

Construction Contracts

Landmark Legal Decision Makes Governmental Owners Responsible For Damages Attributable To Design Inaccuracies On Public Works Projects

It is no secret that Missouri can be slow to change. There seems to be a reticence or skepticism for that which is new and untried. It is this attitude that has led to us being referred to as the Show Me State. Given this mindset, it should come as no surprise that it took nearly 100 years for Missouri courts to formally adopt a doctrine set forth by the United States Supreme Court regarding construction contracts a century ago.

In 1918, the United States Supreme Court found in *U.S. v. Spearin*, 248 U.S. 132 (1918), that the government offered a warranty “implied by law” to the contractor that the plans provided by the government were adequate for the contractor to perform the work bargained for in the contract. In other words, by providing a set of plans, the government represented to the contractor that the plans would be reasonably accurate for the performance of the work. Since the contractor’s proposal and agreement to perform for a given price were based on those plans, the accuracy of this representation is incredibly important to the contractor.

While this doctrine was widely held and applied in numerous other states, it was not formally adopted in Missouri until the Court handed down



were reasonably anticipated at the time it prepared its proposal and entered into the construction contract. Adoption of *Spearin* allows the contractor to pursue damages associated with the added costs attributable to the design errors. This means that public entities, including cities, counties, school districts, and water and sewer districts, could face added costs

for public construction projects where the design documents are deficient or inaccurate.

The Court in *Penzel* reasoned that the government owner is the one best positioned to bear the risk of loss associated with errors and inaccuracies in the plans and specifications because it prepared or contracted with those who prepared the documents. Typically, in a situation where an owner hires the design professional to prepare the plans and specifications that the contractor is going to construct, the contractor has no claim for damages relating to errors directly against the design professional. This is because there is no contract between the contractor and the design professional. Rather, the contract is between the owner and the design professional. The legal term for this is absence of privity of

its decision in *Penzel Construction Company v. Jackson R-2 School District* in February. According to the Court, “after examining *Spearin* and Missouri precedent, we believe *Spearin* claims are acceptable vehicles for bringing causes of actions based on deficient plans and specifications in construction projects involving a government entity-owner.”

What Is The Significance To Public Entities Of The Formal Adoption Of The *Spearin* Doctrine In Missouri?

Spearin claims are important because they provide some means of recovery for contractors who have been provided a set of plans and specifications from a governmental entity that were not accurate. As a result of these errors and inaccuracies, the contractor has incurred costs in excess of those that

contract. Without a direct contract with the design professional, the contractor typically has no claim against it for errors. According to the Court, “placing the burden on contractors to ensure the adequacy of an owner’s plans would reduce the efficiency of the industry that is especially damaging to societal interest when government owners inevitably fund a portion of these increased costs.”

Thus, under *Spearin*, the contractor can assert a claim against the government owner and the owner can then assert a claim against the design professional.

A good illustration of the foregoing concepts can be seen by an examination of the facts of the *Penzel* case. There, Penzel was bringing a claim largely on behalf of the electrical subcontractor, Total Electric. Penzel and Total Electric argued that: (1) there were numerous things left out of the electrical drawings; (2) the plans called for incompatible parts; (3) parts were specified that were no longer available; (4) there were code violations; and (5) aspects of the plans were inadequate. As a result of the foregoing, Total Electric argued that it incurred added labor costs due to multiple installations, tracking down the correct parts, remedying situations where the wrong part was listed, etc. Based on the foregoing, the Court found that, “*Penzel* has presented sufficient evidence for a reasonable trier of fact to find that the plans were deficient and caused damages.” In other words, under the *Spearin* doctrine, Penzel could be awarded damages for design errors. It should be noted that the Court extended *Spearin* claims to contractors and subcontractors.

The Court was not content to stop at the adoption of the *Spearin* doctrine in Missouri after a century of waiting. It proceeded to formally authorize the use of the modified total cost method for calculating damages.

What Is The Modified Total Cost Method For Calculating Damages Attributable To Delay, Inefficiencies, Lost Productivity And Defective Design?

To understand modified total cost, it is helpful to understand the total cost

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method of calculating damages. Total cost takes the total costs incurred by a contractor on a project and subtracts the cost that it anticipated incurring, as demonstrated by its bid. The difference between the two is the amount it claims as damages.

As an example, assume that a contractor bid \$1,000,000 and the total costs incurred on the project

were \$1,500,000. Using the total cost method, its damages would be \$500,000. There are obvious problems with this method of calculating damages. First, it presumes that the proposal was accurate (i.e. that there were no errors made in preparing it). Second, it presumes that the added costs incurred were not attributable to the contractor and that these costs were reasonable. Because the total cost method is an all-or-nothing



proposition, the Court rejected its use in determining the amount of damages. Missouri requires damages be proved with reasonable certainty.

Going back to the prior example, assume that the contractor underbid by \$200,000. He may have missed an aspect of the work or made mathematical errors. His bid reasonably should have been \$1,200,000. Because the total cost method does not take this into consideration, he would be awarded \$500,000 in damages, rather than the \$300,000 in damages he actually incurred.

The modified total cost method takes the total costs incurred by the contractor and the proposal as a starting point for the calculation of damages, but then takes into consideration other factors, such as errors by the contractor. In other words, it allows for adjustments to the contract/proposal amount, the total cost of performance or both.

Thus, according to the Court, “the modified total cost method is more aligned with our State’s contract law

policy than the total cost method ... The goal of the modified total cost method and the goal of Missouri contract law are consistent.” By so finding, the Court recognized for the first time in Missouri the modified total cost method as an appropriate way to calculate damages under certain circumstances.

Under What Circumstances Can The Modified Total Cost Method Be Used?

The Court in *Penzel* found that the modified total cost method can be used to calculate damages when the facts of the particular case warrant it. In that case, they were found to be warranted because of the “sheer volume and variety of disruptive events.” In other words, it was either highly impractical or impossible to calculate the actual amount of damages attributable to each disruption, delay or error. In these circumstances, the Court found that using the modified total cost method was appropriate.

In so finding, it adopted the following four-part test to determine the appropriateness of the method: (1) the nature of the particular losses make it impossible or highly impractical to determine them with a reasonable degree of accuracy; (2) the contractor’s bid or estimate was realistic; (3) its actual costs were reasonable; and (4) it was not responsible for added expenses.

The foregoing decision will certainly have an impact on public works contracts where the design documents are inaccurate, insufficient or have deficiencies and will impact the method of calculating damages to the contract resulting from these inaccuracies. It should be noted that an application to transfer the case to the Missouri Supreme Court has been filed. While few cases are transferred, it is possible that the Court will agree to hear the case because of the significance of the legal issues presented therein. If it does, the decision adopting the *Spearin* doctrine and the use of the total cost method for calculating damages could be affirmed, reversed or modified. So, stay tuned. 🍋

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