coverage (*i.e.*, whether the virus is a triggering event for property insurance) and whether the pandemic excuses performance of various commitments under banking, credit, and purchase and sale agreements.

Based on our work with various clients, we believe some construction cost disputes have been negotiated while others are simply working their way through the formal contract resolution process. 2021 will likely bring contested court and arbitration disputes regarding force majeure clauses, change-in-law clauses, and generally the allocation of risk and responsibility for costs and delays caused by the pandemic.

We addressed the impacts of COVID-19 to costs and delays on construction projects in a presentation we gave to the Washington State Association of Municipal Attorneys (WSAMA) on October 22, 2020. You can view our presentation by clicking the link here.

In general, the contract's Force Majeure clause is typically the starting point for analyzing the allocation of risk—specifically, that part of the clause that generally limits the remedy to a time extension in lieu of compensation. Because Force Majeure clauses are written differently, and because exceptions to the Force Majeure remedy limitation vary from contract to contract, there is no one size fits all answer to the allocation of risk question. But a recent 2020 decision from the federal Civilian Board of Contract Appeals (CBCA) provides an instructive framework for analyzing a typical contract and fact scenario.

In *Appeal of Pernix Serka Joint Venture v. Department of State*, CBCA No. 5683 (April 22, 2020), the U.S government in 2013 awarded the contractor a firm, fixed-price contract to construct a rainwater capture and storage system in Sierra Leone. The contract included a clause entitled "Excusable Delays," which stated:

> The Contractor will be allowed time, not money, for excusable delays as defined in FAR 52.249-10, Default. Examples of such cases include (1) acts of God or of the public enemy; (2) acts of the United States Government in either its sovereign or contractual capacity; (3) acts of the government of the host country in its sovereign capacity; (4) acts of another contractor in the

> performance of a contract with the Government; (5) fires; (6) floods; (7) epidemics; (8) quarantine restrictions; (9) strikes; (10) freight embargoes; and (11) unusually severe weather.

In 2014, the contractor got worried about the spread of the Ebola virus in Sierra Leone. The World Health Organization declared the outbreak an international public health emergency. The contractor decided to shut the project down, evacuate most of its personnel and advise the government of its decision to temporarily shut down. The government advised the contractor that that there was no basis for an equitable adjustment for the additional costs because the contractor took action unilaterally based on circumstances beyond the control of either contracting party.

The project site was shut down for more than six months. When the contractor remobilized, it employed additional health and safety measures, including expanding its health facilities and employing full time medical staff.

When the contractor submitted a claim for safety and health costs to maintain a safe work site and for costs to demobilize and remobilize at the site, the government granted a time extension of 195 days—but no compensation. The contractor appealed. The government moved for summary judgment. The CBCA granted the motion.

The CBCA held that the Excusable Delay explicitly addressed how acts of God, epidemics, and quarantine restrictions were to be treated and that the contractor was entitled to additional time, but not additional costs.

The contractor advanced two theories for recovery: Cardinal change and constructive change. The cardinal change argument was based on the contention that the government "expected [contractor] to work in ... Ebola crisis conditions without any guidance or direction from [government], or a suspension of work, and that [government] forced [contractor] to return to the project site adding life safety measures not in [contractor's] approved work plan." The CBCA held that this was not enough to make out a cardinal change claim:

> Despite the difficulties encountered during the Ebola outbreak, the Government never changed the description of work it expected from the contractor. Throughout communications with [contractor], the Government repeatedly stated that it would not give directions to the contractor on how it should respond to the ongoing outbreak, instead leaving the decisions solely in the hands of the contractor. Any changes in conditions surrounding performance of the contract arose from the Ebola outbreak and the

> host country's reaction to the outbreak. This situation forced [contractor] to reevaluate how it wished to proceed with the work outlined in the contract. Throughout the situation, [government] informed [contractor], on multiple occasions, that it would not order [contractor] to evacuate the site and that [contractor] must make its own business choices as to whether it needed to demobilize from the site.

Also rejecting the constructive change argument, the CBCA held that "[contractor's arguments] fall short in proving that the Government ordered it to take an action in response to the Ebola outbreak or that the Government's inaction rose to the level of a constructive change."

