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OTHER CONSTRUCTIVE THOUGHTS**CONSTRUCTION GROUP**

A PUBLICATION OF THE ALSTON & BIRD CONSTRUCTION GROUP

NEW CONSTRUCTION**YOU THOUGHT YOUR MOU WAS A CONTRACT? GUESS AGAIN!****THE CASE OF *STEVENS & WILKINSON OF SOUTH CAROLINA V. CITY OF COLUMBIA***

On August 20, 2014, the South Carolina Supreme Court ruled a city's Memorandum of Understanding with a development team did not constitute an enforceable contract, leaving the development team without rights to develop the property or recover over \$1 million spent on pre-development services. The decision came notwithstanding the negotiation of a detailed Memorandum of Understanding (MOU) that included corresponding obligations, the approval of public financing for the development, the creation of architectural plans for the project and the approval of a guaranteed maximum price (GMP) for construction of the project. The consequence of the decision was that the city was allowed to bring in a new developer under a new deal at a substantial cost savings.

In reaching its decision in *Stevens & Wilkinson of South Carolina, Inc. v. City of Columbia*, Appellate Case No. 2012-208490, Opinion No. 27434, (August 20, 2014), the state supreme court overruled a court of appeals decision reversing a trial court's summary judgment ruling finding that the MOU did not constitute a contract and the city had not been unjustly enriched.

Facts

In 2001, the City of Columbia, South Carolina, issued a Request for Qualifications relating to the development of a hotel property intended to service the city's neighboring convention center. Proposals were submitted and in December 2002, a development team made up of three developers, a designer, Turner Construction and underwriter Salomon Smith Barney were selected for the project, which was to be publicly funded by \$60 million in municipal bonds.

In April 2003, the city and development team entered into a detailed MOU that provided that the city would acquire the property and form a not for profit entity to own the hotel and issue bonds to finance the development of the property. In consideration of these obligations, the development team was required to coordinate the design, development, construction and delivery of the hotel. As part of the development team's pre-development services, the architect would develop preliminary plans for the project to enable the city to determine whether bond financing was feasible.

The MOU provided that if the city determined it was not feasible to finance the project, it could cancel the project and the development team would not be entitled to reimbursement for any of its pre-development services. If the financing was feasible, the MOU provided that the parties would enter into additional agreements, including a development management agreement, to memorialize the specific terms of the deal. It also provided that if the city breached the terms of the development agreement or there was a catastrophic event that prevented the development, the development team would be reimbursed for its pre-development costs.

Over the course of the next year, the architect developed preliminary plans for the project at a cost of \$1.2 million, which resulted in the establishment of a city-approved GMP for project construction. In March 2004, the city approved a \$71 million financing plan and was scheduled to issue bonds on April 1, 2014. However, before the bonds were issued, a third-party developer approached the city with a plan that would allow for a privately financed hotel project at a fraction of the publicly financed cost. The city elected to abandon its publicly funded project (and the development team) and go forward with the alternative development. Notwithstanding the city's about face, it never made a finding that the public financing was unfeasible. Apparently, it just liked the privately financed project better.



Summary of Decisions Below

The development team filed suit against the city asserting claims for breach of contract, quantum meruit and unjust enrichment. Pursuant to the city's motion for summary judgment, the trial court dismissed all of the claims. That decision was reversed in part by the state court of appeals¹ which found that, based on the language of the MOU and parol evidence, there was a triable issue of fact as to whether there was a contract and that the lower court erred in finding that there was no material issue of fact on the quantum meruit claim because the court of appeals was not able to determine that the city had not benefited from the architect's development of project plans.²

The Supreme Court's Decision

With respect to the breach of contract claim, the state supreme court ruled that plaintiffs could not prevail as a matter of law because the MOU did not constitute an enforceable contract. It noted that the MOU contemplated that a series of agreements between the parties would have to be negotiated in the future, and because the terms of those key agreements were not known, the court was not in a position to enforce contract terms that did not exist.

