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Survey of 2000 through 2002 Second Circuit Construction Law Decisions

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I. INTRODUCTION

This article surveys the construction law decisions of the Second Circuit from the years 2000 through 2002. These decisions apply varied legal doctrines, reflecting the dynamism of the construction industry.

Construction is a field where a diverse range of parties engage in high-risk ventures under shifting relationships. Disputes are common, as expectations are often frustrated. The resolution of these disputes draws from more than just a set of core doctrines isolated to the construction industry.\(^1\) As can be seen from some of the cases in this Article, resolving construction disputes requires the use of general doctrines of law as they have developed specific application to repeating fact patterns found in construction.\(^2\) The cases in this Article address a number of these issues and include professional malpractice, economic loss, arbitration, insurance coverage, subcontracts, suretyship and pre-qualification.

Most construction cases, not involving claims against the federal government, involve questions of state law and find their way to the federal system through diversity of citizenship jurisdiction. The cases selected for this Article present little exception to that precept, and deal primarily with state law issues arising from the laws of the States of Connecticut and New York.

In addition to Second Circuit decisions, this Article also contains

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1. The law of bid disputes, delay claims and changed conditions claims, for example, apply specially to the construction industry.
2. Doctrines of general contract law, due process and insurance, for example, frequently control construction disputes.
district court decisions where they represent significant new holdings or newly clarified holdings.

II. DECISIONS

A. Professional Malpractice

In 2000, the Second Circuit took the task of deciding a rather arduous appeal from consolidated cases involving financially failing hydro-electric plants in upstate New York. The case is *Hydro Investors, Inc. v. Trafalgar Power, Inc.*[^3] Although the issues are many and the facts are complex, the case presents two narrow and concise issues for the purposes of this Article, both of which broadly define the scope of liabilities and damages that design professionals may owe to project owners.

First, applying New York law, the Second Circuit held that a design professional commits malpractice not only by generating a technically unfeasible design, but also by the failure of its design to meet a client’s stated goals.[^4] Second, the Second Circuit held that New York’s economic loss rule does not apply to bar damages for lost revenues arising from professional malpractice where the particular negligent acts induced the project owner to undertake construction of the project.[^5]

1. Professional Malpractice

The claim of professional malpractice on appeal arises from energy output estimates provided to the owner, Trafalgar Power, Inc. ("TPI"), by the defendants Neal Dunlevy and the engineering firm that employed him, Stetson-Harza (the "Engineers").[^6] Those estimates were used in an analysis of costs and revenues provided to prospective lenders upon which TPI and others relied and used to determine the location of the power plants.[^7] The jury found that the Engineers negligently miscalculated the water head at one dam[^8] and the bypass flow

[^3]: 227 F.3d 8 (2d. Cir. 2000).
[^4]: Id. at 15.
[^5]: Id. at 17-18.
[^6]: Id. at 12.
[^7]: *Hydro Inv., Inc.*, 227 F.3d at 12.
[^8]: Id. at 13 (a dam’s head is “the drop in height of water, from the reservoir down
requirement at another.\textsuperscript{9} The Engineers moved to set aside the verdict as a matter of law on the grounds that the plaintiffs failed to adequately prove professional malpractice and the resulting damages.\textsuperscript{10} That motion was denied by the district court, and this appealed followed.\textsuperscript{11}

On appeal, the Engineers alleged that TPI failed to prove that the malpractice proximately caused the plaintiff’s damage.\textsuperscript{12} Specifically, the Engineers asserted that it was not their negligence which caused the two power plants to produce less energy; rather, it was the low head of the river and a regulatory agency’s requirement of a bypass flow that resulted in less energy being produced.\textsuperscript{13}

The court disagreed, stating that “[t]he legal cause of TPI’s injury was Dunlevy’s failure to adequately convey the realities of [the dams] with a level of professional care that would have allowed TPI to make its business decisions with respect to those sites based on reasonably reliable technical information.”\textsuperscript{14} Presumably, TPI would have not contracted to build the two dams, or would have made other arrangements, had it been provided correct calculations.

With respect to other causes of harm on the project, such as excessive construction costs and poor decision making by TPI, the court stated that the Engineers need not be the sole cause of harm, only a substantial factor, which they were.\textsuperscript{15}

The court’s holding makes it clear that a design professional can be found negligent for professional services that are not directly related to physical flaws in a structure. In addition, malpractice may consist of supplying incorrect information to a client on which the client relies in making business decisions.

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9. Id. at 13 (bypass flow is the flow off water which must circumvent the dams energy generating machinery). The Second Circuit also stated that the evidence, taken in the light most favorable to plaintiff, revealed that Dunlevy and Stetson-Harza had little experience with hydro-electric projects; recent college graduates performed most of the calculations; and Dunlevy’s and Stetson-Harza’s energy output estimates were “overly optimistic.” Id.

11. Id. at 15.
12. Id. at 15. The elements of professional malpractice under New York Law are “(1) negligence, (2) which is the proximate cause of (3) damages.” Id. (citing Marks Polarized Corp. v. Solinger & Gordon, 476 N.Y.S.2d 743, 744 (N.Y. 1984)).
13. Hydro Inv., Inc., 227 F.3d at 15.
14. Id. at 15.
15. Id. at 15.
2. Economic Loss Rule

The Engineers also contested the amount of the $7.6 million award on the grounds that a part of the damages awarded against them were "economic loss" that could not be recovered in tort. Their appeal alleged that "the district court improperly permitted TPI to obtain a damage award based on 'lost revenue' in violation of the economic loss rule found in New York cases." TPI argued in opposition that Engineers' professional malpractice fell within a narrow exception to the economic loss doctrine. The court agreed, following a discussion of the New York economic loss doctrine.

