

# THE LEGAL CONTEXT OF CONSTRUCTION

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## I. INTRODUCTION

Construction projects are complex and multifaceted. Likewise, the law governing construction is complex and multifaceted. Aside from questions of what one can do in construction, there looms also the question of what one may do—that is to say, what the law of construction allows. So what is the law of construction? What factors influence the evolution of construction law?

For practical purposes, the law applicable to construction projects falls into three major categories: contract, tort, and statutory/regulatory. Contract law may seem intuitively logical, at least on the surface. Tort law may not seem logical in application, but it is an omnipresent influence on any construction project. Statutory or regulatory law generally applies to construction simply because some governing body has said it should, whether the application is logical or not. This book discusses in detail these legal bases of construction law. In this first chapter, each theory is introduced in concept.

## II. CONTRACT LAW

Contracts are the threads from which the fabric of commerce is woven. A contract may be as simple as an agreement to pay for food ordered in a restaurant, or so complicated that no legion of lawyers could hope to decipher the real intent, or somewhere in between. Whatever their character, contracts govern the transactions that permeate our existence.

Contracts and contract law dominate construction. What is a contract, and what is contract law? A contract has traditionally been defined as “a promise or set of promises, for the breach of which the law gives a remedy, or the performance of which the law

in some way recognizes as a duty.”<sup>1</sup> Thus, a contract is basically a set of promises made by one party to another party, and vice versa. In the United States, contract law reflects both the common law of contracts, as set forth in court decisions, and statutory law governing the terms of certain transactions. An example of the latter is the Uniform Commercial Code (UCC), adopted by every state except Louisiana. See **Chapter 6**.

Parties with capacity to contract may generally agree to whatever they wish, as long as their agreements do not run afoul of some legal authority or public policy. Consequently, an owner and a contractor generally are free to agree to an allocation of risks in the context of a construction project,<sup>2</sup> but they may not agree to gamble on the project’s outcome. The former agreement reflects a policy of freedom of contract; the latter violates public policy prohibitions on certain gambling transactions.

### III. BREACH OF CONTRACT

A “breach of contract” results when one party fails in some respect to do what that party has agreed to do, without excuse or justification.<sup>3</sup> For example, a contractor’s failure to use the specified trim paint color, or its failure to complete the work on time, constitutes a breach of contract. An owner may likewise breach its contract obligations. Many contracts expressly provide, for example, that the owner will make periodic payments to the contractor as portions of the work are completed. If the owner unjustifiably fails to make these payments, this failure constitutes a breach. Similarly, an owner may be held in breach for failing to meet other nonfinancial contractual obligations, such as timely review and return of shop drawings and submittals. In short, any failure to live up to the promises that comprise the contract is a breach.

Whenever there is a breach of contract, the injured party has a legal right to seek and recover damages. In addition, if there has been a serious and “material” breach—that is, a breach that, in essence, destroys the basis of the parties’ agreement—the injured party is justified in treating the contract as ended.<sup>4</sup>

### IV. IMPLIED CONTRACT OBLIGATIONS

Express contract obligations are those that are spelled out in the agreement or contract. Less obvious than the express duties under a contract, but just as important, are those obligations that are implied in every contract. Examples of these duties include the obligations of good faith and cooperation (See **Chapter 5**).

<sup>1</sup>SAMUEL WILLISTON AND RICHARD LORD, *WILLISTON ON CONTRACTS* § 1:1 (4th ed. 2007).

<sup>2</sup>See *Interstate Contracting Corp. v. City of Dallas, Tex.*, 407 F.3d 708 (5th Cir. 2005) (involving contract between city and contractor for execution of storm water detention tanks. The contract shifted the risk of defective plans to contractor. The court held that city contract was valid under Texas law because the contract language expressly and unambiguously placed that risk on the contractor).

<sup>3</sup>See RESTATEMENT (SECOND) OF CONTRACTS § 235.

<sup>4</sup>See generally 17 AM. JUR. 2d *Contracts* § 606 (2008).

In the context of a construction project, one of the most important of these implied duties is the obligation that each of the contracting parties cooperate with the other party's performance.<sup>5</sup> The fact that this obligation is implied rather than express is not reflective either of its importance or of the frequency with which it forms the basis for breach actions. Rather, the obligation to cooperate forms the very foundation of the agreement between the parties.

