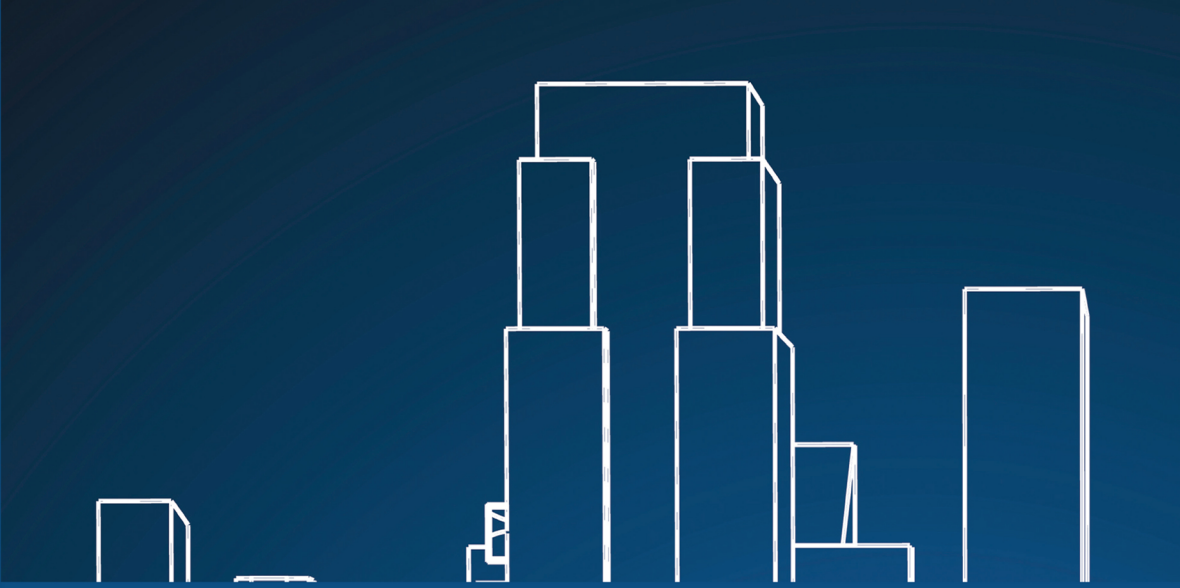

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CONTRACT LAW IN THE CONSTRUCTION INDUSTRY CONTEXT

Carl J. Circo

Contract Law in the Construction Industry Context

This book chronicles how contract cases from the construction industry have influenced, solidified, refined and particularized U.S. contract law. The book's central claim is that the construction industry experience has helped to contextualize U.S. contract law and, therefore, has encouraged the common law to be more receptive to flexible legal standards and practices and less constrained by the relatively rigid rules that often characterize contract law. Other scholarly books analyze the themes, values, standards, and principles of contemporary contract law, but none captures how construction industry relationships and practices have influenced the common law of contracts.

After providing an overview of construction law as a specialty of the practicing bar and as a field for scholarly inquiry, this book examines the construction industry cases that have most directly influenced contract law. It reviews how industry dispute patterns have caused courts to refine contract law principles or to adapt and modify other principles. Separate chapters explain the special roles that cases in the U.S. Supreme Court and in the lower federal courts have played in defining and distinguishing contract law in the construction industry. The final chapters assess implications the construction industry cases hold for contract theory writ large, and for the future of contract law.

This book is essential reading for legal scholars, construction law and contract law specialists, and those interested in how the construction industry has helped shape the U.S. legal system.

Carl J. Circo, J.D., is Ben J. Altheimer Professor of Legal Advocacy at the University of Arkansas School of Law, U.S.A.

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To Bobbi, for the encouragement, understanding, and patience.

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Preface

Experience brings contract law to life. Two centuries' experience with construction contract disputes has helped to shape contract law. That experience has also given birth to an important branch of contract law in practice and in the courts. Contract scholars have overlooked or under-valued the role and place of the construction industry cases. Indeed, the academy in the United States largely ignores construction law as a subject of scholarly investigation and analysis. This book begins to remedy that scholarly neglect.

This book chronicles how the contract cases from the construction industry have influenced, solidified, refined and sometimes particularized U.S. contract law. The book's central claim is that the construction industry experience has helped to contextualize U.S. contract law and, therefore, has encouraged the common law to become more receptive to flexible legal standards and practices and less constrained by the relatively rigid rules that often characterize contract law. Other scholarly books analyze the themes, values, standards, and principles of contemporary contract law, and some briefly note the special relational and contextual characteristics of construction industry contracts, but none captures how construction industry relationships and practices have influenced the common law of contracts.

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Part 1

Contract law and the construction industry

1 The practice and study of construction law

Construction Law evokes contrasting connotations. Practitioners know construction law as a legal specialty for those representing project owners and investors, design professionals, and the construction industry trades. In that sense, construction law stands as an established and recognized field, encompassing the broad legal knowledge and skills required to advise industry clients. The bar embraces construction law as a practical amalgamation drawn from a legal spectrum that includes tort, contract, insurance and risk management, intellectual property, labor law, administrative law, surety law, complex litigation and alternative dispute resolution, secured financing, statutory liens, design professional rights and obligations, and related topics. Legal theory, policy, and organizing principles hold, at best, a secondary place in applied construction law. For academics in the United States, however, construction law's very legitimacy as the subject of scholarly inquiry remains tentative. Many law professors, if they have any developed conception of construction law at all, think of it only as a practice specialty involving a disparate array of legal principles, statutes, and regulations affecting design and construction activities. Only a few U.S. legal academics research and write in the area. A small minority of law schools regularly offer a course in construction law, and most of them hire practicing lawyers to teach the subject on a part-time basis.

Is there, in fact, a coherent body of construction law meriting scholarly inquiry? What might justify conferring such status on legal aspects of the construction industry? Beginning in the second half of the twentieth century, Justin Sweet, now Professor of Law Emeritus at the University of California, Berkley, pioneered the scholarly study of U.S. construction law. Throughout his distinguished career, Professor Sweet has called on legal educators to pay greater attention to the field.[1] Others concur. In an influential 1998 law review article, Professor Thomas Stipanowich, now the Academic Director of Pepperdine Law's Straus Institute for Dispute Resolution, convincingly argued the case for more scholarly attention to construction law.[2] Two years later, Professor Jay Feinman, Distinguished Professor at Rutgers School of

1 *See, e.g.*, JUSTIN SWEET, SWEET ON CONSTRUCTION LAW 37 (1997).

2 Thomas J. Stipanowich, *Reconstructing Construction Law*, WIS. L. REV. 463, 493-98 (1998).

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Law, Camden, disappointedly concluded that, except for the work at that time of Professors Sweet and Stipanowich, "there has been no sustained scholarly attention" involving construction contracting in particular.[3]

Bruner and O'Connor's excellent treatise on construction law, published by Thomson Reuters, does much to rectify the situation, especially because it offers many valuable scholarly insights along with its comprehensive practical guidance. Steven G. M. Stein's treatise on construction law, published by Matthew Bender, also thoroughly covers the topic, especially for practitioners. The Stein treatise dates back to 1983, while Bruner and O'Connor introduced theirs as recently as 2002. Thankfully, we have these two multi-volume works to help fuel the academic venture, but they cannot furnish the complete solution. Indeed, the Bruner and O'Connor treatise dedicates an entire section to the legal academy's relationship with construction law, which it characterizes as "Academia's benign neglect of the study of construction law."[4] An economic case study of a complex construction project similarly notes that "Legal and economic scholars have devoted little attention to an industry—construction—that seems to offer valuable lessons about the organization of economic activity."[5] As recently as 2011, Professor Sweet would again lament the "serious paucity of research on construction law."[6]

This book responds to the call for more scholarly attention to construction law. It concentrates on the close relationship between the construction industry experience and the common law of contracts. As a first step, however, this introductory chapter offers an overview of construction law, first from a practitioner's perspective, and then from a scholar's. Finally, it reframes the case for expanding legal research into construction law.

Construction law as a practice specialty

In 1981, one of the most dramatic aspects of construction law thrust me into the specialty. I was then a junior member of a team addressing liability issues stemming from the notorious collapse of suspended lobby "skywalks" at the Kansas City Hyatt Hotel. That disaster claimed 114 lives. The incident brought about renewed attention to life and safety issues that building design and construction inherently involve.[7] My immersion in extensive legal

3 Jay M. Feinman, *Relational Contract Theory in Context*, 94 Nw. U.L. Rev. 737, 747 (2000).

4 1 Philip L. Bruner & Patrick J. O'Connor, Jr., Bruner and O'Connor on Construction Law § 1:4 (Westlaw 2018).

5 William A. Klein & Mitu Gulati, *Economic Organization in the Construction Industry: A Case Study of Collaborative Production Under High Uncertainty*, 1 Berkeley Bus. L. J. 137, 138 (2004).

6 Justin Sweet, *Standard Construction Contracts: Academic Orphan*, Construction. Law., Winter 2011, at 38, 39.

7 *See* Duncan v. Mo. Bd. for Architects, Prof'l Eng'rs & Land Surveyors, 744 S.W.2d 524 (Mo. Ct. App. 1988); *see also* Carl J. Circo, *When Specialty Designs Cause Building Disasters: Responsibility for Shared Architectural and Engineering Services*, 84 Neb. L. Rev. 162, 203-07 (2005).

research and tedious discovery processes stemming from that horrific tragedy led to my lifelong professional ties to the construction industry. Over the next two decades, I learned the enormity of the construction industry in both human and economic terms. I came to appreciate its legal, financial, and technical complexity through representing public and private project owners, construction lenders, design professionals, general and trade contractors, and other participants in a wide range of projects. The work convinced me that the legal aspects of building design and construction require expertise both practically and intellectually.

Drawing on similar experience, courts and commentators have noted that construction industry disputes often merit a distinctive application of legal principles. For example, in one case, a trial judge declared that "construction contracts are a separate breed of animal."[8] Another highlighted the extraordinary risk management challenges the industry presents, saying, "except in the middle of a battlefield, nowhere must men coordinate the movement of other men and all materials in the midst of such chaos and with such limited certainty of present facts and future occurrences as in a huge construction project."[9] The Colorado Supreme Court explained that, in resolving liability issues arising from construction projects, judges must often deal with complex "networks of interrelated contracts."[10] Bruner and O'Connor offer this characterization of the legal system's adaptation to the construction industry context: "Like other highly complex fields of human endeavor, the construction process has spawned its own unique customs, practices, and technical vocabulary, which in turn led courts and legislatures to develop legal principles consistent with industry realities." Professors Goetz and Scott, in addressing aspects of interpretation problems in contract law in general, concluded that "unusual economic conditions" affecting certain construction project delivery systems resulted in "new contractual regimes."[11] Observations such as these attest to construction law's unique characteristics for courts, arbitrators, and legal counsel.

A specialized construction bar existed at least for several years before my personal introduction to it. The Bruner and O'Connor treatise provides an excellent, concise account of the professional foresight of the lawyers who first helped to define the practice specialty, beginning around the middle of the twentieth century.[12] In 1976, the American Bar Association established its Forum on Construction Law (then called the Forum on the Construction Industry), a step that marked a coming of age for the construction bar. The

8 Paul Hardeman, Inc. v. Ark. Power & Light Co., 380 F. Supp. 298, 317 (E.D. Ark. 1974).

9 Blake Constr. Co. v. C. J. Coakley Co., 431 A.2d 569, 575 (D.C. 1981).

10 BRW, Inc. v. Dufficy & Sons, Inc., 99 P.3d 66, 72 (Colo. 2004).

11 Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261, 296 (1985).

12 BRUNER & O'CONNOR, *supra* note 4, at § 1:5.

Forum now has several thousand members, and Bruner and O'Connor estimate that the U.S. bar includes more than 35,000 lawyers who concentrate their practices on the construction industry. Today, those practitioners have extensive resources to inform their specialty. Both the Forum and the more recently organized American College of Construction Lawyers publish high quality legal journals, and they, along with a few other local and national organizations, regularly sponsor continuing legal education programs for construction lawyers. Additionally, several publishers offer practice manuals covering every aspect of the construction law practice. Without the professional demand of these practitioners, however, there would be but a scant body of published resources on construction law.

A scholarly perspective on construction law

As noted above, a few academics and commentators have promoted legal scholarship into building design and construction. This book owes much to their work. Construction law, however, has not yet achieved the status of a recognized field of study within the legal academy. This neglect does not reflect a judgment that construction industry cases have no use in legal education. Several observers have noted that industry cases traditionally accounted for up to 20 percent of the primary opinions included in leading contract casebooks.[13] My own casual review of current texts suggests a similar count. Nor does the academy's disinterest result from any lack of specialization among legal educators and scholars, or from any apparent concern among law professors that the balkanization of legal fields could weaken legal education or legal studies. The Association of American Law Schools has over 80 sections covering most legal specialties, from administrative law to trusts and estates. In between, the AALS includes sections on many important industries and economic sectors, such as agriculture and food law, financial institutions and consumer financial services, insurance, internet and computer law, medicine and health care, and sports law. Sections also draw from many highly specialized areas of interdisciplinary studies, including law and anthropology, law and mental disability, law and religion, and law and South Asian studies, to name a few. In addition, the AALS list extends to an impressive number of human endeavors and interest groups, each representing a narrowly targeted but significant societal interest. These cover aging and the law, art law, animal law, disability law, election law, mass communication law, poverty law, and much more. Although I have been teaching, researching, and writing about construction law as a full-time law professor for over 15 years, I am not aware of any substantial group of similarly engaged law professors who might affiliate into an AALS section on construction law. The Forum on Construction Law and the American College of Construction Lawyers

13 *See id.* at § 1:4 n.9; Stipanowich, *supra* note 2, at 494; Sweet, *supra* note 1, at 37.

include committees or groups for construction law professors, but their membership comes almost entirely from part-time professors. Indeed, all the other law school professors whom I currently know to be teaching construction law courses regularly do so on a part-time basis, and they identify primarily as practitioners. Their published works, while exceedingly useful to scholars, speak most directly to the construction law bar.

How can the legal academy give but meager attention to such an important segment of the economy and society? The construction industry generates many complex and varied problems for litigation and for alternative dispute resolution; it presents difficult risk management challenges brimming with legal issues; and it holds the keen interest of a sizeable and distinguished, specialized bar. Why, then, do we find no corresponding academic specialty? On this, I can only speculate. To be sure, the legal aspects of construction do not frequently dominate the headlines in news outlets, save when disaster strikes. The construction industry, as one of the oldest human enterprises, lacks the appeal of the new and novel. The industry rarely generates national or global policy debates. Neither the public nor the legal professorship likely perceives construction law as glamourous. The stakes in construction disputes, while often high-dollar, do not implicate such overarching values as life, liberty, individual autonomy, human happiness, or global peace. Can we not, however, say much the same about many other areas of dedicated legal scholarship? Each of the factors mentioned above probably plays some role in limiting interest in construction as a subject of inquiry in the legal academy, but I doubt that, even in combination, they provide the complete explanation. I suspect that two other circumstances more specifically block the road that could take construction law as known in the practice and in the courts to a place in the legal academy.

First, in an environment that increasingly and quite productively brings interdisciplinary scholarship to our law schools, the construction industry affords no convenient cross-disciplinary bridge within the academic community for law professors. The industry exists instead at an intersection of professional schools. The substantial and important interdisciplinary movement in higher education incentivizes collaborations between law and practically all fields of the humanities and the social sciences, as well as some areas of the natural sciences. It offers much less encouragement to bring together legal educators and their colleagues in architecture, engineering, construction science, and construction management. Moreover, for almost as long as construction law has been a recognized practice specialty, a high proportion of those entering law teaching as full-time professors and who engage in interdisciplinary work hold a J.D. plus an advanced degree in a traditional academic field. They rarely come to the law with post-graduate credentials from the professional schools that serve the construction industry. The second reason relates closely to the first. While architecture, engineering, and construction generate many interesting and important legal issues, academic lawyers who have little or no experience representing industry clients face an

especially steep learning curve. An intimate and extended encounter with construction projects affords the best, if not the exclusive, introductory credential for exploring construction law. In combination, these two considerations have probably made it exceptionally difficult for law professors with an interest in the legal issues the industry presents to achieve the critical mass required to give birth to an academic field of construction law. This conclusion intimates no indictment of law professors or their colleagues in other professional schools; it merely offers a feasible explanation of the dilemma that construction law scholarship faces.

Suggesting why the legal academy offers no comprehensive specialty in construction law hardly justifies that state of affairs. The construction industry experience can teach us much about the law. It also has led to some important legal developments and has influenced many others. For these reasons, legal scholars should investigate and illuminate construction law. Through this book, I propose to advance those goals primarily by looking at the common law of contracts in the construction industry context.

Looking for meaning in the construction industry contract cases

My proposal for a more comprehensive scholarly investigation of construction law implies no grandiose idea. Studying construction law will not lead to new first principles of law. It will never define theoretical concepts in the order of private property, freedom of contract, individual rights to autonomy or liberty, or any of the other overarching themes at the heart of legal philosophy, jurisprudence, and legal education. That is only to say that construction law in our law libraries and law schools will not compete with property, contract, or tort, nor will it hold a place in the legal academy next to constitutional law or international human rights. Those who advance the study of construction law will not thereby offer an analytic perspective to equal the comprehensive frameworks of the great interdisciplinary schools, such as law and economics, or law and social science. Studying construction law, however, can further our appreciation of how law evolves and adapts based on experiences in a particularly significant segment of society. It can help us illuminate the strengths and weaknesses of alternative approaches to solving evolving legal problems and regulating exchange transactions. Construction law scholars can also produce research and provide innovative frameworks to help legislatures, administrative agencies, courts, arbitrators, mediators, and practicing lawyers better serve a society increasingly dependent on complex networks of interdependent relationships of the kind known so well to the construction industry.