The court stated that New York adopted the economic loss rule in 1982 with the New York Court of Appeals' decision in Schiavone Construction Co. v. Elgood Mayo Corp. The rule, as applied in New York, bars recovery of economic losses sounding in negligence when there is no property damage or personal injury. Consequently, a claimant in New York is limited to an action in contract for the benefit of the bargain only. Strict application of the economic loss rule to the instant case would limit TPI's damages to only that which it could recover under contract, not professional malpractice. Absent privity with the defendant design professional this could severely limit, if not

16. Id. at 16.
17. Hydro Inv., Inc., 227 F.3d at 16. Connecticut is presently struggling with its economic loss doctrine. Recently, in a case in which the authors appeared, the Connecticut Superior Court, Judicial District of Waterbury, found that the economic loss rule applies in Connecticut to bar claims against design professionals absent privity of contract, property damages or personal injury. See Amity Reg'l Sch. Dist. No. 5 v. Atlas Constr. Co., No. X06 CV 99-0153388S, 2000 WL 1161095, at *2 (Conn. Super. Ct. Jul. 26, 2000). The superior court based its reasoning by extending the supreme court's holding in Flagg Energy Dev. Corp. v. General Motors Corp., 244 Conn. 126, 153, 709 A.2d 1075, 1088 (Conn. 1998), which held that "commercial losses arising out of the defective performance of contracts for the sale of goods cannot be combined with negligent misrepresentation," to bar tort claims against design professionals. The decision was simultaneously challenged by a Connecticut Superior Court, Judicial District of Stamford, decision which held that the economic loss rule does not bar tort claims when privity is lacking if the damages were reasonably foreseeable. See Carolina Cas. v. 60 Gregory Blvd., No. CV 98-0169383S, 2000 WL 350284, at *2 (Conn. Super. Ct. Mar. 21, 2000). The Connecticut appellate courts have yet to decide the issue.
18. Hydro Inv., Inc., 227 F.3d at 16.
19. Id. at 16.
20. Id. at 16 (citing 436 N.E.2d 1322 (N.Y. 1982)).
22. Hydro Inv., Inc., 227 F.3d at 16 (citing 532 Madison Ave., 711 N.Y.S.2d at 391).
completely preclude, recovery.

The Second Circuit discussed the policy issues underlying the economic loss rule. The court observed that the rule's policy goal of providing predictability to commercial undertakings and avoiding unanticipated liabilities must be reconciled with awarding of appropriate damages to compensate for negligent acts.

To resolve the tension between these two goals the Second Circuit turned to *Sommer v. Federal Signal Corp.* In *Sommer*, the New York Court of Appeals carved out an exception to the economic loss rule to allow for an award of damages against a fire alarm company which negligent acts of an employee caused millions of dollars in fire damages. The New York court established six factors for a court to examine in deciding to apply the economic loss rule. As viewed by the New York court, the test is one of determining if a claim is truly a contractual claim guised as a tort, in which case the doctrine ought to apply and economic losses are barred. If, on the other hand, the claim is closer to a pure tort, the doctrine ought not to be applied, and damages should be recoverable. The factors are as follows: (1) the defendant's duty of care is derived not just from contract but from the nature of services; (2) the defendant's industry is regulated by a government body; (3) the defendant serves a significant public interest; (4) a breach of duty by the defendant could have catastrophic consequences; (5) the nature of the relationship between the plaintiff and defendant; and (6) that the loss was sudden rather than prolonged.

After reviewing those elements, the Second Circuit held that TPI's malpractice claim sounded in tort and was not a contract claim disguised as a tort. Based on that holding, one could presume that the court reasoned that the Engineers should be liable because their services as design professionals implicate public interests, are regulated by the government, and have a standard of care that is defined by their profession, not just by the terms of their engineering services contract.

23. *Hydro Inv., Inc.*, 227 F.3d at 16.
25. *Hydro Inv., Inc.*, 227 F.3d at 17.
27. *Id.* at 1369-70.
28. *Id.* at 1369.
29. *Id.* at 1369.
31. See *id.* at 1369-70.
The court also stated:

[T]he better course is to recognize that the rule allows such recovery in the limited class of cases involving liability for the violation of a professional duty. To hold otherwise would in effect bar recovery in many types of malpractice actions. 33

This is an important holding, as it sets a clear exception to the economic loss doctrine. Under *Hydro Investors, Inc.*, a design professional can be liable for the economic losses arising from the designer’s services as well as physical harm from design errors.

B. Arbitration

Arbitration agreements are common clauses found in construction. Almost every form agreement, such as the 1997 edition of the American Institute of Architect ("AIA") form agreements, as well as many manuscripted construction contracts, call for arbitration. Even those contracts that do not make arbitration mandatory often call for arbitration at one party’s sole discretion.

The following three cases deal with various aspects of arbitration as applied in the construction context. The issues raised in these cases include fraudulent application of the arbitration clause, use of arbitration clauses as custom in the steel industry, and incorporation by reference of arbitration clauses.