In reaching this conclusion, it rejected the court of appeals finding that specific "valid consideration" language contained in the MOU³ and the parties' performance of several of the steps provided for in the MOU constituted evidence of the parties' mutual intent that the MOU was a binding contract. The supreme court ruled that because the MOU's language on its face required a finding that the MOU was a nonbinding agreement to agree in the future, parol evidence was not relevant.⁴ It also cited to authorities, including *Corbin on Contracts*, that instructed that the parties' intent is not controlling as to whether a contract exists or not. The court's ruling that the MOU on its face was not a contract cut off any argument by the plaintiffs that the city owed the plaintiffs a duty of good faith and fair dealing to follow through on the contract.

What was not discussed in the opinion, and perhaps was not argued for strategic reasons by the plaintiffs,⁵ was that at least one portion of the MOU constituted a severable contract. That is, it appears that an argument could have been made that specific provisions existed in the MOU defining the plaintiffs' right to be reimbursed for its pre-development services, unless the city determined that the public financing was unfeasible.

To add insult to injury from the development team's perspective, perhaps more troubling was the supreme court's finding that there was not sufficient evidence to avoid summary judgment on the quantum meruit claim. The facts showed that the city provided the preliminary design developed by the development team to the subsequent private developer and that the city manager acknowledged that the ultimate hotel development configuration closely resembled the development team's conceptual design. Notwithstanding that this was a review of a summary judgment ruling, "where all inferences are to be made in favor of the non-moving party," the court noted that there was no evidence that the new developer actually used this design information and concluded that the "mere scintilla" of evidence offered by the plaintiffs was not enough to defeat summary judgment.

Lessons to Be Learned from *Stevens & Wilkinson*

The facts presented in the court of appeals and supreme court opinions clearly establish that the parties believed that they had entered into some kind of binding contract. This conclusion is clear based upon both the "valid consideration" provision and the absence of language typically seen in "agreements to agree" providing that "the parties acknowledge and agree that this is not a binding contract."


¹ The court of appeals upheld the dismissal of the unjust enrichment claim, finding that a required element of such a claim—an unqualified commitment to pay—did not exist.

² The court of appeals decision *Stevens & Wilkinson of South Carolina v. City of Columbia*, (Ct. App. Opinion 4914, November 30, 2011)

³ The specific "valid consideration" language was: "In consideration of the foregoing, and the mutual promises contained herein, and other valuable consideration, the sufficiency and receipt of which is hereby acknowledged, the parties agree as follows. . . ."

⁴ The court dismissed the significance of the "valid consideration" language in the MOU, referring to it as "boilerplate." This conclusion is open to considerable debate; in practice, the inclusion of such language in an MOU is very unusual and clearly signaled the parties' intent to be bound.

⁵ Under its breach of contract claim, the development team argued that the city was not entitled to cancel the MOU, rather than just arguing that it was entitled to be reimbursed the \$1.2 million that had been spent on the pre-development services.



Additionally, the parties clearly had taken several steps in conformance with the MOU to achieve the key result—the issuance of the bonds—that would allow the project to go forward. However, the court’s focus on the lack of an agreed upon development agreement was critical to its decision. Development agreements are not boilerplate contracts but rather contracts that are unique in each instance. The court clearly felt hamstrung to make up the terms of that agreement.⁶

Hindsight is always 20/20, but perhaps the plaintiffs could have fashioned the MOU to divide the scope of work into a series of phases with separate consideration for each phase. That way, if there is a “no-go” decision by the public entity at any point, the developer would at least be in a position to be reimbursed for services provided.

At the end of the day, notwithstanding the contracting parties’ intent, if a contract defers agreement of material terms to the future without providing any kind of definition of those terms, a party stands a good chance of having what it believes to be a binding contract ruled unenforceable.

UNDER CONSTRUCTION

NO CLAIMS FOR THE UNLICENSED CONTRACTOR

In a recent federal court decision, the U.S. Court of Appeals for the Ninth Circuit considered whether *unlicensed* contractors are prohibited from bringing construction related legal claims against others and whether they are prohibited from asserting certain counterclaims in the event they are sued. The case arose after an Oregon law was passed in 2005 that allowed only contractors with valid licenses from the state’s Construction Contractors Board to commence breach of contract claims with the board, in arbitration or in any court. When the law was amended in 2007, new language was added to make clear that a “claim” meant not just an insurance claim, but any lawsuit, specifically a “court action.” The legislation was heavily backed by the state’s Construction Contractors Board. Coincidentally, by 2013, the law was revised back to the original language that only prohibited the unlicensed contractor from commencing a “claim” (not a “court action”) for construction work.

