

You Be The Judge

BY MICHAEL G. TAYLOR

THE PROJECT

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IGHTY MALLS IS THE OWNER OF A LARGE SHOPPING MALL IN THE STATE OF UTOPIA. Some years after construction of the mall, the roof begins to leak. Mighty Malls hires Roofs R Us to investigate the problem and advise it on possible solutions. When informed that a new roof is necessary, Mighty Malls hires Roofs R Us to design the new roof, act as its representative during the bidding process, and to inspect and supervise the reroofing project.

Hypothetical No. 1

Roofs R Us diligently prepares plans and specifications for the new roof. It also prepares a bid list, and invites Blown Away Roofing and three other roofers to bid on the project. The morning of bid opening day, Roofs R Us opens the bids and discovers that Blown Away is low bidder. On Roofs R Us' advice, Mighty Malls awards the project to Blown Away.

Roofs R Us helps Mighty Malls prepare a written contract and sends it to Blown Away for signature. Two weeks later, without having signed the contract, Blown Away's chief estimator calls Roofs R Us and states that he's made a mistake. He reminds Roofs R Us that Blown Away has not signed a contract, and states that he is withdrawing his bid. Mighty Malls turns to Roofs R Us for advice.

What advice should Roofs R Us give Mighty Malls?

Hypothetical No. 2

Again assume that the bids are opened and that Blown Away's bid is low. Just as Roofs R Us is about to award the project to Blown Away, it receives reliable information from the second lowest bidder that Blown Away has performed poorly on three recent projects. Mighty Malls asks Roofs R Us what its options are.

What should Roofs R Us advise? Does it make a difference if the project is publicly financed?

Hypothetical No. 3

For the past five years, Roofs R Us has performed an annual roof inspection for Mighty Malls. Roofs R Us and Mighty Malls have no written contract, but for the past five years, Mighty Malls paid without objection Roofs R Us' standard rate of \$80.00 per hour. This year, Roofs R Us decides its standard rate is too low, and it raises its rate to \$125.00 per hour. It then performs another roof inspection for Mighty Malls and invoices Mighty Malls at the new rate. Mighty Malls refuses to pay.



What is Roofs R Us entitled to be paid?

Hypothetical No. 4

Suppose that Roofs R Us performs its roof investigation and issues a written report detailing its findings and advising Mighty Malls to immediately reroof the mall. Mighty Malls is unhappy with the detail and quality of the report. It fires Roofs R Us and refuses to pay for the report.

What are Roofs R Us' remedies? Can it file a mechanic's lien on the mall property? Are its lien rights affected if Mighty Malls never proceeds with the reroofing?

What if Roofs R Us had started its reroofing design by the time it was fired?

Hypothetical No. 5

Roofs R Us spends significant time preparing design documents for the mall. After design services have been provided, and while the project is under construction, Mighty Malls learns that Roofs R Us has neither obtained nor applied for a license to practice architecture in the state of Utopia. Mighty Malls had paid Roofs R Us for some services but, under financial stress because of other deals that have gone sour, uses this as an excuse not to pay Roofs R Us the remainder of its fee.

What if Roofs R Us had already submitted its license application during the design phase?

What if Roofs R Us had submitted its license application before starting any work, and actually obtained the license before Mighty Malls raised the issue?

What if Roofs R Us didn't have a license, but it could show that all its architects who actually worked on the design were individually licensed in Utopia?

What if Roofs R Us was not the prime architect and provided no design services, but was simply retained by the prime architect as a consulting architect?

What if Roofs R Us sought compensation not for the design services it provided, but for the supervisory services it had provided during the construction phase of the project or for the consulting services it provided prior to the design?

Sensing a good thing, Mighty Malls commences an action against Roofs R Us to force it to pay back all amounts Mighty Malls had earlier paid to Roofs R Us.

Can Mighty Malls force Roofs R Us to return all previous amounts paid, and essentially require Roofs R Us to provide its services for free?