B. Statute of Repose: Court of Appeals Rejects "Fraud" Exception; Contractor Protected by Repose Statute Notwithstanding Submission of False Documents Attesting to Work Completion

In 2016, a gas explosion occurred in the Greenwood neighborhood of Seattle. An investigation concluded that a gas service line had not been 'cut and capped' as falsely documented by the contractor at the time and that the leak and explosion would not have occurred but for the contractor's improper abandonment of the gas service line in September 2004.

Plaintiff Puget Sound Energy (PSE) sued the gas contractor, Pilchuck Contractors, in 2018—more than 14 years after Pilchuck had stopped work on the upgrade project in the neighborhood. The trial court upon motion dismissed PSE's lawsuit based on the construction statute of repose, which generally bars claims that do not accrue within six years after substantial completion.

In *Puget Sound Energy v. Pilchuck Contractors*, the Court of Appeals affirmed the dismissal of PSE's lawsuit, holding that Pilchuck was protected by the statute of repose. The Court of Appeals addressed and decided three specific issues in reaching this conclusion:

First, the Court held that even though the contractor did not perform the specific promised work on the specific section of pipeline that later exploded, the contractor's work in general in the neighborhood constituted an "improvement" on real property and therefore was an activity covered by the statute of repose. The Court rejected PSE's more granular argument that because Pilchuck had failed to work on the specific pipeline as promised, then its specific work on the exploded section was not an "improvement" as defined by the statute of repose: "The fact that the work was not done as represented may give rise to a claim but does not remove the situation from the purview of the statute of repose."

Second, the Court turned away PSE's argument that 2004 did not mark the actual substantial completion date because the contractor never completed the promised work of cutting the capping the line (and therefore could not be used or occupied for its intended purpose). Rejecting this argument, the Court held as follows: "The broader project was substantially complete because PSE's customers were receiving service via the new gas lines and PSE treated the subject gas service line as retired." Consequently, because PSE's claims accrued in 2016 at the time of the explosion, well outside the six-year window from substantial completion in 2004, the Court held that the repose statute barred the claim.

Third, PSE argued that the Court should recognize a fraud or equitable estoppel exception to the statute of repose based on the contractor's submission of a false work notice indicating that the subject pipeline had been properly retired. Noting that prior cases had not squarely decided this issue, the Court held that Washington does not recognize a fraud exception to the statute of repose.

C. Subcontractors: Court of Appeals Denies Recovery to Subcontractor in WSDOT Design-Build Project Based on Noncompliance with Section 1-04.5 and Inapplicability of Quantum Meruit

In *Scarsella Brothers, Inc. v. Flatiron Constructors, Inc.,* the Court of Appeals addressed claims and counterclaims between a subcontractor and general contractor on a WSDOT design-build project known as the I-405 Bellevue to Lynnwood Project.

Scarsella executed a $14.8 million subcontract with Flatiron for earthwork. During the job, Flatiron withheld $2.7 million from Scarsella's billings on various grounds such as lack of documentation for force account work. At trial, plaintiff Scarsella sought $12 million in extra costs plus prejudgment interest and attorney fees. Flatiron counterclaimed arguing Scarsella significantly delayed the completion of the project.

After a bench trial, the trial court rejected Scarsella's claim for recovery of $12 million based on Scarsella's failure to comply with the notice and protest provision of the prime contract (WSDOT Specification Section 1-04.5), required Flatiron to release the withheld $2.7 million to Scarsella, and denied Flatiron's claim that Scarsella delayed completion of the project.

The Court's decision affirming all aspects of the trial court's judgment contains numerous rulings of interest to construction lawyers and clients:

- The prime contract's notice provision was held to be incorporated by reference into the subcontract, requiring Scarsella to comply with Section 1-04.5.
- Scarsella's failure to comply with Section 1-04.5 was a waiver of its extra cost claims, citing *NOVA Contracting, Inc. v. City of Olympia*.
- The fact that the subcontract contains a clause pricing extra work at "cost plus 10%" does not replace or supersede section 1-04.5 of the prime contract.
- Flatiron's prior progress payments were not a "promise" not to deduct future progress payments, and Flatiron was therefore not estopped from deducting payments.
- The fact that Flatiron as general contractor has (under applicable subcontract terms) the power to unilaterally modify the project schedule does not excuse Flatiron's failure to timely and accurately prepare construction schedules and supervise and direct the project.
- The Court denied recovery to Scarsella on the alterative theory of quantum meruit, mainly because the terms of the contract anticipated the potential for additional work and provided mechanisms for pricing any such added work.
- Because Scarsella and Flatiron both prevailed on major issues, neither was considered to be the "prevailing party" for an award of attorneys' fees.
- Scarsella was not entitled to an award of prejudgment interest under RCW 39.04.250(3) on the $2.7 million Flatiron withheld from its pay applications because the withholding by Flatiron was determined to have been in good faith.