This book investigates some of these possibilities. It mainly explores the common law of contract as developed in the construction industry context. The two chapters in Part 2 explore the relationship between construction industry cases and several fundamental doctrines and principles of contract law. Chapter 2 covers those doctrines and principles that industry cases influenced most directly, and Chapter 3 addresses the role industry cases have played in adapting, refining,

or constraining other doctrines and principles. The two chapters in Part 3 review the federal cases. Chapter 4 looks broadly at cases decided by the U.S. Supreme Court. Chapter 5 reviews the extensive body of construction contract law in the lower federal courts. As Chapter 4 explains, through the cases the U.S. Supreme Court decided during the nineteenth century, and early in the twentieth century, it participated in some fundamental developments in U.S. contract law. After that period, construction industry cases virtually disappeared from the Supreme Court's docket, except for isolated circumstances in which issues under the U.S. Constitution or federal legislation arose incidentally within the industry. More recently, as Chapter 5 documents, decisions by lower federal courts having jurisdiction over federal contracts have generated a distinct body of construction contract law that has frequently influenced corresponding developments under state law. In Part 4, Chapter 6 analyzes the implications that the construction cases hold for contract theory, and Chapter 7 offers a final perspective on what the construction contract cases teach, how the construction industry experience may influence future legal developments, and where construction law scholarship may eventually head.

Part 2

The role and significance of the industry cases

2 The construction industry and core principles of contract law

Construction industry cases have played several starring roles in the development of U.S. contract law. In 1977, Professor Justin Sweet, who begat construction law scholarship in the United States, wrote that "construction law has led to the development of a few general contract rules of law."[1] In particular, he named substantial performance, unilateral mistakes in competitive bids, third-party dispute resolution, and unforeseen subsurface conditions. We can modify and expand Professor Sweet's claim by saying that construction law has both influenced and advanced several important principles of contract law. By this I intend two related but distinct claims. First, construction industry cases have played an especially important role in the evolution of a few general principles of contract law. The doctrine of substantial performance, as Professor Sweet noted, offers the most well-recognized example, but there are others. Second, other construction industry cases have refined or customized contract law principles in significant ways. This Chapter considers the first category, beginning with the substantial performance doctrine. Chapter 3 assesses the second.

Substantial performance

We take up substantial performance first, and in considerable detail, not only because it has become closely associated with construction industry contract disputes, but also because its story demonstrates so well the role that this one sector of commerce has played in the common law of contracts. There are, in my opinion, four other contract law topics with sufficiently similar lineage to merit treatment in this Chapter: economic waste; unilateral mistake; offers made irrevocable by reliance; and the decline of the pre-existing duty rule. None of these, however, equals the substantial performance doctrine's strong link between the industry cases and the associated general principle of contract law. For this reason, I review substantial performance at length and then use that analysis as a benchmark for a briefer assessment of the others.

1 Justin Sweet, Sweet on Construction Law 294 (1997).

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To understand how the substantial performance doctrine evolved and affected contract law, we must begin with the predecessor doctrine of constructive conditions of exchange. Lord Mansfield famously articulated the constructive conditions principle in *Kingston v. Preston*.[2] The case involved a contract between a silk mercer and his covenant servant for the sale to the servant of the business and stock in trade. The buyer agreed to make regular payments to the seller for an agreed time and to provide security acceptable to the seller for the payments promised. Lord Mansfield held that the seller was not liable for breach for refusing to consummate the sale when the buyer failed to deliver the promised security. If the contractual promises of the parties were independent, as the buyer argued, then the seller would have had a damage remedy for the buyer's breach but would not have been relieved of the obligation to transfer the business. The express terms of the contract apparently did not specify delivery of the security as a condition precedent to the seller's obligation. Lord Mansfield held that the arrangement implicitly conditioned the seller's obligation to transfer the business on tender of the security—the buyer's obligation to provide security was a constructive condition.

Prior to *Kingston v. Preston*, the common law seems to have rather rigidly presumed that each contracting party's promise in an exchange of promises was independently binding without regard to the other party's performance.[3] *Kingston v. Preston* provided the foundation for the constructive conditions of exchange doctrine, which rebuffs that presumption. Subsequent cases clarified that even when courts properly regard performance of a promise to be a constructive condition, partial performance of the promise might suffice for purposes of the doctrine on the basis that, in certain circumstances, the victim of a partial breach can be made whole through a damage award. In that way, contract law holds the breaching party responsible for the partial failure of performance without effecting a forfeiture of further rights on the contract. This limitation on the constructive conditions doctrine, which eventually became the substantial performance doctrine, avoids unnecessarily harsh consequences when a contracting party has performed to some extent although not completely or perfectly. It emerged both in England and in the United States relatively quickly in *Kingston v. Preston's* wake, but its precise dimensions remain cloudy even today.[4]

2 Kingston v. Preston (1773) 99 Eng. Rep. 437 (K.B.).

3 *See* 8 CORBIN ON CONTRACTS § 32.2 (Lexis 2018).

4 *See* Crouch v. Gutman, 31 N.E. 271, 273 (N.Y. 1892); Ellen v. Topp (1851) 155 Eng. Rep. 609; Boone v. Eyre (1777) 126 Eng. Rep. 160(a) (K.B.) (also decided by Lord Mansfield). *See generally* 8 CORBIN ON CONTRACTS, *supra* note 3, at §§ 32.3-32.8; Amy B. Cohen, *Reviving Jacob and Youngs, Inc. v. Kent: Material Breach Doctrine Reconsidered*, 42 VILL. L. REV. 65 (1997); Eric G. Andersen, *A New Look at Material Breach in the Law of Contracts*, 21 U.C. DAVIS L. REV. 1073, 1079-92 (1988).

Both the first and the second Restatement of Contracts incorporate this modified version of the constructive conditions principle.[5] Section 237 of the second Restatement states it this way: "it is a condition of each party's remaining duties to render performances to be exchanged under an exchange of promises that there be no uncured material failure by the other party to render any such performance due at an earlier time."[6] Note that only an "uncured material failure" to perform invokes the Restatement's constructive conditions principle.

Corbin on Contracts offers this alternative iteration of the modified construction conditions principle: "When justice seems to require that a contractor's duty to perform should be conditional on some fact or event, the court should hold it to be a condition of the duty unless the parties clearly expressed an intention to the contrary."[7] Note that in this variation, any "fact or event" may be a constructive condition whether or not it involves the performance of a contractual duty. Note also the absence of any objective test for identifying a condition, the specified standard being simply what "justice seems to require."

Under the constructive conditions principle thus understood, therefore, a contracting party may, under the appropriate circumstances, be justified in withholding its own performance unless and until the condition occurs or is satisfied. What is the extent of the constructive conditions doctrine? How do courts discern what justice requires in the face of a partial failure to perform? How do they distinguish between material and immaterial breaches? And when does the failure or partial failure of the condition merely suspend the non-breaching party's further obligations under the contract rather than operate as a complete release? These questions all remained to be worked out through the common law process.

In the two centuries following *Kingston v. Preston*, the U.S. authorities on materiality have generally analyzed a partial failure of performance by balancing a variety of factors to determine whether it is fair and just to treat the partial breach as a basis to suspend or discharge the other party's contractual obligations.[8] Differentiating a breach on this basis has been an elusive problem in contract law from Lord Mansfield's days to the present.[9] The balancing test sometimes sets up substantial performance as the antithesis of a material breach—nothing more than a way to express the conclusion that a particular partial breach is not material.[10] When used in this way, the

5 Restatement (Second) of Contracts § 237 (Am. Law Inst. 1981); Restatement (First) of Contracts § 274 (Am. Law Inst. 1932).

6 Restatement (Second) of Contracts § 237 (Am. Law Inst. 1981).

7 8 Corbin on Contracts, *supra* note 3, § 32.1.

8 *See generally* Andersen, *supra* note 4, at 1081-84.

9 *See id*. at 1074-76.

10 *See generally* 14 Williston on Contracts § 44:55 (4th ed. 1993); Cohen, *supra* note 4, at 79 n.51; Andersen, *supra* note 4, at 1135.

substantial performance concept is not a separate standard but simply a manner of expressing a balancing test conclusion.

An alternative line of authority, however, implies a substantial performance concept that goes beyond the vagueness of a multi-factor balancing test. In discussing substantial performance in this Chapter, I refer to this alternative principle. It recognizes that in some situations partial performance of a constructive condition may be substantial in a more meaningful way because, in some sense, the party complaining of the partial failure of performance has already received the essence of the bargained for exchange.[11] In some sense, indeed, but what can that mean? How do contemporary courts discern substantial performance in this more literal way? As explained below, they have done so to a considerable extent by working out the contours of the concept in cases in which builders fall short of full or perfect performance under construction contracts.

Appreciating the impact that the construction industry cases have had first requires recognizing that the substantial performance principle to which I refer functions as contract law's most objective application of an otherwise strikingly subjective distinction between material and immaterial breaches. The second Restatement represents the contemporary, balancing test approach to material breach in U.S. contract law, based on a list of abstract factors that courts should weigh. In this respect, the second Restatement largely carries on, albeit with refinements, the approach that the first Restatement originally articulated. For purposes of contrasting the balancing test for materiality with the substantial performance principle, we can draw out the relevant considerations from the second Restatement without concerning ourselves with the nuances between the two Restatement versions.

Recall that under Section 237 of the second Restatement, the constructive conditions principle is concerned only with an absence of any uncured *material* failures of performance. While any failure of performance under a contract is a breach,[12] only a material breach provides a basis for the other party to withhold its own performance.[13] An immaterial breach ordinarily gives the other party a claim for damages, but not the right to withhold its own performance or to be discharged from its remaining contractual obligations. Furthermore, under the Restatement, even a party who has materially breached will usually have the right to cure during some limited period before the other party is discharged.[14] If the failure continues uncured beyond a reasonable time, the non-breaching party may eventually be discharged

11 *See* 5 Philip l. Bruner & Patrick J. O'Conner, Jr., Bruner and O'Connnor on Construction Law § 18.12 (Westlaw 2018); *see generally* 8 Corbin on Contracts, *supra* note 3, at §§ 32.7, 32.8, 36.1-36.7; Justin Sweet & Marc M. Schneier, Legal Aspects of Architecture, Engineering and the Construction Process 465-67 (7th ed. 2004).

12 Restatement (Second) of Contracts § 235(2) (Am. Law Inst. 1981).

13 *Id.* § 237.

14 *Id.* § 242.

permanently from its future performance obligations and may deny the breaching party the right to continue to perform.

Section 241 of the second Restatement provides the notoriously subjective framework that courts regularly use to analyze whether or not a breach is material. Section 241 lists these five factors for courts to consider:

(a) the extent to which the injured party will be deprived of the benefit which he reasonably expected;
(b) the extent to which the injured party can be adequately compensated for the part of that benefit of which he will be deprived;
(c) the extent to which the party failing to perform or to offer to perform will suffer forfeiture;
(d) the likelihood that the party failing to perform or to offer to perform will cure his failure, taking account of all the circumstances including any reasonable assurances;
(e) the extent to which the behavior of the party failing to perform or to offer to perform comports with standards of good faith and fair dealing.

In the abstract, these considerations provide only a vague standard for working out the materiality analysis. It is easy to understand why, as already mentioned, *Corbin on Contracts* reduces the judicial task to an inquiry into what "justice seems to require." Under this approach, many contract disputes leave considerable room for reasonable minds to differ. Federal courts have held, for example, that the U.S. Forest Service materially breached a contract with a timber company by denying access to a little less than 16 percent of the contract area, but not by denying access to a little more than 6 percent.[15] At what point between 6 and 16 percent does the transition occur from the material to the immaterial in such a contract, and how is the Forest Service, a timber company, or a court to discern the difference? Similarly, a relatively short delay in performance sometimes will, but sometimes will not, be material.[16]

In contrast to these close-call situations, some cases present far clearer circumstances of a partial failure of performance that should logically be deemed immaterial for purposes of the constructive conditions doctrine. The most common and easily understood of these involves an injured party who has, in effect, already received the essential benefits of the bargained for exchange notwithstanding the other party's partial failure to perform. This, in effect, is

15 *Compare* Stone Forest Inds. v. United States, 973 F.2d 1548 (Fed. Cir. 1992) *with* Everett Plywood Corp. v. United States, 512 F.2d 1082 (Ct. Cl. 1975). *See* Cohen, *supra* note 4, at 84-85 (criticizing the contrasting results reached by the *Everett Plywood* and *Stone Forest* courts as illustrating the arbitrariness of the material breach principle).

16 *See* RESTATEMENT (SECOND) OF CONTRACTS § 242, illustr. 7 (AM. LAW. INST. 1981) (whether a 10-day delay in making a payment due under a contract for series of deliveries of goods is material depends on a variety of circumstances in accordance with §§ 241 (a), (b), (d), (e), and 242(b)).

the distinct substantial performance branch of the materiality principle that courts came to recognize primarily through a recurring pattern of construction industry cases.

The second Restatement does not expressly endorse this distinct notion of substantial performance. It comes closest via a comment elaborating on Section 241(c)'s forfeiture factor. That comment explains that a forfeiture of contract rights works an especially harsh penalty on a party guilty of a partial failure of performance who "has relied substantially on the expectation of the exchange, as through preparation or performance."[17] On this basis, the comment reasons that "a failure is less likely to be regarded as material if it occurs late, after substantial preparation or performance, and more likely to be regarded as material if it occurs early, before such reliance." Neither this comment nor any other provision of the Restatement, however, offers a definition or test for substantial performance apart from the materiality factors.

This is where the construction industry cases come into play. Several of Section 241's illustrations and comments reflect the influence of the construction industry cases in framing a substantial performance standard that can, in the appropriate circumstances, operate as a more objective expression of materiality.[18] Similarly, in treatise, casebook, and scholarly commentary, the routine examples of substantial performance in this more objective sense involve a building project owner who is already occupying the project and using it for its intended purpose and who refuses to pay the builder the contract balance because construction details have not been completed or corrected.[19] In this way, the construction industry has provided the most important reference point for analyzing the materiality of a partial breach in any context.

Situations common to construction disputes offer relatively clear settings for working out the substantial performance concept as a distinct and more objective variation on the generally more subjective materiality standard. In effect, the construction industry cases have presented recurring opportunities for standard applications of the substantial performance defense, thereby providing a model for courts in the United States to use as an analogy in other contexts. To appreciate how this came about, we now turn our attention to Judge Cardozo's opinion in *Jacob & Youngs, Inc. v. Kent*,[20] the 1921 case that scholars regularly identify as the foundation of the substantial performance doctrine in U.S. contract law.

17 *Id.* § 241(c), cmt. d.

18 *See* id. § 241, cmts. b & d, illustr. 1, 2, 6, & 7.

19 *See, e.g.*, 8 CORBIN ON CONTRACTS, *supra* note 3, at §§ 36.2-36.9; WILLISTON ON CONTRACTS, *supra* note 10, at § 44:57; CHARLES L. KNAPP, NATHAN M. CRYSTAL, HARRY G. PRINCE, PROBLEMS IN CONTRACT LAW: CASES AND MATERIALS 809-827 (8th ed. 2016); LON L. FULLER & MELVIN ARON EISENBERG, BASIC CONTRACT LAW 902-910 (7th ed., 2001); Cohen, *supra* note 4, at 75-82 and *passim*; Andersen, *supra* note 4, at 1091 and *passim*.

20 Jacob & Youngs, Inc. v. Kent, 129 N.E. 889 (N.Y. 1921).

George Kent contracted with Jacob & Youngs, Incorporated to build for Kent a country residence. A plumbing specification called for "well galvanized, lap welded pipe of the grade known as 'standard pipe' of Reading manufacture."[21] Several months after Kent took possession and moved in, but before he paid Jacob & Youngs a relatively small balance of the contract price, he discovered that at least some of the pipe was manufactured elsewhere than Reading. Because much of the plumbing had been enclosed within walls, the evidence did not show what percentage of the pipe failed to conform to the specifications. Kent's architect directed that the nonconforming pipe be removed and replaced. Jacob & Youngs refused that order and sued for the contract balance. The builder's theory was based on the assertion that the pipe actually used was equivalent in kind and quality to that specified. The trial court excluded certain evidence of this nature and directed a verdict for the owner, effectively holding that the owner's duty to pay the contract balance was conditioned on performance by the builder strictly in accordance with the specifications.

While acknowledging that any failure of performance by the builder was a breach, Cardozo cited several cases for the proposition that "an omission, both trivial and innocent, will sometimes be atoned for by allowance of the resulting damage, and will not always be the breach of a condition to be followed by a forfeiture."[22] The breach of contract analysis could have stopped there, and the case would simply be an example of the ill-defined principle that a slight breach is not material under the constructive conditions doctrine. Indeed, most of what Cardozo said about the breach simply emphasized its relative insignificance in the same vague sense intimated by the constructive conditions cases of the day. In his penultimate sentence, however, leading up to a holding on the proper measure of damages, Cardozo characterized the situation with a phrase that subsequently came to represent a much more objective test for materiality in certain building construction cases. "The rule that gives a remedy in cases of substantial performance with compensation for defects of trivial or inappreciable importance has been developed by the courts as an instrument of justice."[23] The central holding of *Jacob & Youngs* addresses the economic waste limitation on damages awarded to an owner for defective work, a topic considered next in this Chapter. But by labeling, perhaps incidentally, the builder's work as substantial performance, Cardozo set the stage for courts to recognize a special application of the immateriality breach parry to the constructive conditions thrust.

A consistent series of later cases relied on *Jacob & Youngs* to develop this principle: substantial performance of a construction contract generally occurs (thereby negating any claim of material breach) when the builder has

21 *Id.* at 890.
22 *Id.*
23 *Id.* at 892.

completed the work to such an extent that the owner can use the project for its intended purpose; and the existence of defects or incomplete work of a kind commonly encountered at that stage of construction ordinarily does not establish a material breach on the builder's part. A great many cases invoke this principle when an owner makes a constructive conditions argument based on a builder's partial failure of performance.[24] The cases reflect a common-sense understanding of the substantial performance doctrine in this specific situation, sometimes referred to as *substantial completion* (rather than substantial performance). The resulting principle allows a builder to recover the contract price after an adjustment in the owner's favor for minor incomplete or deficient work.

