



AGC Law in Brief

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Preventing Limitation of Liability End-Runs

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Owners who are dissatisfied with their contractors' performance increasingly assert fraud-based claims in addition to breach of contract claims because fraud-based claims are not typically barred by contractual waivers and limits of liability. Fraud-based claims may also create the potential for punitive damages in addition to compensatory damages. Contractors and their counsel, however,

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can limit their potential exposure for fraud-based claims through careful contract drafting and thoughtful selection of the law to be applied to disputes.

When selecting the law to be applied to disputes, contractors should first consider the codified law of the jurisdiction where the project is to be built and of any jurisdiction whose law they are considering. They should first determine whether the state in which the project is located is one of the approximately 26 states that has a “home court rule” that deems void any choice of law clause that applies the law of another state to domestic construction projects. See, e.g., Va. Code Ann. § 8.01-262.1; Tex. Bus. & Com. Code Ann. § 272.001; N.Y. Gen. Bus. Law § 757. If the state in which the project is located has such a statute, a contractor’s selection of another state’s law will likely not be enforced unless the parties agreed to arbitrate their disputes (in which case the Federal Arbitration Act [FAA] may supersede state law) or the project was located in a federal enclave, such as a military base (in which case state law does not apply). See *Ope Int’l LP v. Chet Morrison Contractors*, 258 F.3d 443 (5th Cir. Tex. 2001) (deeming preempted Louisiana’s home-court rule as applied to an agreement to arbitrate subject to the FAA); *United States ex rel. Milestone Contractors, L.P. v. Toltest, Inc.*, No. 1:08-cv-1004-WTL-JMS, 2009 U.S. Dist. LEXIS 44382 (S.D. Ind. May 27, 2009) (Indiana home-court rule had no effect given that state law did not apply to training base of Indiana National Guard).

Another group of statutes that contractors should consider are those that regulate the availability of punitive damages. Approximately 25 states cap punitive damages at specified amounts or multiples of actual damages. For example, New Jersey caps punitive damages at five times compensatory damages or \$350,000, whichever is greater, N.J.S.A. 2A:15-5.14; Ohio caps punitive damages at two times compensatory damages under most circumstances, O.R.C. 2315.21(D)(2)(a); and Nebraska does not permit punitive damages at all, see Neb. Const. art. VII, sec. 5, note 3 (citing *State ex rel. Cherry v. Burns*, 602 N.W.2d 477 (Neb. 1999)).

Contractors should also consider differences in common (aka judge-made) law. For example, in most jurisdictions, the economic loss rule bars plaintiffs from asserting tort causes of action to recover for “economic loss,” typically defined as any loss other than personal injury or third-party property damage. Some jurisdictions, such as Missouri, include fraud among the tort causes of action for which plaintiffs may not recover for economic loss. See *Self v. Equilon Enters., LLC*, No. 4:00CV1903 TIA, 2005 U.S. Dist. LEXIS 17288 (E.D. Mo. Mar. 30, 2005). Wisconsin and Michigan apply the economic loss rule when the alleged fraud is interwoven with, as opposed to extraneous to, the contract. See *Kaloti Enters., Inc. v. Kellogg Sales Co.*, 699 N.W.2d 205 (Wis. 2005); *Huron Tool & Eng’g Co. v. Precision Consulting Servs., Inc.*, 532 N.W.2d 541 (Mich. Ct. App. 1995). California is among the many jurisdictions that exclude fraud entirely from the economic loss rule, citing concerns about deceitful contracting. See *Robinson Helicopter Co. v. Dana Corp.*, 102 P.3d 268 (Cal. 2004).

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Pennsylvania's "gist of the action" doctrine is another example of a helpful common law rule. Similar to the economic loss rule, it precludes owners from asserting extra-contractual claims, including fraud-based claims, that "merely duplicate" their contractual claims. See *Bruno v. Erie Ins. Co.*, 106 A.3d 48 (Pa. 2014). In Washington, courts have dubbed the doctrine the "independent duty" doctrine, reasoning that a contracting party has a duty in tort to another contracting party only if that duty is independent of the agreement. See *Donatelli v. D.R. Strong Consulting Eng'rs, Inc.*, 312 P.3d 620 (Wash. 2013).

