



**CAPITAL PROJECT  
STRATEGIES**

# **Lessons Learned: Recent Developments in Design-Build Caselaw**

**January 22, 2013**

**Michael C. Loulakis, Esq., DBIA  
President/CEO**

**Capital Project Strategies, LLC  
mloulakis@cp-strategies.com**

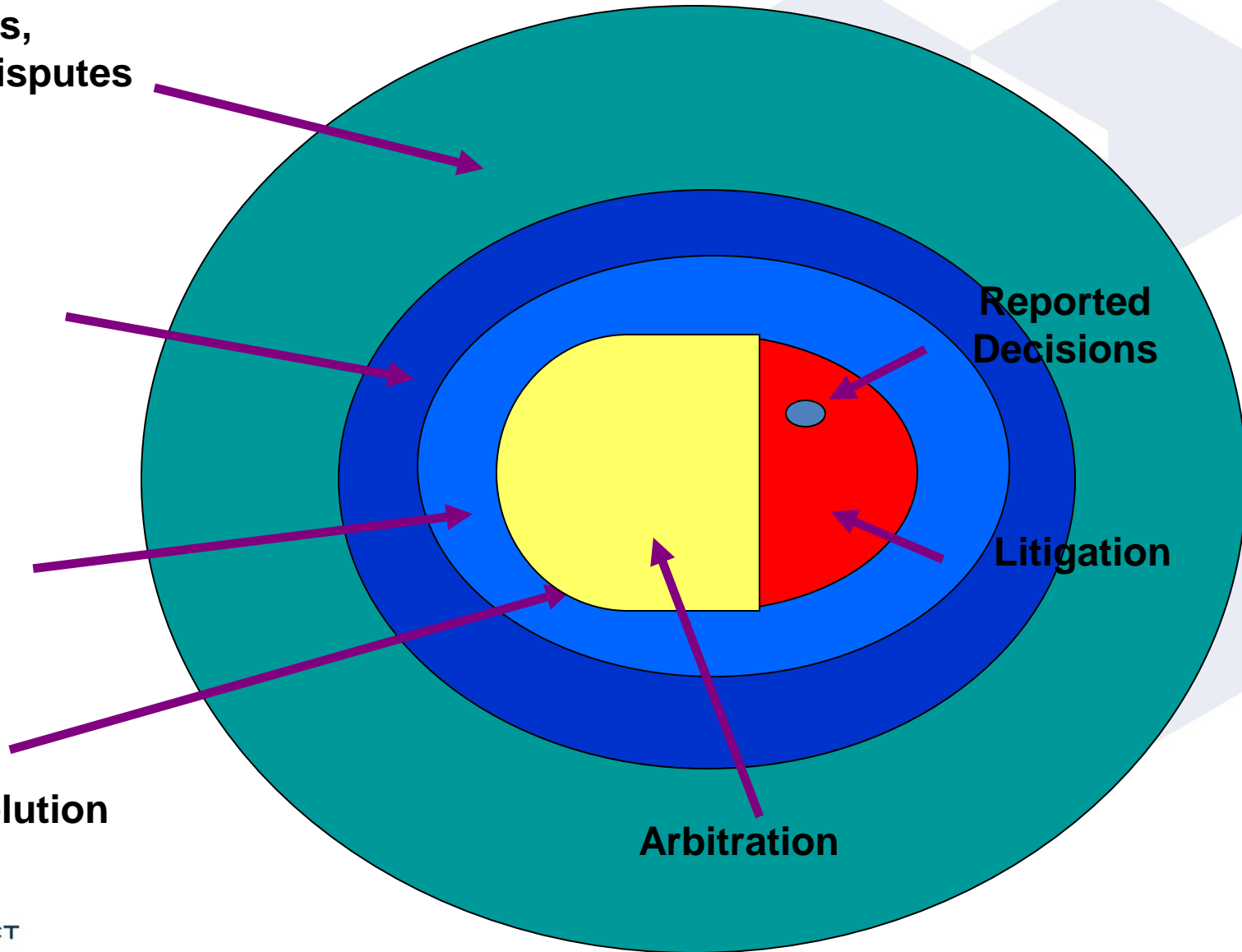
# Universe of Disputes

Change Orders,  
Contractual Disputes

Structured  
Negotiations

ADR  
(nonbinding)

Binding  
Dispute Resolution



# What Can We Learn from the Last 3 Years of Reported Decisions?

- Design-builders are losing some big cases
  - Breadth of covenant of good faith and fair dealing in design-build is uncertain
  - Exculpatory clauses are being enforced
  - Agencies using questionable procurement and administration practices are being protected by contract language
- “Normal” contract administration problems remain at the root of many disputes

