

T.A.D.C. Construction Law Newsletter

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**Update on Cases Impacting Construction
Litigation**

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LAN/STV, A Joint Venture of Lockwood, Andrews & Newman, Inc. and STV Incorporated v. Martin K. Eby Construction Company, Inc., 2014 Tex. LEXIS 509 (Tex., June 20, 2014).

The Texas Supreme Court has issued an opinion enforcing the “Economic Loss Rule” to prevent general contractors from recovery damages for delay from design professionals not in direct privity with the contractor.

LAN/STV contracted with the Dallas Area Rapid Transit Authority (DART) to provide design plans and specifications for a light rail line in Dallas. Separately, DART contracted with Martin K. Eby Construction Company (Eby) to construct the light rail line. There were no contracts between Eby and LAN/STV. Very shortly after construction commenced, Eby “discovered” that the plans had numerous errors and asserted that 80% of the construction drawings required revisions and modifications. Eby contended that it lost \$14,000,000.00 on the project.

In a separate action, Eby sued DART for breach of contract which was dismissed for failure to exhaust administrative remedies. During that proceeding, the hearing officer dismissed Eby’s claim in its entirety and held that DART was entitled to

liquidated damages from Eby. The matter was settled while the administrative appeal was pending. Eby, separately, filed suit against LAN/STV for negligence and negligent misrepresentation. By the time the case was tried, only the negligent misrepresentation cause of action was prosecuted. The jury found fault on the part of LAN/STV (45%), DART (40%) and Eby (15%). The trial court rendered judgment and both parties appealed.

In its opinion, the Texas Supreme Court only reviewed the point raised by LAN/STV that claims for negligent misrepresentation were barred by the “Economic Loss Rule”. The Court did a lengthy and detailed analysis of the economic loss rule, including an analysis of the Restatement (Third) of Torts: Liability for Economic Harm. The Court noted that the Restatement concludes, in general, that ‘there is no liability in tort for economic loss caused by negligence in the performance or negotiation of a contract between the parties,’ citing Restatement, (Third) §3. Justice Hecht wrote that this case was the first in which the court analyzed the application of the “Economic Loss Rule” to contractual strangers. The Court acknowledged that Texas had previously recognized an exception for the recovery of purely economic losses in connection with the negligent performance of services in professional malpractice cases. The Court cited several cases involving legal malpractice claims, accounting malpractice and even discussed negligence claims against architects (although the citation relates to Chapter 150 of the Texas Civil Practice & Remedies Code – Certificate of Merit). The Court reiterated its previous recognition of the negligent misrepresentation cause of action set out in Section 552 of the Restatement (Second) of Torts and applied that in the legal

malpractice case of *McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests*, 991 S.W.2d 787 (Tex. 1999). Eby attempted to cite *McCamish* and other cases to say that the economic loss rule should not bar recovery against LAN/STV.

The Court noted that negligent performance of services and negligent misrepresentation are “both torts...based on the same logic” with similar “general theor[ies] of liability.” The Court noted that the “Economic Loss Rule” should not apply differently to the different tort theories. In agreeing that an architect’s plans are “intended to serve as a basis for reliance by the contractor, the Court stated that ‘the contractor’s principal reliance must be on the presentation of the plans by the owner, with whom the contractor is to reach an agreement, not the architect, a contractual stranger. The architect is liable to the owner for deficient plans. Therefore, the Court concluded that the general contractor had no direct cause of action against the architect retained separately by the owner for economic losses caused by allegedly defective plans.

This case, along with the *Black + Vernooey v. Smith*, 346 S.W.3d (877 (Tex. App. – Austin, 2011, pet. denied) seems to indicate the Texas Supreme Court’s determined refusal to expand the duties of design professionals beyond parties with whom they are in direct contractual privity. In assisting clients in contract drafting, one must be mindful to avoid expanding contract rights to third party beneficiary so that no such rights or causes of action are created in favor of a general contractor or any subcontractor. In Texas, to the extent that a contractor has delay claims based upon negligently prepared plans and specifications AND the contractor is a contractual stranger to the design

professional, the cause of action must be brought against the owner who must then determine whether or not an independent claim should be brought against the design professional.

Zachry Construction Corp v. Port of Houston Authority of Harris County, Texas, Case No. 12-0772 (Texas Supreme Court, August 29, 2014).

In this closely watched opinion, the Texas Supreme Court took up the question of whether a “no damages for delay” provision of a contract shields an owner from liability for deliberately and wrongfully interfering with a contractor’s work on a construction project. In what was a case of first impression for the court, the Texas Supreme Court answered “No”.

