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SUPREME JUDICIAL COURT EXTENDS OWNER'S IMPLIED WARRANTY OF DESIGN TO CONSTRUCTION MANAGERS AT RISK

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I. INTRODUCTION.

The question to be decided in the case discussed below was whether or not a construction manager at risk has the right to seek indemnity from the owner as to subcontractor claims against it, which claims are based on faulty plans and specification. The superior court said 'no'. The Supreme Judicial Court said 'yes' but with two qualifications. This a case of 'first impression' (the first time a Massachusetts appellate court has dealt with this issue). Although this is a decision at the construction manager at risk level, this decision could very definitely apply to subcontractors who have pass-through-type claims due to inadequate design.

II. THE PROCEDINGS IN THE SUPERIOR COURT.

Coghlin Electrical Contractors, Inc. (Coghlin or Subcontractor) brought an action against Gilbane Building Company (Gilbane), a Construction Manager at Risk (CMR), alleging a breach of contract stemming from a public construction project to build a psychiatric facility in Worcester (Project), which was a two hundred thirty-seven million dollar project. There was a Gilbane- Division of Capital Asset Management and Maintenance (DCAM or DCAMM) contract (Contract) with regard to Project. Among other allegations, Coghlin sought damages against Gilbane, claiming that Gilbane had mishandled certain design changes to the wall and ceiling areas, had failed to abide with the scheduling, had failed to properly coordinate the work and had provided Coghlin with only restricted access to the jobsite. Coghlin's five principal claims were in the vicinity of several million dollars.

Gilbane filed a third-party complaint against DCAMM claiming that DCAMM was legally liable for any "damages caused by design changes and design errors" that Coghlin might be awarded in this litigation. Gilbane alleged that DCAM owed Gilbane indemnity because under Massachusetts common law, a party who "furnishes plans and specifications for a contractor to follow in a construction job . . .impliedly warrants their sufficiency for the purpose intended."

Long-time ***Scribbles*** readers know that it is very difficult for subcontractors and general contractors to sue design professionals for negligence relating to deficiencies in the plans and specifications because of the 'economic loss doctrine'. (See *Squib* #1) That rule says that for

such claims to be viable, there has to be either property damage or personal injury. And, the loss of money is not considered as being 'property damage'.

Since an owner has a contract with the design professional, it can always sue the design professional *in contract.* My own experience has been that owners seldom do this. But, generally speaking, subcontractors, general contractors and CMRs can't sue a design professional in contract because they don't have a contractual relationship with the design professional. Unless subcontractors and contractors can sue the owner under *some* theory, this can leave them without a judicial remedy.

Gilbane under Contract had extensive indemnity obligations to DCAM. The Superior Court Judge found the following words from the Contract as telling. Gilbane had agreed to: "indemnify, defend and hold DCAM harmless from and against all claims, damages, losses and expenses . . . .arising out of or resulting from the performance of the Work."

Gilbane, on the other hand, contended that there was *other* language in the Contract that appeared to be favorable to its position: '(t) he obligations of the CM under Section 1 above . . .shall not extend to the liability of the Designer . . . arising out of (i) the preparation or approval of maps, Drawings, opinions, reports, surveys Change Orders, designs or Specifications, or (ii) the giving of or the failure to give directions or instructions by the Designer…"

Contract provided that the CMR would: "review, on a continuous basis, development of the Drawings, Specifications and other design documents produced by the Designer. . . Review of the documents is to discover inconsistencies, errors and omissions between and within design disciplines'. This same paragraph in the Contract expressly said, however, that Gilbane will not be "assum(ing) the Designer's responsibility for design".

The Superior Court Judge found against Gilbane as to its attempts to be indemnified by DCAM for contract document errors as to claims brought against Gilbane by Coghlin.

The Judge stated in his opinion that "Massachusetts common law traditionally has been protective of construction contractors where the owner has supplied erroneous or, perhaps, ambiguous plans and specifications." The Judge said that this principle of law is inapplicable to a CMR-owner contract. Accordingly, the Superior Court granted DCAM's motion to dismiss the third-party complaint because Gilbane had the obligation to indemnify DCAM from claims precisely including such as the claims brought by Gilbane in this suit. In the superior court, the case was decided largely based on the indemnification clause in the contract and did not deal with any discussion of the substantive issue of whether or not a public owner owes a CMR indemnity due to errors in the contract documents other than simply by saying that this common law rule does not apply to CMRs.