Most jurisdictions require plaintiffs asserting fraud claims to prove a multitude of factors — including materiality, intent, justifiable reliance and proximate cause — to a stringent standard of proof. Several jurisdictions, however, permit unique causes of action that present a lower barrier. South Carolina has a cause of action known as "breach of contract accompanied by a fraudulent act," which permits a jury to award punitive damages for a breach of contract so long as the plaintiff can prove that the breach was "accomplished with fraudulent intention" and "accompanied by a fraudulent act." See, e.g., *Maro v. Lewis*, 697 S.E.2d 684 (S.C. Ct. App. 2010). But, because breach of contract accompanied by a fraudulent act is a state-law, contract-based cause of action, contractors can avoid its application by selecting a different jurisdiction's law in their contracts. See *Palmetto Health Credit Union v. Open Solutions, Inc.*, No. 3:08-cv-3848-CMC, 2010 U.S. Dist. LEXIS 67768, at *17-19 (D.S.C. July 7, 2010).

The common law can also be a source of guidance on the language that contractors should employ in drafting their contracts. Courts in some jurisdictions, including Delaware, Illinois, New York and Texas, have held that so-called "non-reliance clauses," in which the parties expressly represent that they relied only on information within the agreement, bar plaintiffs from subsequently asserting fraud claims based on extrinsic representations. See *RAA Mgmt. v. Savage Sports Holdings*, 45 A.3d 107 (Del. 2012) (applying New York law, but concluding decision would have been the same under Delaware law); *Schraeger v. Bailey*, 973 N.E.2d 932 (Ill. App. Ct. 2012); *Danann Realty Corp. v. Harris*, 5 N.Y.2d 317 (1959); *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 179 (Tex. 1997). A non-reliance clause is more specific than a standard integration clause, which merely recites that the contract is the sole agreement between the parties and replaces any prior agreements. A standard integration clause is generally insufficient to limit the parties' obligations to promises within the agreement. See, e.g., *Schraeger*, 973 N.E.2d 932. In any jurisdiction, the more clearly and precisely a non-reliance clause details the information the contracting parties rely on in forming their agreement, the more likely it is to be enforced. A non-reliance clause that is bargained for between sophisticated business entities is also more likely to be enforced than is one in a boilerplate consumer contract.

Contractors should also keep in mind that their choice of law will likely impact the conduct and cost of any litigation, as well as the best choice of outside counsel to handle the matter. Choice of law should also be coordinated with choice of venue; they need not be the same, but counsel should consider how likely courts in the chosen venue are to conscientiously and effectively

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apply the law of another state. Contractors should work closely with their counsel to select the law most appropriate for their projects.

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Misclassifying Workers as Independent Contractors: A Costly Mistake

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Construction companies must be aware of the difference between employees and independent contractors. State and federal agencies are increasingly targeting the misclassification of workers in the construction industry. The repercussions for misclassifying employees as independent contractors, intentionally or not, include government audits, lawsuits by the government or by the misclassified worker, and payments of back wages, past taxes, civil penalties, and damages.

The United States Department of Labor (“DOL”) recently introduced Interpretation No. 2015-1, explaining the proper classification of workers as either employees or independent contractors for purposes of the Fair Labor Standards Act (“FLSA”) compliance. An estimated 3.4 million employees are misclassified as independent contractors annually. Employer avoidance of the FLSA causes state and federal governments to lose millions of dollars in tax revenue every year.

Under the FLSA, “employ” is broadly defined as “to suffer or permit to work.” To determine whether a worker is an employee or an independent contractor, the DOL examines six “economic reality” factors in light of this broad definition of employ.

Difference in Employees and Independent Contractors in the Workplace

The difference between employees and independent contractors is an important one. Employees are subject to the FLSA's minimum wage and overtime requirements, while

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independent contractors are not. Further, employers must pay state and federal unemployment tax, social security and Medicare taxes, and unemployment taxes on employees' wages, but not wages of independent contractors. When employers misclassify employees as independent contractors, the workers lose workplace protections and state and federal agencies lose tax revenue.

Classifying Workers Using “Economic Reality” Factors

Whether a worker is an employee or an independent contractor depends on an analysis of six “economic reality” factors in light of the FLSA’s directive that the term “employee” is broadly applicable. The economic reality factors are taken as a whole, as indicators of a worker’s economic dependence or independence.

1) The Extent the Work is an Integral Part of the Principal’s Business

The more “integral” work is to the principal’s business, the more likely that the worker is an employee. An independent contractor’s work is typically not integral to the principal’s business. DOL includes as an example the difference between a carpenter and a software developer on a construction project. The carpenter is integral to the business of a construction company that frames homes because making and repairing wood is critical to framing homes. On the other hand, a software development company that schedules projects and tracks bids and orders performs work that is not integral to a construction project.