# Lesson No. 1

## Design-Builders are Being Held Responsible for Problems Caused by 3<sup>rd</sup> Parties

# How Does Contract Allocate Risk when Performance is Frustrated by Actions of Non-Party?

- Design-builders have a false sense of security:
  - Contractual relief for delays beyond their reasonable control
  - Expect 3<sup>rd</sup> parties to be controlled by intergovernmental agreements
  - Expect that the owner will step in and address problems
  - View contractual obligation to comply with laws and get permits as legal boilerplate
- Owners often in best position to keep 3<sup>rd</sup> parties in line, but often do not mitigate the problem

# *Bell/Heery v. United States (2012)*

- \$238M prison in Berlin, New Hampshire for FBOP
- Contract required DB, “in conjunction with FBOP,” to:
  - Consult with state officials in preparing design
  - Allow inspections by state officials
  - Give “due consideration to recommendations” made by state officials
  - Comply with all terms and conditions of permits
- Standard “Permits and Responsibility” FAR clause:
  - Obtain necessary permits and comply with law
  - No additional expense to government

## ***Bell/Heery v. United States*** (cont'd)

- Alteration of Terrain Permit established phasing plan and limits of disturbance areas
  - Issued by NH Department of Environmental Services
  - Extensively modified by NHDES after construction started, causing delays and additional costs to DB
- Court rejected DB's claim that FBOP did not "intercede" to engage NHDES or resolve problems
  - No contractual obligation for FBOP to do so during construction
  - Concluded that NHDES imposed requirements that neither FBOP or DB could reject or ignore
  - Rejected claim that FBOP breached covenant of good faith and fair dealing

## ***Bell/Heery v. United States*** (cont'd)

Implied covenant of good faith and fair dealing is not an amorphous catch-all designed to evade the express terms of the contract. What that duty entails depends in part on what that contract promises (or disclaims).

\*\*\*\*

In short, having expressly assumed responsibility for compliance with New Hampshire law, plaintiff cannot invoke the implied covenant of good faith and fair dealing to shift that responsibility to defendant.



# ***Fluor Intercontinental, Inc. v. Department of State (2012)***

- \$63M embassy project in Astana, Kazakhstan
  - Low bid process with no stipend
  - DOS furnished a Standard Embassy Design that was to be site-adapted
- RFP stated that local government was to provide site infrastructure (roads, power, water and sewers)
  - Indicated utilities would be available in time to support construction activities
  - Indicated “informal commitment” by host government to expedite local governing processes to minimize delays
  - Required Fluor to coordinate with local authorities
  - Contained standard language for site investigation

# *Fluor Intercontinental, Inc. v. Department of State* (cont'd)

- Site utilities were delivered significantly late
  - Substantial efforts and costs to work around the problem
  - Fluor notified DOS of problem over a year after it mobilized to site
- Court rejected claims for breach of warranty and covenants of good faith and fair dealing
  - No clear and direct promise that utilities would be delivered on time
  - Fluor should have seen this for itself when it visited site
  - Site Investigation clause puts risk on Fluor

# ***Fluor Intercontinental, Inc. v. Department of State*** (cont'd)

Fluor contends that the [RFP] represented that infrastructure would be delivered to the site to support construction. The [RFP], at best, stated only that local government authorities have committed to provide utilities, including power, water, sanitary/storm sewers, and telecommunications, to the site area by June 2003.

Nothing in these statements can be construed to be a promise from DOS that these events would occur.

“[A]bsent fault or negligence or an unqualified warranty on the part of its representatives, the Government is not liable for damages resulting from the action of third parties.”

## Lesson No. 2

**Design-Builders May be Seeing an  
Erosion of the *Spearin* and Good  
Faith and Fair Dealing Doctrines**

# ***Metcalf Construction Co., Inc. (2011)***

- Housing project at Marine Corps base in Hawaii
  - \$50 million project cost \$75 million to complete
  - Main issues involved differing site conditions and failure of Navy to act reasonably
- Metcalf was unable to prove its DSC claims despite:
  - Finding “moderate to high” expansive soils vs. “slightly” expansive
  - Navy requiring remediation of chlordane when Navy said this would not be required
  - Court relied upon obligation of Metcalf to conduct further investigations and found it could not rely on RFP information

