

CONSTRUCTION LEGAL EDGE

SUMMER 2015

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PARTING IS SUCH SWEET SORROW: PENNSYLVANIA BIDS FAREWELL TO THE GIST OF THE ACTION DOCTRINE, AND FURTHER OPENS THE DOOR TO INSURANCE COVERAGE FOR CONSTRUCTION LOSSES

Traditionally, contractors, design professionals, and insurers doing business in Pennsylvania have enjoyed some certainty that the contracts defining their relationships with their clients would also define their potential liability. Pennsylvania's "gist of the action" doctrine had long been applied by the courts to dismiss tort claims like claims for negligence, when the "gist" of the plaintiff's claims actually relate to the parties' contractual obligations. To put it simply, if the conduct at issue in the plaintiff's complaint arose out of the parties' contractual relationship, the plaintiff's only remedy was a breach of contract claim. Since the damages in a contract case are much more quantifiable, the parties knew the potential risks for failing to live up to their obligations.

While other jurisdictions moved away from the gist of the action doctrine – South Carolina lawyers even adopted the term "con-tort" to describe the scope of the claims allowed – Pennsylvania courts continued to routinely dismiss tort claims when pled alongside breach of contract claims. The Pennsylvania Supreme Court's decision in *Bruno v. Erie Insurance*, 106 A.3d 48 (Pa. 2014), issued in December of 2014, significantly narrows the venerable gist of the action doctrine and signals permission by the courts to allow plaintiffs to pursue claims the parties never considered when negotiating their contract.

The Bruno Case

David and Angela Bruno bought a home in Bradford, McKean County, Pennsylvania in September 2007. They obtained a homeowner's insurance policy which included express coverage for physical loss to the property caused by "fungi," up to a limit of \$5,000 for a direct physical loss to the insured caused by mold.

When the homeowners found black mold in their basement they reported the mold to their insurance carrier. The carrier then hired a forensic engineering company to investigate the mold problem. Following the engineer's inspection of the mold, the engineer advised the homeowners that the mold was harmless. Based on this assurance, the homeowners remained in the home, but they subsequently found more mold growing on leaking pipes. They again made a claim to their carrier, and again the carrier hired the same engineer to inspect the mold. But the engineer neither disclosed the results of the tests to the homeowners nor advised them of any health hazards posed by the mold.

The homeowner subsequently began to suffer severe respiratory ailments and had the mold tested at their own expense. They then discovered that the mold was hazardous to their health. They again asked carrier for the full mold benefit and received the entire policy limits of \$5,000. Ultimately, the homeowners were forced to demolish their house and the family continued to suffer health problems attributed to and as a result of exposure to the toxic mold.

The homeowners sued the carrier for breach of contract and for negligence. They also sued the engineering company for negligence. The carrier filed Preliminary Objections as to the negligence claim in the Complaint, stating that it was barred by the gist of the action doctrine which would limit damages to those available under the insurance contract. The trial court sustained the carrier's preliminary objections and dismissed the negligence claim, and the Superior Court subsequently affirmed the dismissal.

The Supreme Court then reversed the lower courts' rulings. The Supreme Court held that "a negligence claim based on the actions of the contracting party in performing contractual obligations is not viewed as an action on the underlying contract itself, since it is not found on the breach of any specific executory promises that comprise the contract." Going further, the Court stated that, in such circumstances, "the contract is regarded merely as the vehicle or mechanism which established the relationship between the parties during which the tort of negligence was committed."

Ultimately, the Supreme Court held that, the homeowners claim against the carrier was predicated on the allegedly negligent actions taken by the carrier's agents on behalf of the carrier while they were performing the carrier's contractual obligation to investigate the claim made by the homeowner under the policy, not by the obligation of the insurance contract itself. In other words, the gist of the homeowners' action was not that the carrier failed to fulfill its contractual obligations, but rather that the carrier and the engineer

acted negligently while undertaking the carrier's contractual obligations by making false assurances regarding the toxicity of the mold and affirmatively recommending to the homeowner that they continue their renovation efforts. Consequently, the homeowners suffered subsequent physical harm because of their reasonable reliance on those assurances of both the carrier and its agent/engineer. The Supreme Court explained that the homeowners' allegations of negligence facially concern the carrier's alleged breach of a general social duty, not a breach of any duty created by the express language in the insurance policy itself.

Implications

The distinction between a breach of a party's contractual obligations and negligence in actions while undertaking its contractual obligations is problematic, at best. The holding in Bruno suggests, for example, that if a site owner wants to assert claims against a masonry subcontractor claiming that the masonry work resulted in water intrusion and related damages, the owner only has to plead that the damages were caused by negligence "in the course of" the masonry work in order to be able to seek damages in tort. This would allow the owner to seek damages unavailable under contract law, and it could impact insurance coverage differently than a breach of contract claim standing on its own.