Zachry Construction Corporation contracted to construct a wharf on the Bayport Ship Channel for the Port of Houston Authority. The contract included a provision that recited:

“[Zachry] shall receive no financial compensation for delay or hindrance to the work. In no event shall the Port Authority be liable to [Zachry] or any subcontractor or supplier, any other person or any surety for or any employee or agent of any of them, for any damages arising out of or associated with any delay or hindrance to the work, regardless of the source of the delay or hindrance, including events of force majeure, AND EVEN IF SUCH DELAY OR HINDRANCE RESULTS FROM, ARISES OUT OF OR IS DUE, IN WHOLE OR IN PART, TO

THE NEGLIGENCE BREACH OF CONTRACT OR OTHER FAULT OF THE PORT AUTHORITY. [Zachry's] sole remedy in any case shall be an extension of time."

At the conclusion of the project, the parties ended up in litigation, with Zachry claiming \$30 million from delays caused by the Port, and the Port of Houston withholding \$2.36 million in delay damages from Zachry.

After a three month trial, the jury found that the Port breached the contract by rejecting alternative designs, causing Zachry to incur \$18,602,697 in delay damages. The jury also found that the delay "was a result of the Port's ... arbitrary and capricious conduct, active interference, bad faith and/or fraud." On appeal of this verdict, the Court of Appeals held that the "no delay damages" provision of the contract barred Zachry's recovery of delay damages. To add "insult to injury", the court awarded the Port \$10,697,750 in attorney's fees. The Supreme Court granted Petition for Review and issued a lengthy opinion, which was written by Justice Hecht and joined by four other justices, with four justices dissenting. Justice Hecht's opinion first addressed the issue of whether the Port of Houston's sovereign immunity barred Zachry's claim. The opinion concluded that the Local Government Contract Claims Act waived immunity for a contract claim for delay damages, even if those damages are not expressly provided for in the contract. The majority opinion then turned to whether Zachry's claim was barred by the "No Damages for Delay Provision" of the contract. The court determined that since the jury found that it was the Port's arbitrary and capricious acts which caused the delay, enforcing such a provision to allow one party to intentionally injure another with

impunity would violate public policy. Accordingly, the court ruled that the "No Damages for Delay Provision" could not be enforced to waive Zachry's damages as found by the jury in this case. This opinion, therefore, places Texas squarely within the majority of other jurisdictions in recognizing exceptions to the enforcement of "No Damages for Delay" clauses.

Chapman Custom Homes, Inc., et al v. Dallas Plumbing Company, __ S.W.3d __, 2014 Tex. LEXIS 690 (2014).

The Texas Supreme Court recently determined that the "Economic Loss Rule" does not necessarily bar a claim by a building owner against a subcontractor who participated in original construction. Specifically, the plaintiff homeowner had contracted with a homebuilder to construct a new residential structure. The plumbing work on the home was subcontracted to the eventual defendant, Dallas Plumbing Company. After the home was completed, plumbing leaks resulted, causing extensive damage to the home. Both the builder and homeowner sued the plumber for the resulting damage, alleging theories of Breach of Contract, Breach of Express Warranty, and Negligence. The trial court granted summary judgment to the plumber prior to trial. The Dallas Court of Appeals affirmed the trial court's ruling, reasoning that the homeowner could not recover contract damages because it was a not a party to the builder's subcontract with the plumber. Likewise, the appellate court concluded that the trial court had not erred in granting summary judgment as to plaintiff's negligence claims, because the pleadings only asserted breach of duties assumed in the plumbing subcontract.

On Petition for Review of both the builder and the homeowner, the Supreme Court granted the Petition, and without hearing oral argument, reversed the Court of Appeals judgment and remanded the case to the trial court. In doing so, the Texas Supreme Court criticized the Court of Appeals' analysis of the "Economic Loss Rule". Specifically, because the plaintiffs' pleadings claimed that the plumber's negligent failure to properly join the water system to the hot water heaters (the specific plumbing defect at issue) was a proximate and foreseeable cause of the water damage to the new house, the allegations did not merely assert the breach of the plumber's contractual duties.

It pointed out longstanding Texas precedent which asserts that a common law duty to perform with care and skill accompanies every contract, and if the failure to meet this implied standard provides a basis for recovery in tort, contract or both under appropriate circumstances. See *Coulson v. Lake LBJ Municipal Utility District*, 734 S.W.2d 649, 651 (Tex. 1987). In the instant case, having undertaken to install a plumbing system in the house, the plumber assumed an implied duty not to flood or otherwise damage the homeowner's house while performing its contract with the builder.

The Supreme Court went on to say that the "Economic Loss Rule" does not bar all tort claims arising out of a contractual setting. A party states a tort claim when the duty allegedly breached is independent of the contractual undertaking and the harm suffered is not merely the economic loss of a contractual benefit. For example, the plumber's duty not to flood or otherwise damage the house is independent of any obligation undertaken in its plumbing subcontract with the builder. Moreover, the

damages allegedly caused by the breach of that duty extend beyond the economic loss of any anticipated benefit under the plumbing contract. As a result, the summary judgment was improperly granted and improperly affirmed by the lower courts. In construction defect litigation, one can anticipate that this case will provide ammunition to those building owners who seek to sue the general contractor's subcontractors as direct defendants, as opposed to relying on the general contractor to join those subcontractors via third-party practice.