For example, a homebuilder met the substantial performance standard even though the pitch of the roof deviated to some extent from the specifications, and corrective work, costing about 2 percent of the contract price, also remained to be completed after issuance of a certificate of occupancy.[25] In another case, involving a dispute over the exterior finish of a residence, the court upheld the trial court's finding of substantial performance despite evidence of some discrepancy between the color agreed on and that which the contractor achieved, and also the existence of cracks in the finish that could be remedied at modest expense.[26] In a case in which the project owner claimed that the builder materially breached a contract for construction of a concrete water slide, the court upheld the trial court's finding of substantial performance because the evidence was sufficient to support the conclusion that "the cracks have not interfered with the operation of the structure in its intended use."[27] A legion of similar cases firmly ensconces this substantial performance concept.[28]

The most important lesson of *Jacob & Youngs* and its progeny is that the material breach issue need not inevitably devolve into a subjective exercise of weighing vague considerations, such as those listed in Section 241 of the second Restatement. Courts have a viable objective standard (or at least a much less subjective one) to use in many construction industry cases. Under that standard, a builder can commonly defend against a material breach assertion by showing delivery to the owner of a project that is practically complete in the sense that the owner can take possession of the project and use it for its intended purpose; incomplete finish details and common construction defects do not preclude substantial performance, provided that none of the unfinished details or uncorrected defects prevents the owner

24 *See generally* 5 BRUNER & O'CONNOR, *supra* note 11, at § 18:12.

25 Clem Martone Construction, LLC v. DePino, 77 A.3d 760, 771-72 (Conn. App. 2013).

26 S.D. & D. L. Cota Plastering Co. v. Moore, 77 N.W.2d 475, 477-78 (Ia. 1956).

27 W.E. Erickson Const., Inc. v. Cong.-Kenilworth Corp., 503 N.E.2d 233, 237 (Ill. 1986).

28 *See generally* 5 BRUNER & O'CONNOR, *supra* note 11, at § 18:12; 2 STEVEN G. M. STEIN, CONSTRUCTION LAW. ¶ 4.15 (Lexis 2018); SWEET & SCHNEIER, *supra* note 11, at 465-67.

from using the project as intended. The constructive conditions doctrine requires no more of a builder than the practicalities of building construction realistically permit.

What connects the constructive conditions doctrine in a special way to construction law, therefore, is that in the construction industry cases, substantial performance often works as a much more predictable and pragmatic test of materiality than what the Restatement factors offer as a general matter. This is especially so when a project owner wishes to deny the builder the right to continue working on the project or to receive further compensation following the builder's partial failure of performance. Of course, the builder that cannot meet the substantial performance test can still argue that any breach it may have committed is not material under the balancing test of the Restatement. But in many instances, the superior defense is that the builder cannot be liable for a material breach because the builder has already substantially performed its obligation to build the project.

Experience and custom in the construction industry provide the compelling analysis underlying the substantial performance cases. Almost any construction project imposes on the builder so many complex performance duties that perfect adherence to plans and specifications is practically impossible. If courts were to apply the constructive conditions doctrine to condition the owner's obligation to pay on the builder's full performance in a literal sense, the owner might never be obligated to pay. Moreover, for most building projects, the finder of fact can usually determine with a relatively high degree of confidence whether or not the builder's imperfect performance gives the owner the essential benefits of the bargain. The objective question is whether the project has been completed to the point that the owner can take possession and use the project for its intended purpose; beyond that point, a damage award can make the owner whole on account of defective work and incomplete construction details. The point here is not that substantial performance defined in this way as substantial completion always produces the best or even a just result. The point is simply that in construction industry cases, for better or worse, the common law process has yielded a viable and relatively predictable standard that courts routinely use to solve the material breach puzzle.

This specific application of the material breach concept has achieved such widespread acceptance that the leading industry contract forms define substantial performance in this sense as a critical milestone.[29] Many standard industry construction contracts refer to the stage of construction when the project can be turned over to the owner for its intended use, subject only to minor defects and minor incomplete details, as "substantial completion." Custom and practice in the industry, as well as the industry cases, effectively recognize that substantial completion ordinarily establishes substantial performance for purposes of the constructive conditions doctrine. Construction contracts routinely provide for the

29 SWEET & SCHNEIER, *supra* note 11, at 462-63.

risk of casualty loss to pass to the owner at substantial completion and for the owner then to pay most of the remaining contract balance to the builder, subject to withholding an amount based on the estimated costs of finishing incomplete work and correcting remaining details.[30] The substantial completion milestone is often formalized via a process in which the builder and the owner or the owner's representative inspect the project and create a list (punch list) of the details to be completed and the defects to be corrected. With the help of this industry practice, substantial completion of a building project as an example of substantial performance has become the gold standard for resolving the materiality issue embedded in the constructive conditions doctrine.

By establishing an objectively verifiable test of substantial performance for a major category of construction industry cases, the substantial completion concept facilitates a more orderly model for the materiality analysis in a much wider range of cases. Substantial completion in the building context serves as an analogy that courts draw on in a range of cases in which the issue is whether one party's partial failure of performance should discharge the other party's duty to perform. The analogy applies both in construction industry cases not resolved under the substantial completion rubric and in cases arising outside of the industry context. In this way, the courts have evolved Cardozo's analysis in *Jacob & Youngs* into the broader substantial performance doctrine of contract law.

For the construction industry, this reasoning by analogy is important because the substantial completion test cannot resolve all materiality disputes that arise under construction contracts. For example, even though the substantial completion test, as normally rendered, only applies to the performance obligations of a general contractor or a subcontractor, comparable reasoning may apply when an architectural firm sues for the balance of its fee notwithstanding its partial failure of performance.[31] Similarly, because the duty to complete construction applies only to a builder, an owner who commits a partial default cannot invoke the traditional substantial completion standard, but still may avoid the consequences of the constructive conditions doctrine by showing substantial performance in an analogous sense.[32]

Beyond the important role that the substantial completion cases play by analogy within the construction industry, they also have helped courts resolve partial default cases in many other contexts. The range of disputes over imperfect or incomplete performance in which courts analogize to the

30 *See generally* 3 BRUNER & O'CONNOR, *supra* note 11, at §§ 5:185, 8:23.

31 *See* Roland A. Wilson & Assos. v. Forty-O-Four Grand Corp., 246 N.W.2d 922, 925-26 (Iowa 1976).

32 *See* Pack v. Case, 30 P.3d 436, 442 (Utah Ct. App. 2001) (owner seeking to enforce a roofing contractor's warranty substantially performed by paying the bulk of an unliquidated balance due on the contract); Kossler v. Palm Springs Developments, Ltd., 161 Cal. Rptr. 423, 433 (Ct. App. 1980) (builder who relied on its own substantial rather than complete performance could not avoid its remaining obligations under the contract on the basis that its customer must "fully perform, i.e., take the house as it was and pay the full contract price therefor.").

substantial completion cases include those arising under employment contracts,[33] insurance policies,[34] real estate transactions,[35] oil and gas contracts,[36] information services agreements,[37] and more. What is especially significant about many of these cases is that the courts deciding them have drawn on construction industry cases as precedent, or at least have used the language and concepts first articulated in industry cases. While many authorities acknowledge that the substantial performance principle applies in a special way to building contracts, and a few even express the opinion that it should generally be limited to building contracts,[38] a substantial performance doctrine, guided by the substantial completion concept developed in the construction industry, has become a general principle of contract law.

Before concluding this assessment of the role that the construction industry cases have played in developing the substantial performance doctrine, it is worth noting that courts and commentators sometimes conflate immaterial breach and substantial performance. At times, this merely reflects that the phrase "substantial performance" can serve as shorthand for the conclusion that a breach is immaterial under the traditional balancing test.[39] The construction industry cases, however, demonstrate that we should distinguish between the two concepts even while recognizing their close relationship. It is true that a breach ordinarily cannot be material for purposes of the constructive conditions doctrine if the breaching party has substantially performed.[40] The fact that the party allegedly in breach has not (yet)

33 Measday v. Kwik-Kopy Corp., 713 F.2d 118, 125-26 (5th Cir. 1983) (employee could establish substantial performance by showing that he performed the specific duties and tasks specified in the employment contract).

34 Gibson v. Grp. Ins. Co., 369 N.W.2d 484, 486 (Mich. Ct. App.1985) (insured substantially performed his obligation to cooperate in insurer's investigation of a suspicious fire; although he initially refused to provide certain information, he eventually did so).

35 Schneider v. Dumbarton Developers, Inc., 767 F.2d 1007, 1013 (D.C. Cir. 1985) (purchaser's untimely attempts to close real estate transaction did not meet the substantial performance standard).

36 Cookson v. W. Oil Fields, Inc., 465 F.2d 460, 462 (10th Cir. 1972) (where contract called for drilling one well in each of five years, substantial performance was achieved by drilling six wells over the period although no well was drilled in two of the five years).

37 Micro-Managers, Inc. v. Gregory, 434 N.W.2d 97, 103-04 (Wis. Ct. App. 1988) (software developer substantially performed where contract called for the exercise of skill and expertise but did not guarantee quality of the work).

38 *See, e.g.*, Morris v. Homco Int'l, Inc., 853 F.2d 337, 343 (5th Cir. 1988).

39 *See, e.g.*, 8 CORBIN ON CONTRACTS, *supra* note 3, at §§ 36.3-36.8; Leaman v. Wolfe, 31 F.Supp.3d 687, 897-98 (E.D. Pa. 2014).

40 *See* Cohen, *supra* note 4, at 79 n. 51. There may be limited exceptions, such as when a court apparently treats as material a breach that is manifested after the breaching party no longer has any contractual duties left to perform. *See, e.g.*, Roland A. Wilson & Assocs., 246 N.W.2d at 922. (architect liable for a material breach in conducting re-inspection of completed work even though the re-inspection apparently was the final step in the architect's duties). *Cf.* Andersen, *supra* note 4, at 1135 (arguing that courts often inappropriately undertake a materiality analysis when the party allegedly in breach no longer has any duties left to perform).

substantially performed, however, does not thereby establish a material breach. Thus, if an owner prevents a builder from continuing the work, a court may hold that defects in the work finished to that point constitute immaterial rather than material breaches and that the owner wrongfully terminated the contract and effectively denied the builder the opportunity eventually to achieve substantial performance.[41] Thus, not only do the construction industry cases provide the customary and most analytically helpful examples of substantial performance, they also often lead the way in demonstrating why substantial performance cannot be the sole, nor even necessarily the most common, route to establishing that a partial breach is immaterial.

It goes too far to claim that the substantial performance doctrine owes its existence to the construction industry cases, or even that it originated with the industry cases. The concept dates back at least to a late-eighteenth-century English case involving the sale of a plantation,[42] and to several substantial performance cases decided in the nineteenth and early twentieth centuries arising out of contracts from other segments of commerce.[43] In the United States, however, the doctrine achieved prominence primarily through a series of building contract cases beginning even before *Jacob & Youngs*.[44] That Cardozo's opinion had such an impact is testimony to his standing as a leading common law jurist of his time.

What we can say, therefore, is that the construction industry cases account for the important place the substantial performance doctrine has held in U.S. contract law from at least the time of the first Restatement of Contracts. In effect, the industry's substantial completion cases popularized the substantial performance defense and helped solidify its meaning as a fundamental principle of contract law. A significant proportion of substantial performance cases have arisen over the years from construction industry disputes. Moreover, the industry cases have provided ideal, recurring settings for courts to apply and refine the doctrine and for scholars to explore it. *Jacob & Youngs* remains the classic case for introducing law students to the concept. Perhaps more significantly, the situation in which a building contractor delivers to a disgruntled owner a substantially completed project, albeit with relatively minor defects or unfinished punch-list work, illustrates the most compelling, common, and

41 *See* Butera v. Boucher, 798 A.2d 340, 346 (R.I. 2002).

42 *See* Boone v. Eyre (1777) B.R. East. 17 Geo.3 (KB).

43 *See* Omaha Water Co. v. City of Omaha, 156 F. 922, 926 (8th Cir. 1907) (contract for supply of municipal water and related equipment); Blitz v. Toovey, 9 N.Y.S. 439, 441 (City Ct. 1890) (contract for entertainment performances); Ellen v. Topp (1851) 155 Eng. Rep. 609 (indenture of apprenticeship).

44 *See* Braseth v. State Bank of Edinburg, 98 N.W. 79 (N.D. 1904); Spence v. Ham, 57 N.E. 412, 413 (N.Y. 1900); Crouch, 31 N.E. at 273; *Damages - Measure of Damages - Substantial Performance of Building Contract*, 22 HARV. L. REV. 381 (1909); *Contracts-Substantial Performance-Recovery.-Flagg v. Schoenleben, 142 N. Y. Supp. 1004*, 17 YALE L.J. 542, 543 (1908).

commonsense example of the doctrine's logic and fairness. Indeed, but for the construction industry cases, the substantial performance response might be practically indistinguishable from other less definitive counters to a total breach claim.

The substantial performance doctrine is the most obvious instance of construction industry experience influencing the course of U.S. contract law. This stems primarily from three attributes. First, it has a strong construction industry pedigree in the common law tradition, apparent both in the seminal cases and in a subsequent line of industry cases that courts used to extend its reach or to solidify its importance. For future reference, I will call this the *pedigree factor*. Second, the industry context infuses the doctrine's development and application, both because industry customs, practices, and dispute patterns played prominent roles in leading cases and because the doctrine eventually had a reciprocal effect on the industry (recall how contemporary contracting practices incorporate the doctrine as a practical feature). This I will call the *contextual factor*. Finally, via the *general principle factor*, we can rightly classify substantial performance as a general principle of U.S. contract law both in theory (witness its recognition in the Restatement and in the scholarly literature) and in practice (courts routinely use the doctrine to resolve cases in a wide range of contexts). Based on these same considerations, I find at least four other suitable, but lesser, examples of industry cases and concepts that have significantly infiltrated U.S. contract law. The next one under consideration is closely connected to substantial performance but casts a far paler shadow.

Economic waste

Cardozo's opinion in *Jacob & Youngs* performed double duty. In addition to inspiring general acceptance of the substantial performance doctrine, it also helped formulate a principle that limits damages recoverable for breach of contract. As discussed previously, the builder's breach in *Jacob & Youngs* involved using pipe that differed from what the contract specified not in type, quality, function, or cost, but only in the location of its manufacture. Because the deviation seemed trivial and the finished residence gave the owner the essential benefits of the bargain, the builder was entitled to the unpaid balance of the contract price, but with an appropriate adjustment to compensate the owner for the damage attributable to the breach. Cardozo acknowledged that in an ordinary case of construction defect not amounting to a material breach, the measure of the owner's damages should be the cost to correct the defect. But not so when that cost "is grossly and unfairly out of proportion to the good to be attained. When that is true, the measure is the difference in value."[45]

Cardozo's concise explanation, which does not use the phrase "economic waste," simply asserts that in a construction defect case in which the builder

45 Jacob & Youngs, Inc. v. Kent, 129 N.E. 889, 891 (N.Y. 1921).

has substantially performed, justice will not tolerate a damage award determined by the considerable cost of demolishing and reworking much of a completed structure for no better purpose than to provide the owner funds sufficient to reconstruct a building of equal or comparable market value. The rule of the case, as later articulated more fully in many similar opinions relying on *Jacob & Youngs*, permits only nominal or no damages when the disappointed owner fails to prove a significant difference in market value between the project as completed and as promised.[46]

This principle, popularly called the economic waste doctrine, is now firmly established in construction defect cases. The Restatement (Second) of Contracts expressly links the economic waste limit on damages to the construction industry. Section 348(a), which adopts the principle, provides:

> If a breach results in defective or unfinished construction and the loss in value to the injured party is not proved with sufficient certainty, he may recover damages based on
>
> (a) the diminution in the market price of the property caused by the breach, or
> (b) the reasonable cost of completing performance or of remedying the defects if that cost is not clearly disproportionate to the probable loss in value to him.

While the construction industry cases provide the most common examples of the economic waste principle as a damage limitation, the doctrine deserves recognition as a broader feature of U.S. contract law, and not merely a quirk of construction law, for at least two reasons. First, courts have considered and have sometimes applied the doctrine in other contexts. Second, the doctrine has attracted considerable attention from legal scholars.

Economic waste cases from outside of the construction industry typically involve a promise to perform some task comparable to a construction project although that task is not the central purpose of the contract.[47] In the most famous and controversial of these cases, at the end of the contract term, a contracting party fails or refuses to perform restorative work on the other party's property as promised. In an early case, a divided Minnesota Supreme Court declined to apply the doctrine where the lessee under a lease for removal of sand and gravel from the leased property breached its covenant to

46 *See* 11 CORBIN ON CONTRACTS, *supra* note 3, at §§ 60.1, 60.2; 5 BRUNER & O'CONNER, *supra* note 11, at § 18:13.