In April 2009, before the original language in the law was restored, an unlicensed contractor challenged the state law to clarify the legal rights of unlicensed contractors. The unlicensed contractor had entered into a subcontract, under which the unlicensed contractor agreed to fabricate and install certain equipment to build and supply a biological wastewater treatment unit and an aeration diffuser system. At the time of the subcontract agreement, the unlicensed contractor had made the general contractor aware that it did not have an official license from the state’s Construction Contractors Board; however, the subcontract was executed. At some point during the project, the general contractor terminated the subcontract agreement. Shortly thereafter, the general contractor sued the unlicensed contractor, alleging breach of contract, failure to timely and diligently perform the subcontracted services and failure to provide certain equipment and cure certain defaults. The unlicensed contractor counterclaimed for money owed.

To resolve the matter, the federal court relied heavily on both the text and the purpose of the revised unlicensed contractor law. What did “court action” mean? Did replacing the term “claim” with “court action” limit the remedies for unlicensed contractors? Could unlicensed contractors assert a breach of *counterclaim* if they found themselves in a lawsuit? The federal court found that because the state law’s intent was to deter unlicensed contractors from performing construction work by denying them the ability to pursue *all* claims for compensation of their work, it would be absurd to allow unlicensed contractors to recover damages when they are sued but not when they file a complaint seeking damages. Because the contractor was not licensed by the board during the time it was sued nor, importantly, at the time it filed its counterclaim, it could not recover for any damages based on its counterclaims. The court’s opinion did not go so far as to specify whether, under the 2013 revisions, unlicensed contractors would now be able to assert counterclaims.

Cases like this evidence why contractors should familiarize themselves with the laws of the state where they are performing construction work and be sure to be in full compliance with licensing requirements. Contractors that fail to have valid licenses may bar their own recovery of potential damages. Meanwhile, owners and general contractors should gain the same familiarity with licensing requirements and, by doing so, may quickly put themselves in a superior legal position in the event they discover that an unlicensed contractor has damaged a project.

Steller J Corp. v. Smith & Loveless, Inc., Case No. 12-35780, 2014 WL 2884556 (9th Cir. June 26, 2014).

⁶ We do not know the extent to which the parties had negotiated the terms of the development management agreement that was contemplated to be signed on the date of the issuance of the municipal bonds, i.e., just before the city’s decision to abandon the publicly financed project.



EVEN WITHOUT AN AGREED PRICE, AN ANTICIPATED CONTRACT AMOUNT CAN BE DETERMINED

When a contractor orally agrees to renovate a house but fails to reach an agreed upon price, what happens if the contractor is replaced and goes unpaid? Further, what if the homeowner asserts both a breach of contract claim and a negligence claim against the contractor? Can she recover damages for both claims? In a recent Tennessee case, a state court submitted the issues to a jury, and the jury found that both the contractor and the homeowner were at fault. Based on a treble damages clause under state law, the homeowner was entitled to multiplied damages for the contractor's negligence, so she was able to have her liability offset and recover from the contractor.

The case arose after a homeowner secured the contractor to perform and oversee renovations and home repairs, including painting, carpentry, plumbing, kitchen remodeling, electrical work, ceiling repair, floor refinishing, tiling and carpet removal. The parties reached an oral agreement for the services in August 2011, but by October 2011, the homeowner informed the contractor that his services were no longer needed. In a quick about-face four days later, the homeowner allowed the contractor to finish the services. However, by that time, the contractor had found other work and was unsatisfied that he had not been paid by the homeowner on his latest invoice. The homeowner found a replacement contractor.

