global construction solutions

JAMS

THE LATEST NEWS IN CONSTRUCTION ADR FROM THE WORLD'S LEADING NEUTRALS

Spearin Lite? The Limited Implied Warranty in a Construction Management at Risk Project

By Hon. Nancy Holtz (Ret.)

We are all familiar with the *Spearin* doctrine: In the classic design-bid-build project delivery system, an owner furnishes stamped plans and specifications provided by its separately contracted design professional for a contractor to follow in a construction job. As long as the contractor relies on the plans and specifications in good faith (over which the contractor has had no input or control), the owner impliedly warrants their sufficiency for the intended purposes *(United States v. Spearin 1918).*

In the recent case of *Coghlin v. Gilbane*, the Massachusetts Supreme Judicial Court (SJC) faced the question of what warranty, if any, an owner in a public project provides a contractor relating to the adequacy of its design professional's prepared and stamped plans when utilizing the project delivery method known as the "construction management at risk" (CMAR) project delivery method. Under this method, the CMAR is typically retained early in the design process and consults with the owner and its designer of record regarding design clarity, cost, constructability and other issues, which require the CMAR to be familiar with the design as it is completed.

In *Coghlin*, the SJC concluded that a public owner of a CMAR project does in fact give an implied warranty regarding the designer's plans and specifications. The public owner may be liable to the CMAR for damages caused by a breach of the implied warranty if the construction manager proves that its reliance on the owner's defective plans and specifications was in good faith and the construction manager acted reasonably in light of its own design responsibilities.[1]

Background: The Massachusetts Division of Capital Asset Management and Maintenance (DCAMM) was the owner of a construction project to build a new psychiatric hospital for the state.

> See "Spearin Lite" on Page 4

Arbitrators Confronting Corruption

By Andrew Aglionby

It is an unfortunate truth that corruption is quite often alleged in connection with commercial contracts. As arbitrators are invited to look into such allegations, what should they do, and what are the special issues to manage?

It would be unusual for people to make it easy to identify their corrupt actions for the world to see; by their very nature, those things are usually hidden away, and this causes some complications.

> See "Corruption" on Page 6

Also in Our Spring 2016 Newsletter:

Effective Arbitration Management: Addressing Damages Early

By Carol Ludington and Nancy Greenwald

While arbitrators continually strive to work with the parties to craft a process that is thorough, fair and efficient, we observe that in practice, case preparation often focuses on the liability issues first and leaves damages until much later. This lack of focus on damages early in a case often results in erroneous expenditures of time and energy as well as, ultimately, unhappy parties. If there is an early focus on damages, the process can more effectively assist the parties to concentrate on the core elements of their case, reduce discovery, truncate the process and provide more fertile ground for settlement discussions.

Why is an Early Focus on Damages Important?

A lack of early attention to damages can be costly, adversely impact the quality of available information and impede settlement. For example, if case preparation proceeds with an inflated assumption regarding potential damages, more may be expended on legal fees than is justified by realistic damages. In another example, without early attention to damages, discovery may be completed before a significant damages issue is identified, and opportunities for discovery regarding this important issue may be missed, leaving the experts, attorneys and arbitrators without important information. In either situation, unrealistic views of the magnitude and availability of damages may be an impediment to settlement of the dispute.

By contrast, early attention to damages can avoid unpleasant surprises, improve the quality of damages information and analysis, help match costs to potential benefits and facilitate settlement. An early focus can also help properly define and control the scope of discovery and help the arbitrator and the parties address the issue of proportionality. Finally, it helps ensure that the parties come to a settlement conference or the arbitration hearing with reasonable damages calculations backed up by solid approaches and facts.

Tools for Arbitrators and Parties to Address Damages Early

- **Perform an Initial Damages Assessment –** An initial damages assessment is a tool that can be used shortly after or before a dispute is initiated, and before discovery begins, utilizing the parties' own damages experts or a damages neutral (an expert jointly selected by the parties). The purpose of the initial damages assessment is to identify a realistic magnitude of damages, key damages issues and relevant discovery needed to address these issues. This realistic view of damages may facilitate early settlement of a dispute. If early settlement does not occur, the dispute process can then be tailored to fit the magnitude of realistic damages and to ensure that discovery uncovers the information necessary to adequately address key damages issues. Damages discovery can then shift from general discovery to focused discovery relating to the key damages issues identified by the initial damages assessment.