47 *See, e.g.*, Dixon v. City of Phoenix, 845 P.2d 1107, 1112-14 (Ariz. Ct. App. 1992) (declining to apply the doctrine to damages to vegetation on plaintiff's land caused by a city contractor where the damage breached a provision of a right of entry agreement between the city and the landowner). Tort law recognizes a somewhat analogous principle for awarding damages for injury to land. *See* RESTATEMENT (SECOND) OF TORTS § 929(1) (a) cmt. b. (AM. LAW INST. 1979).

restore the site to a uniform grade even though the evidence was that the cost of restoration would far exceed the value of the land.[48] More recent cases involving similar failures to perform land restoration duties, however, tend to favor the doctrine.[49] Thus, courts have applied the doctrine to limit the damages a landowner may recover for the lessee's breach of its obligation under a strip mining lease to restore the land when the lease term expires.[50] The economic waste doctrine has also been asserted in other situations, such as a case in which an airplane lessor alleged that the lessee failed to perform maintenance obligations,[51] and one in which the buyer under a stock purchase agreement sued the sellers for breaching warranties concerning the condition of the corporation's assets.[52]

Scholarly attention to the economic waste cases suggests an even more compelling reason for treating the doctrine as a notable feature of U.S. contract law. The criticism has generally been harsh.[53] While the literature focuses primarily on construction industry and land restoration cases, it offers broader implications for contract law theory.[54] To some, the economic waste cases demonstrate that a subjective damage rule can leave too much to judicial discretion and thereby yield inconsistent results.[55] Arguably, the cases also show how far courts can go astray when they misapply the economic underpinnings of contract law.[56] Professors Schwartz and Scott conclude that when courts limit damage awards based on the economic waste principle they "are practicing a form of soft paternalism. Judges believe that, notwithstanding the express terms of the contract, the parties must have made a mistake."[57] Moreover, they argue that this "judicial tendency to attribute a lack of foresight or incompetence to parties in commercial contexts, and thus to override explicit contracts with mandatory rules, is regrettably

48 Groves v. John Wunder Co., 286 N.W. 235, 238 (Minn. 1939).

49 *See* Alan Schwartz & Robert E. Scott, *Market Damages, Efficient Contracting, and the Economic Waste Fallacy*, 108 COLUM. L. REV. 1610, 1625-29 (2008).

50 *See* Youngs v. Old Ben Coal Co., 243 F.3d 387, 392-93 (7th Cir. 2001); Peevyhouse v. Garland Coal & Mining Co., 382 P.2d 109 (Okla.1962).

51 BLB Aviation S. Carolina, LLC v. Jet Linx Aviation, LLC, 748 F.3d 829, 841 (8th Cir. 2014).

52 Chemical Waste Management, Inc. v. Sims, 939 F.Supp. 599, 602 (N.D. Ill. 1996).

53 *See, e.g.*, Schwartz & Scott, *supra* note 49; Juanda Lowder Daniel & Kevin Scott Marshall, *Avoiding Economic Waste in Contract Damages: Myths, Misunderstanding, and Malcontent*, 85 NEB. L. REV. 875 (2007); Carol Chomsky, *Of Spoil Pits and Swimming Pools: Reconsidering the Measure of Damages for Construction Contracts*, 75 MINN. L. REV. 1445 (1991). *See also* Christine Hurt, *The Windfall Myth*, 8 GEO. J.L. & PUB. POL'Y 339, 341 n.5 (2010) (incidentally commenting on the economic waste cases as an example of the traditional notion that contract law disfavors damages that the courts perceive as windfalls).

54 *See* Daniel & Marshall, *supra* note 53, at 880 n.17 (commenting that the doctrine "is relevant to any contract in which a party's expectancy interest primarily relates to the performance of a construction-type service").

55 *See* Chomsky, *supra* note 53, at 1460-69.

56 Daniel & Marshall, *supra* note 53, at 877.

57 Schwartz & Scott, *supra* note 49, at 1668.

widespread." As examples, they assert that this attitude accounts "for overly restrictive liquidated damage rules, for ignoring merger clauses and instead forcing costly trials on interpretation issues, for preventing efficient contractual restrictions on the parties' ability to renegotiate, and for much else."[58]

No matter how controversial the doctrine may be when extended beyond the building context in which it most frequently arises, from the construction industry perspective, the economic waste doctrine may best (or at least most comfortably) be understood as a limited and rational extension of the material breach and substantial performance principles.[59] A convincing justification for the doctrine exists when correcting defective construction would require, as in *Jacob & Youngs*, extensive demolition of nonconforming work that meets the substantial performance test.[60] For what sense does it make for a court, after having concluded that a builder has delivered to the owner essentially what the parties bargained for, then to allow the owner a large damage recovery based on the cost to correct or complete minor deficiencies that have little or no adverse impact on the project's market value?

To the extent the doctrine fails to resolve contract disputes satisfactorily that arise outside the industry context, the reason may simply be that courts have too often invoked it in the face of a material breach. In the usual construction industry case, the economic waste defense only applies if the builder has substantially performed as to the singular contractual obligation to complete a building project; in the other contexts in which cases applying the doctrine have been most severely criticized, two or more distinct obligations are arguably both essential aspects of the bargained-for exchange, even if only one of those obligations is the central object of the contract (e.g., mining may be the central object, but restoration of the land may still be essential to the bargain).

Although the economic waste doctrine bears a close connection to the substantial performance doctrine, both historically and logically, its significance as a construction industry influence on U.S. contract law is relatively meager when judged by the three factors that make substantial performance so notable. Like substantial performance, economic waste has a strong construction-industry pedigree in the common law tradition, demonstrated in the very same seminal case and in a closely relating line of industry cases. Also, as with substantial performance, the industry context characterizes the economic waste doctrine's development in the sense that industry customs, practices, and dispute patterns figured prominently in the doctrine's development. The close relationship between the two doctrines in factually comparable cases made this predictable if not inevitable. The economic waste doctrine, however, has not had a reciprocal effect on industry customs and practices similar

58 *Id.* at 1668-69.

59 *See* 4A Bruner & O'Connor, *supra* note 11, at § 13:3.

60 *See generally* E. Allan Farnsworth, Farnsworth on Contracts § 12.13 (4th ed. 2004).

to that of the substantial performance doctrine, as there has been no widespread incorporation of the concept into construction contracts or practices that industry participants follow. In other words, the contextual factor is present, but it is one dimensional—industry customs and practices and circumstances influenced the judicial development of the doctrine, but the industry has not incorporated the concept into standard contracting relationships. On the third consideration, it is much harder to classify the economic waste doctrine as a general principle of U.S. contract law. Perhaps it is in theory, as indicated by its incorporation into the Restatement and its popularity as a topic of scholarly discussion. But even on the theoretical front, the doctrine has a much narrower reach beyond the construction cases. The Restatement acknowledges the doctrine essentially as a rule for construction defect cases, and the treatises and scholarly literature generally afford it relatively cool treatment, especially when invoked beyond the industry. Furthermore, as a practical matter, courts apply the economic waste doctrine in a relatively small set of cases outside of the industry.

Unilateral mistake

The author of a 1911 article in the Columbia Law Review declared that the "law relating to mistake is in a state of great confusion."[61] After offering a framework for reconciling seemingly conflicting authorities on mutual mistake, he turned to the unilateral mistake cases and flatly concluded that when one party makes an offer based on a faulty assumption, there is no defense unless the other party is aware of the mistake.[62] A series of cases in which bidders on construction projects made estimating errors provided the primary support for this proposition. Seventeen years later, another Columbia Law Review article focused more closely and comprehensively on construction industry bidding cases and found considerable openness to a unilateral mistake defense, a trend the author rejected.[63] "Despite numerous dicta (usually thrown off as sops to the losing party) that equity will rescind a contract for unilateral mistake where there has been no negligence by the mistaken promisor and no change of position by the promisee, it is submitted that the opposite is not only the prevailing but the preferable view."[64] Although both of these articles considered unilateral mistake cases in several contexts, the attention they gave to competitive bidding errors show how significantly the construction industry cases influenced the early conceptions of unilateral mistake in U.S. contract law.

61 Roland R. Foulke, *Mistake in the Formation and Performance of a Contract*, 11 COLUM. L. REV. 197, 197 (1911).

62 *Id*. at 224.

63 Edwin W. Patterson, *Equitable Relief for Unilateral Mistake*, 28 COLUM. L. REV. 859 (1928).

64 *Id*. at 885 (footnote omitted).

Unilateral mistake cases challenge courts to develop a suitable rationale for relieving even the most sympathetic of mistaken parties. Contract law quite logically does not easily accommodate relief from a promise based on one party's mistake because a main function that contracts serve is holding the contracting parties to promises by which they themselves have decided how to allocate risks of an uncertain future.[65] Early cases recognizing a defense tended to do so on the basis that, when one party alone labors under a mistake, there may never have been a meeting of the minds.[66] Confusion and inconsistency in the cases, coupled with competing perspectives on the subjective intent theory of contract, begged for an alternative rationale.[67]

Over the years, construction industry bidding error cases presented a recurring situation that helped the courts refine general principles based primarily on identifiable equitable considerations rather than on rigid rules of contract formation.[68] Bidding in the construction industry, and especially competitive bidding for public projects, often takes place under stressful conditions that arguably create equities favoring relief from a more or less innocent mistake. Inadvertent and predictable miscalculations, misplaced line item amounts, complex specifications, competitive pricing pressures, and inflexible time constraints often lead to significant errors in contractor and subcontractor proposals. Statutes, regulations, or practices that require the bids to remain open as irrevocable offers until the project owner awards the contract, usually to the lowest responsible bidder, can make it impossible for bidders to correct errors. In many instances, the bidder discovers the mistake before the project owner has taken any significant steps in reliance of the bid. As a result, the construction industry has presented some of the most sympathetic and compelling opportunities for courts to recognize a unilateral mistake defense. These factors have often influenced judges and commentators alike.[69]

In time, courts clarified and refined the law relating to mistake, including by recognizing a limited but significant unilateral mistake defense. As expressed in Section 153 of the second Restatement of Contracts, the defense may apply when a contracting party's error concerns a basic assumption that is material to the exchange. Many courts have adopted the Restatement rule,

65 *See* 7 CORBIN ON CONTRACTS, *supra* note 3, at § 28.28; E. Allan Farnsworth, *Oops! The Waxing of Alleviating Mistakes*, 30 OHIO N.U. L. REV. 167, 175 (2004).

66 *See* Moffett, Hodgkins & Clarke Co. v. Rochester, 178 U.S. 373 (1900); Bd. of Sch. Comm'rs of City of Indianapolis v. Bender, 72 N.E. 154 (Ind. App. 1904); *see generally* 7 CORBIN ON CONTRACTS, *supra* note 3, at § 28.39.

67 *See generally* Andrew Kull, *Unilateral Mistake: The Baseball Card Case*, 70 WASH. U. L.Q. 57, 61-68 (1992) (arguing the superiority of the traditional analysis based on a subjective, mutual assent analysis).

68 *See, e.g.*, 1 BRUNER & O'CONNOR, *supra* note 11, at §§ 2:117, 2:123-2:129; 7 CORBIN ON CONTRACTS, *supra* note 3, at § 28.40; Melvin A. Eisenberg, *Mistake in Contract Law*, 91 CAL. L. REV. 1573, 1596-1601 (2003).

69 *See generally* 1 BRUNER & O'CONNOR, *supra* note 11, at §§ 2:133-2:135, 2:139-2:142; 1 STEIN, *supra* note 28, at ¶ 2.04.

which identifies factors that must be present to justify a unilateral mistake defense. In this way, contemporary U.S. contract law takes a far more flexible and forgiving approach than the common law originally permitted, particularly where the court regards an economically significant mistake to be innocent, and it further concludes that allowing the defense will not unduly prejudice the other party.

The Restatement provides:

> Where a mistake of one party at the time a contract was made as to a basic assumption on which he made the contract has a material effect on the agreed exchange of performances that is adverse to him, the contract is voidable by him if he does not bear the risk of the mistake under the rule stated in § 154, and
>
> (a) the effect of the mistake is such that enforcement of the contract would be unconscionable, or
> (b) the other party had reason to know of the mistake or his fault caused the mistake.[70]

Thus, where a mistake as to a basic and material assumption has an adverse effect on the mistaken party, application of the defense essentially turns either on the unconscionability of enforcing the contract under the circumstances or on whether the other contracting party has reason to know of the mistake. (We can safely treat the situation in which the other party's fault caused the mistake as being subsumed in the reason-to-know principle.[71]) As evidenced by the number of industry cases cited in the Reporter's Note, the alternative elements expressed in parts (a) and (b) of Section 153 find antecedent support in construction industry cases.

For example, a case decided in 1904 granted relief to a bidder who, in the last-minute rush to submit the bid, overlooked one of several pages of items making up the bid and completely omitted an item.[72] While the court, in keeping with the restrictive authorities of the day, formally based the decision on the rationale that the parties never reached a true meeting of the minds, the opinion also suggested that it would be unconscionable to hold the unfortunate contractor to the bid where the economic consequences to the bidder would be disastrous and the status quo could be restored without unfairness to the recipient, who had timely notice of the error. A 1913 case on similar facts even more clearly invoked unconscionability as a relevant consideration.[73]

70 Restatement (Second) of Contracts § 153 (Am. Law Inst. 1981).

71 *See* 1 Bruner & O'Connor, *supra* note 11, at §§ 2:144 & 2:146.

72 Bd. of Sch. Comm'rs of City of Indianapolis v. Bender, 72 N.E. 154 (Ind. App. 1904).

73 Barlow v. Jones, 87 A. 649 (N.J. Ch. 1913).

As reflected in the early twentieth-century law review articles on mistake mentioned previously, construction industry cases have long recognized a defense if the bid recipient knows of the bidder's mistake. It did not take long for the courts then to consider whether "reason to know of the mistake," as subsection 153(b) contemplates, should be treated similarly to knowledge in fact. In a 1925 case, the court noted as significant the fact that the erroneous low bid submitted for a school building project was so much less than the next lowest one that members of the school's board of regents suspected an error.[74] A 1950 case more fully embraced the principle that when the bid recipient has reason to know of the error, the court should grant relief to the bidder.[75]

Pre-Restatement competitive bidding cases such as these, including several others cited in the Reporter's Note, planted the seeds for Section 153, although they commonly also reflected the limiting formalism that characterized the contract cases of the era. In particular, the earliest cases commonly invoked the no-meeting-of-the minds legal rationale, and they tended to emphasize the absence of any culpable negligence by the bidder rather than explicitly relying on the more flexible conscionability concept.

A 1978 Illinois opinion provides a good illustration of a transitional case that more closely presages the approach to the unilateral mistake defense that Section 153 ultimately adopted.[76] The general contractor in that case submitted a bid of $882,600, based in part on an excavating subcontractor's proposal that contained a $150,000 underestimate. Under the bidding rules that applied to the competitive bidding process for the public works project, the low bidder to whom the owner awarded the contract would forfeit its $100,000 bid security for failing to enter into a contract at the price bid. Thus, to use the terms the Restatement eventually employed, the error concerned a basic assumption, and it would have a material and adverse effect on the general contractor. The court explained that the Illinois standard for granting relief was "that the mistake relate to a material feature of the contract; that it occurred notwithstanding the exercise of reasonable care; that it is of such grave consequence that enforcement of the contract would be unconscionable; and that the other party can be placed in statu[s] quo."[77] Although under the bidding documents imposed by the owner, the general contractor certified that it had undertaken a sufficient investigation in connection with the bid, the court held that the general contractor had exercised due care in preparing its bid and in relying on the proposal from a subcontractor with which it had a long-standing relationship. Finally, the court concluded that the public owner should have suspected a bidding error due to the substantial difference between the general

74 Bd. of Regents of Murray State Normal Sch. v. Cole, 273 S.W. 508 (Ky. Ct. App. 1925).

75 Rushlight Automatic Sprinkler Co. v. City of Portland, 219 P.2d 732, 753 (Or. 1950).

76 *See* Wil-Fred's, Inc. v. Metropolitan Sanitary Dist., 372 N.E.2d 946 (Ill. Ct. App. 1978).

77 *Id.* at 951.

contractor's bid and the next lowest one and the owner's pre-bid estimate of the project cost. Those considerations would have satisfied the alternate basis articulated in subsection (b). The analysis did not dwell on whether it would have been unconscionable to hold the general contractor to the bid, but the standard the court articulated for granting relief under Illinois law, together with the court's emphasis on evidence that both the general contractor and the subcontractor would have suffered financially devastating consequences, implicitly comports with the alternate basis under subsection (a).

A comment to Section 153 further acknowledges the influence of the construction industry cases by noting that competitive bidding errors, especially on public construction projects, as well as erroneous interpretations of construction specifications, provide the most common instances in which a unilateral mistake justifies avoiding a contract.[78] Additionally, eight of the Restatement's thirteen illustrations under Section 153 involve construction industry situations.[79] Construction industry cases also comprise a substantial proportion of the cases listed in the annotations to Section 153. To a significant degree, the courts have worked out, and they continue to refine, the contours of the unilateral mistake defense through the industry cases.

In today's construction industry, unilateral mistake is more than a common-law contract defense. In reaction to the common law, many public bidding statutes and regulations now incorporate a process by which a bidder may withdraw a bid and obtain return of any bid security on account of a material mistake, especially if the bidder brings the error to the public authority's attention before it is too late to accept the next lowest bid.[80] Additionally, some competitive bidding procedures allow modification or withdrawal of a submitted bid before the scheduled bid opening.[81]

Naturally, circumstances in several other contexts also have contributed to the growing body of law on unilateral mistakes.[82] The annotations to Section 153 include cases involving settlement agreements, real-estate transactions, insurance contracts, and pricing errors made by sales personnel or stated in advertisements. The Restatement's use of unconscionability as a basis for granting relief allows courts to extend the unilateral mistake defense to a wide range of cases "and the invitation has been readily accepted by judges who regard the fairness of the contractual exchange as an appropriate object of intervention."[83] Professor Farnsworth noted the expansion of unilateral mistake as a defense in other contexts but, at the same time, concluded that,

78 RESTATEMENT (SECOND) OF CONTRACTS § 153, cmt. b (AM. LAW INST. 1981).

79 *See id.*, illust. 1-4, 7-10.

80 *See* 1 STEIN, *supra* note 28, at ¶ 2.04.

81 *See* 1 BRUNER & O'CONNOR, *supra* note 11, at § 2:88.

82 *See* Melvin A. Eisenberg, *Mistake in Contract Law*, 91 CAL. L. REV. 1573, 1601-09 (2003).