The implied obligations to coordinate and cooperate are reciprocal and apply equally to all contracting parties. By way of illustration, an owner owes a contractor an obligation to allow the contractor access to the site in order to perform its work; a prime contractor has a similar duty not to hinder or delay the work of its own subcontractors; and one prime contractor is obligated not to delay or disrupt the activities of other parallel prime contractors to the detriment of the owner. Each example demonstrates that a contracting party owes an obligation of cooperation to the other party, whether owner-contractor or contractor-subcontractor. See **Chapter 5 and Chapter 8**.

In addition to the obligation of cooperation, the owner and the contractor have other implied obligations, such as warranty responsibilities. The owner's implied warranty of the adequacy of plans and specifications furnished by the owner is of great importance to the contractor, and the breach of this warranty forms the basis for a large portion of contractor claims. The existence of an implied warranty in connection with owner-furnished plans and specifications was recognized in *United States v. Spearin*.<sup>6</sup> The so-called *Spearin* doctrine has become well established in virtually every American jurisdiction that has considered the question of who must bear responsibility for the results of defective, inaccurate, or incomplete plans and specifications. In layman's language, the doctrine states that when an owner supplies the plans and specifications for a construction project, the contractor cannot be held liable for an unsatisfactory final result attributable solely to defects or inadequacies in those plans and specifications. The key in this situation is the allocation of the risk of the inadequacies of the design to the contracting party, which furnished the design. Thus, in a design-build project, the design-build contractor, not the owner, may bear the risk for a design error or deficiency. See **Chapters 2, 5, and 9**.

Similarly, contractors have other warranty responsibilities with regard to the results of their performance. For example, when the owner of a newly built structure or the purchaser of construction-related goods or services is justifiably dissatisfied with the facility, goods, or services, the owner may have a cause of action against the general contractor based on a breach of construction warranties. The nature of that action and the remedies available to the owner would, in large measure, depend on the provisions of the contract.

Even where there are no express warranties in the contract, most courts, under applicable state law, will imply a warranty for workmanship and materials, provided there is no contract provision to the contrary.<sup>7</sup> This implied warranty may, in some

<sup>5</sup>See 73 SAMUEL WILLISTON AND RICHARD LORD, WILLISTON ON CONTRACTS § 63:22 (4th ed. 2007).

<sup>6</sup>248 U.S. 132 (1918).

<sup>7</sup>13 AM. JUR. 2D *Building, etc. Contracts* § 10 (2008).

instances, be operative regardless of the presence in the contract of express warranties of limited duration that would appear to restrict the scope of the contractor's warranty liability.

## V. EVOLUTION OF CONSTRUCTION LAW

The basic concept of contractual rights and duties and the legal principles governing the interpretation and enforcement of contracts have been established for centuries in English and American common law.<sup>8</sup> The fact that the common law of contracts is grounded in the precedent of prior decisions helps provide certainty in commercial transactions and may suggest that construction law does not evolve. The latter is not correct. Rather, over the last century, there have been significant developments that have materially altered the allocation of rights and responsibilities of the parties and the construction process. This evolution is driven by a combination of factors including practices and principles developed in the context of federal government contracting, the widespread adoption of standard-form contracts, and a shift from the traditional design-bid-build project delivery system.

Since World War II, the federal government has been the largest single buyer or construction services in the world. The procurement and administration of construction projects involve contracts that employ relatively standard terms and conditions. An array of administrative boards of contract appeals (boards) and special courts have operated for decades for the sole purpose of resolving disputes on federal contracts. These tribunals have generated a tremendous number of decisions that collectively provide the single largest body of law in the area of construction disputes. Many of the decisions noted in this book, which address substantive principles of construction law, involve the resolution of disputes and claims on federal government construction contracts. Numerous fundamental principles of construction law have their genesis in federal government construction contracts. It is impractical to speak of modern American construction law without the consideration of federal procurement law, and the discussion of that law is interlaced in each of the substantive chapters of this book. For example, the concept of a termination for convenience clause is clearly rooted in federal government contracts. While relatively unknown in nonfederal construction contracts 50 years ago, it has become relatively common place in standard form commercial contracts today.<sup>9</sup> The precedents developed in the context of federal government contracts provide examples of contract provisions and the law interpreting those provisions. Even if those precedents are not binding authority on other courts or tribunals, the analysis can be and often does serve as persuasive authority.

Similarly, the shift away from the traditional design-bid-build delivery system, which began in the second half of the twentieth century, has stimulated the adoption of contract forms that blur and often blend the role of designer and contractor.<sup>10</sup> This trend

<sup>8</sup>E. ALLAN FARNSWORTH, *CONTRACTS*, § 1:4–1:7 (3d ed., Aspen L. & Bus. 1999).

