



## **RECENT COURT DECISIONS OF RELEVANCE TO CONTRACT DOCUMENTS**

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1. **Issue:** Enforceability of Liquidated Damages. Appeal of Sauer, Inc., ASBCA No. 62395, 21-1 B.C.A (CCH) ¶ 37845 (Apr. 16, 2021).

**Summary:** The Appeal of Sauer involved the enforceability of liquidated damages (LDs) in a construction contract. Sauer was awarded a task order by the U.S. Army Corps of Engineers to construct the 82nd Airborne Division Headquarters at Fort Bragg. The project was divided into three phases: construction of the new building, moving into the new building, and demolition of the old building with subsequent construction of a parking lot. While Sauer finished the first two phases on schedule, they lagged 33 days in the final phase. The Corps, holding the entire project's timeline in view, levied LDs amounting to about \$144,000 on Sauer. Sauer objected, arguing that the Corps had beneficial occupancy of the premises well before the agreed completion date and, therefore, the assessed LD's did not represent a reasonable relationship to the actual damages incurred.

**Decision:** The Armed Services Board of Contract Appeals determined that the LDs following substantial completion are inappropriate and the mere division of a contract into different phases does not inherently assign equal importance to all phases. The assessment of the full LD rate after completing initial phases is unenforceable. The Board held that if Sauer did delay the completion of Phase III, only a proportionate LD, not the full stipulated amount, would be justifiable.

**Comment:** Liquidated damages, like many common contract provisions, may be subject to certain limitations implied by courts. Here, the Board was applying the federal common law of contracts. While the requirement that LDs bear a reasonable relationship to actual damages is typically cited by courts, courts vary widely on the application of that oft cited principal. Moreover, some jurisdictions differ as to whether their courts will even hear proof on what actual damages are in the face of an otherwise enforceable LD clause. The key takeaway is a reminder that contract drafters should make a reasonable attempt to equivocate LDs to actual damages which will be incurred, if the contingency triggering LDs occurs. As demonstrated here, that may involve tiered or segmented LDs, by phase, where, for example, a delay to a later phase will not result in the same damages as an earlier phase.

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2. **Issue:** Superior knowledge claims. *Marine Indus. Constr., LLC v. United States*, 158 Fed. Cl. 158 (2022).

**Summary:** Marine Industrial Construction (MIC) was awarded a contract to dredge certain waterways MIC's bid was 31% below the second lowest bidder. Accordingly, MIC was asked to confirm its bid, which it did. After MIC encountered a number of issues resulting in no significant progress, MIC was issued a notice to cure and, eventually, was terminated for cause (default termination) by the U.S. Army Corps of Engineers (COE). In response, MIC filed suit seeking costs incurred due to, *inter alia*, COE's failure to disclose its superior knowledge. In particular, prior to bidding the project, COE modified its past standard procurement practices by using a performance-based specification (as opposed to design specifications) and removed some key information and warnings about the project's environment—such as the presence of latent objects and when certain areas of the project had last been dredged. Importantly, the information removed was all known by the COE and was relevant information to a reasonable bidder.

**Decision:** The court used a four-point standard to determine a breach of contract under the superior knowledge doctrine. Specifically, to prove a superior knowledge claim the court held MIC must prove: (1) that it undertook to perform without vital knowledge of a fact that affects performance costs or duration; (2) the government was aware MIC had no knowledge of and had no reason to obtain such knowledge without the government's disclosure; (3) any contract specification supplied misled MIC or, at least, did not put it on notice to inquire; and (4) the government failed to provide the relevant information. Most relevant here was the COE's omission of prior requirements for a 12-inch discharge pipe from their 2014 solicitation for the same dredging, which led MIC to use their 10-inch discharge pipes. The court concluded that the COE's omission was vital to contract performance and adversely affected the project's costs and duration. The court acknowledged that the COE had superior knowledge about the need for the 12-inch pipe but failed to disclose it. The COE's reinstatement of the 12-inch requirement in subsequent solicitations further reinforced this notion.

**Comment:** Owners should be mindful when removing certain longstanding specifications or practices during procurement—especially if they do not call attention to the change. Superior knowledge claims typically arise from stand-alone documents. However, this case appears to extend such claims to circumstances where the information was embedded in past contract specifications and solicitations. One important note is the pre-bid site investigation and its role in superior knowledge claims—in particular, that if the undisclosed information is reasonably discoverable information during a pre-bid site investigation is a defense to a superior knowledge claim. Here, however, the court found the information was not reasonable discoverable.

3. **Issue:** Waivers of subrogation and third-party claims. *U.S. Automatic Sprinkler Corp. v. Erie Ins. Exch.*, 204 N.E. 3d 215 (Ind. 2023).