83 Andrew Kull, *Unilateral Mistake: The Baseball Card Case*, 70 WASH. U. L.Q. 57, 77 (1992).

as recently as 2004, "[m]ost of the cases that have granted relief for unilateral mistake have involved building contractors that make simple clerical errors in calculating bids on construction projects."[84] The years leading up to and following adoption of the Restatement (Second) of Contracts have seen the unilateral mistake defense emerge as a general principle of U.S. contract law, with the construction industry cases playing a nearly dominant role in the common-law progression toward that result.

Much as with substantial performance and economic waste, the unilateral mistake defense emerged and evolved largely through construction industry cases, thereby registering a strong pedigree factor. Contract scholars have frequently acknowledged the connection.[85] With respect to the contextual factor, the special circumstances of competitive bidding for public construction projects provided the key background considerations that led courts to recognize the defense. In contrast to the contextual attributes of the substantial performance doctrine, however, the contextual relationship has been essentially one dimensional, although not quite to the same extent as with the economic waste doctrine. That is, customs and practices in the industry have not adapted much to the unilateral mistake principle except in those jurisdictions in which statutes and regulations provide for relief in some instances of bidding errors. Finally, the Restatement's recognition of the defense, as well as the level of attention that contract scholars and educators accord to unilateral mistake testify to its status as a general principle of U.S. contract law. The defense, however, applies in a relatively small number of cases, both in the industry cases and beyond. Judged by the general principle factor, therefore, the unilateral mistake defense falls short of the substantial performance doctrine as a construction industry influence on contract law.

Offer as enforceable option contract

The influence of a single construction industry case on U.S. contract law pedagogy is nowhere more evident than in *Drennan v. Star Paving Co.*[86] Almost from the time that Justice Traynor penned the *Drennan* opinion in 1958, law students have studied the case as the source of a significant exception to the general principles of offer and acceptance. The counter-principle of *Drennan* holds that an offer otherwise revocable becomes enforceable by the offer recipient as an option contract when it reasonably and foreseeably induces the recipient to rely substantially and detrimentally on the offer as a binding promise. In *Drennan* the court invoked and expanded the policy behind the promissory estoppel principle to hold that a subcontractor's price proposal to a general contract could become irrevocable once the general

84 Farnsworth, *supra* note 65, at 186.

85 *See, e.g.*, Farnsworth, *supra* note 65; Eisenberg, *supra* note 82.

86 Drennan v. Star Paving Co., 333 P.2d 757 (Cal. 1958).

contractor incorporated the subcontractor's price quote into the general's own bid submitted in a public project's competitive bidding process that resulted in award of the contract to the general. Section 87(2) of the second Restatement explicitly adopts this principle as a general rule of contract law.[87] Despite the challenging questions contract scholars have raised about Traynor's rationale and about the extent to which the holding should or does apply outside of the construction industry bidding context,[88] one can scarcely ignore the impact that the *Drennan* principle has had on contract law pedagogy and scholarship.

From the historical and theoretical perspectives, the principle of *Drennan* and section 87(2) arrived as a mid-twentieth-century innovation that claimed no long and distinguished judicial genesis. The promissory estoppel doctrine that gave Traynor a foundation on which to base his holding boasts no ancient common-law roots.[89] Moreover, Traynor's reasoning by analogy to the promissory estoppel theory of section 90 of the Restatement (First) of Contracts cited no case in which a court transformed an offer similar to the subcontractor's price proposal into a promise upon which to support an estoppel claim. This distinguished and creative jurist manufactured out of sparse precedents the novel argument that a court could imply a promise on the subcontractor's part not to withdraw the offer if the general contractor honestly and reasonably relied on the subcontractor's price in calculating the winning bid by which the general contractor became contractually bound to the project owner. However appealing one may find the logic as a normative matter, the common law of contracts, as it stood at the time, did not comfortably suggest it.

Considered from a pragmatic point of view, *Drennan* and section 87(2) emanated uniquely from a construction industry setting. Perhaps for that very reason, they have found only limited application outside that precise problem. Traynor's use of the record before the court in *Drennan* emphasized the peculiar practices and customs associated with competitively bid construction projects, and it drew effectively on that background to show that the subcontractor submitted its offer both realizing that the general contractor might reasonably rely on the price proposal to secure the project's contract award, and hoping for that result.[90] Practically all of the cases accounting for the principle's acceptance among judges and scholars involve essentially the same fact pattern as did *Drennan*—a general contractor who responds to an

87 RESTATEMENT (SECOND) OF CONTRACTS § 87(2) (AM. LAW INST. 1981).

88 *See, e.g.*, 1 FARNSWORTH, *supra* note 60 § 3.25; Victor P. Goldberg, *Protecting Reliance*, 114 COLUM. L. REV. 1033, 1036-37 (2014); Jay M. Feinman, *Promissory Estoppel and Judicial Method*, 97 HARV. L. REV. 678, 680 (1984).

89 *See* Charles L. Knapp, *Rescuing Reliance: The Perils of Promissory Estoppel*, 49 HASTINGS L.J. 1191, 1196-1201 (1998); Benjamin F. Boyer, *Promissory Estoppel: Principles from Precedents: I*, 50 MICH. L. REV. 639, 640 (1952) (noting the relative recent standing of promissory estoppel as an "express formulation").

90 *Drennan*, 333 P.2d at 758-60.

invitation for competitive bids, usually on a public construction project, relies on a subcontractor's price proposal in calculating its bid, receives the award, and thereby becomes contractually bound to the project owner, and then the subcontractor withdraws the proposal before the general contractor formally communicates its acceptance to the subcontractor. The annotations to section 87(2) confirm that the overwhelming majority of cases applying the principle continue to involve that circumstance. Indeed, eminent scholars have argued convincingly that the principle has had little influence beyond the construction bidding situation.[91] From that perspective, *Drennan* has probably garnered far more attention than it deserves. Still, courts have resorted to section 87(2) in other circumstances, including an offer in an oil and gas farmout agreement,[92] settlement discussions,[93] and an employee's resignation letter.[94]

The *Drennan* principle has not achieved, and may never achieve, a central place among the general principles of U.S. contract law. Offers seem only rarely to induce the kind of reasonable, foreseeable, and substantial reliance endemic in the construction bidding setting. Even so, anyone interested in a comprehensive and coherent theory of U.S. contract law must confront and acknowledge *Drennan* and section 87(2). If nothing else, the principle has made a significant impression in the teaching of contract law and in the scholarly literature, and it has thereby earned its place in this discussion of construction industry cases that have significantly influenced U.S contract law.

As an aside to this discussion, I want to acknowledge the relationship between the *Drennan* principle and the line of cases on unilateral mistake in competitive bidding. In most of the circumstances in which courts have held a subcontractor's offer to be enforceable as an option contract based on the general contractor's reliance, the subcontractor wishes to withdraw the offer because of a mistake in calculating the price proposal. The subcontractor, therefore, could invoke the unilateral mistake defense. The cases recognize the conundrum and reach different results depending on all of the relevant circumstances, including whether the general contractor can assert the subcontractor's unilateral mistake as a basis for withdrawing or otherwise avoiding its own bid submitted to the project owner.[95] Under Section 153 of the second Restatement, as well as under most other articulations of the unilateral mistake defense, if the general contractor is bound by the contract award notwithstanding the underlying error in the subcontractor's proposal, the subcontractor may lose the argument unless the evidence is that the

91 *See* Victor P. Goldberg, *Traynor (Drennan) Versus Hand (Baird): Much Ado About (Almost) Nothing*, 3 J. LEGAL ANALYSIS 539 (2011); *see also*, Feinman, *supra* note 88; Farnsworth, *supra* note 65.

92 Strata Prod. Co. v. Mercury Expl. Co., 916 P.2d 822 (N. Mex. 1996).

93 *In re* Donovan's Case, 791 N.E.2d 388 (Mass. App. 2003).

94 French v. Bd. of Ed. of Santa Monica Unified Sch. Dist. of Los Angeles Cty., 71 Cal. Rptr. 713 (Ct. App. 1968).

95 *See* 1 BRUNER & O'CONNOR, *supra* note 11, at § 2:138.

general contractor knew or should have known of the subcontractor's mistake. In Restatement terms, under those circumstances, the court could find that it would not be unconscionable to enforce the contract against the subcontractor based on the general contractor's reliance. Or, as some other authorities would have it, restoring the status quo would be unfair to the general contractor. In some instances, however, the court may conclude that the equities favor the subcontractor, especially if the error has a substantial financial impact on the subcontractor with reference to its portion of the project but has a much smaller financial impact on the general contractor based on the entire project.[96]

As this discussion has already suggested, the *Drennan* principle deserves a somewhat tempered endorsement under this chapter's construction industry influence rubric, primarily because it largely fails under the general principle factor. To be sure, one could argue that *Drennan* has led to a general principle of U.S. contract law based on the Restatement's endorsement, along with the extensive theoretical commentary on the principle and its recognition in the standard contract law curriculum in law schools. But, as has also already been noted, judicial applications of *Drennan* or section 87(2) of the Restatement scarcely register beyond the construction industry's competitive bidding situation. As a result, we can say that the line of cases involved has a strong construction industry pedigree, but at the same time we must conclude that the pedigree factor has limited importance because the principle has not greatly influenced U.S. contract law. The *Drennan* principle makes a much stronger case under the contextual factor. Traynor's opinion draws heavily on the customs, practices, and expectations of those who participate in competitive bidding for public construction projects. Indeed, the circumstances under which subcontractors submit proposals to general contractors during competitive bidding on public projects present a unique and ideal case for extending promissory estoppel as recognized in contract law at least since the first Restatement. A subcontractor who submits a proposal is implicitly inviting the general contractor to use the stated price in calculating what the subcontractor hopes will be the winning bid for the project. Furthermore, the subcontractor should also know the rules that apply to the general's bid, which in many jurisdictions provide that there will come a time when the general's bid cannot be amended or withdrawn and that the general will forfeit a bid bond or other required security if the general ends up with the successful bid but then refuses to sign a contract at that price. Even though the *Drennan* line of cases and section 87(2) have a small footprint in U.S. contract law, I give them a place in this Chapter due to the regard that contract law theorists and teachers have for it, and also because it represents an especially important application of contract law's promissory estoppel and reliance policies.

96 *See id.*

Changed circumstances and the pre-existing duty rule

A frequently maligned and now much diminished rule holds that neither a promise to perform an existing legal duty nor the performance of an existing legal duty can supply the consideration required for a binding contract.[97] Viewed broadly, this principle, known as the pre-existing duty rule, has two primary manifestations.[98] One branch of the rule, under which partial payment of a liquidated debt cannot discharge the debtor, has the more ancient roots.[99] A second branch of the pre-existing duty rule, which evolved from the first one, prevents enforcement of a one-sided contract modification by which a contracting party gains an advantage for simply agreeing to perform according to the original contract.[100] This subsection reviews the role that construction industry cases played in the refinement and eventual decline of this second iteration of the rule.

According to one account, the contract-modification prong of the rule dates back at least to a pair of cases decided around 1800 in which English courts refused to enforce maritime employers' promises, agreed to mid-voyage and arguably under duress, to pay seamen more than the amount that the seamen originally agreed to accept for their services.[101] An early U.S. case applying the rule to a contract modification dispute also involved a seaman's claim for increased pay.[102] It may be that the maritime context influenced English courts in particular to establish the rule, in part due to that industry's commercial importance in the United Kingdom at the time. I find that possible explanation especially interesting because it relates to the claim advanced in this book that the experiences of a particular industry have uniquely influenced principles of contract law (as most clearly demonstrated by Justice Traynor's resort in the *Drennan* case to construction industry bidding practices to extend the promissory estoppel principle). Whether or not the distinctive context of maritime employment contracts explains why courts developed the pre-existing duty rule to control contract modifications, this version of the rule eventually spread well beyond that sector of commerce to such diverse transactions as bailments, building contracts, installment sales, leases, and

97 2 CORBIN ON CONTRACTS, *supra* note 3, at § 7.1.

98 *See* Joel K. Goldstein, *The Legal Duty Rule and Learning About Rules: A Case Study*, 44 ST. LOUIS U. L.J. 1333, 1335-40 (2000).

99 *See* Kevin M. Teeven, *Development of Reform of the Preexisting Duty Rule and Its Persistent Survival*, 47 ALA. L. REV. 387, 389-94 (1996).

100 *See* Corneill A. Stephens, *Abandoning the Pre-Existing Duty Rule: Eliminating the Unnecessary*, 8 HOUS. BUS. & TAX L. J. 355, 358-62 (2008).

101 *See* Burton F. Brody, *Performance of a Pre-Existing Contractual Duty as Consideration: The Actual Criteria for the Efficacy of an Agreement Altering Contractual Obligation*, 52 DENVER L.J. 433, 436-37 (1975) (discussing Harris v. Watson (1791) 170 Eng. Rep. 94 (K.B.) and Stilk v. Myrick (1791)170 Eng. Rep. 1168 (C.P.)).

102 Alaska Packers' Ass'n. v. Domenico, 117 F. 99 (9th Cir. 1902).

brokerage arrangements, and it ultimately achieved the status of a general principle of contract law.[103]

As applied to proposed contract modifications, the pre-existing duty rule came up frequently throughout the nineteenth and much of the twentieth century in construction industry cases, in circumstances in which a project owner agreed to increase compensation to the builder because of unanticipated difficulties that made the work cost more than the builder originally anticipated.[104] Because construction industry contracts routinely involve complex performance obligations spread over extended periods of high uncertainty and constant change, they offer many reasons for participants, especially the general contractor or a subcontractor, to seek additional compensation after having agreed to a fixed-price or guaranteed-maximum-price contract.[105] The classic situation involves adverse site conditions that the builder did not expect to encounter. [106] For example, a builder may request a price increase after discovering underground problems, such as more rock than initial investigations or past experience in similar settings would indicate, soil conditions that differ significantly from what initial investigations disclosed, surprising ground-water or surface-water problems, or discovery of buried obstructions.[107] These cases squarely present the question whether the owner's agreement to pay more than the original contract price should be enforced only if supported by consideration beyond the contractor's pre-existing contractual obligations.

Contract scholars have long criticized the notion that technical adherence to the consideration doctrine should necessarily restrict the freedom of contracting parties to make binding adjustments that improve the bargain for one party without new value flowing to the other party.[108] The literature analyzing the pre-existing duty rule consistently recognizes that the construction industry cases have played key roles in the rule's development and, more significantly, in its softening over the past hundred years or so.[109]

A line of cases beginning in the late nineteenth century applied the pre-existing duty rule to price adjustments in construction industry cases.[110] One of the most influential early opinions was decided by the Minnesota Supreme

103 *See* Brody, *supra* note 101, at 440-56.

104 *See* Stephens, *supra* note 100, at 360; Hazel Glenn Beh, *Allocating the Risk of the Unforeseen, Subsurface and Latent Conditions in Construction Contracts: Is There Room for the Common Law?*, 46 KAN. L. REV. 115, 120-24 (1997). *See also* 2 CORBIN ON CONTRACTS, *supra* note 3, at § 7.6.

105 *See generally* Teeven, *supra* note 99, at 419-20.

106 *See generally* 4 BRUNER & O'CONNOR, *supra* note 11, at §14:3.

107 *Id.*

108 *See, e.g.*, Goldstein, *supra* note 98, at 1340-50; Teeven, *supra* note 99, at 419-36; Brody, *supra* note 101, at 433.

109 *See, e.g.*, 2 CORBIN ON CONTRACTS, *supra* note 3, § 7.6; Teeven, *supra* note 99, at 441-42, 456-60; Beh, *supra* note 104, at 120-25; Brody, *supra* note 101, at 456-60.

110 *See, e.g.*, Stephens, *supra* note 100, at 360-63; Brody, *supra* note 101, at 441-42.

Court in *King v. Duluth M. & N. Railway*.[111] The court invoked the pre-existing duty rule with respect to a price modification to a construction contract but also explained that, in an appropriate case, the existence of circumstances wholly unanticipated by the parties at the time they entered into the contract could justify an exception to the general rule. The court teased out the analysis from earlier construction industry cases. Another influential case decided at about the same time is *Lingenfelder v. Wainwright Brewing Co.*, in which the Missouri Supreme Court applied the rule to invalidate an owner's promise to pay additional compensation to the project architect.[112] *Lingenfelder's* significance relates more to the court's implicit policy rationale, rather than its resort to the pre-existing duty rule as the formal basis for the decision. The evidence in the case indicated that the architect's demand for a fee increase resulted from his bitterness over the owner's decision not to purchase certain equipment for the project from a company in which the architect had a financial interest. While absence of consideration provided the declared legal basis for the decision, the court noted with deep concern that the owner was practically coerced into accepting the architect's demand in order to get the job completed on schedule. This apprehension harkens back to the seamen's pay cases, which show the same unease over circumstances suggesting duress or abusive tactics. Indeed, a convincing case can be made that, beginning with the earliest cases, courts using the pre-existing duty rule to invalidate contract modifications, especially in the construction industry context, were often less concerned about legal consideration than with the aroma of economic duress or other abusive dealing.[113]

While industry cases rendered throughout the first part of the twentieth century continued to apply the pre-existing duty rule, more and more of them, when warranted by the facts, adopted the changed circumstances exception recognized in *King v. Duluth M. & N. Railway*.[114] To a significant extent due to these construction industry cases, U.S. contract law now includes this important exception to the pre-existing duty rule, which may apply whenever a contracting party proposes a favorable adjustment to the original deal for simply agreeing to perform as already required under the contract. Section 89(a) of the second Restatement reflects this general principle that exempts contract modifications of this kind from the pre-existing duty rule. Under Section 89(a), an agreed modification to a party's obligations under an executory contract is binding without consideration "if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made."[115] Beyond the body of contract

111 King v. Duluth, M. & N. Ry. Co., 63 N.W. 1105 (Minn. 1895).

112 Lingenfelder v. Wainwright Brewing Co., 15 S.W. 844 (Mo. 1891).

113 *See generally* Teeven, *supra* note 99, at 406-08; Brody, *supra* note 101, at 458-60.