<sup>9</sup>See e.g., ConsensusDOCS 200, ¶ 11.4 (2007 ed.) and AIA A201, §14.4 (2007 ed.)

<sup>10</sup>See **Chapter 7**, “Authority and Responsibility of the Design Professional.”

has resulted in the development of new standard form agreements that seek to allocate duties and risks consistent with the parties' evolving roles. Even if the parties' roles and duties are substantially altered, however, the legal analysis of those duties may still seek to follow and apply basic principles of the common law of contracts.<sup>11</sup>

## VI. TORTS

A tort is a “civil wrong, other than a breach of contract, for which the court will provide a remedy in the form of an action for damages.”<sup>12</sup> A tort is not the same thing as a crime, although the two areas overlap to some extent. A crime is an offense against the public at large and is prosecuted by public officials. In contrast, a tort action is a civil action commenced and maintained by the injured party itself. Such an action seeks to recover compensatory and even punitive damages from the wrongdoer (tort-feasor).

The law of torts changes as societal norms change, because one important consideration is: Who must bear the burden of a loss? Torts are generally divided into three basic categories: intentional torts, negligent torts, and strict liability.

### A. Intentional Torts

An “intentional” tort is just what the name suggests: a tort where the wrongdoer either expressly or by implication intended the act that resulted in the injury. Assault and battery falls into this category, although this tort rarely occurs in a construction dispute. Fraud and misrepresentation, by contrast, may appear in a construction case, as with a claim that the contract documents “misrepresented” some material fact or condition on which a contract was based.

In *Sherman R. Smoot Co. v. Ohio Department of Administrative Services*,<sup>13</sup> the Court of Appeals of Ohio discussed the application of the theory of misrepresentation in the context of a changed condition claim. The Ohio Department of Administrative Services supplied the contractor with inaccurate information concerning the subsurface conditions permitting the use of trench footings. The court noted that the contractor introduced uncontroverted evidence that soil borings, like the plans, indicated that the subsurface conditions would permit the use of trench footings. Yet the contractor eventually found the subsurface conditions to be unsuitable for trench footings. When the contractor asserted a changed condition claim on the basis of the misrepresentation in owner provided soil borings, the department contended that the contractor was not entitled to rely on the soil borings because the contract stated that they were for information purposes only. The court found, however, that it was apparent that the state intended the contractor to use the soil borings in preparation of its bid such that the contractor was entitled to rely on them.

<sup>11</sup>See, e.g., *United Excel Corp.*, VABCA No. 6937, 04-1 BCA ¶ 32,485 (traditional contract interpretation principles related to the resolution of ambiguities in the specifications applied to a design-build project).

<sup>12</sup>W. PAGE KEETON, PROSSER AND KEETON ON THE LAW OF TORTS, § 1 (5th ed. 1984).

<sup>13</sup>136 Ohio App. 3d 166, 736 N.E.2d 69 (2000).

Another example of an intentional tort is “conversion.” Conversion is the interference with the property of another to the extent that the wrongdoer deprives the owner of possession. When the wrongdoer sufficiently deprives the rightful owner of his or her property, a court might remedy the harm by assessing damages in an amount equal to the fair market value of the property at the time of the conversion. Conversion may come into a construction project where a project participant alleged to have received but not distributed (i.e., kept to itself) contract proceeds for the work of a lower-tier contracting party. Economic relations are entitled to protection against unreasonable interference. Interference with economic relations, which has been regarded by the courts as a separate tort—and which is of particular interest to contractors—is inducement to breach of contract, or interference with contract rights.

The area where this tort comes into play most often is in labor disputes. Interference with contract rights was, at one time, a fertile field for labor union liability. The common law quite strictly curtailed union activities (such as secondary boycotts and picketing) that prevented the performance of existing contracts. Over the years, however, the tort liability of labor unions has been radically affected by federal legislation affecting industries involved in interstate commerce. The existence of a contract, in itself, is no longer the exclusive consideration. The effect of labor legislation (such as the Norris-LaGuardia Act, the National Labor Relations Act, the Wagner Act, and the Taft-Hartly Act) on common law liability of unions is beyond the scope of this section but should be analyzed in connection with the effects of strikes and boycotts on a contractor’s performance.