In January 2012, the contractor sued the homeowner for breach of contract and failure to pay for services and later added an unjust enrichment claim. The homeowner counterclaimed for breach of contract, negligence and misrepresentation of the costs that were being claimed by the contractor. The homeowner sought treble damages under state law. During the two-day trial, a jury examined the scope of services and found that, although no agreed upon price was reached by the contractor and the homeowner, the scope of work and invoices justified a finding that the anticipated contract was for more than \$3,000; therefore, the homeowner could get treble damages under state law. Additionally, the jury found that the homeowner *had* breached the contract but also that the contractor had performed work negligently though had not misrepresented his claimed costs. On balance and because of the multiplied damages, the homeowner came out on top. The contractor appealed the jury's verdict.

The state court of appeals honored the jury verdict and explained that the testimony and evidence in the record, including invoices, were enough for the jury to determine the amount of the contract even though the agreement was an oral contract. The state court of appeals also explained that because breach of contract and negligence claims require different showings of evidence, it was possible for the homeowner to have been liable even while the contractor was liable. The lack of a written agreement and informality of the pleadings justified deference to the jury's verdict.

Time and again, oral agreements like these can lead to disagreements during a project and legal conflicts when projects are completed. The more parties can write out their understandings and specific agreements in the beginning, the more the parties may be able to predict—and limit—their exposure down the road, especially when both act to cause each other injury.


Boyd v. Wachtler, Case No. M2013-01545-COA-R3-CV, 2014 WL 2957256 (Tn. Ct. App. June 26, 2014).

SUBCONTRACTOR LIMITS ON BRINGING CLAIMS AGAINST THE GOVERNMENT

The general rule is that a subcontractor cannot bring a claim against the government unless it has contractual privity with the government or is an intentional third-party beneficiary of an agreement. However, subcontractors can typically bring claims against the government if a prime contractor brings the suit on behalf of the subcontractor as a pass-through or sponsored claim. The following case demonstrates the importance for a subcontractor to determine early on what parties it may potentially file a claim against and if it will be able to bring the claim against the government.

A design builder was selected by the United States Army Corps of Engineers to design and construct family housing in Alabama. The design builder entered into a subcontract with a subcontractor to complete the electrical work on the project, but the design builder eventually defaulted on its contract with the Corps and its surety took over the work. The surety hired another contractor to complete the project. The surety executed two agreements with the subcontractor. The first assigned its subcontract to the contractor and the other released the surety from any claims the subcontractor had against it.

The subcontractor completed its work and claimed it was never fully compensated for various change orders. The surety ended up filing a claim for an equitable adjustment with the government, and the government settled the claim with the surety. The subcontractor subsequently sent a claim to the surety seeking payments of over \$500,000. The surety responded by stating the majority of the amounts due had been paid, leaving a balance of only approximately \$1,000. The subcontractor met with the Corps' contracting officer to try to resolve the payment



issues. The contracting officer informed the subcontractor it had no authority to help the subcontractor recover the payments and that the Miller Act was the appropriate remedy for nonpayment by the surety.

The subcontractor then filed a request for help from the Army Services Board of Contract Appeals, which determined it lacked subject matter jurisdiction because the subcontractor was not a contractor as required by the Contracts Dispute Act (CDA). The subcontractor eventually filed suit in the United States Court of Federal Claims seeking monetary relief from the government under the subcontract. The government filed a motion to dismiss, arguing the court lacked subject matter jurisdiction over the contract claims.

The government argued the subcontractor lacked privity of contract and could not bring a claim under the CDA, also asserting the court had no ability to exercise jurisdiction over the claim. The subcontractor conceded it lacked privity of contract with the government, but argued that absent privity a subcontractor may bring claims against the government if the prime contractor brings suit on behalf of the subcontractor as a pass-through or sponsored claim. The subcontractor argued the surety's settlement with the government constituted a pass-through claim that entitled it to a portion of the settlement proceeds. However, the surety was not a party to the suit filed in the federal claims court, and it maintained it was not liable to the subcontractor for the damages it sought, both of which were required for a valid pass-through claim. The court granted the government's motion to dismiss for lack of subject matter jurisdiction because the subcontractor lacked privity of contract with the government and there was not a valid pass-through or sponsored claim.

Montano Elec. Contr. v. United States, 114 Fed. Cl. 675, 2014 U.S. Claims LEXIS 105 (Feb. 20, 2014).