Hypothetical No. 6

Five years after the mall opens, Mighty Malls' facilities manager calls and asks Roofs R Us to perform a quick inspection of the roof. The facilities manager states that Mighty Malls has not experienced any problems with the roof, and that the inspection is just a precautionary measure. Roofs R Us agrees to perform an inspection for the flat fee of \$1,000. It inspects the roof and finds nothing wrong. Two months later, the roof collapses, resulting in catastrophic losses for Mighty Malls and its tenants. Collectively, their business interruption claims total more than \$20 million, and they sue Roofs R Us for this amount under a negligent inspection theory. It turns out that the roof had not been installed in accordance with the original plans and specifications.

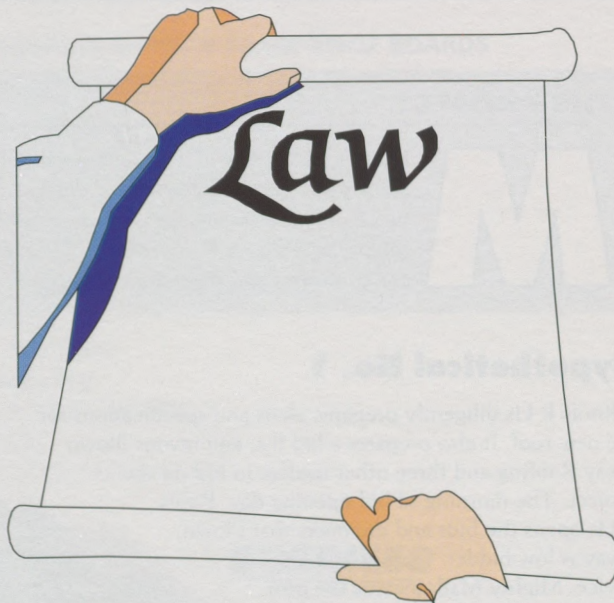
Does Roofs R Us have a good defense to the claims brought by Mighty Malls and its tenants?

Does it make a difference if Roofs R Us and Mighty Malls had entered into an inspection contract which contained the following clause: "The liability of Roofs R Us and the liability of its employees are limited to the contract sum."

Hypothetical No. 7

Suppose again that the roof fails with the same catastrophic results, but that instead of a design flaw, the cause of the failure is tied to the roofing manufacturer's defective membrane. The roofing manufacturer had issued its standard 10 year warranty on the project.

Does Mighty Malls have a good breach of warranty claim against the manufacturer? If not, what additional claim might it have against Roofs R Us?



ANSWER TO HYPOTHETICAL NO. 1

What advice should Roofs R Us give Mighty Malls?

Under the doctrine of "promissory estoppel," Mighty Malls and Roofs R Us can hold Blown Away to its bid even in the absence of a written contract as long as: Blown Away's bid was a clear and definite offer to perform the work at a certain price; Blown Away knew that if its bid was low, Mighty Malls would rely on it; Mighty Malls actually did rely on it; and Mighty Malls would suffer detriment if Blown Away failed to honor its bid.

ANSWER TO HYPOTHETICAL NO. 2

What should Roofs R Us advise? Does it make a difference if the project is financed by public funds?

On private projects, the owner is under no obligation to accept the low bid. Mighty Malls can, and because of the type of information it received, should, refuse to award the project to Blown Away. On public projects the owner is obligated to award to the lowest "responsible" and "responsive" bidder. Here, the information received by Roofs R Us is probably sufficient to allow Mighty Malls to reject Blown Away's low bid on the grounds that it is not a responsible bidder.

ANSWER TO HYPOTHETICAL NO. 3

What is Roofs R Us entitled to be paid?

It depends. Legally, the answer is a close call. Oral contracts are enforced by courts, but only if the parties have agreed on definite terms. Here, the issue is whether the court will consider the payment term to be "standard rate," or simply \$80 per hour. This hypothetical simply points out the risks of oral contracts. All contracts should be in writing.

ANSWER TO HYPOTHETICAL NO. 4

What are Roofs R Us' remedies? Can it file a mechanics' lien on the Mall? Are its lien rights affected if Mighty Malls never proceeds with the reroofing?

What if Roofs R Us had completed its design services by the time it was fired?