- **Utilize an Arbitrator's Claim Template –** A claim template creates a structure for organizing information to be provided to the arbitrator. For each claim, the template includes a brief description of each claim; the legal basis for each claim; the parties involved; related cross-counterclaims, defenses, etc.; identification of relief requested (including calculations); relevant witnesses; and a listing of exhibits relevant to each claim. It is another tool for focusing the parties' attention on damages issues from the outset, giving them a format that assists them in focusing on the information they actually need to present to make their case, hence reducing the volume of irrelevant information. It can be offered to the parties as a guide for organizing information provided to the arbitrator.

- **Establish Damages Deadlines –** Dispute activities are often triaged based on deadlines, but scheduling and procedural orders typically include few deadlines related to damages. In fact, many such orders do not even include the

word "damages." In the absence of damages-related deadlines, attention to damages is often deferred in order to focus on the next deadline. Establishing damages-related deadlines in the scheduling order helps ensure that damages get attention early enough in the process.

- **Require Initial Damages Disclosures –** Requiring exchange of initial damages contentions and basic data encourages realistic damages assessment. Initial damages contentions may include identification of damages measures, methodology and estimated magnitudes. Exchanging basic data such as sales volumes, revenues and related costs provides a basis for these early quantifications. Also, early exchange of this basic data may help avoid time-consuming and costly discovery.

- **Utilize a Damages Neutral –** Using damages experts as neutrals (such as a damages special master, damages advisor, expert determiner, arbitrator and mediator) leverages the expertise of the damages neutral to provide clear understanding of the issues, needed information and appropriate damages outcomes. Although a damages neutral is not necessary in many cases, it may be useful in disputes that involve complex or significant damages issues. In these situations, a damages neutral may assist regarding expert determination of specific damages issues and may assist in resolving damages discovery disputes. Although use of a damages neutral may involve added costs, these costs may be offset by streamlined discovery and by early resolution.

Early attention to damages can avoid unpleasant surprises, improve the quality of damages information and analysis, help match costs to potential benefits and facilitate settlement.

Promoting Settlement with Early Damages Assessment

It is generally said that the parties will know 80 percent of the facts they need to know to evaluate a case within a short time after a case is filed. Given this, the early focus on and understanding of the amount and nature of damages at issue can help narrow the gap between the parties' views of the amount of damages at issue, increasing the possibility of settlement without the time and cost involved in obtaining the remaining 20 percent of the facts.

Conclusion

Implementing creative damages approaches earlier in the arbitration process reduces time and cost, better matches cost to potential benefits and makes dispute resolution more accessible. Although implementing these approaches may require some additional efforts early in a dispute, these efforts are quickly rewarded with better information, efficiencies and informed decisions. One size does not fit all, and all of these procedures may not be appropriate for a particular dispute, but establishing damages deadlines, exchanging initial damages contentions and basic data and performing an initial damages assessment quickly and economically identify the magnitude of potential damages and key damages issues. If there is a realistic, preliminary understanding of both the legal issues and potential damages, informed decisions can be made to implement a process that is tailored to fit each case and that properly matches costs to potential benefits.

*Carol Ludington, **www.ludingtonltd.com**, is a CPA with more than 30 years of experience in hundreds of complex commercial and intellectual property disputes. She frequently serves as a testifying and consulting expert, performs initial damages assessments and consults regarding ADR and creative dispute resolution processes. She has served as an arbitrator, is currently on the AAA Roster of Arbitrators, is a qualified neutral under Rule 114 of the Minnesota General Rules of Practice and is an Associate of the Chartered Institute of Arbitrators.*

*Nancy Wiegers Greenwald, **ngreenwald@construction.org**, is an experienced arbitrator and mediator with more than 30 years of experience in the construction industry, both as an attorney and a business executive. She serves on the American Arbitration Association's Construction Industry Panel of Arbitrators and Mediators, among others. She is a member of the Executive Committee and Leadership Council of the Dispute Resolution Section of the American Bar Association, Forum on Construction Law, Litigation Section and Business Law Section. She currently serves as Executive Director of the Construction Institute at the University of Hartford.*