## B. Negligence

Negligence in the popular sense is the lack of due diligence or care.<sup>14</sup> It is a second branch of the law of torts, and may be distinguished from intentional torts by the fact that no specific intent need be proven for the imposition of liability. The traditional elements of a claim for negligence are:

- (1) A duty, or obligation, recognized by the law, requiring the actor to conform to a certain standard of conduct, for the protection of others against unreasonable risks.
- (2) A failure on its part to conform to the standard required.
- (3) A reasonably close causal connection between the conduct and the resulting injury. This is what is commonly known as legal cause or proximate cause.
- (4) Actual loss or damage resulting to the interests of another.<sup>15</sup> Typically, these would be the claimant’s economic or monetary damages.

<sup>14</sup>See generally W. PAGE KEETON, PROSSER AND KEETON ON THE LAW OF TORTS, § 30 (5th ed. 1984).

<sup>15</sup>*Velez Constr. Corp. v. United States*, 777 F.2d 1550 (Fed. Cir. 1985); *Leviton Mfg. Co., Inc. v. Fireman’s Fund Ins. Co.*, 226 Fed. App. 671 (9th Cir. 2007); W. PAGE KEETON PROSSER AND KEETON ON THE LAW OF TORTS, § 30, 165 (5th ed. 1984).

Negligence as a theory of recovery against the project architect or engineer (design professional) is important for contractors because their lack of contractual privity with the design professional makes a breach of contract action impossible. Third-party beneficiary arguments (i.e., where the contractor asserts that it is an intended beneficiary of the contract between the owner and the design professional, and is thus entitled to recover damages for negligent breach of contract) are accepted in some jurisdictions;<sup>16</sup> however, traditional negligence arguments probably stand a greater chance for success.<sup>17</sup>

The standard of conduct applied to the design professional is not that of the reasonable person but rather that of the “reasonable design professional.” The usual requirement is that the design professional must have the skill and learning commonly possessed by members, in good standing, of its profession. It will be liable for the harmful results if it does not meet that standard.<sup>18</sup>

This duty of competence is owed to anyone, including the contractor, who could foreseeably be injured by the design professional’s negligence. It is not dependent on any contractual relationship between the parties. The duty of competency also extends to both the design and supervisory functions of the design professional (to the extent that it is obligated by the contract with the owner to function in a supervisory capacity).

The contractor, like the design professional, may be held liable for negligence that results in injury to third parties—whether that negligence is attributable to unsafe construction methods while the work is in process or to defects in the completed structure. According to 13 AM. JUR. 2D *Contracts* § 139 (2008), during the course of construction, a contractor may be liable for its negligence that results in personal injury or property damage to persons rightfully on the premises, occupants of adjacent premises, and persons lawfully using a street or highway abutting the construction site. Subcontractors, likewise, are liable to third parties where their negligence results in personal injury or property damage. This liability extends to the owner when a subcontractor negligently damages the building during construction, even though there is no contractual privity between the owner and the subcontractor.

### C. Strict Liability

Strict liability is liability without regard to fault. Contractors generally encounter strict liability when they become involved in highly dangerous activities, such as blasting or demolition. In general, if a party is aware of the abnormally dangerous condition or activity, and has voluntarily engaged in or permitted it, that party accepts that it will be liable for resulting damage even though it has taken every reasonable precaution, was not negligent, or was not at fault in any moral sense.<sup>19</sup>

<sup>16</sup>See *COAC, Inc. v. Kennedy Eng’rs*, 67 Cal. App. 3d 916, 136 Cal. Rptr. 890 (1st Dist. 1977) (California has been liberal in granting third-party beneficiary status in such contexts); *Shaw Constructors v. ICF Kaiser Eng’rs, Inc.*, 395 F.3d 533 (5th Cir. 2004) (holding that owner was third-party beneficiary).

<sup>17</sup>*Associated Indus. Contractors, Inc. v. Fleming Eng’g, Inc.*, 162 N.C. App. 405, 590 S.E.2d 866 (N.C. App. 2004); W. PAGE KEETON, PROSSER AND KEETON ON THE LAW OF TORTS, § 30, 167 (5th ed. 1984).

<sup>18</sup>*Associated Indus. Contractors, Inc. v. Fleming Eng’g, Inc.*, 162 N.C. App. 405., 590 S.E.2d 866 (N.C. App. 2004). W. PAGE KEETON, PROSSER AND KEETON ON THE LAW OF TORTS, § 30, 161 & 185 (5th ed. 1984).