Unless Mighty Malls can show that the detail and quality of the report were so poor as to constitute professional malpractice on the part of Roofs R Us, Roofs R Us is entitled to be paid for its report. If the parties had agreed in advance to what Mighty Malls would pay for the report, then Mighty Malls would be obligated to pay this amount. If no such agreement had been made in advance, then Mighty Malls would be obligated to pay the "fair value" of the report. This, of course, could be a difficult issue to determine, and illustrates the advantages of entering into written, rather than oral, contracts.

Regarding the mechanic's lien issue, laws vary from state to state. Most states provide that those who contribute to the improvement of real property can file a mechanic's lien on the property. In Minnesota, for example, *Minn. Stat. §514.01* provides:

"Whoever performs engineering or land surveying services with respect to real estate, or contributes to the improvements of real estate by performing labor, or furnishing skill, material or machinery for any of the purposes hereinafter stated, whether under contract with the owner of such real estate or at the insistence of any agent, trustee, contractor or subcontractor of such owner, shall have a lien upon the improvement . . ."

In Minnesota, the Minnesota Supreme Court has held that certain architectural services are lienable under this statute. For example, in *Korsunsky, Krank, Erickson Architects, Inc. v. Walsh*, 370 N.W.2d 29 (Minn. 1985), the Court held that project architects were entitled to file a mechanic's lien when they provided substantial architectural and design services related to the development of the property, including work for approval of a zoning change, a preliminary plat, and site plans. A lien can be

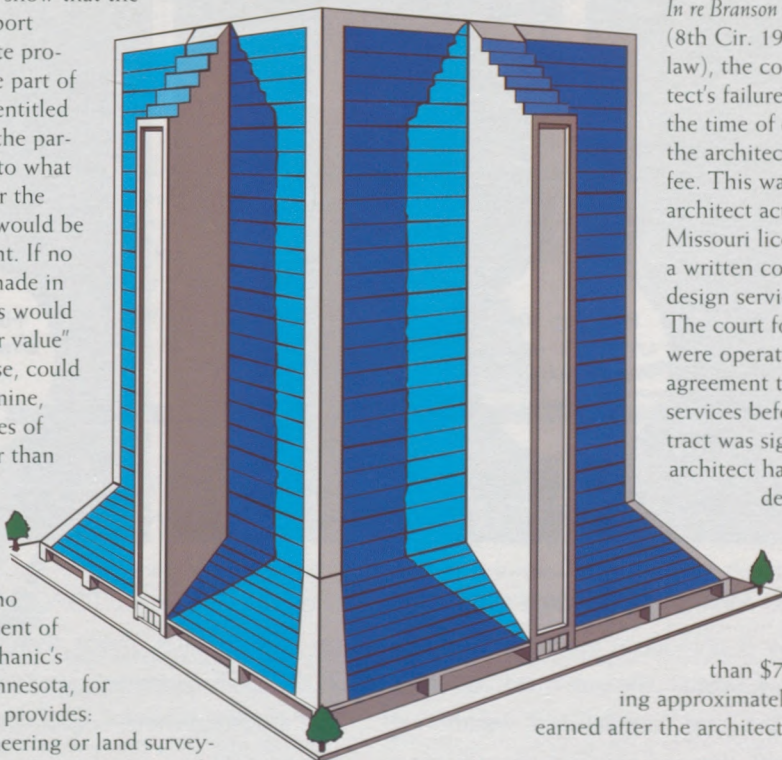
filed even if the improvement for which the design was provided is never constructed. However, in *Phillips-Klein v. Tiffany Partnership*, 474 N.W.2d 370 (Minn. App. 1991), the Minnesota Court of Appeals held that an accounting expert retained by the owner to provide consulting services only, including services related to locating and obtaining financing for the project, obtaining the necessary zoning variances, and coordinating leasing arrangements, did not perform services constituting an "improvement" for which a mechanic's lien could be filed.

Different states may treat these issues differently. The important point of this hypothetical, however, is that it may be possible for a roof consultant to file a lien, at least if it has performed any design services.

ANSWER TO HYPOTHETICAL NO. 5

What if Roofs R Us had already submitted its license application during the design phase?