If this is where the case and this issue ends, I find such a decision to be short-sighted. Massachusetts bid law says that one of the twin fundamental goals of Massachusetts public work competitive bidding is for the owner to get the lowest, possible price that competition affords. Holding each party in the construction process responsible for defects in its performance – and

not paying, in effect, for two different designers, which the superior court decision essentially would result in – would seem to work towards that goal. If the superior court decision was the final word on this subject, under this rule of law there would be less competition and less competition usually means higher prices.

III. THE PROCEEDINGS IN THE SUPREME JUDICAL COURT.

The Supreme Judicial Court (SJC) is Massachusetts' highest appellate court, which reviewed the superior court decision.

The recent Supreme Judicial Court decision in the case of Coghlin Electrical Contractors, Inc. v. Gilbane Building Company *et al* extended an owner's implied warranty of design to construction managers at risk. However, there are two possible problems with the decision, one of which was probably not intended by the SJC but which could end up being very significant nonetheless.

A thread interwoven throughout this decision is the Court's recognition that with Gilbane's lacking a contract with the designer, it is less able or unable to sue the designer *in contract* for deficits in the designer's performance. As mentioned elsewhere in this *Squib,* the economic loss doctrine in Massachusetts precludes most cases *in tort* involving claims of negligence by contractors against design professionals. (**ED.** A 'tort' claim is one which is not dependent on the existence of a contract for there to be liability.) Such claims fail because Massachusetts' courts have traditionally not seen the loss of money as being the same thing as property damage, however illogical and ridiculous that conclusion appears to be. To be sure, there have been some cases critical of that rule and there are some exceptions to that rule such as, for example, allowing claims in projects where the contract documents 'negligently misrepresent' the work such as, for example, the laying out of the location for a road by putting it in the wrong place.

As to the issue under discussion, the SJC said that while the CMR can make 'suggestions' during the pre-bid design phase, the owner is under no obligation to accept them.

In finding that there is an implied warranty of the design in the CMR system, the Court said that: "The implied warranty derives in part from the basic principle that "responsibility for a defect rests on the party to the construction contract who essentially controls and represents that it possesses skill in that phase of the overall construction process that substantially caused the defect. . .we adhere to this basic principle by applying the implied warranty to public construction management at risk contracts, where the owner maintains control of the design by contracting a separate designer and may be able to transfer liability to the designer responsible for the defect . . ." (**ED**. Since the owner has a written contract with the designer, it can at least sue the designer *in contract* for design defects, something that the CMR can't ordinarily do.)

The Court said that the guaranteed maximum price for a construction management at risk contract can be made as early as when the design documents are only 60% completed and that the Legislature could not have reasonably intended that the CMR should bear all of the risk

arising from the design when the CMR may not have seen as much as forty percent of the design documents before agreeing to a guaranteed maximum price.

The Court did say that the implied warranties as to the design documents would be different as between general contractors and CMRs. The general contractor would have to rely on the plans and specifications 'in good faith' to have such claims. The CMR, on the other hand, could only benefit from the implied warranty 'where it has acted in good faith reliance on the design and acted reasonably in light of the CMR's design responsibilities'. So, the general contractor on a typical bid project only has to demonstrate 'good faith' to get the implied warranty where the CMR has to demonstrate both 'good faith' and that its reliance on the design documents was reasonable.

(**ED**. In the real world and practically speaking, how much difference would there likely be between the two standards? And, assuming that there *is* a difference, would a typical fact-finder be sufficiently knowledgeable to *understand* the difference?)

The SJC said that a determination of whether the implied warranty would apply (or only would be partially applied) could vary depending on the CMR's participation in the design process. More participation: possibly less implied warranty. Less participation: possibly more implied warranty. Therefore, said the Court, the CMR could only obtain damages for design defects when it acted in good faith and its reliance was reasonable.