1. Garten v. Kurth

In *Garten v. Kurth*, 34 the Second Circuit addressed the nature of a fraud that may defeat an arbitration clause. The court applied the federal "substantial relationship test" developed by the Second Circuit in *Campaniello Imports, Ltd. v. Saporiti Italia, S.p.A.*, 35 by which an arbitration agreement may be voided if there is a substantial relationship between a fraud or misrepresentation used to induce a party to enter into

33. *Id.* at 18.
34. 265 F.3d 136 (2d Cir. 2001).
an agreement to arbitrate and the agreement to arbitrate itself. 36 In Garten, the Second Circuit held that a contractor’s threatening “surefire victory” in arbitration did not satisfy the substantial relationship test between the arbitration clause in the contract documents and the fraudulent acts of the contractor. 37 As a result, the arbitration clause was enforced. 38

The plaintiffs contracted with defendant, Peter Kurth, to design a playhouse behind their home for their daughter. 39 The defendant estimated the construction cost to be approximately $180,000. 40 The defendant, as part of his duties, collected bids from various contractors. 41 The lowest bids were from three companies which, though not revealed to the plaintiffs at the time, were controlled by the defendant. 42 After one year of construction, the $180,000 playhouse was incomplete and the plaintiffs had paid over $700,000 to the defendant for his companies’ work on the project. 43

After escalation of the dispute the defendant told the plaintiffs that their contract called for arbitration; 44 he claimed that he was an expert at arbitration and that the plaintiffs would have to hire a lawyer, incurring additional expenses. 45 The plaintiffs brought the underlying suit in the United States District Court for the Southern District of New York. 46 The defendant moved to compel arbitration and dismiss the suit. 47 The plaintiffs opposed that motion on the grounds that the defendant used the arbitration clause as part of his fraudulent scheme to obtain additional money from the plaintiffs. 48 The district court denied the motion to dismiss, finding that the court had authority to address the allegations of fraud because they went to the arbitration clause itself. 49

36. Garten, 265 F.3d at 144.
37. Id. at 143-44.
38. Id. at 144.
39. Id. at 138.
41. Garten, 265 F.3d at 139.
42. Id.
43. Id.
44. Id.
45. Garten, 265 F.3d at 139.
46. Id. at 138.
47. Id. at 140.
48. Id.
49. Garten, 265 F.3d at 140-41.
The district court specifically found that the defendant's statements that he "knows arbitration like the back of his hand" and that the plaintiffs would be better off paying him than going to arbitration, revealed a substantial relationship between the arbitration provision in the contract and the defendant's fraudulent scheme.\(^{50}\)

The Second Circuit reviewed the case law regarding fraud as applied to the enforcement of arbitration clauses.\(^{51}\) In the end, it agreed that the appropriate test was the substantial relationship test, but it disagreed with the district court's application of the test to the facts.\(^{52}\) The Second Circuit acknowledged that courts are "to require some substantial relationship between the fraud or misrepresentation and the arbitration clause in particular."\(^{53}\) The substantial relationship, however, must be "more than a mere claim that the 'arbitration clause is an element of the scheme to defraud'; it must include 'particularized facts specific to the . . . arbitration clause which indicate how it was used to effect the scheme to defraud.'"\(^{54}\) In the case at hand, the Second Circuit found the defendant's statements were nothing more than "aggressive posturing" and not used as a weapon.\(^{55}\) The court claimed that if it upheld the district court decision, it would "permit future plaintiffs to avoid arbitration in all general fraud contexts by merely citing comments made by their adversaries."\(^{56}\)

2. *Aceros Prefabricados S.A. v. TradeArbed, Inc.*\(^{57}\)

In *Aceros Prefabricados S.A. v. TradeArbed, Inc.*, the Second Circuit concluded that arbitration is so common in the steel industry that the addition of an arbitration clause to a contract proposal is not a "material alteration" of the contract.\(^{58}\) As a result, under Article 2 of the New York Commercial Code, the clause was deemed included in the parties' contract absent specific objection.\(^{59}\)

The issue presented to the court was a classic law school battle of
the forms question to be resolved in accordance with Section 2-207 of
the New York Commercial Code.\textsuperscript{60} It arose from the following facts.
The Contractor, Aceros Prefabricados, S.A., ("Aceros") is a large South
American contracting company and TradeArbed ("TA") is an affiliate of
one of the world's foremost steel manufacturers.\textsuperscript{61} The parties began
corresponding concerning Aceros' prospective purchase of steel from
TA.\textsuperscript{62} On January 12, 2000, about one month after that correspondence
began, TA sent Aceros a letter that purported to confirm Aceros' order
for steel, but did not contain an arbitration provision.\textsuperscript{63} TA then sent to
Aceros subsequent confirmations of orders that did contain arbitration
provisions.\textsuperscript{64}

Because Aceros considered only the January 12, 2000 letter as a
binding contract between the parties, Aceros maintained that it was not
bound by the arbitration condition referenced in the subsequent
confirmations.\textsuperscript{65} The district court agreed with Aceros and found that
the January 12, 2000 letter constituted a binding contract between the
parties.\textsuperscript{66} The court thus ruled that the arbitration provisions found in
the subsequent confirmations were proposals and not part of the
agreement because they materially altered the contract as a matter of
law.\textsuperscript{67}

The Second Circuit reversed the district court's decision and
rejected the notion that the arbitration agreements, as proposed
additional terms, constituted material alterations to the contract as a
matter of law.\textsuperscript{68} Instead, it stated that the materiality of such proposed
additional terms must be examined on a case-by-case basis under the
preponderance of the evidence standard with the burden of proof resting
with the party that opposes inclusion.\textsuperscript{69}

The court stated that "[a] material alteration is one that would
result in surprise or hardship if incorporated without express awareness

\begin{itemize}
  \item \textsuperscript{60} N.Y. U.C.C. § 2-207 (McKinney 1993).
  \item \textsuperscript{61} Aceros Prefabricados, 282 F.3d at 95-96.
  \item \textsuperscript{62} Id.
  \item \textsuperscript{63} Id. at 96.
  \item \textsuperscript{64} Id.
  \item \textsuperscript{65} Aceros Prefabricados, 282 F.3d at 96. TA did not dispute that the General
Conditions of Sale, which contained the arbitration clause, were not actually enclosed
with the confirmations, but only referenced therein. Id.
  \item \textsuperscript{66} Id.
  \item \textsuperscript{67} Id. at 96-97.
  \item \textsuperscript{68} Aceros Prefabricados, 282 F.3d at 100.
  \item \textsuperscript{69} Id.
\end{itemize}
by the other party."' 70 With this standard, the court noted that Aceros did not "submit any evidence demonstrating either subjective or objective surprise at the inclusion of an arbitration clause." 71 The court also noted that "[u]nder New York law, an arbitration agreement does not result in hardship or surprise where arbitration is the custom and practice within the relevant industry." 72 Because arbitration agreements are standard in the steel industry, it did not materially alter the contract.