In many states, this would not matter. For example, in *In re Branson Mall, Inc.*, 970 F.2d 456 (8th Cir. 1992) (applying Missouri law), the court held that the architect's failure to obtain a license at the time of contracting prevented the architect from recovering its fee. This was true even though the architect actually obtained a Missouri license before it executed a written contract to provide design services to the developer. The court found that the parties were operating under an oral agreement to provide architectural services before the written contract was signed, and that the architect had provided most of its design services before it obtained the required license and signed the written contract. As a result, the architect lost more than \$700,000 in fees, including approximately \$100,000 in fees earned after the architect was fully licensed.



What if Roofs R Us had submitted its license application before starting any work, and actually obtained the license before Mighty Malls raised the issue?

Under the holding in *In re Branson Mall, Inc.*, 970 F.2d 456 (8th Cir. 1992), (discussed above), if Roofs R Us had already entered into the design contract, this would make no difference at all. Roofs R Us would still be unable to recover its fee.

What if Roofs R Us didn't have a license, but it could show that all its architects who actually worked on the design were individually licensed in Utopia?

In many states, this makes no difference. In *Ellers, Oakley, Chester, & Rike, Inc. v. St. Louis Cargo Services, Inc.*, 984 F.2d 1108

(10th Cir. 1993) (applying Missouri law), the court held that an unlicensed engineering firm may not recover compensation for its professional services even though all the individual engineers performing the work were licensed. Because the firm itself failed to register and obtain a Missouri certificate of authority to provide engineering services, its contract was held void under state law. As a result, the firm was denied any recovery of its approximately \$275,000 in fees under either breach of contract or equitable theories. The fact that individual engineers of the firm were licensed was not relevant to the court because the court found that the firm was more than just the "alter ego" of its engineers. The court noted that, "Far from being a mere technicality, the use of the corporate form confers substantial benefits upon those engineers practicing within a corporation, including, for example, shielding the individual engineers from personal liability for the corporation's debts and obligations."

What if Roofs R Us was not the prime architect and provided no design services, but was simply retained by the prime architect as a consulting architect?

In those states that strictly enforce licensing requirements, this makes no difference. For example, courts in New York, Missouri and Vermont have explicitly held that even if an architect performs "non-design" services, failure to obtain the necessary license results prevents the architect from recovering his fee. See *Gordon v. Adenbaum*, 567 NYS 2d 777 (A.D. 1991); *Ellers, Oakley, Chester, & Rike, Inc. v. St. Louis Cargo Services, Inc.*, 984 F.2d 1108 (10th Cir. 1993); and *Markus & Nocka v. Julian Goodrich Architects, Inc.*, 250 A. 2d 739 (Vt. 1969).

What if Roofs R Us sought compensation not for the design services it provided, but for the supervisory services it had provided during the construction phase of the project?

Same answer as above.

Sensing a good thing, Mighty Malls commences an action against Roofs R Us to force it to pay back all amounts Mighty Malls had earlier paid to Roofs R Us. Can Mighty Malls force Roofs R Us to return all previous amounts paid, and essentially require Roofs R Us to provide its services for free?

Yes. This answer is true for both contractors and architects. See, for example, *Kansas City Community Center v. Heritage Indus., Inc.*, 972 F.2d 185 (8th Cir. 1992). Applying Missouri law, this holds that the architect must return approximately \$9,500 in fees paid him for the design of a rehabilitation center. See also *Ransburg v. Haase*, 586 N.E.2d 1295 (Ill. App. 3 Dist. 1992). Applying Illinois law, this requires the architect to return \$83,876 in fees already paid him for the design and construction of a duplex residence.

ANSWER TO HYPOTHETICAL NO. 6

Does Roofs R Us have a good defense to the claims by Mighty Malls and its tenants?

Does it make a difference if Roofs R Us and Mighty Malls had entered into an inspection contract which contained the following clause, "The liability of Roofs R Us and the liability of its employees are limited to the contract sum."