Bruno v. Erie Insurance also appears to be another step for Pennsylvania down the path away from the Kvaerner-Gambone-Abbott trilogy of cases that limited insurance coverage for construction and defect-related claims under commercial general liability ("CGL") policies. The Kvaerner series of cases basically restricted coverage for construction claims under CGL policies holding that claims of faulty workmanship were not fortuitous events, or "occurrences" triggering the policy's coverage. In the 2013 Indalex v. National Union case, Pennsylvania's intermediate appellate court, the Superior Court, held that coverage was available for such claims when the allegations included personal injury claims or damage to products and property other than the products built or supplied by the contractor-insured. With the Bruno decision, the Supreme Court appears to have endorsed the Indalex analysis, and opened the door to insurance coverage for claims that would have been previously limited in Pennsylvania.



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PENNSYLVANIA SUPREME COURT RULES THAT HOME IMPROVEMENT CONSUMER PROTECTION ACT DOES NOT BAR CONTRACTORS FROM RAISING A CLAIM FOR MONEY DUE BASED ON QUANTUM MERUIT

In 2008, the Pennsylvania General Assembly enacted the Home Improvement Consumer Protection Act, effective July 1, 2009, intended to prevent homeowners from being taken

advantage of by unscrupulous home improvement contractors.

To accomplish this goal, the Home Improvement Consumer Protection Act specified that when a home improvement contractor undertook any “home improvements,” as enumerated in the Act, on “land or a portion of the land adjacent to a private residence or a building or a portion of the building which is used or designed to be used as a private residence for which the total cash price of all work agreed upon between the contractor and the owner is more than \$500,” the contract pursuant to which the work was to be done, in order to be enforceable, had to be legible and in writing, and conform to thirteen other specific requirements. [73 P.S. §§ 517.2, 517.7(a).]

In *Shafer Electric & Construction v. Mantia*, 96 A.3d 989 (2014), the Supreme Court was asked to decide whether, if a contract between a home improvement contractor and a homeowner was not enforceable because it did not comply with all of the requirements of the Act, the contractor could still recover under a common law theory of *quantum meruit*, that is for the value of the services it had performed. The Supreme Court concluded that under what it characterized as the “plain, unambiguous language of § 517.7(g)” of the Act, such recovery was not barred.

The Supreme Court’s ruling is good news for home improvement contractors whose customers have refused to pay them for work done. However, a recovery in *quantum meruit* may well not provide a contractor with the profit he hoped to make on a project. As the Court noted in *Shafer Electric*, “*quantum meruit* remedies are much more constrained. The contractor claiming *quantum meruit* may only recover the reasonable value of the services rendered, as determined by a trial court after taking evidence on the matter.” In an action for breach of contract, on the other hand a contractor could expect to recover his “expectation interest” in the form of, “above anything else, his expected and built-in profit arising from the contract.”

The *Shafer Electric* case also provides a cautionary tale with respect to contract documentation. Although Shafer Electric had provided detailed proposals, on paper, to the homeowners with respect to the work to be performed, a two-car garage addition to their house, which the homeowners had agreed to, nowhere in this paperwork were, for example, the approximate start and completion dates for the project, as required by § 517(a)(6), listed nor were the homeowners informed of the toll-free, consumer protection hotline number required by § 517(a)(12). The documents did contain the name, address and telephone number of the contractor, a description of the work to be performed, the materials to be used and a set of specifications, and the total sales price, as specified in § 517(a)(5), (7), (8). Compliance with those subsections, but not the others meant that the contract was not valid or enforceable against the owner as written.

In *Shafer Electric*, the Supreme Court also endorsed the holding of the Superior Court in an earlier case in which that court held that a contractor could recover in *quantum meruit* when

the contract at issue was oral. But again, that contractor would only be able to recover the reasonable value of the services provided, not his “expectation interest.” Contractors should note that the complete text of the Act, which also requires contractors to register with the Bureau of Consumer Protection of the Pennsylvania Attorney General, is available online at www.attorneygeneral.gov.



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THE DIFFERENT WARRANTIES COVERING A CONTRACTOR'S WORK

A general's or subcontractor's job is far from over when it receives final payment on a construction project. Rather, final payment begins a new phase of the project, the warranty phase, which may last years. This is true even where the owner/contractor contract calls for a one-year period for the contractor to return to the site and repair “warranty” items. This article will address some of the warranty obligations that are created by contract.