Most large construction contracts call for structural steel. Thus, the application of this holding to the construction industry is foreseeable. Furthermore, as previously noted, arbitration provisions are common to the construction industry itself. Although the holding of Aceros Prefabricados is limited to the steel industry, its application to the construction industry may follow under the same reasoning.


In Choctaw Generation Limited Partnership v. American Home Assurance Co., the defendant surety sought to avoid a direct lawsuit brought by the owner on a performance bond, by arguing that the owner could only assert claims through the arbitration clause with the general contractor. 74 The surety succeeded, even though it had not signed the arbitration agreement, because the owner was estopped from avoiding arbitration of a dispute with a non-signatory where the non-signatory has a close relationship with the parties bound to arbitrate, and where the dispute is closely linked to a dispute that is subject to arbitration in an underlying contract. 75

The dispute arose from a contract to build an innovative power-generation facility. 76 The plaintiff power generator, Choctaw Generation Limited Partnership ("Choctaw"), entered into an agreement

70. Id. (quoting N.Y. U.C.C. § 2-207 cmt. 4 (McKinney 1993)).
71. Aceros Prefabricados, 282 F.3d at 100.
73. 271 F.3d 403 (2d Cir. 2001).
74. Id. at 404.
75. Id.
76. Id. at 403.
with Bechtel Power Co. ("Bechtel") to build the facility. The project was delayed, leading to an arbitration proceeding between Choctaw and Bechtel. Meanwhile Choctaw assessed liquidated damages and collected them by drawing on a letter of credit, and then demanded that the defendant surety, American Home Assurance Company ("American Home"), surety on a performance bond, replenish the letter of credit. American Home rejected that demand, and Choctaw initiated this action seeking an injunction ordering American Home to replenish the letter of credit. American Home moved for an order to stay the proceedings pending arbitration.

The district court issued Choctaw's requested injunctive relief and ordered that American Home replenish the letter of credit. The court also refused to order Choctaw to arbitrate the dispute with American Home because the bond did not contain an arbitration provision and, though the construction contract did, American Home was not a signatory of that construction contract.

American Home appealed the decision to refuse to compel arbitration based on two theories. First, American Home claimed that the bond incorporated by reference the construction contract, which included an arbitration clause. Second, American Home claimed that Choctaw was "estopped from avoiding arbitration of a dispute with a non-signatory (such as American Home) where the non-signatory has a close relationship with the parties bound to arbitrate, and where the dispute is closely linked to a dispute that is subject to arbitration in the underlying contract." The Second Circuit agreed with American Home on the latter of its two theories and did not therefore review the former.

In so holding, the Second Circuit identified that its precedent, as established by Smith/Enron Cogeneration Partnership, Inc. v. Smith Cogeneration International, Inc., and Thomson-CSF, S.A. v. Am.
 Arbitration Association, 89 allowed the court to review "the relationship among parties, the contracts they signed (or did not), and the issues that had arisen, to arrive at the conclusion that the controversy was arbitrable at the behest of the non-signatory." 90

Conducting that review, the court found that the controversy between American and Choctaw was closely bound to the dispute between Choctaw and Bechtel. 91 Both the underlying dispute (Choctaw's entitlement to liquidated damages) and the dispute between American Home and Choctaw (whether Choctaw could compel replenishment of the letter of credit to fund the liquidated damages) turned on the same facts and contract provisions. 92 Thus, because the controversy at issue between the non-signatory and the signatory was closely related to the controversy between the signatories, the signatory, Choctaw, was estopped from refusing to arbitrate its controversy with the non-signatory, American Home.

With this decision, the Second Circuit has subscribed to what is a becoming an increasingly embraced doctrine in the federal circuits and the states. 93 Moreover, this issue has wide potential application in construction disputes where a surety is involved. While the court did not rule on the surety's first claim, that a surety can demand arbitration with the owner because the bond incorporated the terms of the construction contract, this decision comes close to having the same practical effect. Unless a surety claims a defense specific to the bond, its defenses to payment will often be those of the contractor in an already pending dispute between the contractor and the owner. Thus, in the Second Circuit and elsewhere, the surety can force the owner to arbitrate.

89. 64 F.3d 773, 779 (2d Cir. 1995).
90. Choctaw Generation Ltd. P'ship, 271 F.3d at 407.
91. Id. at 406.
92. Id. at 407.
C. Subcontracts

The Second Circuit also decided a few decisions involving contractual relationships between general contractor and sub-contractor or sub-contractor and supplier—two of which are discussed following. Both cases highlight the Second Circuit’s willingness to allow contractual provisions to be determined by the trier of fact.

1. Bolt Electric, Inc. v. The City of New York\textsuperscript{94}

In the first case, \textit{Bolt Electric, Inc. v. The City of New York}, the Second Circuit reversed the district court’s grant of summary judgment for the City of New York holding that an issue of material fact existed as to the interpretation of language found in a letter of guaranty issued by the New York City Department of Transportation (“City”).\textsuperscript{95} The decision underscores the importance of clarity in guarantee agreements, which are frequently employed to maintain progress on distressed projects.