Roofs R Us is in trouble. Under the facts outlined above, it has not entered into a written contract to perform the inspection. Its oral agreement to inspect the roof may be interpreted broadly enough to have required that it have looked at the original plans and specifications prior to reporting that there was "nothing wrong" with the roof. Roofs R Us could have avoided this problem if it had entered into a written contract with Mighty Malls specifying both the scope of its inspection and the services that are outside the scope of its inspection. Its failure to do this in this case may have catastrophic results.

Regarding limitation of liability clauses, while in most states agreements to exonerate a party from its own negligence are not favored by the courts, neither are they automatically voided. However, many courts go out of their way to construe such language against the party who is seeking to avoid liability. This exact limitation of liability language was at issue in a recent case decided by the Oregon Supreme Court, *Estep v.*

MacKenzie Engineering, Inc., 927 P.2d 86 (Or. 1996). In *Estep*, the Oregon Supreme Court held that this exact language in a home inspection contract was not sufficient to bar a home purchaser's negligence claim for a faulty report on the condition of a house the plaintiff intended to purchase. In *Estep*, the parties agreed on an estimated contract fee of \$200. The engineer's

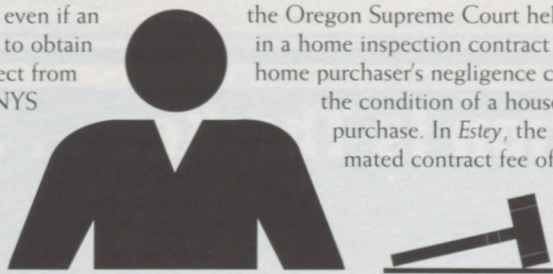
inspection report was based on a limited visual review of the house, and noted only some minor cracks in the walls,

stretch marks in the floors and "some settlement." The report concluded that there did not appear to be any major failure or immediate movement of the foundation. The plaintiff then purchased the house. Six weeks later, the plaintiff discovered that a broken water pipe had been leaking under the house before the date of the inspection. The plaintiff then hired another engineering firm to inspect the house. The second firm found it probable that at the time of the original construction part of the residence was constructed on uncompacted fill, resulting in settlement of the footings and the break in the water line.

The plaintiff sought damages of \$340,000 for the cost of repairing and stabilizing the house. The engineer moved for summary judgment, arguing the limitation clause as an affirmative defense. The trial court agreed, finding that the clause was "conspicuous, clear and unequivocal and did not violate public policy." The Oregon Court of Appeals agreed. On appeal, however, the Oregon Supreme Court reversed, arguing as follows:

"There is evidence that plaintiff relied on defendant's report in choosing to proceed with the purchase. In the context of having to make such an important decision, plaintiff most likely would not have understood the limitation of liability clause to effectively immunize defendants from liability for negligently rendering a flawed report."

The plaintiff, the court added, might reasonably have under-



stood the word "liability" to refer only to liability arising from breach of contract, or from reasonable failure to discover latent defects, or from property damage resulting from the review itself.

An attorney can help draft a proper limitation of liability clause.

ANSWER TO HYPOTHETICAL NO. 7

Does Mighty Malls have a good breach of warranty claim against the manufacturer? If not, what additional claim might it have against Roofs R Us?

Probably not. Many standard manufacturers' warranties contain significant limitations on their liability. For example, the typical manufacturer's warranty does not cover the entire roofing system, but only those components provided by the manufacturer. It also limits the consequential or incidental damages that can be recovered. In plain terms, this means that the manufacturer is claiming that it is not liable for business interruption damages or for damage to the interior of a building as a result of a roof leak or collapse. The typical manufacturer's warranty also contains limitations on the absolute dollar

amount that can be recovered. Most, for example, limit this dollar amount to the original cost of the roofing system.

In practical terms, these warranty limitations mean that an owner facing a catastrophic loss is likely to focus on the roofing consultant and its insurance carrier for a greater portion of the recovery.



About The Author

Mike Taylor is a shareholder in the firm of Leonard, Street and Deinard, a 145 lawyer firm with offices in Minneapolis and St. Paul, Minnesota. For the past 14 years he has specialized in roofing system and curtain wall litigation, and has represented owners, architects, consultants and roofing contractors on projects throughout the United States.

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