Spearin Lite *Continued from Page 1*

The DCAMM utilized the CMAR method, as defined in Massachusetts General Laws, Chapter 149A, Sec. 2. The act defines CMAR as "a construction method where a construction management at risk firm provides a range of preconstruction services and construction management services which may include cost estimation and *consultation regarding the design of the building project*, the preparation and coordination of bid packages, scheduling, cost control, and value engineering, acting as the general contractor during the construction, detailing the trade contractor scope of work, holding the trade contracts and other subcontracts, prequalifying and evaluating trade contractors and subcontractors, and providing management and construction services, all at a Guaranteed Maximum Price, which shall represent the maximum amount to be paid by the public agency for the building project, including the cost of the work, the general conditions and the fee payable to the construction management at risk firm" (emphasis added) at 557-558. G. L. c. 149A, Sec. 2.

In keeping with this method, the DCAMM hired a design professional to develop the design and specifications for the project, as well as prepare final design documents, which it certified as designer of record.

Pursuant to the statute, the DCAMM also hired Gilbane Construction Co. (Gilbane) as the CMAR. Gilbane's early duties were to consult and provide input into the design phase when that design process was 60 percent complete. Among other things, the contract called for Gilbane to "review" the design documents "on a continuous basis" for "clarity, consistency, constructibility, maintainability/operability and coordination among the trades."

After the DCAMM approved the final design documents, Gilbane proceeded with construction of the project, including entering into a contract with the electrical subcontractor, Coghlin Electric (Coghlin).

During the construction phase, problems arose regarding scheduling and coordination of subcontractors. Additionally, Coghlin hit a significant roadblock affecting its ability to do its contracted work within budget. The plans revealed a significant inconsistency: The design called for only two feet of space between the ceiling and the bottom of the structural steel, whereas the design of the electrical and mechanical work required five feet in which to place the specified equipment. This discrepancy needed to be resolved. All in, Coghlin's increased costs were approximately 50 percent more than the original contract amount.[2]

Approximately one month before substantial completion, Coghlin submitted a request to Gilbane for equitable adjustment of the contract price. Coghlin then sued Gilbane, alleging breach of the subcontract and claiming damages for additional costs due to design errors as well as errors arising from various scheduling, coordination and management issues. Gilbane filed a third-party complaint against the DCAMM seeking indemnification for these damages arising out of the design defects claimed. The DCAMM responded with a motion to dismiss, claiming that Gilbane's CMAR role meant that it too had input into the design and the DCAMM did not provide an implied warranty against the damages claimed by *Coghlin*; in other words, the *Spearin* doctrine did not apply to this public project. The lower court agreed, dismissing the third-party complaint against the DCAMM, and the SJC granted direct appellate review.

Will *Spearin* apply? The question of who was responsible for the additional costs incurred by Coghlin—owner or contractor—lit the fuse on this case of first impression in the country as to what extent, if any, the *Spearin* doctrine would apply to a public project utilizing a construction management at risk delivery method. In order to understand the SJC's rationale for applying the *Spearin* doctrine to the relationship between public owner and CMAR—in a limited form—it is necessary

to focus on the relationship between the owner and the CMAR. The SJC noted that this relationship is different from the traditional relationship between owner and contractor. It observed that "[b]y contracting during the design phase, the owner may involve the [CMAR] in project planning and…benefit from the [CMAR's] expertise," citing Lewin & Schaub, Jr., Construction Law, Sec. 17:42 (2012) and P.L. Bruner & P.J. O'Connor, Jr., Bruner and O'Connor on Construction Law, Sec. 6:59 (2002) ("CMAR provides preconstruction services tailored to introduce construction expertise into the design phase").

The SJC considered legislative intent. Specifically, the SJC noted that "[t]he possibility that the CMAR may consult regarding the building design does not suggest that the CMAR should be the guarantor against all design defects, even those that a reasonable CMAR would not have been able to detect." Pursuant to the legislation, the guaranteed maximum price (GMP) may only be established when the design is at a minimum of 60 percent completion. Further, the legislation does not call for the contractor to have full and final control. Therefore, the SJC reasoned that the "legislature could not reasonably have intended that the CMAR, by agreeing to a GMP, would bear all the risk arising from the design when the CMAR may not have seen as much as 40 percent of the design documents before agreeing upon a GMP. Even where a CMAR is given substantial consultative responsibilities regarding the design, the owner remains free to reject the CMAR's advice and suggestions." Further, the SJC looked to the language of G. L. 7C, Sec. 51(e) applicable to CMAR projects, requiring the public agency or design professional to obtain a minimum level of professional liability insurance covering negligent errors, omissions and acts of the designer. In sum, the SJC was convinced that the legislature intended to give the CMAR a greater advisory role but that it did not intend to eliminate, in its entirety, the owner's responsibility for design defects.