114 *See* Brody, *supra* note 101, at 456-57.

115 *See* RESTATEMENT (SECOND) OF CONTRACTS § 89(a) (AM. LAW INST. 1981).

law governing building construction and other service contracts, the Uniform Commercial Code takes the more radical step by completely rejecting the pre-existing duty rule for agreements governed by Article 2.[116] Courts in some jurisdictions have also broadly abandoned the rule.[117]

The near absence today of construction industry cases involving the pre-existing duty rule requires a brief comment. Industry cases on the issue are far less significant now than when courts first developed the unforeseen circumstances exception. Indeed, almost none of the cases reported under the annotations to Section 89 involve building construction, although three of the five illustrations directly relating to Section 89(a) use construction industry situations.[118] Similarly, few construction industry cases decided after the adoption of Section 89 appear in the scholarly commentary on exceptions to the pre-existing duty rule.[119]

The logical and likely explanation for this reduced role of construction industry cases is that participants in the industry long ago recognized the advantages of reallocating much of the risk of unforeseen site problems (which account for the most common kind of unanticipated circumstances affecting construction projects) so that the project owner, rather than the general contractor and trade subcontractors, bears them.[120] A compelling economic rationale accounts for this contracting preference. Every builder knows that any project might involve unusual or unforeseeable site conditions that could increase costs in surprising and dramatic ways, but no builder can reliably predict whether or to what extent the risk will materialize for a particular project. To justify taking the unforeseen conditions risk, the rational builder must include in the project pricing a substantial contingency amount.

Federal contracting authorities were the first to recognize that it is generally efficient to shift back to the owner this risk of increased costs on a project-by-project basis.[121] By agreeing to incorporate into the contract a procedure for increasing the price in the event of unforeseen site conditions, the project owner avoids the additional cost of a contingency in the contract price for differing site conditions that may never arise. Instead, by retaining the risk, the owner pays an additional cost for unforeseen conditions only if and to the extent that those conditions actually exist on the particular job. This judgment became the basis for a federal regulation requiring that most federal construction contracts include what the industry now generally knows as a differing-site-conditions clause.

Other public owners reached the same conclusion, and eventually differing-site-conditions clauses became a common practice throughout the industry, as

116 U.C.C. § 2-209(1).

117 *See* Stephens, *supra* note 100, at 362.

118 *See* RESTATEMENT (SECOND) OF CONTRACTS § 89, illus. 1,2, & 4 (AM. LAW INST. 1981).

119 *See* Stephens, *supra* note 100; Goldstein, *supra* note 108.

120 *See* 4A BRUNER & O'CONNOR, *supra* note 11, at § 14:1; SWEET & SCHNEIER, *supra* note 11, at 527–37.

121 *See* 4A BRUNER & O'CONNOR, *supra* note 11, at § 14:45.

confirmed by the incorporation of such clauses into many standard industry contract forms. As a result, the contemporary construction industry regularly avoids many potential disputes over the pre-existing duty rule and its unforeseen circumstances exception, save only when the parties disagree about the proper interpretation of a differing-site-conditions clause.[122] The fact that construction industry cases no longer dominate in the application of the unforeseen circumstances exception, however, does not diminish the important part that industry cases played in the development of the exception, culminating with § 89(a) of the Restatement as a general principle of contract law.

Assessing the influence that the construction industry cases have had on the unanticipated circumstances principle raises some interesting nuances. In the first place, the pre-existing duty rule has waned due to several different factors. Contract law's evolution on this point does not have as pure a construction industry pedigree as do the other principles that this chapter discusses. A line of construction industry cases played an important role, but other cases also moved it along the way in tandem with the industry's differing-site-conditions experience. Similarly, the second aspect of the assessment, the contextual factor, is strong in the sense that practically every construction project has a high risk of unanticipated circumstances that may induce an owner to agree to increase the contract price without exacting additional consideration from the contractor. But the construction industry experience did not dominate the common-law development because other contractual relationships present comparable circumstances. At the same time, the policy rationale that supports a contract modification without additional consideration is so well accepted in the construction industry that customs and practices have evolved and adapted to the point that most construction contracts include carefully conceived and detailed differing-site-conditions provisions. As a result, the contextual factor associated with the principle is two dimensional, in the same way as it is with the substantial performance doctrine, and even to a greater extent. Finally, the unanticipated circumstances principle that has so greatly diminished the pre-existing duty rule has unquestionably achieved the status of a general principle of U.S. contract law, but it has done so due to a variety of influences. The construction industry cases made a significant contribution to this development, but less so than with respect to the other principles discussed in this chapter.

Assessing the industry's impact on core principles

The principles of substantial performance, economic waste, unilateral mistake, offers made irrevocable by reliance, and unanticipated circumstances as a substitute for consideration reflect important instances of construction industry

122 *See generally* Kimberly A. Smith, *Differing Site Conditions and Metcalf: Judicial Shifting of the Risks*, Construction Law., Summer 2014, at 35.

cases influencing contract doctrines and policies. In the first place, each derives to a significant extent from the construction industry experience—the practices, customs, dispute patterns, and overall context in which participants in the construction industry structure and manage their exchange relationships. All of these principles also played integral roles in the evolution of contract law. In each line of cases, contract law has moved palpably from the relatively rigid rules of the early common law toward far more flexible principles, from a subjective intent theory of contract to one focused on such values as expectations, reliance and fairness, and toward a jurisprudence much more heavily influenced by experience than by logic (themes to which we return in future chapters). These considerations alone make the study of construction industry cases worthwhile but, as will be developed in later chapters, there are other reasons why construction law deserves a place in legal education and legal scholarship.

With reference to the contributions that the construction industry cases have made to general principles of contract law, the five topics discussed in this chapter have the greatest significance. There are, to be sure, other candidates. As noted at the beginning of this chapter, Professor Sweet mentions the law of unforeseen subsurface conditions as a distinct topic, while I have chosen to subsume it within the pre-existing duty rule discussion. He would also include third-party dispute resolution. For reasons that I will explain in the next chapter, I prefer to assign alternative dispute resolution to a separate category, along with several other aspects of contract law.

3 Adaptations, refinements, and constraints in the industry cases

Starring roles aside, contract law bears the marks of construction industry cases in many other significant respects. These include palpably contextual adaptations of general contract law principles, as well as subtle refinements and notable constraints. Some of these apply primarily to industry disputes, and others apply more broadly but with peculiar value in construction cases. This chapter explores many of these adjustments to contract law. A dominant contextual strain both unites these topics and separates them from those discussed in Chapter 2. That is, the lines of cases covered here all manifest influences of construction industry circumstances, customs, and practices, which Chapter 2 calls the contextual factor, while they only modestly, if at all, share the industry pedigree or general principle attributes that Chapter 2 also highlights. Several topics that this chapter classifies as contract law adaptations, refinements, or constraints receive further attention in later chapters that focus on other discrete aspects of contract law in the construction industry context.

Implied warranties and other implied obligations

At least since the late nineteenth century, U.S. courts have openly embraced what some authorities call the implication process, by which courts recognize contractual obligations not expressly included in the contracting parties' agreements.[1] Even before then, decisions in both England and in the United States reflected this process, although without the benefit of a fully developed jurisprudential framework for doing so.[2] Implication, as commonly understood by courts and lawyers, can manifest itself in three distinct (and sometimes overlapping) ways: as a matter of interpretation, a court may conclude that the contracting parties used an express but oblique contractual statement to imply that they intended the obligation as part of their agreement; also as a matter of interpretation, a court may infer, perhaps based on

1 6 Corbin on Contracts §§ 26.1-26.4 (Lexis 2018).

2 *See* Larry A. DiMatteo, *Cardozo, Anti-Formalism, and the Fiction of Noninterventionism*, 28 Pace L. Rev. 315, 318-31 (2008).

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the context of the transaction as well as from circumstantial contract language, that the parties intended their agreement to include the obligation; and finally, a court may impose a duty as a policy matter wholly independent of the parties' intent.[3] This third aspect of the process, in which courts impose terms that the contracting parties in no way bargained for "is lawmaking" and not contract interpretation.[4] The implication process in this sense of court-imposed duties first achieved prominence as a matter of tort law, but eventually became a common feature of contract cases.[5] At times, and in particular in the case of implied warranties, this branch of the implication process seriously blurs the distinction between negligence, products liability, and contract.[6]

Although many construction industry cases demonstrate the implication process in its first two senses (that is, through contract interpretation), I do not place the holdings in those cases in the categories of significant adaptations, refinements, or constraints.[7] They have not, for example, apparently advanced or altered any of the interpretive principles that courts use in other kinds of contract cases. Nor have they defined an approach to contract interpretation that uniquely adapts the implication process to the construction industry. A different picture emerges, however, when we consider a narrower band of industry cases in which courts impose contractual obligations that the contracting parties themselves did not in any sense intend. For this reason, the cases in which courts impose obligations on parties to construction contracts, especially in the form of the implied warranties, merit some attention here.

Judicially imposed contract obligations began to take form in such ways as the implied warranty of good title in the sale of real property, implied obligations of reasonableness, good faith and fair dealing, and a range of warranties of quality in the sale of goods.[8] These cases had no special ties to the construction industry. In time, courts quite naturally held that the implied duties

3 *See* Peter Linzer, *"Implied," "Inferred," and "Imposed": Default Rules and Adhesion Contracts-the Need for Radical Surgery*, 28 PACE L. REV. 195, 195-98 (2008).

4 *Id*. at 198.

5 The early design professional liability cases provide a good example. Courts commonly relied on tort principles when they first started to recognize a duty of professional care owing from a design professional to the client and only later were willing to imply the duty into contracts for design services. *See* Carl J. Circo, *When Specialty Designs Cause Building Disasters: Responsibility for Shared Architectural and Engineering Services*, 84 NEB. L. REV. 162, 177-83 (2005). Also, the law of implied warranties, which is the ultimate focus of the current discussion, originated in tort and only later emerged as a matter of contract. *See* William L. Prosser, *The Implied Warranty of Merchantable Quality*, 27 MINN. L. REV. 117, 118-22 (1943).

6 *See generally* Walter F. Pratt, Jr., *American Contract Law at the Turn of the Century*, 39 S. CAR. L. REV. 415 (1988); Prosser, *supra* note 5, at 118-19; 122-25.

7 *See generally* 1A PHILIP L. BRUNER & PATRICK J. O'CONNOR, JR., BRUNER AND O'CONNOR ON CONSTRUCTION LAW §§ 3:1-3:51 (Westlaw 2018).

8 *See* Pratt, *supra* note 6, at 443-50; 458-64; Prosser, *supra* note 5, at 119-22.

of good faith and fair dealing applied to construction contracts.[9] Additionally, courts recognized certain implied duties that were peculiarly adapted to the industry contexts, such as the duty of a contracting party with special or superior knowledge pertinent to the performance of the contract to disclose that information to the other party[10] and the duty of a bidder to seek clarification of obvious ambiguities or discrepancies in the bidding documents.[11] The United States Supreme Court announced one of the most significant of all implied warranties for the industry in 1918 when it held that an owner that provides detailed plans and specifications to a builder thereby implicitly warrants that those plans and specifications are suitable for the purpose of constructing the project (more on this doctrine in Chapters 4 and 5).[12]

A leading treatise on construction law identifies several implied obligations that the courts have read into construction contracts in addition to those already mentioned; these include, among others, implied warranties applicable to design-build contracts, duties that owners may have to disclose certain material information to bidders and contractors, and an implied warranty by an owner that specified brand-name or single-source products that the owner requires to be used are commercially available.[13]

While each of these implied duties represents an important adaptation of the implication process to the construction industry context, these instances of implication largely conform to general developments in contract law without introducing any remarkable innovations. The line of construction industry cases implying warranties of quality work, however, constitutes a modest but notable advance in the law of implied warranties.

Beginning in the late nineteenth century and continuing through the middle of the twentieth, courts started to imply warranties of quality into certain contracts for services as well as for sales. Some of the first cases involved food served to a customer (which courts sometimes perceived as involving service rather than the sale of food as a separate good) and contracts for bailment, shipment by carrier, and lease of a furnished apartment.[14] Authority for implying a duty of good workmanship into a contract for construction appears in some U.S. cases by at least the beginning of the nineteenth century, although the earliest cases were somewhat indefinite as to the legal basis for the duty and its scope.[15] Most significantly, while this first generation of implied warranty of quality cases might apply to contracts that were purely for construction services, as when

9 *See* 3 BRUNER & O'CONNOR, *supra* note 7, at § 9:103.

10 *See* 1 BRUNER & O'CONNOR, *supra* note7, at § 3:25.

11 *See id*. at § 3:64.

12 United States v. Spearin, 248 U.S. 132 (1918).

13 3 BRUNER & O'CONNOR, *supra* note 7, at §§ 9:91-:96, 9:99-:102.

14 *See* E. Allan Farnsworth, *Implied Warranties of Quality in Non-Sales Cases*, 57 COLUM. L. REV. 653 (1957); Prosser, *supra* note 5, at 151-53.

15 *See* 3 BRUNER & O'CONNOR, *supra* note 7, at §§ 9:67-:70.

a landowner hired a contractor to build or improve a structure, the implied warranty would not necessarily extend to the sale of a newly or recently constructed building.[16] To a significant extent, this followed from the *caveat emptor* principle, as well as from the doctrine of merger by which terms of a contract for the purchase and sale of real estate became inoperative when the buyer accepted a deed to the property that did not repeat those terms. Similarly, some of the earliest cases indicated that even a landowner who contracted purely for construction services could easily waive any implied warranty by accepting the work.[17]

After the turn of the twentieth century, the consumer protection movement advanced the idea of implied warranties of quality in consumer transactions. The rich literature documenting the history of implied warranties of quality need not be recounted here.[18] By the early twentieth century, broad acceptance of implied warranties of quality in the sale of goods appeared in the form of the Uniform Sales Act.[19] The Uniform Commercial Code advanced and expanded implied warranties in the sale of goods.[20] Some construction industry transactions are subject to the UCC, and thus are governed by these statutory versions of implied warranties of quality.[21] Most industry contracts, however, being predominantly for services rather than goods, fall outside the scope of the UCC.[22] As a result, implied warranties in the construction industry largely emerged and evolved through the common-law process. While the established law of implied warranties in the sale of goods influenced the construction industry cases, as did the cases implying a warranty of habitability into residential leases, courts adapted those principles distinctly in response to the industry context.[23] The line of cases implying warranties of quality in residential construction deserves further review as an interesting case study in the common-law progression of the implication process.

Courts began to imply warranties of quality into contracts for the sale of new residential property around the second half of the twentieth century.[24] The initial trend was to imply warranties of habitability, fitness, or good workmanship into contracts for custom-built homes or in the sale of homes

16 *See* Frona M. Powell & Jane P. Mallor, *The Case for an Implied Warranty of Quality in Sales of Commercial Real Estate*, 68 WASH. U. L.Q. 305, 307-09 (1990).

17 *See* Kellogg Bridge Co. v. Hamilton, 110 U.S. 108, 114-19 (1884); BRUNER & O'CONNOR, *supra* note 7, at § 13:53.

18 *See, e.g.*, Prosser, *supra* note 5, at 117; Karl N. Llewellyn, *On Warranty of Quality, and Society (pt. I)*, 36 COLUM. L. REV. 699 (1936); Karl N. Llewellyn, *On Warranty of Quality, and Society (pt. II)*, 37 COLUM. L. REV. 341 (1937)

19 *See* Uniform Sales Act, § 15.

20 U.C.C. §§ 2-314, 2-315.

21 *See* 3 BRUNER & O'CONNOR, *supra* note 7, at § 9:29.

22 *See* id. at § 9:53.

23 *See* O'Mara v. Dykema, 942 S.W.2d 854, 859 (Ark. 1997); Redarowicz v. Ohlendorf, 441 N.E.2d 324, 328-29 (Ill. 1982).

24 *See* Farnsworth, *supra* note 14, at 666 (mentioning a possible "tendency to extend implied warranties of quality to the seller of mass produced housing").

still under construction, but not in sales of completed homes.[25] Not long after this, courts began to imply similar warranties into contracts for the sale by a builder of newly completed residential property.[26] The nature of the implied warranties in these cases, especially when the courts used terms such as habitability and fitness, often signaled a strict liability standard. [27] Because this approach guaranteed a level of suitability of the end product, it differed in kind from the older implied warranty of workmanlike performance, which might protect only if the work was negligently performed or otherwise failed to conform to minimum standards for a builder's knowledge and skill. During this early period, however, it was not always clear from one jurisdiction to another whether the implied warranty of habitability gave the consumer more or less substantive protection than an implied warranty of workmanlike performance.[28]

Characteristics of the residential housing market naturally led to a progression of cases that invited the courts to expand the implied warranty in several ways. Although jurisdictional distinctions continue, many courts eventually recognized that a consumer buying a newly constructed house reasonably expects something more than non-negligent construction or mere habitability in the literal sense. As courts refined the nature of the warranty, they frequently clarified that the implied warranty of habitability goes well beyond the workmanlike performance standard. "Liability attaches to the builder/vendor of residential property regardless of fault if the home contains defects substantially impairing its habitability."[29] Some courts carefully distinguished the implied warranty of workmanlike performance from the warranty of habitability, while others seemed to equate the two. Courts that intended an enhanced warranty often used terms in addition to habitability, such as "sound workmanship and proper construction."[30] One court put it this way: "the house must be reasonably suited for its intended use and not simply inhabitable."[31]

The cases also soon challenged traditional notions of contractual privity because developers and others who sell newly constructed or recently constructed homes often do not themselves build those homes. In several jurisdictions, courts enforced the implied warranty against subdivision developers who worked closely with builders and against other sellers who played a somewhat indirect role in the construction process.[32] From that point,

25 *See, e.g.*, Hoye v. Century Builders, Inc., 329 P.2d 474, 476 (Wash. 1958); Cox v. Curnutt, 271 P.2d 342, 344–45 (Okla. 1954). *See generally* Powell & Mallor, *supra* note 16, at 307-309.