The issue arose on the project to reconstruct the Eastern Parkway in Brooklyn, New York.\textsuperscript{96} Bolt Electric, Inc. (“Bolt”), a supplier of electrical materials, requested the letter when the general contractor filed a bankruptcy petition.\textsuperscript{97} The letter of guaranty stated that the City “will purchase from Bolt Electric, Inc. all materials ordered specifically for the Eastern Parkway contract.”\textsuperscript{98}

The general contractor continued operations, however, and, after the letter of guaranty was issued, the general contractor issued a purchase order to Bolt for $2,126,746.00.\textsuperscript{99} That same day, the City declared the contractor in default.\textsuperscript{100} Because of the contractor’s default, Bolt did not deliver any of the materials called for by the purchase order.\textsuperscript{101} Thereafter, a completion contractor was selected by the City.\textsuperscript{102} The replacement contractor did not order any electrical supplies from Bolt.\textsuperscript{103} Bolt then sued the City for its failure to follow

\textsuperscript{94} 223 F.3d 146 (2d. Cir. 2000).
\textsuperscript{95} Id. at 150.
\textsuperscript{96} Id. at 147.
\textsuperscript{97} Id. at 147-48.
\textsuperscript{98} Bolt Electric, Inc., 223 F.3d at 150.
\textsuperscript{99} Id. at 148.
\textsuperscript{100} Id.
\textsuperscript{101} Id.
\textsuperscript{102} Bolt Electric, Inc., 223 F.3d at 148.
\textsuperscript{103} Id.
through on the general contractor’s purchase order. The district court granted a motion for summary judgment by the City on the grounds that based on the plain language of the guaranty letter, which stated that the City “will purchase from Bolt Electric, Inc. all materials ordered specifically for the Eastern Parkway contract,” the City promised only to guaranty payment for materials specifically ordered by Bolt to perform the project. Because Bolt did not perform on the disputed purchase order, it did not specifically order materials and the City had no obligation to pay Bolt anything. Bolt appealed, arguing that there was a genuine issue of material fact as to the interpretation of the guaranty letter. Specifically, Bolt argued that the letter required the City to “step in and purchase from Bolt the materials ordered by [the contractor] on the project,” which includes those obligations arising from the purchase order issued after the letter of guaranty.

The Second Circuit held that “reasonable minds differ” as to the interpretation of the operative language of the guaranty. The letter could be read in either manner, and, therefore, summary judgment was inappropriate. Parties to construction projects are frequently confronted with insolvency problems in the midst of projects. Given the high cost of delay in construction, and the procedural impediments to forcing a change of contractors, owners often seek alternative credit arrangements to keep projects going. Guaranty arrangements can assist in reaching that goal. The Bolt Electric case illustrates, however, the risks entailed in setting up arrangements without careful and detailed written understandings.

104. Id.
105. Id.
106. Bolt Electric, Inc., 223 F.3d at 149.
107. Id.
108. Id. (emphasis added).
109. Id. at 150.
110. Bolt Electric, Inc., 223 F.3d at 150.

The next case, *Wright Lining and Construction Co., Inc. v. Tully Construction Co., Inc.*, is one of the few Second Circuit decisions that relates exclusively to construction law. It deals with "deletion" clauses, which are found in most sophisticated construction contracts, especially in public civil work.

Deletion clauses allow owners to eliminate portions of the work called for in the contract, with limited and predictable cost exposure to the owner. The protections these clauses offer to owners come at a cost to contractors. Contractors take significant risks when they bid on jobs where there are economies of scale to the job, and synergies between different parts of the work. When the owner deletes a part of the work, the impact on the contractor may go beyond the price assigned to that item. The case presents an extreme application by the owner of such a clause.

In *Wright Lining and Construction Co., Inc.*, the Second Circuit affirmed the district court's decision to allow the jury to resolve ambiguous contract language. The court held, by summary order, that the deletion clause in question was ambiguous when "applied to the situation where subcontractor's entire performance was eliminated in favor of a substitute subcontractor."

The issue arose on a project to cap a landfill in Southampton, New York. The contract documents called for the installation of a plastic liner made with polyvinyl chloride ("PVC"). The general contractor subcontracted to Wright Lining and Construction the installation of the PVC liner. Thereafter the general contractor persuaded the owner to allow substitution of a different product. When contractor engaged a different subcontractor to install the substituted liner, Wright sued for breach of contract. Wright won a jury verdict.

The general contractor moved for judgment as a matter of law and

112. Id. at *1.
113. Id.
114. Id.
116. Id. at *1.
117. Id.
118. Id.
a new trial on the grounds that its actions were allowed by the deletion clause.\textsuperscript{120} That clause read: “the Subcontractor shall have and make no claim for damages for anticipated profits or for loss of profits... because of the entire omission of any quantities of items stated in the ‘Contractor’s Proposal of the Construction Contract.’”\textsuperscript{121} The general contractor contended that this language was unambiguous and therefore should not have been open to interpretation by the jury.\textsuperscript{122} The district court denied that motion and the contractor appealed.\textsuperscript{123}

The Second Circuit stated that the application of this clause to the instant case where the entire subcontract was eliminated was ambiguous.\textsuperscript{124} In light of that ambiguity, it was proper for the district court to allow the jury to resolve the issue of interpreting that contract clause as question of fact.\textsuperscript{125}