Call Back Warranties

Many standard form contracts require a contractor to return to the project and repair or replace defective work for a period of one year. The AIA A201-1997 General Conditions provides under 12.2.2.1 call back warranty obligations of one year.

Under this provision, the owner and contractor each have obligations under the call back warranty. An owner must promptly notify the contractor of a defect in the contractor's work. If the owner's delay makes the problem more difficult or expensive to repair, the contractor may not be required to return and make repairs.

Although an owner's failure to timely notify the contractor of a defect may relieve the contractor of any obligation to make repairs, an owner must give the contractor the opportunity to make repairs before calling in another contractor and attempt to charge the original contractor for the cost of the repair.

An owner's notice must not only be prompt, it must also sufficiently identify the problem. A contractor must make the repairs within a reasonable amount of time after the request. The timing of the contractor's response is somewhat subjective, and may depend on the particular circumstances of the alleged defect and the nature of the repairs. If the contractor does not timely respond to the notice, the contractor may have breached the call back warranty.

From an owner's point of view, the notice should contain more than just an identification of the items needing repair. It should also inform the contractor that if it does not make the repairs, the owner will do so itself and charge the contractor for the costs. It should also request confirmation from the contractor that the work will be performed and inform when the contractor will do so. The contractor, on the other hand, should promptly respond to the

request and inform the owner of its intentions with respect to the requested repair work. A contractor ignores a request at its own peril.

General Warranty Obligations

Confusion often arises when a contractor believes that the call back warranty is the extent of its responsibility to the owner. As noted above, the call back warranty is separate and apart from other, more general warranty obligations. Thus, a contractor is not simply responsible for items that require repair if it receives notice within the call back period.

An owner may still be able to bring an action against a contractor and recover damages where the contractor refused to make repairs to items discovered after the call back period. The A201-1997 General Conditions makes it clear that the call back warranty is a period of time that the contractor is required to return and make repairs, and is in addition to the general warranty obligation. Compare Article 3.5 and 12.2.2.1.

Conclusion

Contractors are subject to different types of warranties and different time frames that they may have to honor such warranties. An understanding of the differences and the applicable periods of time is critical when responding to demands from owners making “warranty” claims.

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EMPLOYER LIABILITY EXCLUSION NARROWED BY PENNSYLVANIA SUPREME COURT

In a case with far reaching implications for all employers in Pennsylvania, including design professionals, contractors, and subcontractors, the Supreme Court of Pennsylvania recently reversed several decades of precedent by significantly narrowing the potential application of employer liability exclusions in commercial liability policies. In an opinion issued on May 26, 2015 in the case of *Mutual Benefit Insurance Co. v. Politsopoulos*, No. 60 MAP 2014 (Pa. 2015), the Court explained that an exclusion in a commercial liability insurance policy issued to a restaurant stated that the policy did not provide coverage pertaining to liability for injury to an employee of the insured “arising out of and in the course of employment by the insured.” The policy also contained a “separation of insureds” clause which provided that the insurance “applies separately to each insured against whom claim is made or suit is brought.” The restaurant leased its premises from property owners who, although not named in the declarations, were insureds by definition under the policy by virtue of the lease language. The claim at issue arose when an employee of the restaurant fell on an outside set of stairs and commenced an action against the property owners, asserting they were negligent in maintaining the stairs.

The insurer acknowledged that the property owners were insured under the policy but disclaimed coverage under the employer’s liability exclusion because the injured party was

an employee of “the insured.” The property owners contended that the exclusion was unclear and that the exclusion should only apply to the specific insured seeking coverage. They also contended that the separation of insureds clause provided that the coverage extends separately to each insured against whom claims are asserted. The insurer in turn filed a declaratory judgment action which resulted in the trial court upholding and enforcing the exclusion, citing the long standing Pennsylvania Supreme Court case *Pa. Manufacturers’ Assn. Ins. Co. v. Aetna Cas. & Sur. Ins. Co.*, 426 Pa. 453, 233 A.2d 548 (1967).

The trial court noted that the use of the word “the insured” rather than “any” or “an insured” demonstrated that the interests of the different insureds were intended to be several rather than joint. On appeal the Superior Court reversed, holding that the plain language of the separation of insureds clause requires that coverage should be evaluated “as though the Employer does not exist” and that its read of the policy dovetails with the exclusivity of remedy under the Workers’ Compensation Act inasmuch as the property owners did not enjoy the immunity protection of the Act.