D. Construction Defects/Liquidated Damages: Court of Appeals Clarifies Contractor Burden of Proof on Affirmative Defense to Owner's Defect Claim and Permits Apportionment of Liquidated Damages

Lake Hills Investments LLC v. Rushforth Construction Co., Inc. is a significant case that contains several clarifications of Washington law concerning a contractor's affirmative defense of defective design, and apportionment of liquidated damages.

The case arose from a development project consisting of a public library, two mixed-use residential/retail buildings, three commercial buildings, and townhouses. Based on delay in completion of various phases, the owner assessed liquidated damages and alleged construction defects by the builder. The builder alleged the owner caused the delay by underpayment of work and that the alleged defects were mainly due to the owner's failure to provide a sufficient design as required under the *Spearin* implied warranty. The builder ultimately stopped work.

The jury in its special verdict form found the builder responsible for the majority of construction defects, but also that the owner was responsible for the vast majority of delays and for underpaying. The trial court entered a net award in favor of the contractor of over $9.5 million, including nearly $6 million in attorney's fees and costs.

On appeal, the owner argued that the Court's jury instructions were erroneous because they did not require the builder, for its affirmative defense to the defect claim, to prove that the alleged flaw in the design was the "sole" cause of the defect. The owner argued that such a "sole cause" instruction was necessary because otherwise the builder might entirely escape liability for construction defects by showing that a defect in the plans and specifications merely contributed to defect or even if the builder's deficient performance caused some of the damage.

The Court of Appeals agreed and vacated the judgment in favor of the builder, remanding for a new trial:

> A defective plans affirmative defense can relieve a breaching general contractor of its liability by proving an alternate proximate cause. [Builder's] affirmative defense theory was that a single cause, defective plans or specifications, injured [owner]. To be relieved of all liability for its breaches, [builder] had to prove [owner's] defective designs "solely" caused the plaintiff's damages.

We note that on October 15, 2020, the builder filed a Petition for Review with the Washington Supreme Court, challenging the validity of this holding. The Petition has not been acted on as of this writing.

Lake Hills is also notable for its welcome clarification of a previous decision, *Baldwin v. National Safe Depository Corporation* that seemingly disallowed apportionment of liquidated damages in delay cases. Finding that this case was now out of step with recent rulings, the Court stated:

> When *Baldwin* was decided, the majority rule was that liquidated damages should not be apportioned when both parties contributed to the injury. But over the past 30 years, a "strong majority" of jurisdictions have come to allow apportionment of liquidated delay damages.
>
> The modern trend is for courts to endeavor to apportion liquidated damages based on causation of delay as between the owner and

> contractor." Baldwin itself reflected this trend away from the then-majority rule by relying upon traditional contract principles to uphold the jury's apportionment of liquidated damages. The modern rule is clear and well-reasoned: a fact finder can apportion liquidated construction delay damages when the evidence and the parties' contract allow it.

Finally, the Court of Appeals held that the Court's instruction on the duty of good faith and fair dealing was erroneous. The builder had argued to the jury that its duty to continue performance was excused by the owner's breach of good faith and fair dealing. The Court's good faith instruction read as follows:

> If one party enters into a contract with another, there is an implied agreement by each to do nothing that will hinder, prevent, or interfere with the performance of the contract terms by the other.
>
> If [builder] proves by a preponderance of the evidence that [owner] interfered with or prevented [builder] from completing its work in its entirety within the time required and/or completing the project in its entirety, then [builder] was excused from performing its duty of the same.

On appeal, the owner argued that this instruction improperly excused the builder's performance due to a "nonmaterial" breach of the duties of good faith and fair dealing. The Court of Appeals held that instruction was erroneous by not requiring the builder to prove the breach was a "material" breach: "A nonmaterial or cured breach will not excuse a party's failure to perform. Accordingly, only a material breach of the duties of good faith and fair dealing excuses the other party's performance."