**Summary:** A tenant entered into a contract with a contractor whereby the contractor would install, and the tenant would be “solely” responsible to maintain adequate property insurance in the event the system (*i.e.*, a sprinkler system) failed—in other words, the “owner” assumed the operation and maintenance risk of the system after final completion and acceptance of the work. Even though the tenant assumed the risk of operation and maintenance, the contract provided additional “authorizations” which the owner could order whereby the contractor would perform “repair, replacement, and emergency services.” The agreement further included waivers of subrogation such that “no insurer or other third party [would] have any subrogation rights against” contractor. The parties to the contract shifted the risk of property loss to the insurer upon completion and acceptance of the work. After completion of the work and after contractor performed maintenance under an additional work authorization, a leak occurred in the system, presumably due to the contractor’s negligence, which resulted in property damage to the tenant’s leasehold as well as another tenant in the building. Both tenants’ insurer covered the property loss; and both insurers sought to recover from the contractor. The actions were consolidated.

**Decision:** On appeal to the Indiana Supreme Court, the court held that neither the tenant-owner nor the third-party tenant could recover against the contractor. As to the tenant, the court held that the waiver of subrogation unambiguously expressed an intent to shift all risk of loss to the insurer. The waiver of subrogation was enforced by the terms of the agreement which not only waived subrogation but affirmatively required the insured to carry insurance for the loss—giving rise to a reciprocal obligation to protect the other party from the loss. Thus, the insurer of the first party cannot subrogate against the second party because the insurer’s rights are limited by the rights of its insured. As to the third-party tenant, the court applied the general rule that once work is accepted by the owner the contractor is shielded from third-party liability. While courts have limited the applicability of the acceptance rule when the damage is reasonably foreseeable, the absence of privity bars recovery against the contractor unless there is actual or threatened personal injury, which is reasonably foreseeable.

**Comment:** Waivers of subrogation, coupled with a promise to procure insurance, express a clear intent to shift the risk of loss to the insurers. This case is both a good example of that commonly understood risk transfer in action and an application where the negligence arises from subsequent services performed within the scope of the original agreement but after substantial completion. In addition, this case illustrates the distinction between contractual duties, negotiated between parties to

a contract, and non-contractual common law duties. Typically, personal injury and property damage is actionable against a negligent party. However, where, as here, the negligent party is no longer in control of the source of the damage (i.e., the sprinkler system) by virtue of it turning over control to the property owner, such right to recover becomes less clear, with many courts limiting recover to more egregious conduct or conduct which is reasonably foreseeable to result in personal injury.

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**4. Issue:** Arbitration Enforcement and Confirmation. Notre Dame vs. TJAC Waterloo & ZVI Construction.

In a complex arbitration involving the University of Notre Dame's acquisition of a renovated building in London from TJAC Waterloo and ZVI Construction, a series of legal battles played out in both London and the U.S.

**Summary:** The Situation: Notre Dame identified deficiencies in the renovation, claiming remedial work costs of \$8.5 million. Arbitration Round One: An arbitrator tentatively ruled on liability but made clear it wasn't final. Yet, when the final report was released, it held TJAC and ZVI jointly liable. While the title and a few statements hinted at this being a preliminary decision, the arbitrator indicated that the binding decision couldn't be altered.

U.S. Court Involvement: With the damages phase delayed, Notre Dame, not confident in the other parties' ability to pay potential damages, sought legal security in the U.S. The District Court confirmed the arbitrator's liability decision and authorized a \$7 million property attachment.

Appeal: The appeal by TJAC and ZVI was heard by retired Supreme Court Justice David Souter. He confirmed the lower court's decision, basing it on the understanding that the arbitrator's determination was indeed final and binding.

Arbitration Round Two: For damages, the arbitrator took a segmented approach over four years, making multiple awards. Notre Dame sought to confirm these awards in 2020.

Further U.S. Legal Rounds: The defendants contested the confirmation of some awards, claiming they were beyond a three-year statute of limitations. But the 1st Circuit Court of Appeals held that the awards weren't final until the last award was issued, making Notre Dame's motion timely.

**Decision:** The courts maintained that an interim decision can be final if the parties have agreed to it, though this is an exception, not the rule. Here, there was agreement to bifurcate the case into liability and damages, but not on the exact handling of damages, and therefore only the last of those awards should be “final.”

**Comment:** Arbitration is an optional method of dispute resolution in EJCDC© documents—e.g., EJCDC® C-800, Supplementary Conditions of the Construction Contract. Arbitration is often described as a “fast track” method of dispute resolution. As the above case demonstrates, however, arbitrations can be just as complicated and, sometimes, more so given the additional steps required to enforce arbitration awards.

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