The SJC appears to have said that the implied warranty could be negated by an express disclaimer of the implied warranty in the contract:

"Express disclaimer of implied warranty. Having found that there is an implied warranty of the designer's plans and specifications in construction management at risk contracts made pursuant to G. L.c .149A, we now consider whether the contract between DCAM and Gilbane expressly disclaims the owner's implied warranty. . ."

No such express disclaimer was found for this particular Contract.

(**ED**. With this decision, a public owner seemingly could avoid responsibility for the implied warranty simply by putting into its contracts with the CMR *one sentence* stating that there is an express disclaimer of such an implied warranty as to the accuracy of the design documents applicable to this contract and project. Since design professionals face indemnity (contract) claims from owners with regard to the sufficiency of the design documents and since an architect or engineer generally prepares much of the entire design/bid documents, how many projects are likely not to have this sentence?!)

The Court found that the extensive indemnification requirements that Gilbane had in its owner-CMR Contract did not preclude Gilbane's right to the implied warranty claims that it might make against DCAM with regard to this case.

IV. CONCLUSION.

There are three things that I would like to say about this decision.

The first is that it's unlikely that a fact-finder would be able to make distinctions between the good faith of the general contractor and the good faith *and* reasonable reliance of the CMR. Construction cases and matters that are not simply collection cases can often be quite complex and any serious case is awash with all kinds of paper. I had a lengthy arbitration a few years back where the files were brought into the hearing room on a folding hand truck/dolly. My experience has been that most judges I have been in front of don't know a lot about construction law and even less about the public bid laws. So, it may be that the differences between what a general contractor has to show and what the CMR has to show may be distinctions without a practical difference. So, in the real world, I think that the CMR won't have a great deal of difficulty in obtaining the implied warranty of the design documents as to that specific distinction. Score one in the CMR's column!

The second thing, however, is that it would appear from this decision that the entire implied warranty as to the sufficiency of the design documents can be avoided by the inclusion of *one sentence* in the construction contract specifically saying that there will be no such implied warranties for this job because they are specifically and expressly disclaimed. In the real world, this will likely mean that, in the future, the vast majority of CMR contract documents will have a sentence in them including an express disclaimer of any such implied warranties. So, in a sense, this decision doesn't accomplish much because while it provides an implied warranty after making an extensive analysis of this issue, it would appear that the progress on this entire issue can be simply avoided with the addition of that one sentence. The irony in this situation is that in my reading of the SJC decision, I don't think the Court intended such a result. I don't think that the Court understood that such might *be* the result. But, much as third party beneficiary contractual claims can be negated by the inclusion in a contract of 'there are no intended beneficiaries to this contract', the inclusion of one simple sentence in the contract documents might very well negate this implied warranty.

The third thing is a comment that can be made both with regard to CMR contracts and general contractor per 'plans and specifications' public contracts. Basic contract law presumes that the terms of a contract are bilateral, negotiated by both parties. Basic contract law presumes that a contract is an 'arms-length' transaction with neither party being compelled to enter into a contract but with both parties developing what the ultimate contract shall be.

The sad and obvious truth is that CMRs and general contractors have no or almost no input into what the terms of the actual deal – the contract – will be for any form of competitively bid public project. The terms of the contract are generally dictated by the public owner and/or its design professionals. Yet, the legal rights of both CMRs and general contractors are usually dependent on the contracts the parties enter into, whether those terms are negotiated or, essentially, dictated. It only seems fair to me that in interpreting contractual rights, the courts

should take some cognizance of that fact, at least as one factor that should be taken into consideration before legal rights are defined. By and large, they don't for this type of issue.

The case was remanded – sent back – to the superior court for further proceedings consistent with this decision. Perhaps we will see this case another time further down the road, in which case we will further report!

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* A *'squib'* is defined as 'a short humorous or satiric writing or speech'. Wiktionary defines a '*squib'* as: "a short article, often published in journals, that introduces empirical data problematic to linguistic theory or discusses an overlooked theoretical problem. In contrast to a typical linguistic article, a squib need not answer the questions that it poses."

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