An amicus brief filed by the Pennsylvania Association for Justice noted that Pennsylvania’s approach under *PMA v. Aetna* belonged to a small minority of states that interpret employer liability exclusions broadly to bar coverage for lawsuits brought by employers of any named insured. The Supreme Court affirmed the Superior Court’s ruling solely on the basis of the ambiguity of the employer’s liability exclusion because of its varied use of the definite and indefinite articles in relation to “the insured”. The court also noted that the separation of insureds provision lent support to its holding. The court further criticized the *PMA v. Aetna* court’s reliance on cases interpreting automobile insurance policies.

This holding is likely to allow broader coverage for contractors in construction site accidents to the extent that they are either named insureds or insureds by definition under commercial liability policies.



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TEAMWORK IN CONSTRUCTION: A RECOMMENDATION REGARDING COLLABORATION

In my time as a soldier, a professional football player, and a business owner, I have come to understand the value of teamwork. Today I own RBVetCo LLC, a self-performing general contractor that offers pre-construction, site development, and interior finishing services. I had no construction experience before starting RBVetCo in 2004, but the lessons I learned from the playing fields of Notre Dame to the battle fields of Vietnam, honed by the tutelage of the Rooneys and Chuck Noll of the Pittsburgh Steelers are life lessons that I apply to the construction industry.

The Rooneys focused on leadership, people, and vision: find the leader, take care of your people, give them a vision, and the results will follow. The leadership - Chuck Noll; people - nine Hall of Famers; vision - be the best you can be; results - Four Super Bowls.

Chuck Noll said “The single most important thing we had in the Steelers of the 70’s was the ability to work together.” It’s true today as it was true then. Selecting a cohesive team for a project is crucial to provide a good foundation for success. The key to meeting the program goals and vision on any project is successfully choosing the right team and getting them on board early. Coordination of trades is extremely important and the slightest issues can lead to delays.

Like a teammate and a player, each trade contractor brings its own expertise, skills, and values to the table. The general contractor needs to know as much as possible about each subcontractor to select the proper team to align skills that a project needs. But it goes both ways, as a player needs to showcase his specific skill set, it behooves subcontractors to connect with general contractors to educate them on your skillsets to be considered for upcoming projects. A general contractor wants to bring a winning team to each and every project.

Like members of a platoon or players on a field, owners, design professionals, contractors, and subcontractors must work together. Fortunately, like the NFL with its League Office, we have the Master Builders’ Association. I have benefited from the recent efforts of the AIA-MBA Joint Committee as the result of considering the information contained in its publication titled “Project Collaboration Best Practices.” This resource contains a section on team selection, as well as other subject areas. It can serve as a guide for a project to be built collaboratively regardless of the delivery method.

I used to study football playbooks. Now I review MBA’s Best Practice Guide for Construction. I recommend it to you. Teamwork in construction gets the same positive results as teamwork in sports. For more information on “Project Collaboration Best Practices,” consider visiting <http://www.aiambajointcommittee.org/ProjectCollaboration.asp>.

ROCKY BLEIER OF RBVETCO, LLC

THE AUTHOR OF THIS ARTICLE IS THE AUTHOR OF “FIGHTING BACK,” WHICH TELLS THE TRUE STORY OF A NOTRE DAME GRADUATE, WHO, AFTER BECOMING A RUNNING BACK FOR THE PITTSBURGH STEELERS IN 1968 WAS DRAFTED BY THE U.S. ARMY DURING THE VIETNAM WAR. INJURED BY A BULLET TO THE THIGH AND A HAND GRENADE TO THE LOWER RIGHT LEG, ROCKY IS TOLD THAT HE WILL NEVER WALK AGAIN. NOT ONLY DOES HE WALK AGAIN AFTER A LONG REHABILITATION, ROCKY RETURNS TO TRAIN WITH THE STEELERS. WITH THE SYMPATHY AND SUPPORT OF STEELERS’ OWNER, ART ROONEY, ROCKY MAKES THE TEAM AGAIN. THE APPLETON, WISCONSIN NATIVE WAS A RUNNING BACK DURING THE PERIOD THAT THE PITTSBURGH STEELERS WON FOUR SUPER BOWL CHAMPIONSHIPS.



WHERE IN THE WORLD?



Construction Mystery: Multiple theories have been offered to explain how these massive monuments were erected. It is now thought that major deforestation resulted from providing the logs that were used to roll the statues from the mountains where they were carved, to the shoreline, where they stand. Ironically, the island natives' efforts to honor their ancestors ultimately led to the demise of their culture due to the environmental repercussions of their building technique. Question to be answered in the next edition of the Construction Legal Edge: What is the name of this isolated Polynesian island?

CONTRIBUTED BY JANE OCKERSHAUSEN, TRAVEL EDITOR

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