E. Termination: City Held Liable for Wrongful Termination of Public Works Contract; Not Entitled to Offset Credit for Costs to Repair Defective Work

In *Conway Construction Co. v. City of Puyallup*, the Court of Appeals addressed issues arising from the City's decision to terminate the contractor for default after becoming concerned about defective work and unsafe work conditions. Shortly after the termination, the Department of L&I issued a citation to the contractor for a "serious" safety violation endangering its workers.

The contractor sued the City (1) asking the Court to declare the termination for default improper and deem it to be for public convenience and (2) for breach of contract and unjust enrichment. After a bench trial, the trial court found the City breached the contract when it terminated the contractor and awarded damages and attorney's fees.

On appeal, the City first argued, on order of precedence grounds, that it was not required to give the contractor 15 days' notice to cure before termination because Section 22 of the agreement took precedence over WSDOT Section 10-8.8 (which requires a 15 day cure period). The Court of Appeals saw no conflict between the two provisions, however, because Section 22 did not speak to termination process or procedures. It therefore held the City was bound by Section 1-08.8's cure period even though the agreement took precedence and set forth separate grounds for termination.

The Court of Appeals also rejected the City's argument that the safety violation by itself was conclusive as to the City's right to terminate. Relying on the trial court findings that the contractor was working with L&I to address the trench safety issue at the time of the termination, the Court of Appeals stated that "substantial evidence established that [contractor] resolved the safety regulation breach, which the City asserts justified termination."

Additional relevant holdings of interest include the following:

- The Court of Appeals declined to consider the City's "subsequently discovered evidence" to justify the termination.
- The City was not entitled to offset its costs incurred to repair the contractor's faulty work because the City had failed to give the contractor notice and opportunity to cure the defective work.
- The attorney's fee award in favor of the plaintiff contractor was reversed because the plaintiff did not make a fee-shifting settlement offer under RCW 39.04.240, and was therefore not the "prevailing party" for an award of legal fees.

F. Public Works Lien Claims: Subcontractor's Bond and Retainage Claims Rejected by Court of Appeals Due to Untimely Filing

The general contractor, hired to build an aquatic center for a Washington city, became unable to finish the project at which point its bond surety stepped in to pay bills and complete the work. The contractor had executed assignments for the benefit of the surety, including to rights in payment to retainage under RCW 60.28.011. The owner determined that the work was

substantially complete on April 1, 2016 and thereafter formally accepted the work by resolution dated February 21, 2017.

An excavation and utility subcontractor filed a combined lien claim against the bond and retainage on March 27, 2017. But bond claims must be filed 30 days after the owner's acceptance, putting this lien four (4) days late. And retainage claims must be filed no later than 45 days after completion of the work, making this lien nearly one year late if the substantial completion date of April 1, 2016 is the operative date.

On the subcontractor's appeal from the trial court's dismissal of its lien claim, the Court of Appeals affirmed the dismissal and rendered the following relevant holdings:

- The subcontractor argued that the owner's resolution accepting the project was not conclusive, i.e., that collateral evidence could be offered to show that acceptance in fact occurred later. The Court rejected this argument, holding that the resolution was conclusive absent a showing of fraud or collusion. The lien claimant can't "look behind" to impeach the resolution.
- The Court interpreted "completion of the contract" (which is the trigger for the 30 days' notice under the bond statute) to mean completion by the contractor, and therefore the fact that the owner had to undertake subsequent administrative work to close out the contract did not extend the deadline.
- Pointing to the fact that its bond notice was only four (4) days late, the subcontractor made a "substantial compliance" argument, which the Court rejected (distinguishing defects in the form of a notice, which at times are excused under the substantial compliance rule, from an entirely untimely notice).
- The subcontractor argued that substantial completion on April 1, 2016 is not the same as "completion" of the work under the retainage statute, and therefore the 45 days did not begin to run on April 1, 2016. Interestingly, the Court rejected this argument and seems to have held that the owner's certification of "completion" of work on April 1, 2016 cannot be impeached even though punch list work remained.
- The subcontractor argued the owner violated its due process rights by not giving notice of the April 1, 2016 trigger date. The Court agreed that "the loss of lien rights to funds held in trust under RCW 60.28.011 implicates a property interest protected by due process." But the Court ultimately denied the due process claim because subcontractors have "multiple ways to protect their interest in the retainage fund" such as negotiating with the general contractor for advance notice of the filing deadline, tracking the contractor's progress payments, or filing filings regularly through the project. The Court also noted that requiring public bodies to provide notice to numerous subcontractors would be an undue administrative burden.