<sup>19</sup>*Hilltop Nyack Corp. v. TRMI Holdings, Inc.*, 694 N.Y.S.2d 717 (N.Y. App. Div. 1999). 57 AM. JUR. 2D *Negligence* § 377 (2007).

## VII. STATUTORY AND REGULATORY LAWS AFFECTING CONSTRUCTION

The contract and tort bodies of law just discussed trace their origins to the historical dealings of peoples in organized society. They reflect, rather than dictate, the customs, values, and expectations of society's members. As society evolves, so do the customs, values, and expectations of its members, followed in short order by the development and evolution of the common law of contracts and of torts. This evolution occurs principally through the mechanisms of court decisions of actual cases and controversies between members of society. In short, contract and tort law reflect society.

Statutory and regulatory law, by contrast, does not necessarily evolve from any aspect of society. These laws become laws because some governing body with authority to do so declares that they should be laws. This is not to suggest that statutes and regulations are less significant or valuable than common law concepts of contract and tort; it is merely to observe that statutes and regulations derive from a different source and in a different manner. These statutes and regulations can materially affect how business is conducted in the construction industry. For example, the statutes and implementing regulations establishing ethical standards of conduct in business transactions and setting forth severe sanctions for practices such as false or inflated claims, kickbacks, collusive or bidding schemes, and the like, that deviate from the expected standards of ethical conduct have become commonplace in the context of public construction projects. These statutes provide a context for the measurement of ethical business conduct. With the adoption of the United States Sentencing Guidelines<sup>20</sup> and the Sarbanes-Oxley Act,<sup>21</sup> similar standards came to be applied to business conduct in general. Given the expense associated with defending against a claim that one of these statutes has been violated, prudent contractors should devote senior management attention to developing and implementing effective compliance plans with these standards of conduct.

Anyone familiar with construction and the construction process can name numerous statutes and regulations and may at some time have dealt with these statutes, such as:

- Licensing statutes for designers and contractors
- Statutes governing qualifications to conduct business in a particular jurisdiction
- Building codes
- Regulations governing the issuance of building permits
- Environmental laws and regulations
- Regulations governing the public procurement process, such as the Federal Acquisition Regulation and comparable state and local government contracting procedures and regulations
- Statutes governing workplace safety

<sup>20</sup>See False Claims Act (Federal), 31 U.S.C. § 3729, *et seq.*; California False Claims Act, CAL. GOV'T CODE § 12650, *et seq.*; Florida False Claims Act, FLA. STAT. § 68.081 *et seq.*; Illinois, 740 Ill. COMP. STAT. ANN. 175/1, *et seq.*; VA. CODE ANN. §§ 8.01–2.16.1, *et seq.*

<sup>21</sup>Sarbanes-Oxley Act of 2002, Pub. L. No. 107–204, 116 Stat. 7456.

- Statutes governing wages and benefits paid to construction workers
- Statutes governing social policies such as equal opportunity laws
- Statutes governing labor relations in construction
- Statutes governing the concept of prompt payment on public and even nonpublic projects
- Insurance statutes such as workers' compensation laws and regulations
- Lien and bond statutes
- Statutes addressing the rights and remedies available to owners of certain properties, such as condominiums
- Bankruptcy laws
- Dispute resolution procedures, such as those that prescribe the disputes process on contracts with the United States

The list could go on and on. This book, in subsequent chapters, will address each of these topics, which frequently present themselves in construction projects. In this effort, neither this book nor any book can be exhaustive; hence, it is imperative that those involved in the construction process obtain competent and timely counsel and advice about construction-related legal issues pertinent to their particular project. The objective here is simply to give the reader an overview of some of the more commonly occurring legal topics, as well as the interpretation of principles governing the duties and obligations of the parties to a construction project.

### POINTS TO REMEMBER

- The rights and obligations of the parties to a construction project are, in general, first defined by their contracts.
- In general, parties are free to contractually allocate the risks, duties, and obligations associated with a construction project, so long as the parties do not violate the law or public policy.
- An understanding of any contract often requires analysis of the written terms and conditions as well as the application of the common law of contracts and any statutes governing that particular transaction.
- Contract obligations and duties are also subject to implied obligations, such as the duties of good faith and cooperation.
- In addition to contract law principles, the conduct of the parties to a construction project will also be evaluated in light of the applicable law of torts.
- Tort liability can be based on conduct amounting to an intentional tort, negligence (breach of the applicable standard of care), or strict liability reflecting public policy.
- In every jurisdiction, the construction project and the parties' obligations are also subject to myriad federal, state, and local laws and regulations.