\textbf{D. Suretyship}

The Second Circuit did not issue any decisions in 2000-02 bearing on suretyship issues. There was, however, a decision within the Circuit of consequence to surety law. The decision, issued by the District Court for the Southern District of New York in 2000, is \textit{International Fidelity Insurance Co. v. County of Rockland, SWCF.}\textsuperscript{126}

The case concluded that a performance bond surety is liable to an obligee when a principal delays completion, even though the principal is not terminated by the obligee.\textsuperscript{127} This differs from the usual situation in owner claims against sureties. In the typical case, an owner, or other obligee, terminates the principal contractor, and calls upon the surety to complete the project or otherwise perform its duties under the performance bond. In this case, however, there had been no termination. The court nonetheless found the surety liable for delay damages, stating that “[t]he obligee is not required to formally default and terminate the contractor in order to obtain the surety’s performance of a contractual obligation, the performance of which would have been required by the contractor even in the absence of default and

\begin{thebibliography}{127}
\bibitem{120} \textit{id.}
\bibitem{121} \textit{id.} at *2.
\bibitem{122} \textit{id.}
\bibitem{123} \textit{Wright Lining & Constr. Co., Inc.}, 2001 WL 121863, at *2.
\bibitem{124} \textit{id.}
\bibitem{125} \textit{id.}
\bibitem{126} 98 F. Supp. 2d 400 (S.D.N.Y. 2000).
\bibitem{127} \textit{id.} at 411-40.
\end{thebibliography}
termination."\textsuperscript{128}

The case arose under an unusual setting where there had been two defaults on the project, one followed by another.\textsuperscript{129} The project was a nursing facility owned by Rockland County ("County").\textsuperscript{130} The first contractor defaulted, and its surety, International Fidelity Insurance Co. ("IFIC"), pursuant to an AIA Document A312-1984 Bond (the "Bond"), elected to complete the project with a new contractor,\textsuperscript{131} Hirani Contracting Corporation ("Hirani").\textsuperscript{132} Hirani in turn posted a performance bond (the "Second Bond") in favor of IFIC, issued by Fidelity and Guaranty Insurance Co. ("F&G").\textsuperscript{133} Thus, with respect to the completion work, IFIC stood in the position of an owner, and F&G as the surety obligated to IFIC.

Then Hirani declared bankruptcy and subsequently failed to finish punch list items.\textsuperscript{134} The County then terminated the original performance bond surety, IFIC, for "failure to cure" but permitted IFIC to finish the project through yet a third contractor.\textsuperscript{135} While IFIC was taking these steps, it never terminated Hirani.

The County charged IFIC with liquidated damages.\textsuperscript{136} IFIC brought this lawsuit in response,\textsuperscript{137} and the County counterclaimed for its delay damages.\textsuperscript{138}

Although many issues of state law were raised in this action, the issue most relevant to this Article relates to the liability of Hirani's surety to its obligee, IFIC. IFIC sought to hold F&G liable for Hirani's delays. The legal hurdle for IFIC was that it never defaulted or terminated Hirani. F&G relied on the condition precedent language of the bond, which in Paragraph 3 states that "the Surety's obligation under this Bond shall arise after . . . [t]he Owner has declared a Contractor Default and formally terminated the Contractor's right to complete the contract . . .."\textsuperscript{139}

\textsuperscript{128} Id. at 437.
\textsuperscript{129} Id. at 403.
\textsuperscript{130} Int'l Fid. Ins. Co., 98 F. Supp. 2d at 407.
\textsuperscript{131} Id. at 407, 411.
\textsuperscript{132} Id. at 408.
\textsuperscript{133} Id.
\textsuperscript{134} Int'l Fid. Ins. Co., 98 F. Supp. 2d at 408.
\textsuperscript{135} Id.
\textsuperscript{136} Id.
\textsuperscript{137} Id.
\textsuperscript{138} Int'l Fid. Ins. Co., 98 F. Supp. 2d at 409.
\textsuperscript{139} Id. at 432. Paragraph 4 states: "when the Owner has satisfied the conditions of Paragraph 3, the surety shall promptly and at the Surety's expense take one of the
The court found that hurdle surmountable. The court first noted that F&G's obligation to indemnify IFIC for liquidated damages assessed by the County arising from Hirani's delay came from both the Second Bond and the Completion Contract incorporated by reference into the Second Bond.\textsuperscript{140} That contract stated that "[t]he Completion Contractor [Hirani] agrees that it shall be solely responsible to reimburse the Surety [IFIC] for any liquidated or other damages for delay as may be claimed by the [County] due to the Completion Contractor's failure to complete the Contract within said time period."\textsuperscript{141}

The court then considered whether the termination and notice provisions in Paragraph 3 were a condition precedent to all obligations for which F&G might be liable, or only to those obligations listed in Paragraph 4 of the Second Bond.\textsuperscript{142} The difference was important because Paragraph 4 contained the surety's duties to cure a contractor default, while the court found duties elsewhere in the bond establishing the surety's liability for damages.\textsuperscript{143}

The court concluded that the termination and notice provisions were merely a promise with respect to non-Paragraph 4 obligations.\textsuperscript{144} Applying New York law, the court reasoned that language of the Second Bond "the Surety's obligation under this Bond shall arise after . . ." did not contain the "unmistakable language" required by New York law such as "unless and until" or "condition precedent" to become a condition rather than a promise as to all obligations.\textsuperscript{145}

The court further supported its conclusion by examining Paragraphs 1 and 2 of the Second Bond.\textsuperscript{146} In particular, Paragraph 1 states that "[t]he Contractor [Hirani] and the Surety [F&G], jointly and severally, bind themselves . . . to the Owner [IFIC] for the performance of the Construction Contract."\textsuperscript{147} Paragraph 2 states that "[i]f the