- Challenging the attorney's fee award to the surety, the subcontractor made two arguments which the Court rejected:
    - First, the subcontractor argued that because under RCW 50.28.011 and RCW 39.08.030 only the lien claimant can be awarded fees, the surety's use of the fee-shifting settlement offer mechanism under RCW 39.04.240 conflicted with the lien statutes and must give way. Noting the mandatory nature of the language in RCW 39.04.240, the Court disagreed and thus allowed the surety rely on the fee-shifting offer statute as the basis for its fee award.
    - Second, the subcontractor argued that because the surety itself was not party to the public works contract, it could not avail itself of RCW 39.04.240. Wrong, said the Court: "The statute does not require that the party seeking attorney fees is a party to the underlying contract."

G. Subcontractor Listing Statute Expansion and Amendment (RCW 39.30.060)

The legislature amended RCW 39.30.060 (commonly referred to as the subcontractor listing statute) to include new listing requirements for both "structural steel installation and rebar installation" subcontractors.

The statute still requires prime contractors on public works contracts expected to cost one million dollars or more to submit the names of the HVAC, plumbing and electrical subcontractors with whom they intend to subcontract (RCW 39.30.060(1)(a)). As it relates to this provision, the statute now requires the invitation to bid to require such submission "[w]ithin one hour of the published bid submittal time." (The statute had previously required the ITB to require submission "as part of the bid, or within one hour" of the bid submittal). It is not clear whether this modification changes any substantive obligation as it relates to the existing listing requirement.

The statute now also requires prime contractors on public works contracts expected to cost one million dollars or more to submit the names of all "structural steel installation and rebar installation" subcontractors that they intend to use on the project (RCW 39.30.060(1)(b)). This requirement—in contrast to the HVAC/plumbing/electrical subcontractor requirement—mandates such submission within 48 hours of the bid submittal time.

Several notes on this amendment:

First, the statute confusingly lists the two separate requirements in the alternative ("or"), and one might interpret the amended statute to allow listing of the steel/rebar subcontractors in lieu of the

existing HVAC/plumbing/electrical subcontractor listing requirement. That said, it appears clear from the legislative history that the amendment is intended to impose an additional (and not alternative) listing requirement. Among other things, the original bill would have required all subcontractors to be named within one hour of submitting a bid. The eventual compromise bill greatly narrowed the listing expansion (settling on structural steel and rebar installation subcontractors). It seems unlikely that the legislature intended to effectively reduce the listing requirement in this context.

Second, the legislature directed the Capital Projects Advisory Review Board (CPARB) to review the existing subcontractor listing requirements and (among other things) "recommend appropriate expansion" of those listing requirements. We expect to see further developments in this area in the near future.

Third, the amendment by its terms appears to apply solely to steel/rebar installation subcontractors, and would not apply to (for instance) steel fabricators.

Fourth, we strongly recommend that all public owners work with legal counsel to review and revise, as appropriate, public works bidding documents to incorporate this new subcontractor listing requirement.

H. Apprenticeship Utilization / Bidder Responsibility Amendment (RCW 39.04.350)

The legislature amended RCW 39.04.350 (the bidder responsibility criteria statute) to require that bidders with a history of "receiving monetary penalties for not achieving the apprentice utilization requirements" or "habitual[ly] utilizing the good faith effort exception process" to submit an "apprenticeship utilization plan" within ten business days of the notice to proceed date. RCW 39.04.350(3)(e).

The amendment provides no guidance regarding the "history" that would trigger such a requirement, and how (and under what circumstances) a public owner is authorized to make such a determination.

Presumably—given the addition of the requirement to the bidder responsibility statute—a failure by a bidder (upon request of the public owner) to provide the apprenticeship utilization plan within the 10-day deadline would subject the bidder to a determination of non-responsibility. That said, the new requirement is not contained in the "mandatory" bidder responsibility section of the statute (RCW 39.04.350(1), and it is not entirely clear whether the legislature intended the new requirement to be considered as "supplemental criteria" under RCW 39.04.350(3).

We recommend that any public owner desiring to make use of this new requirement to work with legal counsel to clearly identify the requirement in the bidding documents, including specific criteria the owner intends to apply in determining whether a given bidder has a "history" that would make it subject to this additional requirement.

CONSTRUCTION & PROCUREMENT

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