## ***Metcalfe Construction Co., Inc. (cont'd)***

- Navy's conduct mentioned throughout decision:
  - Clear examples of over-inspection (rejection of a countertop  $1/64^{\text{th}}$  of an inch off specification)
  - Acknowledgment by Navy witnesses that this project was “a war ... with no breaks”
  - Incompetent Navy project manager
  - “Hard-nosed attitude” that required Metcalfe to settle claims at low amounts to get progress payments
  - Navy taking over 300 days to investigate the differing site condition claim
- Court still concluded that there was no breach of covenant of good faith and fair dealing

## ***Metcalfe Construction Co., Inc. (cont'd)***

The record establishes that Mr. Takayesu was a difficult and overzealous Navy employee and that there was a retaliatory aspect to some of the noncompliance notices that the Navy issued.

Nevertheless, the court has determined that collectively, these actions do not rise to the level of a breach of the duty of good faith and fair dealing, particularly since the Navy was under pressure to move service members into private housing.

# ***Fluor Intercontinental, Inc. v. Department of State (2012)***

- In addition to lack of utilities, Fluor alleged several other events:
  - Inability to use locally produced precast piles for foundation
  - Erroneous requirement that it encase the upper 3 meters of piles with concrete
  - Changes to the perimeter wall design
- Basic allegations revolved around reliability of RFP information and DOS directives from design review
- Project delayed by 6 months and resulted in multi-million dollar claim



# ***Fluor Intercontinental, Inc. v. Department of State*** (cont'd)

- Court generally found Fluor to be a volunteer, correcting its bidding assumptions as it advanced project
- Citations to a significant number of contract excerpts showing that Fluor had assumed risk
  - Drawings as only showing design intent
  - Contractor not to rely on design sufficiency of geotechnical information
  - No ability to rely on indications of physical data
- *Mortenson* case cited and distinguished

# ***Fluor Intercontinental, Inc. v. Department of State*** (cont'd)

This contract placed all of the responsibility for design and construction (and, as a consequence, all of the risk) on Fluor. While the Government provided Fluor with standard design documents and basic technical specifications developed for use for all embassy construction, the contract made plain that Fluor would be responsible for adapting the design to the specific location in producing the project construction documents. Bidders were expressly told in many different sections of the RFP not to rely on the drawings . . .

## Lesson No. 3

Contractors Take **Great Risk** in  
Failing to Follow the Requirements  
of the Changes Clause

# *Carolina Conduit Systems, Inc. v. MasTec North America (2011)*

- Utility relocation contract for a light rail project in downtown Norfolk, Virginia
  - Conduit supplier and installer started work without written contract
  - Project could not be built as designed because of field conditions (horizontal vs. vertical ductbanks)
    - DB told subcontractor's president "not to worry" about extra costs
    - Subcontract was signed 4 months later did not reflect changed design
- Court rejected subcontractor's claim
  - Failure to follow contract changes clause
  - Signed contract knowing design was not correct
  - Would not recognize oral contract modification

# ***SNC-Lavalin America v. Alliant Techsystems (2011 and 2012)***

- Modernization of acid processing and recycling facility on an Army facility in Radford, Virginia
- RFP specified epoxy-coated concrete for ground floor
  - Learned post-award that epoxy-coating requirement would not meet owner requirements and that needed acid-resistant coating
  - Major design changes to implement change but parties could not agree on price
- Claim denied because contractor failed to meet contract's 15-day notice requirement
  - Court rejected fact that this was owner-directed change
  - Court rejected that there was actual notice

# ***SNC-Lavalin America v. Alliant Techsystems***

## **(cont'd)**

- Owner had several warranty claims based on non-functioning pumps and control valves
  - DB acknowledged that these items were on the punch list and that it knew about them
  - Argued that owner had failed to provide written notice
- Court concluded that the warranty provision did not specify the type of notice and allowed claim to stand
- Note that DB was success in asserting constructive acceleration claim for weather delays

## **Lesson No. 4**

**Remember that Courts will Actually  
Read and Think about the  
Provisions of your Contract**

# *S&B/Bibb Hines v. Progress Energy Florida* (2010)

- Two EPC fixed price power projects impacted by four hurricanes
  - EPC contractor filed \$40 million force majeure claims for labor, equipment and commodity cost increase
  - Court soundly rejects the claim
- Rationale:
  - Fixed price contract puts this risk on contractor
  - Contract contained an unambiguous no damages for delay clause for force majeure
  - Rejection of “equitable adjustment,” “good faith and fair dealing” and “omitted compensation term” arguments
- EPC contractor could have used cost-plus contract, escalation clause and other things to address this risk