\textsuperscript{140} Id. at 433.
\textsuperscript{141} \textit{Int'l Fid. Ins. Co.}, 98 F. Supp. 2d at 433.
\textsuperscript{142} Id.
\textsuperscript{143} Id.
\textsuperscript{144} Id. at 435.
\textsuperscript{145} \textit{Int'l Fid. Ins. Co.}, 98 F. Supp. 2d at 434-35.
\textsuperscript{146} Id. at 435.
\textsuperscript{147} Id. (paragraph 1 states that F&G binds itself (jointly with Hirani) "for the
Contractor performs the Construction Contract, the Surety and the Contractor shall have no obligation under this Bond . . . .” 148 Because Hirani did not complete the contract, the court concluded that F&G was bound to IFIC for the performance of the contract whether or not IFIC terminated Hirani. 149 The court further reasoned that its decision was consistent with the construction law precept that delay damages are assessed even in the absence of default and termination. 150

Thus, the court found that F&G was liable for delay damages even though IFIC never terminated Hirani: “The obligee is not required to formally default and terminate the contractor in order to obtain the surety’s performance of a contractual obligation, the performance of which would have been required by the contractor even in the absence of default and termination.” 151

If followed by other courts, this holding will be of importance to obligees seeking to enforce claims for liability against a performance bond surety when the obligee has not complied with the notice and termination provisions of the bond. Courts may conclude that the default and termination provisions of a bond are intended in part to protect the surety from claims of tortious interference and from overpaying completion contractors. Courts may conclude that these considerations do not apply to the same extent to a surety’s liability for damages, and may therefore excuse obligees of the termination condition when only money damages are sought from a surety.

E. Insurance

The Second Circuit also decided issues involving claims against general contractors’ commercial general liability insurance carriers.

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148. Id. at 435-36.
150. Id.
151. Id. at 437. The court also stated that its decision is consistent with the risk allocation embodied in the Second Bond in that,

there is no risk that a surety, asked to indemnify the obligee after a judgment against that obligee, may be subjected to any potential legal liability for fulfilling the contractor’s contractual indemnification obligation in the absence of a default, since that obligation (at least in this Completion Contract) was not subject to the default requirement in the first place.

Id. That lack of risk is in contrast to the risk of claims for tortious interference should the surety step-in and complete without contractor termination. Int’l Fid. Ins. Co., 98 F. Supp. 2d at 437.
Those cases apply general doctrines of law, but with specific application to the construction industry.

The most pertinent of those decisions illustrates the rule that a certificate of insurance is incapable of amending an insurance policy. In *Vinco, Inc. v. Royal Insurance Company of America*, 152 a general contractor sued a subcontractor’s liability carrier seeking indemnification as an additional insured for an accident in which the subcontractor’s employee was injured on the construction site. 153 The district court held that the general contractor was not an additional insured under the subcontractor’s policy. 154 The Second Circuit affirmed. 155

The issue arose when an employee of the subcontractor, Hilton Mechanical Contractors, Inc. (“Hilton”), sued the general contractor, Vinco, Inc., for an injury sustained at the site. 156 Vinco, Inc. sought indemnification from Royal Insurance Company of America (“Royal”), arguing that, as is custom in the industry, Vinco was covered as an additional insured under Hilton’s policy. 157 To substantiate its claim, Vinco presented evidence of its status as an additional insured—a certificate of insurance. 158 The certificate was issued by an insurance broker, and in fact, listed Vinco as an additional insured. 159 Though the certificate stated that the broker was Royal’s authorized agent, the district court held that the certificate did not impose actual contractual obligations because Vinco did not establish any such agency relationship. 160 Alternatively, the district court added that even if the broker was Royal’s agent, the issuance of a certificate of insurance was outside the scope of its authority. 161

The Second Circuit agreed, and further emphasized that certificates are not insurance policies; rather, they are only informational documents. 162 The court cautioned against taking certificates as official documents and suggested asking for a policy to ensure the certificate is

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152. No. 01-7411, 2002 WL 337988, at *1 (2d Cir. Mar. 4, 2002).
153. Id.
154. Id.
155. Id. at *2.
157. Id.
158. Id.
159. Id.
161. Id.
162. Id. at *2.
Acceptance of certificates of insurance in the industry is very common. Yet this case demonstrates that this practice is insufficient to provide a party with assurance that insurance is in place. Any party desiring such assurance must go a further step to require a copy of the insurance policy itself, to be assured of coverage promised in a certificate of insurance.

A second decision involving a commercial general liability insurance policy highlights the critical issue of whether an insurer must show prejudice to disclaim coverage for an insured when the insured fails to give timely notice of suit. In *Booking v. General Star Management*, the Second Circuit reversed the decision of the United States District Court for the Northern District of New York which granted summary judgment for the insurer. The Second Circuit held that district court erroneously applied New York’s “no-prejudice” rule where Texas law, requiring a showing of prejudice for defective notice, should have governed.

Commercial general liability policies require several specific obligations of the insured. Among those is the duty to give timely notice of suit, without which an insurer can disclaim coverage. Depending on the jurisdiction, an insurer’s ability to disclaim coverage could hinge on the insurer’s showing of prejudice regarding the defective notice. And, as demonstrated by *Booking*, the consequence of failing to comply with a policy’s notice provision varies by state.