26 *See* Powell & Mallor, *supra* note 16, at 308-09.

27 *See* 3 BRUNER & O'CONNOR, *supra* note 7, at §§ 9:71-:72.

28 *Id*.

29 *Id*. at § 9:72.

30 Wingfield v. Page, 644 S.W.2d 940, 943 (Ark. 1983).

31 Redarowicz, 441 N.E.2d at 329.

32 *See, e.g.*, Lane v. Trenholm Bldg. Co., 229 S.E.2d 728, 729-31 (S.C. 1976); *see generally* 5 STEVEN G. M. STEIN, CONSTRUCTION LAW ¶ 18.03 (Lexis 2018).

many courts extended the implied warranties to protect subsequent purchasers, which in turn required the courts to determine how long a consumer could sue under the implied warranties.[33] Finally, courts dealt with the relationship between the implied warranties and express limited warranties and with questions about whether or the extent to which a builder may disclaim the implied warranties.[34] Some cases holding that a builder-vendor may disclaim an implied warranty or modify it by giving a more limited express warranty impose demanding standards for precise and conspicuous language that may be nearly impossible to satisfy.[35]

Through these construction industry cases, courts adapted and translated implied warranty principles to the circumstances of the industry. While this line of cases derived its legal analysis from other implied warranty principles, especially those governing the sale of goods, it now exists as a distinct common law development, having roots both in contract and in tort, and with nuances specifically tailored to the building sector.

Although the cases on implied warranties in construction contracts represent a distinctive application of the implication process, these cases have not significantly influenced the development of contract doctrine writ large. A later section of this chapter takes up the related topic of contextual interpretation in the industry cases. Then, Chapters 4 and 5 discuss the implication process further as an important feature of the federal construction contract decisions. Finally, Chapter 6 considers the theoretical significance of industry cases on contract interpretation.

Third-party dispute resolution

As mentioned at the beginning of Chapter 2, Professor Sweet's list of construction law's significant influences on general principles of contract law includes third-party dispute resolution. This claim holds special force with respect to the enforceability of contract clauses referring claims and disputes to an individual already involved with the transaction, such as a project architect or engineer. This common construction industry practice implicates the same general principles of contract law that apply whenever an agreement conditions a contractual obligation on a decision by an expert, such as an appraiser, an attorney, or a title company.[36] Moreover, third-party dispute resolution provisions in construction contracts often raise more fundamental policy questions because project architects and engineers usually have their

33 *See, e.g.*, Redarowicz, 441 N.E.2d at 329; Terlinde v. Neely, 271 S.E.2d 768, 769–70 (S.C. 1980). *See generally* 2 STEIN, *supra* note 32, at ¶ 5B.01.

34 *See, e.g.*, Bullington v. Palangio, 45 S.W.3d 834, 838-40 (Ark. 2001); O'Mara, 942 S.W.2d at 859; Powell & Mallor, *supra* note 16, at 314-316.

35 *See* Powell & Mallor, *supra* note 16, at 315.

36 13 WILLISTON ON CONTRACTS § 38:25 (4th ed. 1993).

own contractual or even employment relationships with one of the contracting parties, most often the owner.[37] These situations trigger issues under contract law similar to those raised by obligations conditioned on the subjective satisfaction of one of the contracting parties or on other events arguably within the control of the obligated party.[38] Courts have generally invoked freedom of contract principles to uphold such provisions unless the provision is so extreme as to be illusory or the complaining party can show that the decision was arbitrary or made in bad faith under the particular circumstance.[39]

The construction industry cases have not necessarily played a singular role in these contract law developments, although some of the leading cases arose out of construction contract disputes.[40] Chapter 4 discusses the early influence of the U.S. Supreme Court in endorsing provisions in government construction contracts that refer disputes to a government contracting officer or a federal agency. The prominence of industry cases on these issues probably results from two fundamental attributes of the construction context. First, the uncertainty inherent in a construction project creates an environment that practically assures that claims and disputes between the contracting parties will require attention during performance. Second, efficient, fair, and effective resolution of these problems typically benefits both from industry expertise and from an understanding of the specific project and circumstances giving rise to the problem. For these reasons, construction industry contracts frequently refer claims and disputes that arise during performance to an expert already involved in the project, most often a design professional. As already mentioned, because the architect or engineer most closely associated with a project commonly has a contractual or even a direct employment relationship with the project owner, these third-party dispute resolution provisions raise enforceability issues under contract law. Among the most controversial situations in which courts have enforced provisions for disputes to be resolved by interested participates are those in which the contract gives final, binding authority to an employee of the project owner.[41]

37 *See* Carol J. Patterson, *Contractual ADR Provisions: The House Always Wins*, CONSTRUCTION LAW., Winter 2004, at 16; Thomas J. Stipanowich, *Contract and Conflict Management*, 2001 WIS. L. REV. 831, 846.

38 *See* 8 CORBIN ON CONTRACTS, *supra* note 1, at §§ 31.11 – 31.12; Stipanowich, *supra* note 37, at 846–47.

39 *See* 8 CORBIN ON CONTRACTS, *supra* note 1, at § 31.6.

40 *See id.* at § 31.12.

41 *See, e.g.*, Westinghouse Electric Corp. v. New York City Transit Authority, 623 N.E.2d 531 (N.Y. 1993); C.J. Kern Contractors, Inc. v. N. C. Baptist Hosps., Inc., 284 S.E.2d 119 (N.C. Ct. App. 1981); Gene Ming Lee, *A Case for Fairness in Public Works Contracting*, 65 FORD. L. REV. 1075, 1108 (1996). *But cf.* MCI Constructors, Inc. v. Hazen and Sawyer, P.C. 401 F.Supp.2d 504, 514 (M.D.N. C. 2005) (invoking "an objective standard of reasonableness based upon good faith and fair play" where the designated decision maker was not an industry expert).

Construction law has influenced the law governing third-party dispute resolution in a larger sense because the construction industry was one of the first to popularize agreements referring future disputes between the contracting parties to mandatory arbitration and other independent alternative dispute resolution processes. In particular, one of the earliest editions of the American Institute of Architects' standard form for construction contracts, issued in 1915, provided for arbitration.[42] This arrangement challenged those contract law authorities at the time that questioned the enforceability of agreements requiring future disputes to be resolved by binding arbitration.[43] More recently, popular contracting practices in the construction industry have been among those at the forefront of other important alternative dispute resolution practices, including "structured negotiations, project neutrals, dispute review boards, expert determination, initial decision maker evaluative mediation, and non-binding mini-trials."[44] On this basis, one can argue that construction industry practices influenced the law governing third-party dispute resolution in the broadest sense.

The movement, particularly in the federal courts, favoring contractual alternative dispute resolution provisions, however, has not been uniquely attributable to construction cases. With respect to the most significant developments in contractual alternative dispute resolution provisions—the enforceability of mandatory arbitration clauses—the early construction industry cases emerged in tandem with cases from many other areas, including the financial, maritime, and mercantile industries.[45] Overall, the contemporary body of law favoring mandatory arbitration provisions traces its development more to the influence and expanding judicial application of the Federal Arbitration Act than to experiences in any one industry.[46] The ongoing judicial embrace of mandatory arbitration provisions involves a wide range of contractual exchanges, only a relatively small number of which involve construction projects.[47] Construction industry preferences for other alternative dispute resolution processes have also occurred within a larger movement in which the industry has played a notable, but not dominant, role.[48] Overall, these

42 7 BRUNER & O'CONNOR, *supra* note 7, at § 21:1.

43 *See, e.g.*, U.S. Asphalt Ref. Co. v. Trinidad Lake Petroleum Co., 222 F. 1006 (S.D.N.Y. 1915); *see generally* Paul L. Sayre, *Development of Commercial Arbitration Law*, 37 YALE L.J. 595, 608-13 (1928).

44 7 BRUNER & O'CONNOR, *supra* note 7, at § 21:3.

45 Prof. Macneil gives no special treatment to the role of the construction industry in the rise of commercial arbitration in his review of contemporary U.S. law over that played by financial, maritime, mercantile, and other industries. *See* IAN R. MACNEIL, AMERICAN ARBITRATION LAW: REFORMATION-NATIONALIZATION-INTERNATIONALIZATION 25-80 (1992).

46 *See* Linda R. Hirshman, *The Second Arbitration Trilogy: The Federalization of Arbitration Law*, 71 VA. L. REV. 1305, 1305–07 (1985). Of the three Supreme Court cases in Professor Hirshman trilogy, only *Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983), involved a construction industry contract.

47 *See* 7 BRUNER & O'CONNOR, *supra* note 7, at § 21:9.

48 *See* Stipanowich, *supra* note 37. While Professor Stipanowich acknowledges the long-standing practice in the construction industry "of referring disputes between construction contractors and project

developments have more to do with trends in contracting practices than with the general principles of contract law or the place of industry cases in the development of the law. For that reason, I give only modest attention to this topic.

Damages

The damages cases disclose several nuances and discrete innovations that deserve consideration here more for their collective significance than for their impact on any one legal doctrine. The general legal principles involved, as well as the issues presented, are mostly familiar ones in contract cases. The distinctions mainly involve subtle and technical responses to construction industry circumstances, customs and practices. Chapter 2's discussion of the economic waste doctrine already made this fundamental point concerning damages for breach of a construction contract. Cardozo's pronouncement of the economic waste doctrine in *Jacob & Youngs* was a harbinger of the age of an increasingly flexible judicial approach to balancing classical contract law's insistence on enforcing promises against a more practical recognition of the realities of the construction process. Chapter 2 counts the economic waste doctrine as a leading development from the industry cases primarily because of its controversial implications for contract law generally. By contrast, the damage principles dealt with in this section are more limited in their reach. Taken together, however, the damages cases perhaps do more than any other line of cases to define construction law as an important and distinct species of contract law. The Corbin treatise seems to recognize this by giving lead billing to the construction industry when analyzing contract damages in particular circumstances.[49]

The discussions of separate damage topics that follow begin with a short overview of special rules for calculating and proving damages for breach of a construction contract. These distinctions are too specific to breach of construction contract problems to contribute much on their own to an assessment of how the industry cases fit into an overall understanding of contract law. A review of the somewhat controversial betterment doctrine follows. The next two topics briefly take up express contractual limits on damages and liquidated damage provisions. Although the construction industry cases on those two issues do little more than conform to well-established general principles of contract law, I note them here because they are particularly common features of construction contracts that repeatedly figure into industry contract claims. The final damage topics covered here recount how the

owners to the design professional responsible for planning the project," he does not suggest that the industry cases have played a particularly influential role in the expansion of alternative dispute resolution devices. *See id.* at 846–47.

49 *See* 11 Corbin on Contracts, *supra* note 1, at §§ 60.1–60.6.

courts have reacted to three special practices within the industry that indirectly limit remedies for breach of construction contracts. The last two of those three topics could stand on their own as industry-driven adaptations of general principles of contract law distinct from the law of damages. I choose to include them here because I see them functionally as aspects of the law of damages as administered under contemporary construction contracts. The coverage here does not consider statutory law on damages for breach of construction contracts, other than by way of the general comments at the end of the chapter.

Measure and proof of damages

Arguably, this topic accounts for the greatest number of adaptations, nuances, and deviations that distinguish contract law in the construction industry from general principles of contract law. These differences are, as noted above, too tightly linked to characteristics of the construction process to have broad standing within contract law. More than anything else, they reflect flexibility in the law of remedies. Primarily because of the complexity of the construction process, with its extensive network of interdependent relationships among multiple participants, measuring and proving damages associated with construction disputes is notoriously difficult.[50] For our purposes, it will be sufficient merely to catalog the range of industry-specific approaches and principles. Chapter 5 separately explores how the federal construction contract cases have contributed in special ways to the analysis of a contractor's damage remedies for an owner's breach of a construction contract.

In general, the rules concerning the measure of damages for breach of a construction contract are "circumscribed by principles of expectancy, foreseeability, certainty, waste, mitigation and avoidance," supplemented by equitable remedies "applicable to contracts implied-in-fact and implied-in-law [that] address value of services and unjust enrichment respectively."[51] Depending on the circumstances, the measure of an owner's damages in a construction case may use the cost to repair, replace, or complete the work, the diminution in project value that the breach causes, the temporary loss of use of the project, or a combination of these elements. The economic waste doctrine already discussed in Chapter 2, as well as the betterment doctrine discussed next in this chapter, further refines the law concerning an owner's damages for the builder's breach of a construction contract. Alternative measures and multiple elements also apply to builder's claims, especially when the allegations involve delays, additional work, or lost productivity attributable to the owner's fault, or in some cases simply due to causes beyond the builder's

50 *See generally* JUSTIN SWEET & MARC M SCHNEIER, LEGAL ASPECTS OF ARCHITECTURE, ENGINEERING AND THE CONSTRUCTION PROCESS Ch. 6 (7th ed. 2004).

51 6 BRUNER & O'CONNOR, *supra* note 7, at § 19:1.

control. The elements of a builder's damage calculation may account for the unpaid balance of the contract price, the costs of performance and lost profits, and sometimes the value of the benefit conferred on the breaching owner. Consistent with general principles in breach of contract cases, the preferred method of proof for owners' and builders' claims alike calls for evidence of actual economic injury, with all discrete damage items to be segregated and established by documentary means. The usual constraints apply to recovery of incidental and consequential damages.

Because damage claims in construction cases usually involve numerous distinct activities of multiple participants over extended and overlapping durations, construction cost accounting and scheduling techniques become unusually complicated. For these reasons, the courts have accepted several alternative methods of proving damages, especially when an owner causes delays. The cases support disparate and sometimes conflicting approaches and formulae for dealing with some of the most challenging elements of delay damage claims, such as whether and how a contractor or subcontractor may recover for direct and indirect costs, ranging from idle workforces and equipment, to unabsorbed home office expenses arguably allocable to the delay. Similar considerations may also apply when an owner's breach results in extra work for the builder or disruption in the performance of the work. The judicial evolution on these issues has moved distinctly toward allowing a builder to recover for owner breaches even when the evidence is somewhat imprecise.

A highly developed line of cases addresses all of these aspects of measuring and proving damages, plus others. The issues, theories, arguments, and practices involved are matters of critical concern to the specialized construction bar, but a thorough review of them here would not materially advance the current inquiry into the role of the construction industry cases in U.S. contract law. The treatises cover these matters comprehensively.[52]

Betterment

A fundamental rule of contract law holds that a damage award should not place the injured party in a better position than what would have been the case absent the breach.[53] A similar notion applies to compensatory damages awarded under tort law.[54] One special application of this principle to construction or design defects is sometimes called the "betterment" defense. In

52 Chapter 19 in 6 BRUNER & O'CONNOR ON CONSTRUCTION LAW offers more than 100 intricately detailed sections discussing damages and other remedies in construction cases.

53 11 CORBIN ON CONTRACTS, *supra* note 1, at § 55.3; *see generally* RESTATEMENT (SECOND) OF CONTRACTS § 347 (Am. Law Inst. 1981).; *see also* BRUNER & O'CONNOR, *supra* note 7, at §§ 19:26–:29.

54 *See generally* RESTATEMENT (SECOND) OF TORTS §§ 903 & 920 (AM. LAW INST. 1979); *see also* BRUNER & O'CONNOR, *supra* note 7, at § 19:7.

one of the earliest cases, involving a defective roof that carried a five-year guarantee, the court held that the owner could not recover the full cost of a replacement roof guaranteed for ten years.[55] One of the leading cases is *St. Joseph Hospital v. Corbetta Construction Co.*, in which an architectural firm and a manufacturer were held liable to the owner because plastic laminate wall paneling specified for the project did not comply with the fire safety standards of Chicago's Building Code.[56] The court held that the damage award against the design firm (variously discussed as a contract breach or as professional negligence) and against the manufacturer (based on fraud and deceit) should not include the incrementally higher costs of purchasing more expensive compliant material or the greater installation costs for that material. The court reasoned that if appropriate material had been specified, supplied, and installed in the first place, the owner would have been required to pay those additional amounts.[57] In effect, the owner was not responsible to pay the less expensive costs of purchasing and installing the defective material or for its removal, but was responsible to pay for the more expensive code-compliant material and its greater installation costs.

This defense has frequently been approved by courts in construction cases, and is recognized by the secondary authorities, although it is not always designated as "betterment," or given any label at all.[58] Especially in design defect cases, the principle or closely relating ones may be referred to as the "added first benefit," "enhancement," or "beneficial first cost" defense.[59] Labels aside, the rationale for the principle is simply that a damage award in such a case should not confer a windfall. One court justified the doctrine in this way: "Of course the owner, in making his repairs, is not permitted to charge the contractor with the cost of materials more expensive, or to have the building placed in a better condition, than what was called for in the contract between them."[60]

The construction industry betterment cases operate as the particularized adaptation of a well-recognized limitation on recoverable damages, but they do not establish a distinct legal principle or represent a significant innovation in U.S. contract law. The general principle that a damage award for breach of contract should not bestow a windfall applies in other settings.[61] For

55 Ciminelli v. Umland Bros., 258 N.Y.S. 143, 144 (App. Div. 1932).

56 St. Joseph Hosp. v. Corbetta Const. Co., 316 N.E.2d 51 (Ill. App. 1974).

57 *Id.* at 59.

58 *See* BRUNER & O'CONNOR, *supra* note 7, at §§ 17:99, 19:7, 19:26-19:29; Jerome V. Bales, Shamus O'Meara, & Mark R. Azman, *The "Betterment" or Added Benefit Defense*, CONSTRUCTION LAW., Spring 2006, at 14, n.1.

59 5 BRUNER & O'CONNOR, *supra* note 7, at § 17:99, n.4; Ben Patrick, *The Added First Benefit Rule*, CONSTRUCTION LAW., Summer 2004, at 26; Stewart W. Karge, *Architect-Engineers Damages: The Added First Benefit Theory*, CONSTRUCTION LAW., Nov. 1989, at 1.