## **Lesson No. 5**

# **Design-Builders Need to Follow the Specifications They Create**

# *Younglove Construction v. PSD Development* (2010)

- Design-build for animal feed manufacturing plant in Ohio
- Construction issues started early
  - 28-day compressive strength tests came in below 4,000 psi requirement
  - Design-builder floated rebar and did not precisely follow concrete cover and rebar spacing requirements
- Designer-of-record and others attempted to demonstrate that building was structurally adequate
- Court was not persuaded:
  - Contract obligated design-builder to follow its specifications
  - Definition of “defective” work very broad
  - Structural adequacy goes to measure of damages, but does not eliminate breach

## **Lesson No. 6**

# **Cost-Plus Contracts Are Not “No-Risk” Contracts**

# ***Genon Mid-Atlantic v. Stone & Webster (2012)***

- Upgrade of scrubbers at three power plants
  - \$957M as initial Target Cost plus \$95M contingency
  - \$200M overrun
- Issues to be decided in trial included whether:
  - Reimbursement based upon qualitative review of costs
  - DB complied with language regarding draws on contingency
- Loss of quality incentive and performance incentive bonuses determined to be consequential damages

## **Lesson No. 7**

**When RFP Says “No Exceptions Allowed,” It Means “No Exceptions Allowed”**

# ***Pepco Energy Services v. Department of General Services (2012)***

- Bid protest on a DBFOM contract for a prison's cogeneration plant
  - Proposer expected to negotiate terms of the Energy Services Agreement and Parent Guarantee
  - Owner reinforced that contracts were non-negotiable
  - Owner ultimately declared Proposal to be conditional and rejected it as non-responsive
- Statute allowed agencies to negotiate with responsible proposers in a BAFO process
- Court concluded that RFP was clear on its face and that agency had ability to determine who was responsible

## ***Pepco Energy Services v. Department of General Services (cont'd)***

Significantly, the RFP explicitly provides that the Department “has identified the basic approach to meeting its requirements and will not accept alternative proposals or uninvited proposals.”

\*\*\*

We conclude that the RFP did not entitle [Pepco] to engage in contract negotiations before the Department made a determination regarding whether [Pepco] was a responsible offeror who submitted a responsive proposal.

# ***Bombardier Transportation v. Director, Department of Budget and Fiscal Services, Honolulu (2012)***

- Bid protest on a DBOM contract for Honolulu High-Capacity Transit Corridor Project
  - Bombardier objected to contractor's indemnity obligations being carved out from liability cap
  - Proposal ultimately rejected as non-responsive
- Bombardier argued it was entitled to meaningful discussions on this point
- Court concluded that City had done enough
  - Multiple addenda issued confirming position
  - Agencies are not required to notify offerors of deficiency in proposals
  - City notified Bombardier of its position



## ***Bombardier Transportation v. Director, Department of Budget and Fiscal Services, Honolulu (cont'd)***

While competition is an important interest and may have been further promoted by allowing Bombardier another opportunity to withdraw its language, ensuring efficiency and accountability in the procurement process are equally important.

## **Lesson No. 8**

# **Agencies are Given Deference in Making their Procurement Decisions**

# *Lemoine Company v. Military Department* (2012)

- Bid protest on a Louisiana Army National Guard facility
  - Issue was gable vs. barrel roof
  - Successful proposer's gable roof was rated unacceptable but it was still awarded contract
- Court upheld award
  - Roof design element was 200 out of 3700 points
  - RFP did not say that an unacceptable grade would eliminate the proposal
  - Technical review committee did not know pricing when it scored
  - Even though Lemoine's proposal was "brilliant" and adhered to design intent, it did not provide best value

## **Lesson No. 9**

# **Pay Attention to Conditions Precedent to Arbitration/Litigation**

# ***Ohio Power Company v. Dearborn Mid-West Conveyor Company (2012)***

- Contract for a coal blending system at a power project in West Virginia
  - Project completed in 2006
  - Explosion on October 14, 2009 prompts lawsuit around October 5, 2011
- Case dismissed for failure to go through mediation and stepped negotiations
- Court rejected arguments that:
  - Process was only meant to be used during construction
  - Warranty clause trumped this process
  - Defendant did not raise this as an issue earlier



**CAPITAL PROJECT  
STRATEGIES**

# **Lessons Learned: Recent Developments in Design-Build Caselaw**

**January 22, 2013**

**Michael C. Loulakis, Esq., DBIA  
President/CEO**

**Capital Project Strategies, LLC  
mloulakis@cp-strategies.com**