### F. Pre-qualification of Bidders

In *John Gil Construction, Inc. v. Riverso*, the Second Circuit, by summary order, affirmed a final judgment of the United States

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163. *Id.*
165. *Id.* at 415.
166. *Id.* at 423.
167. No. 00-7603, 2001 WL 363509, at *1 (2d Cir. Apr. 12, 2001).
168. The court’s decision is by summary order and therefore unpublished. Pursuant to section 0.23 of the United States Court of Appeals for the Second Circuit, Rules Relating to the Organization of the Court, the decision was unanimous and “each judge of the panel believe[d] no jurisprudential purpose would be served by a written opinion.” *Appeals To The Second Circuit, § 0.23 (7th ed. 1993).* Summary order decisions are not to be cited in unrelated cases before any other court. *Id.* Although, some practitioners, thinking such rules to be unconstitutional cite to unpublished opinions contrary to the Second Circuit’s rule, such a practice has its risks. *See Thomas*
District Court for the Southern District of New York and held that a contractor has no cognizable property interest in its prequalified-bidder status conferred by the New York City School Construction Authority (the "SCA"). In so holding, the court rejected the contractor’s claims that the defendants violated its right to procedural due process.

The issue arose from the following facts. In August 1995, John Gil Construction, Inc. ("JGC") applied for, and was granted, prequalified-bidder status by the SCA. Such status is necessary for a contractor to enter into a contract for school construction in New York City. Approximately one year later, a different city agency, New York City Off-Track Betting Corporation ("OTB") awarded JGC a construction contract for non-school construction. Billing irregularities in JGC’s contract with OTB, however, prompted a criminal investigation of JGC by the Inspector General for OTB and the Department of Investigation for the City of New York ("DOI"), ultimately resulting in its conviction on twelve counts of fraud.

At some point prior to JGC’s conviction, the SCA was informed of the pending investigation. Upon that notice, the SCA notified JGC that it might suspend JGC’s prequalified-bidder status, which it did on June 1, 1999, not having received a satisfactory explanation as to reasons for

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169. John Gil Constr., Inc., 2001 WL 363509, at *1. The court also held that the contractor failed to demonstrate "any violation of a liberty interest sufficient to support a due process claim." Id. Procedurally, the Second Circuit affirmed the trial court’s granting of the defendants’ motion to dismiss pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure. John Gil Constr., Inc. v. Riverso, No. 99 Civ. 6112, Opinion and Order at 2 (S.D.N.Y Apr. 6, 2000). Because the plaintiff had amended its complaint three times, and each time failed to successfully state a cognizable property interest or sufficient violation of a liberty interest, the trial court dismissed the complaint without leave to amend. Id. at 27-28.


171. John Gil Constr., Inc., Opinion and Order at 4. By virtue of the decision by summary order and the scant discussion in the Second Circuit’s opinion, it appears that the court views its reasoning as trite. Accordingly, it is necessary to turn to the trial court decision for analysis of the issues.

172. Id. at 5.

173. See N.Y. PUB. AUTH. LAW § 1734(3) (McKinney 1999).


175. Id. at 5.

176. Id. at 5.

the investigation. JGC challenged the SCA’s decision under 42 U.S.C. § 1983 as a deprivation of property without due process. The district court rejected JGC’s contention, and the Second Circuit agreed.

The crux of both courts’ analysis turned on finding that JGC had no property interest in its prequalified bidder status and that its liberty interest in its good name and reputation was not damaged by the state actors. “To have a protected property interest, ‘a person clearly must have more than an abstract need or desire for it. He must have more than a unilateral expectation of it. He must, instead, have a legitimate claim of entitlement to it.’” Furthermore, in the case where a statute and regulation “vests in the state significant discretion over the continued conferral of a benefit, it will be the rare case that the recipient will be able to establish an entitlement to that benefit.” The district court found sufficient discretion in the statues and regulations to determine that contractors do not have a property interest in prequalification status conferred by the SCA. The Second Circuit agreed.

Recently, various construction industry groups have lobbied to pass prequalified-bidder legislation for public projects in the State of Connecticut. One lesson public owners may draw from John Gil Constr., Inc., Opinion and Order at 6.

179. Id. at 1. JGC also attempted to have its suspension revoked and two contracts, for which it alleged to be the lowest bidder, awarded to it by the SCA. See John Gil Constr., Inc. v. Riverso, 72 F. Supp. 2d 242, 248 (S.D.N.Y. 1999). JGC alleged that it would suffer irreparable harm because the SCA was required to report the revocation to the Vendor Information Exchange System (“VENDEX”). Id. at 250. The consequence of which would preclude JGC from receiving award of any contract from any city agency. Id. at 250. Because one-hundred percent of JGC’s revenue was from public contracts, the company’s losses would be irreparable. Id. at 251 n.6. Although the court agreed with the potential of irreparable harm, for reasons stated in this Article, the court found that JGC could not prevail on the merits, and therefore denied JGC’s application. John Gil Constr., Inc., 72 F. Supp. 2d at 254, 256.
182. John Gil Constr., Inc., 72 F. Supp. 2d at 251 (quoting Bd. of Regents of State Colleges v. Roth, 408 U.S. 564, 577 (1972)).
183. Id. at 252 (citing Kelly Kare, Ltd. v. O’Rourke, 930 F.2d 170, 175 (2d Cir. 1991)).
184. Id. at 252.
Construction, Inc. is to leave sufficient discretion with the qualifying body so that companies may make no claims to entitlement to its status as a pre-qualified bidder.

III. CONCLUSION

As may be discerned from the variety of disputes before the Second Circuit, many areas of law govern construction claims. These past three years saw disputes that turned on the rules of contract, due process, insurance, surety, tort and warranty. Some were exclusive to the construction industry; others were general rules applied in a specific manner unique to construction. As such, construction lawyers must maintain a high degree of proficiency in many areas of law. This also demonstrates that advocates will benefit from creativity in finding doctrines from other fields to apply to their cases.