2) The Extent a Worker’s Managerial Skill Can Affect Opportunity for Profit or Loss

If a worker’s managerial skills, including hiring, purchasing, and advertising decisions, affect the worker’s opportunity for profit or loss on a future job, the worker is typically an independent contractor. On the other hand, if a worker’s only opportunity for profit or loss is in earnings and overtime on the current job, the worker does not have any managerial skills that may affect his profit or loss, likely making him an employee.

3) The Extent of the Worker’s Investment in Relation to the Principal’s Investment

If a worker makes substantial investments as a business beyond working on the current project, the worker is typically an independent contractor. However, if the worker makes minimal investments, such as minor investments in tools in relation to the investment of the principal, the worker is likely an employee. DOL explains that a worker who provides a substantial investment in relation to a principal’s investment, such as investments in vehicles, rental space, and advertising, is likely an independent contractor. However, a worker who invests in some tools on a project would not be making an investment beyond working on the current project. Therefore, a worker who makes minor investments in relation to the principal would typically be an employee.

4) The Amount of Special Skills or Initiative Used by the Worker

When a worker uses special skills in an independent manner while demonstrating business-like initiative, the worker is typically an independent contractor. This includes exercising business skills and judgment in ordering materials and determining the quantity of materials needed. On

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the other hand, workers who exercise their skills in a dependent matter and rely on a principal to dictate when and where to perform work are typically employees.

5) The Permanence of the Relationship Between the Worker and the Principal

A worker who does not have a permanent or indefinite relationship with a principal due to his or her own independent business initiative is typically an independent contractor. Workers that are at-will, or permanent, are typically employees because they work continuously for the principal. Even seasonal workers are considered employees when they work continuously during the season.

6) The Nature and Degree of the Principal's Control

If a worker exercises meaningful control over his or her work and functions as a separate, independent entity running his or her own business, the worker is typically an independent contractor. A worker who is economically dependent on a principal and relies on the principal to dictate the terms of how work is performed is an employee.

Recent Judgments Against Construction Companies

DOL, the Internal Revenue Service ("IRS"), and state agencies have identified a number of industries where misclassification is prevalent. One of these industries is construction. As a result of increasing investigations regarding misclassification of workers in the construction industry, a number of large enforcement actions against construction companies have occurred.

Sixteen companies in Arizona and Utah deceptively classified construction workers as members and owners of limited liability companies. This allowed the construction companies to avoid FLSA compliance and certain state and federal taxes. In April 2015, after a five-year federal investigation of these companies, federal courts in Arizona and Utah issued consent judgments, requiring the 16 companies to pay a combined \$600,000 in back wages and liquidated damages and \$100,000 in civil penalties.

A construction contractor in Illinois also entered into a consent judgment with the DOL after misclassifying 96 workers as independent contractors. These workers included carpenters, electricians, masons, laborers, painters, and drywall hangers and finishers, who were denied proper compensation for overtime. The contractor paid \$395,465 in back wages and liquidated damages.

Lessons for the Construction Industry

DOL has stated that most workers should be classified as employees under the FLSA's broad definition. With federal and state agencies increasingly scrutinizing classifications of workers in the construction industry, construction companies that employ independent contractors should be on alert.

Companies should keep documentation of its relationship with independent contractors, including any contracts or agreements, tax information, and invoices received from the independent contractor. Further, companies should keep any documentation showing that the

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independent contractor is a separate economic entity. This can include the independent contractor's business license, office address and lease, documentation of owned or rented business equipment or vehicles, tax returns, advertisements, and a list of former or current clients. Companies can also conduct internal audits of workers classified as independent contractors to determine whether independent contractor classification is proper.

If upon examination of the six economic reality factors, a company believes that a worker currently classified as an independent contractor should be classified as an employee, the company should reclassify the worker as an employee to avoid a government audit or a lawsuit. While the company would be liable for back wages and past taxes, the company could apply for the IRS's Voluntary Classification Settlement Program to decrease its federal tax liability.

Smith, Currie & Hancock LLP is a national boutique law firm that has provided sophisticated legal advice and strategic counsel to our construction industry and government contractor clients for fifty years. We pride ourselves on staying current with the most recent trends in the law, whether it be recent court opinions, board decisions, agency regulations, current legislation, or other topics of interest. Smith Currie publishes a newsletter for the industry "Common Sense Contract Law" that is available on our website: www.SmithCurrie.com.