No express disclaimer. Under the terms of the contract, Gilbane was to provide value engineering services without, however, assuming the designer's responsibility for design. The SJC found this language to support rather than disclaim an implied warranty. It left open for another day the question of whether the owner could abrogate this warranty through express disclaimers in the contract.

The indemnification issue. Given its finding of a limited implied warranty by the DCAMM to Gilbane, the SJC found the indemnification provision did not preclude the third-party action against the owner. While broad in scope, the SJC found that the indemnification provision applied only to Gilbane's own work, not to work by the design professional. (See Bruner & O'Connor, Jr., supra at 10:58 ("Nearly every indemnity provision contains language limiting the indemnitor's obligation to loss occasioned in some way or another to the activities or work of the indemnitor.")) Here, Gilbane was contractually responsible for "construction and other services required to be supervised [and] overseen" by it. This would clearly not apply to the design professional's work.

The Coghlin decision provides the first guidance as to how the courts will look at the CMAR delivery method in public projects.

The *Coghlin* decision provides the first guidance as to how the courts will look at the CMAR delivery method in public projects. This matter came to the SJC on a motion to dismiss, so the SJC was unable to determine if in this particular case the CMAR met its burden to prove that it acted in good faith and reasonably in executing its duties of consultation into the design.

So while many questions remain, for now, at least in Massachusetts, when the delivery system for a public project is the construction management at risk method, a limited implied warranty will run from the public owner to the CMAR. ●

Hon. Nancy Holtz (Ret.) is a JAMS neutral based in Boston. She has more than 30 years of experience as a judge, attorney and ADR practitioner resolving significant multi-million-dollar business and construction disputes, as well as employment, wrongful death and other personal injury matters. She can be reached at ***nholtz@jamsadr.com.***

[1]The SJC also ruled that the owner had not disclaimed the implied warranty. It also ruled that the indemnification provision in the contract with the CMAR did not prohibit the CMAR from filing a third-party complaint against the owner as opposed to requiring the CMAR to file a separate complaint against the owner to recover costs caused by an insufficient or defective design under the implied warranty.

[2]There were other alleged causes of the delay and increased costs, including some additional design defect or deficiency claims.

Corruption *Continued from Page 1*

Should there be a threshold parties must satisfy for making allegations of corruption? Some countries have strict rules of professional conduct preventing party representatives making allegations of fraud without sufficient foundation. That is because commercial reputations are hard to win but easy to lose; the conduct rules send a message that it should be serious business to allege corruption, as that has real consequences. But those conduct rules do not apply in all jurisdictions or arbitrations, and it falls to the arbitrators to manage the consequences.