AN ARBITRATOR MAY IMPERMISSIBLY EXCEED ITS POWER IF IT AWARDS DAMAGES FOR A THEORY NOT CLAIMED IN THE ARBITRATION

A general contractor and subcontractor entered into an Engineering, Procurement and Construction Agreement containing an arbitration clause that provided for arbitration in the event of a dispute. The agreement also contained a clause that provided that the contractor and subcontractor would share responsibility for cost overruns except in the event of gross negligence. Further, the agreement capped liability at \$22,043,302, subject to a gross negligence exception.

The contractor sued the subcontractor and alleged gross negligence, claiming that as a result of the gross negligence, the project cost rose from \$272 million to \$415 million. Additionally, the contractor sought consequential damages and damages for various cost overruns. After the parties entered arbitration, the subcontractor moved to dismiss the contractor's claim. The subcontractor argued that the claims were not arbitrable because the contractor's claims could not form the basis of a gross negligence claim and, therefore, the general contractor had no actual claim to arbitrate. The arbitrator denied the motion and determined that the allegations made by the contractor were sufficient to show that, if proven, they could form the basis for a gross negligence action.

Following the arbitration hearing, the arbitrator stated that the contractor lost its gross negligence claim but still awarded it \$22,043,032 in cost overruns. The subcontractor appealed, arguing that the arbitration award should have been vacated because the arbitrator exceeded his power, successfully arguing that the arbitrator ruled on an issue that was not presented before him. The gross negligence was the only claim that the contractor presented at the hearing. The arbitrator denied the gross negligence claim, but still ended up awarding the contractor cost overrun damages. The court held that, under the Federal Arbitration Act, the arbitration award was vacated because the arbitrator exceeded his powers, stating the contractor should not have been awarded cost overrun damages because the arbitrator rejected its only claim.

Arbitration provisions sometimes exclude the ability to file an arbitration demand for various claims. For example, fraud based causes of action are routinely excluded from the arbitration provision and must be brought in court rather than in the arbitration proceeding. As a result, when drafting pleadings and argument for arbitrations, it is crucial to review the arbitration provision to make sure the claims being sought are allowed to be adjudicated through the arbitration hearing. As this case demonstrates, not only is it important to make sure the arbitration allows for the claim to be made, but that the theory of liability in which damages are being sought is properly pleaded and argued at the hearing.

Matter of Colorado Energy Mgt., LLC v. Lea Power Partners, LLC, 114 A.D.3d 561, 981 N.Y.S.2d 44, 2014 N.Y. App. Div. LEXIS 1224, 2014 NY Slip Op 1253 (1st Dep't Feb. 20, 2014).

The background of the page features a blue-tinted architectural drawing. It includes various geometric shapes, lines, and numbers such as 13, 130, 120, and 1. There are also some circular and rectangular outlines, possibly representing building components or site plans.

OTHER CONSTRUCTIVE THOUGHTS

Jeff Belkin, Kevin Collins, Bill Hughes, Chris Roux and John Spangler were all selected for the 2015 *The Best Lawyers in America* list.

Jeff Belkin, Andy Howard and Jessica Sharron successfully defended two technology companies in a False Claims Act (FCA) case arising out of the companies' participation in the federal E-Rate Program, a program that provides financial assistance to low-income schools and libraries for telecommunications services and upgrades. After the district court ruled that the FCA applied to the E-Rate Program, the defendants appealed to the U.S. Court of Appeals for the Fifth Circuit, which reversed, concluding that the FCA does not apply to E-Rate because the funds are not provided by the government and the entity that administers the program is not the government or an agent of the government. In light of the appellate court's decision, on remand the district court was forced to dismiss the case in its entirety with prejudice.

On July 22, 2014, Andy Howard spoke on a panel about the 2014 AIA Design-Build contract documents. The program was co-sponsored by the AIA and the ABA Forum on the Construction Industry.

On October 8, 2014, Jeff Belkin will be part of a panel presenting a seminar on Bid Protests and Procurement in connection with an all-day program titled "Government Law" given by The Seminar Group at the Cobb Galleria Centre in Atlanta.



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