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American Arbitration Association Issues Alternative Rules For Arbitrating Construction Disputes On A More Expeditious Basis

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In June 2014, the American Arbitration Association ("AAA"), working with the National Construction Dispute Resolution Committee ("NCDR")¹, introduced supplementary rules that limit the time and cost of arbitrating construction disputes. The rules, entitled "Supplementary Rules for Fixed Time and Cost Construction Arbitration" ("the Rules"), were developed in response to construction practitioners' concerns over the mounting time and costs involved in traditional construction arbitrations. Most notably, the Rules set limits upon (a) the maximum time to complete arbitration, (b) the number of hearing

¹ The NCDR is an advisory committee made up of approximately 30 industry groups. Fox, Rahn, & Strober, "New AAA Construction Rules Offer Certainty to Arbitration of Construction Disputes," Association of Corporate Counsel, June 19, 2014.

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days, (c) arbitrator fees, and (d) administrative fees charged by the AAA. Maximum periods and fees are subject to a sliding scale and depend upon the amount in controversy. Below is the modified base time/cost schedule provided for in the Rules:² The Rules encourage greater client involvement and awareness. Each party is required to designate an employee, such as in-house counsel or a senior-level executive, whom the AAA will copy on all correspondence and communications relating to the arbitration. Not all types of construction disputes will be effectively arbitrated under the Rules. For example, the Rules only apply to two-party arbitrations; however, a third party surety may be added if it (a) is represented by the same counsel as its principal, and (b) has not asserted an independent claim in the arbitration against either its principal or the other named party.³ The Rules are only intended to be used in connection with construction disputes that have “discrete issues that would benefit from limited document exchange and discovery.”⁴ Although it may be tempting to expand the use of the Rules to more complex cases as a means of controlling time and cost commitments, parties will likely find that the Rules, with their restrictive time frames, limitations upon discovery, and abbreviated arbitration awards (limited to three pages) are simply not suitable for larger, more complex cases. Of course, the needs of a particular arbitration may not be easy to predict in advance. If, following the commencement of arbitration under the Rules, it becomes apparent that additional time or hearing days are required, the arbitrator may, on application of a party (signed by the party’s designated client representative) and for “good cause” shown, permit additional hearing days or time frame extensions.⁵ If an extension is granted, it is within the discretion of the AAA to either continue administering the arbitration under the Rules, or treat it as having been commenced under its regular or complex track construction arbitration rules. Likewise, if the parties fail to adhere to the requirements of the Rules, the AAA may discontinue their use and apply its regular or complex track construction arbitration rules.⁶ In that event, either party may ask the arbitrator to rule that any resulting additional costs be borne by the other party, whose conduct presumably necessitated the transfer.⁷ Use of the Rules may be invoked by either (a) providing for their use in the arbitration clause of a contract of agreement, or (b) by the filing of a “submission agreement” to arbitrate under the Supplementary Rules, signed by both parties. Parties who choose arbitration as the vehicle to resolve disputes are encouraged to familiarize themselves with the Rules, the entire breadth of which is not detailed here. Certainly, the potential for less

² Fees references in this fee schedule may be modified based upon services rendered in a particular arbitration.

³ Rules, SR-1.

⁴ Rules, “Introduction”

⁵ Rules, SR-3.

⁶ Rules SR-14.

⁷ Rules SR-14.

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expensive and more efficient arbitrations is a powerful incentive for opting to proceed under this protocol.

Long known for leadership and innovation in construction law, Peckar & Abramson's Results FirstSM approach extends to a broad array of legal services — all delivered with a commitment to efficiency, value and client service since 1978. Now, with more than 100 attorneys in eleven U.S. offices and affiliations around the globe, our capabilities extend farther and deeper than ever. Find Peckar & Abramson's newsletter [here](#).

ConsensusDocs Technology Platform

The below video will show you the ConsensusDocs cloud-based technology platform in Microsoft Word[®] format. The platform allows you to download your documents to work offline or share through the cloud. You can grant review only access or an editable document to other parties. Also, you can convert PDF documents to Word and compare different ConsensusDocs document versions at the click of a button. The free platform provides:

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- Free Guidance – Toggle User instructions on our off.

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Proposals Now Accepted for Educational Sessions at AGC Convention

Proposals must be submitted online by Aug. 26.

The Associated General Contractors of America is now accepting proposals for a limited number of speaking opportunities for educational breakout sessions at AGC's 98th Annual Convention, March 7-9, 2017 at the Bellagio in Las Vegas, Nevada. AGC's 98th Annual Convention is designed for mid- to senior-level management professionals who work in any of the commercial construction markets: building, federal, heavy, highway and transportation, and municipal and utilities. All educational sessions should be targeted towards these attendees. Special consideration will be given to presentations that are focused on best practices and the unique challenges that construction contractors face throughout the industry. All proposals must be submitted online at <https://proposalspace.com/calls/d/655> by Friday, August 26, 2016. Full details are available [here](#).

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