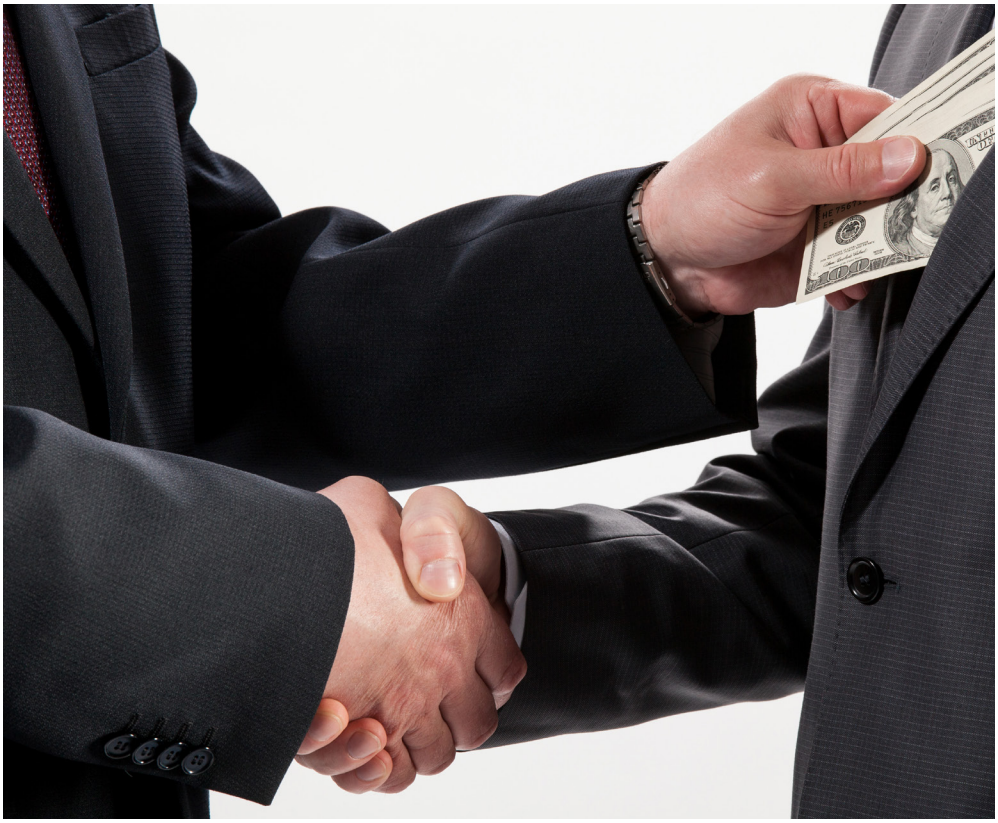
Should arbitrators allow allegations of corruption to continue even if there are no real facts to support them? And if the answer to that is no, what can the arbitrators do? It is far from clear that arbitrators have powers to order allegations of fact struck from pleadings before any hearing. Any preliminary hearing of the allegations will be possible only by setting a timetable and offering each party a fair opportunity to put forward its case, which may perpetuate and perhaps emphasise the allegations, no matter how insubstantial. But there are some tools to use, such as ordering full particulars or even evidence to be produced at an early stage, while considering whether to allow elements of the claim to proceed. In most jurisdictions, it is the duty of the arbitrator to be fair to both parties, and that can mean, in the right circumstances, managing which claims proceed and which do not.

Fraud and corruption may well require more broadly framed document disclosure requests than those within the tightly framed boundaries more familiar in international cases. Yet, at the same time, the disclosure requests must serve the legitimate interests of the parties on the pleaded case and not simply be a fishing exercise using an unjustifiable pleading as an excuse to trawl through otherwise-unobtainable material.

Similarly, arguments arise about the burden of proof. There are often submissions about whether, given the nature of the allegations, the burden of proof is the same as usual or it should be higher (not "balance of probabilities," but "beyond a reasonable doubt").

Then there are the unsettled questions of how to assess and apply evidence when deciding whether the burden has been met. Those alleging corruption argue that it is essential for arbitrators to understand that evidence will be sparse, as it is naturally hidden, and that inferences can and must be drawn from circumstantial evidence of corruption. The companies and people accused do not share this view: They are vocal in saying that clear and compelling evidence is required to make out such claims and that the claims must be proved by those asserting them. The accused point out that they do not bear the burden of disproving the allegation, or of attempting to prove a negative. There can be serious concerns that inferences and circumstantial evidence may lower or even reverse the standard of proof, which, it is said, would be entirely wrong. The correct approach in any arbitration will be

Impartiality and independence are of universal importance in establishing trust and confidence in the system of arbitration but may be subject to even more scrutiny in cases involving issues of corruption.



driven by the different and varied facts of that dispute; of course, it is not possible to suggest any one approach that will always be appropriate.

Findings of corruption can also impact on the very jurisdiction the arbitrators are exercising. How can something birthed by corruption survive? The concept that the arbitration agreement and the substantive contract are separate and severable is well-known and often relied on as the correct jurisdictional basis for arbitrators to decide the corruption issues and, often, the many other issues that are live in the arbitration. There are not many arbitrations in which the arbitrators have declined jurisdiction, but there are some, particularly where the substantive agreements involved were for an illegal purpose (for example, a contract with an agent whose function was then only to facilitate bribery) and were therefore void from the very beginning, not only voidable at a later stage (which would often be the position with contracts procured by corruption, rather than being for corrupt purposes). It is still possible to argue, although it is not easy, that circumstances can mean there was never any consent by the parties to the arbitrators having jurisdiction and that the arbitrators should decline jurisdiction.

The statutory consequences of corruption and fraud are severe. Among others, the Foreign Corrupt Practices Act in the United States and the Bribery Act in the United Kingdom demand careful reading and exact stiff and punitive measures for corporations and individuals, particularly those who have failed in the appropriate management required by those statutes. This can be personal for the highest managers and is not to be ignored. Depending on the legislation involved, the arbitrators themselves may also have to consider if they are obliged personally to report suspected corrupt activity. The confidential nature of arbitration will not provide unlimited protection to those accused or involved.

Impartiality and independence are of universal importance in establishing trust and confidence in the system of arbitration but may be subject to even more scrutiny in cases involving issues of corruption. Some arbitrators, although not many in the United States, feel that it can be confusing to disclose apparently irrelevant details. Particularly in cases of corruption, it may be better to make tiresomely long disclosures of all information, no matter how tangential, so as to shut down later challenges to the award from the earliest stage.

It does not seem that the issues arising from corruption will go away soon, although there is widespread and strengthening recognition and condemnation of all such practices. For the moment at least, arbitrators will continue to face and overcome the challenges of managing processes and making decisions appropriately. Although some of these challenges are complex and seem to have no simple answers, that is also true of many of the other decisions that arbitrators make on different topics; there is every reason to believe that arbitrators are just as effective in dealing with the challenges of corruption. ●

Andrew Aglionby is a JAMS panelist, based in London. He specializes in Business/Commercial, Construction, Energy and Real Estate disputes. He can be reached at ***aaglionby@jamsinternational.com****.*

The JAMS Global Engineering and Construction Group provides expert mediation, arbitration, project neutral and other services to the global construction industry to resolve disputes in a timely manner. To learn more about the JAMS Global Engineering and Construction Group, go to www.jamsadr.com/construction.

New Additions

JAMS announced the addition of Stacy La Scala, Esq. Mr. La Scala will be based in the JAMS Orange Resolution Center and serve as a neutral in a variety of disputes including construction, insurance, business/commercial, and professional liability matters.

Representative Matters

Philip L. Bruner, Esq. was appointed by the ICC as a co-arbitrator to hear disputes regarding the design and construction of a nuclear power plant in Bulgaria.

Kenneth C. Gibbs, Esq. has been engaged to act as mediator regarding disputes arising out of the construction of two major data centers in Utah.

John W. Hinchey, Esq. was appointed as co-arbitrator of a dispute administered by the ICC, between a global nuclear power engineering company and a public utility in Taiwan, involving the design and engineering of a nuclear power, generating facility near Taipei.

Hon. Nancy Holtz (Ret.) successfully mediated a claim arising out of construction of a college science building involving a "no damages for delay" provision, as well as a claim under the cardinal change rule.

Hon. Carol Park Conroy (Ret.) will serve as a mediator in a dispute involving alleged design defects relating to the new Visitor Center at the U.S. Capitol.

Honors

Roy S. Mitchell, Esq. will receive the 2016 Cornerstone award at the ABA Forum on Construction Law's Annual Meeting in April.

Events

George D. Calkins, II, Esq. recently spoke on Finding Common Ground in Drafting and Negotiating Design and Construction Clauses at the American Bar Association Forum on Construction Law in February.

John W. Hinchey, Esq. was a speaker and panelist at the February Annual Meeting of the American College of Construction Lawyers on several topics, including Dealing with Dispute Adjudication Boards, Time and Cost Management in Arbitration and Interviewing Potential arbitrators.

Hon. Carol Park Conroy (Ret.) recently moderated "The Judges Panel" at the 22nd Annual Federal Procurement Institute sponsored by the ABA Section of Public Contract Law in Annapolis, Md. in March.

Newsletter Registration

If you want to stay apprised of the latest developments in construction ADR and you are not already receiving this electronic newsletter, please register online or send us your email address. Register at www.jamsadr.info or email constructionsolutions@jamsadr.com or scan the code to the left.