60 Talbot-Quevereauz Cons. Co. v. Tandy, 260 S.W.2d 314, 316 (Mo. Ct. App. 1953).

61 *See generally* 11 CORBIN ON CONTRACTS, *supra* note 1, at § 55.3.

example, a trial court calculating a damage award for breach of a business acquisition agreement held that the injured party's "recovery is limited to the loss actually suffered by reason of the breach, and he is not entitled to be placed in a better position than he would have been if the contract had been performed."[62]

Express contractual limits

Express limits on the extent or nature of damages recoverable for breach routinely appear in construction contracts. Contract law generally permits the parties to limit damage recovery by advance agreement, subject to potential exceptions in cases of unconscionable terms, seriously unequal bargaining power, illegal penalties, and willful defaults.[63] The construction cases overwhelmingly enforce contractual provisions setting express damage limits, as well as those precluding recovery of consequential or incidental damages (subject to frequent disputes over the fuzzy boundary between direct and consequential or incidental damages). Perhaps the main restriction on enforceability is the standard rule of strict construction by which courts narrowly read provisions in derogation of the common law.[64] Overall, the construction industry cases dealing with express contractual limitations on damages, while especially significant as a practical matter, register as unremarkable from a contract law perspective. In essence, the damage cases establish highly developed and intricate variations on the general damage principles of contract law that the courts have tailored in reaction to the characteristics and practices of the industry.

Liquidated damages

Liquidated damage provisions are nearly as common in construction contracts as are provisions setting limits on liability for damages. Here too, the construction industry cases essentially conform to well-established general principles of contract law. In deference to the freedom of contract doctrine, courts typically respect the parties' advance agreement to fix the amount of damages recoverable should a breach occur.[65] The construction cases adhere to the usual rule that courts will enforce liquidated damage provisions whenever the actual damages would be difficult to prove with certainty and the amount the parties fix is a reasonable advance estimate of the likely

62 Mid-Continent Tel. Corp. v. Home Tel. Co., 319 F. Supp. 1176, 1198 (N.D. Miss. 1970).

63 *See generally* 11 Corbin on Contracts, *supra* note 1, at § 58.16; 6 Bruner & O'Connor, *supra* note 7, at § 19:52.

64 6 Bruner & O'Connor, *supra* note 7, at § 19:56.

65 *See generally* Restatement (Second) of Contracts § 356 (Am. Law Inst. 1981); 11 Corbin on Contracts, *supra* note 1, at § 58.1.

damages.[66] The cases also embrace the familiar corollary against enforcing a liquidated damage provision if it amounts to a penalty.[67] Liquidated damage principles hold special significance in the construction industry with respect to delay damage claims, which are both common and notoriously difficult to calculate.[68]

No-damage-for-delay clauses

The final three damage topics concern special devices construction industry participants use to govern damage recovery. One of the most common is the no-damage-for-delay clause, often found both in contracts between owners and general contractors and in subcontracts. A typical version provides that the contractor (or subcontractor) may be entitled to a schedule extension, but not to damages, as the result of delays caused by the owner (or the contractor) or by other circumstances beyond the contractor's (or subcontractor's) control.[69] Courts often uphold these clauses, arguably on the economic rationale that the contractor or subcontractor can account for the risk of uncompensated delays in its price proposal.[70] At the same time, the courts routinely construe these clauses narrowly, and they establish several relatively broad exceptions for cases involving bad faith or active interference or unreasonably long delays.[71] The complex, multi-participant environment in which delay claims consistently arise in the construction industry make no-damage-for-delay clauses especially controversial. The courts struggle to balance the benefit-of-the-bargain principle, which is central to the very definition of contract, against the realization that construction delays present especially difficult problems of causation and damage calculation.

Conditional payment clauses

These controversial provisions functionally regulate damages even though they speak directly to the right to payment for performance rather than to the right to recover damages for breach.[72] In the construction industry,

66 *See* 6 BRUNER & O'CONNOR, *supra* note 7, at § 19:52.

67 *See generally* Charles J. Goetz & Robert E. Scott, *Liquidated Damages, Penalties and the Just Compensation Principle: Some Notes on an Enforcement Model and A Theory of Efficient Breach*, 77 COLUM. L. REV. 554, 554–55 (1977).

68 *See* 5 BRUNER & O'CONNOR, *supra* note 7, at § 15:82.

69 Cheri Turnage Gatlin, *Contractual Limitations on the Right to Recover Delay Damages and Judicial Enforcement of Those Limitations*, CONSTRUCTION. LAW., Fall 2002, at 32.

70 *Id*.

71 *See* 6 BRUNER & O'CONNOR, *supra* note 7, at § 19:68.

72 *See generally* 3 BRUNER & O'CONNOR, *supra* note 7, at § 8:48; 6 BRUNER & O'CONNOR, *supra* note 7, at § 19:57; Margie Alsbrook, *Contracting Away an Honest Day's Pay: An Examination of Conditional Payment Clauses in Construction Contracts*, 58 ARK. L. REV. 353 (2005).

conditional payment clauses usually appear in subcontracts and come in two varieties. A pay-when-paid clause proportionately shifts onto the subcontractor the risk that the project owner may delay payments to the prime contractor. Because these provisions literally deal with the timing of payment rather than entitlement to payment, the courts tend to interpret them as imposing on the subcontractor only a risk of reasonable delay. Once the court concludes that the owner's payment delay has continued for an unreasonable time, the prime contractor must pay the subcontractor. A pay-if-paid clause purports to condition the subcontractor's right to be paid at all on the prime contractor's receipt of a corresponding payment from the owner. In some jurisdictions, this harsher version is enforceable if it is unambiguous, although the courts often strain to read even clear language as implying only a pay-when-paid intent. In other jurisdictions, a pay-if-paid clause is unenforceable on policy grounds.

Pay-when-paid and pay-if-paid clauses represent industry-specific versions of payment conditions long known to other kinds of contracts.[73] The courts' reluctance to enforce them strictly in accordance with their terms reflects a general preference in contract law to interpret agreements in ways that avoid or reduce the risk of forfeiture.[74] While the construction cases are probably too limited in their scope to be regarded as a principal source of the law on conditional payment obligations, considerable evidence exists that they have influenced general principles of contract law beyond the narrow issue of a subcontractor's right to payment.[75]

Termination for convenience

As with conditional payment clauses, termination for convenience clauses only indirectly regulate the right to damages. In effect, they limit a contracting party's monetary liability for failing to complete its promised performance. An arrangement under which one party to an agreement reserves the unconditional right to exit the relationship at will during performance seems illusory. Under common construction industry practices, however, a termination for convenience clause, in addition to allowing the owner to end the project for any or no stated reason, entitles the contractor to a termination fee or other compensation.[76] Termination for convenience rights originated in public procurement contracts to provide the government a safe exit strategy when a long-term need abruptly concludes, as when a war ends.[77] Over time, they

73 *See generally* 8 CORBIN ON CONTRACTS, *supra* note 1, at § 30.15.

74 RESTATEMENT (SECOND) OF CONTRACTS § 227 (Am. Law Inst. 1981).

75 *See id.*, illus. 1. *See also* 8 CORBIN ON CONTRACTS, *supra* note 1, at § 30.15.

76 *See generally* 6 BRUNER & O'CONNOR, *supra* note 7, at § 19:61.

77 *See* Julie A. Roin, *Public-Private Partnerships and Termination for Convenience Clauses: Time for A Mandate*, 63 EMORY L.J. 283, 286 (2013).

have become standard protections not only in many other kinds of government contracts, but also in certain private contracts, especially in the construction industry, where the economic justification for an extended financial commitment or ongoing relationship can unexpectedly deteriorate or disappear. Under these circumstances, courts normally enforce these provisions as written. On policy grounds, however, some cases hold that the right to terminate may only be exercised in light of some relevant change in circumstances or at least based on a decision made in good faith.[78]

While termination for convenience clauses significantly reallocate the risks of an uncertain future between the owner and the builder, they only rarely raise substantial enforceability questions. They are significant to this discussion in the first place because they have become a relatively common device in construction contracts for the purpose of recasting behavior by one party that would otherwise constitute a breach so that instead it serves as a basis for the other party to claim alternative compensation under the contract. Rather than giving rise to expectation damages, they lead to termination payments more analogous to reasonable reliance damages.[79] Secondarily, the contemporary line of termination for convenience cases in the industry adds a noteworthy gloss to the general principles of good faith and fair dealing.[80] Finally, the construction industry cases have not merely followed an established principle under the law of public contracts; for many years, they have played an important role in the ongoing development of that law.[81]

Unilateral changes

Construction contracts cannot fully define project details, nor can they automatically adjust as circumstances change during the course of construction. For these reasons, among others, project owners normally reserve the right to make changes to the work to be performed during the course of construction.[82] The law and practices on unilateral changes to construction contracts adapt a range of contract law principles to the industry context to achieve a remarkable degree of economically rational flexibility.

Under standard contract law principles, one might question whether one party's right to change the other party's obligations renders the contract

78 *Id.* at 287-91.

79 *Id.* at 285.

80 *See, e.g.*, Vila & Son Landscaping Corp. v. Posen Const., Inc., 99 So. 3d 563 (Fla. Dist. Ct. App. 2012); Questar Builders, Inc. v. CB Flooring, LLC, 978 A.2d 651 (2009); Ryan P. Adair, *Limitations Imposed by the Covenant of Good Faith and Fair Dealing upon Termination for Convenience Rights in Private Construction Contracts*, J. Am. Coll. Construction L. J., Aug. 2013, at 127.

81 *See, e.g.*, Greenlee Constr., Inc., v. General Serves. Admin., 07-2 B.C.A. (CCH) ¶ 33619 (July 2007); Krygoski Const. Co. v. United States, 94 F.3d 1537 (Fed. Cir. 1996); G. L. Christian & Assocs. v. United States, 312 F.2d 418 (Ct. Cl. 1963).

82 *See generally* 1A Bruner & O'Connor *supra* note 7, at § 4:1.

illusory, or unenforceable as an agreement to agree, or subject to challenge as a contract of adhesion.[83] Long-established practices in construction contract terms, however, successfully avoid serious theoretical problems by structuring the owner's right to order changes in the work as an agreed process for modifying the work and for determining the nature and extent of any other adjustments to related contract terms, such as price and schedule.[84] While the courts routinely enforce these provisions, case law protects the contractor against proposed changes that go beyond anything the parties presumably contemplated at the time of contracting. In federal contract cases, as discussed in Chapter 5, the courts use the cardinal change doctrine for this purpose, while state law typically "addresses these situations by applying the concepts of abandonment, termination, rescission and quantum meruit."[85]

Third-party beneficiaries

Contract law's third-party beneficiary rule incites ongoing scholarly criticism.[86] Over the course of the twentieth century, the common law progressively moved away from a rigid rule barring most third-party beneficiary claims toward a framework that allows the claim if the third-party qualifies as an intended beneficiary under the contract and not a merely incidental one. The second Restatement reflects this approach by making the central, albeit elusive, question whether the third-party claimant is an intended beneficiary of the contract.[87]

In light of the interdependence among construction project participants who have no direct contractual relationships with each other, acts and omissions of contracting parties often affect the interests of those who are not parties to the underlying contractual relationship. As a result, industry contracts regularly present third-party beneficiary issues.[88] A general contractor or a subcontractor may assert a claim against an architect or engineer based on the terms of a contract solely between the design professional and the owner, or may sue the project's lender based on the terms of the owner's loan

83 *See generally* 5 CORBIN ON CONTRACTS, *supra* note 1, at § 24.27E; Peter A. Alces & Michael M. Greenfield, *They Can Do What!? Limitations on the Use of Change-of-Terms Clauses*, 26 GA. ST. U. L. REV. 1099 (2010); *see also* Emulsified Asphalt, Inc. of Wyoming v. Transportation Com'n of Wyoming, 970 P.2d 858, 865 (Wyo. 1998) (rejecting an "agreement to agree" challenge).

84 *See* 2 BRUNER & O'CONNOR, *supra* note 7, at § 5:139.

85 *Id.* at § 5:144.

86 *See, e.g.*, David G. Epstein et. al., *An "App" for Third Party Beneficiaries*, 91 WASH. L. REV. 1663 (2016); Alan Schwartz & Robert E. Scott, *Third-Party Beneficiaries and Contractual Networks*, 7 J. LEGAL ANALYSIS 325 (2015); Melvin Aron Eisenberg, *Third-Party Beneficiaries*, 92 COLUM. L. REV. 1358, 1359 (1992); Anthony Jon Waters, *The Property in the Promise: A Study of the Third Party Beneficiary Rule*, 98 HARV. L. REV. 1109, 1149 (1985).

87 RESTATEMENT (SECOND) OF CONTRACTS § 302 (Am. Law Inst. 1981).

88 *See* John V. Burch, P.C., *Third-Party Beneficiaries to the Construction Contract Documents*, CONSTRUCTION LAW., April 1988, at 1.

agreement. An owner may pursue a claim against a subcontractor for defective work. Any number of project participants not expressly protected under the terms of a surety bond obtained by another participant may attempt to recover under the bond. Many project participants may seek payment for work performed or compensation for loss incurred by suing the project owner with whom they have no contract. When the owner enters into multiple prime contracts for different phases or segments of the work, one prime contractor may assert a claim against another prime contractor.

The industry cases have helped to refine the contemporary framework that distinguishes intended third-party beneficiaries, who have enforceable legal rights via the remote contract, from incidental beneficiaries, who do not have those rights.[89] Courts have sometimes noted the special difficulty of applying the rule to construction industry claims. "This is because of the number of different parties that are routinely involved in a project's construction, the complex interrelationships of the professional disciplines involved, the amount of money at stake, and each party's mutual interdependence on the performance of the other."[90] The courts' inconsistent results and analyses accurately reflect both the status of the modern third-party beneficiary rule and the scholarly exploration of the third-party claim problem.[91] Many standard construction industry contracts now attempt to elude the dilemma by including provisions expressly disclaiming any intent by the parties to confer third-party beneficiary status.[92]

Those making third-party beneficiary claims in the construction industry cases often resort also to tort claims in the alternative. As the final section of this Chapter mentions, this tort tactic in turn presents difficult considerations under the economic loss rule, a topic I reserve for Chapter 6.

Contextual interpretation

The highly respected Bruner & O'Connor treatise on construction law observes that several salient features of contract interpretation in the industry cases mark the law as contextual. "It is the 'contextual' environment of construction that gives the construction contract uniqueness among the wide world of contracts."[93] From this perspective, contract law is flexible, governed not by rigid rules that apply in the same way across all types of exchange transactions but by principles that apply differently in different situations. To the extent that this characterization applies, profound implications

89 *See* 9 CORBIN ON CONTRACTS, *supra* note 1, at § 45.3.

90 Moore Const. Co. v. Clarksville Dep't of Elec., 707 S.W.2d 1, 7 (Tenn. Ct. App. 1985) (footnote omitted).

91 *See* Eisenberg, *supra* note 86, at 1392-1406.

92 *See id*. at 1392-92; 2 BRUNER & O'CONNOR, *supra* note 7, at § 5:11.

93 1A BRUNER & O'CONNOR, *supra* note 7, at § 3:2.

follow for courts interpreting construction contracts. "Given their unique transactional context, construction contracts are recognized by the world of contract law as a 'separate breed of animal.'"[94]

As discussed at greater length in Chapter 6, many of the important developments in contract law most directly influenced by or reflected in the construction cases suggest a highly contextual and relational theory of contract. This applies to all the topics included in Chapter 2 and in varying degrees to several already covered in this chapter, especially third-party dispute resolution, unilateral changes, and some aspects of the damage cases. This section adds two other topics that are inherently contextual throughout contemporary contract law and that the construction cases adapt in special ways. While one need not necessarily categorize any of these topics as purely matters of contract interpretation, in deference to Bruner & O'Connor, I take this opportunity to explore that perspective on a limited basis here.

The duty to disclose

The Restatement recognizes a principle that a contracting party may incur liability for failing to disclose information if the circumstances are such that the failure to disclose operates practically as a misrepresentation. Those circumstances include when the party "knows that disclosure of the fact would correct a mistake of the other party as to a basic assumption on which that party is making the contract and if non-disclosure of the fact amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing."[95] As the drafters of the Restatement recognized, the concept contrasts starkly with the ordinary understanding of a contractual relationship. "A party making a contract is not expected to tell all that he knows to the other party, even if he knows that the other party lacks knowledge on some aspects of the transaction."[96] Both as stated and as applied in many cases, the Restatement's abstract duty to disclose suggests a narrow and potentially unruly exception.[97]

In the construction industry cases, however, the courts have refined and particularized the concept, giving it special force when a contracting party, especially the project owner, has important information not easily available to the other party. "Implied in every construction contract is the duty of an owner to disclose fully any information in its actual or constructive possession that (1) is material to the contractor's performance and (2) is not otherwise

94 *Id.* (citing to Paul Hardeman, Inc. v. Arkansas Power & Light Co., 380 F. Supp. 298, 317 (E.D. Ark. 1974)).

95 Restatement (Second) of Contracts § 161 (Am. Law Inst. 1981).

96 *Id.*, cmt. a.

97 *See generally* Kimberly D. Krawiec & Kathryn Zeiler, *Common-Law Disclosure Duties and the Sin of Omission: Testing the Meta-Theories*, 91 Va. L. Rev. 1795 (2005).

generally available to or discoverable upon reasonable inquiry by the contractor."[98] The authorities often refer to this as the "superior knowledge" doctrine, a concept first used to protect contractors in federal contract cases.[99] While the principle continues to appear most often in public contract cases, it has achieved broader standing in construction law. "The 'duty to disclose,' which subsumes the legal duties to inform and to warn, is implied where one party has superior knowledge about performance risks unavailable to the other party."[100] The duty to disclose is not a unique contribution of the construction industry cases; rather, its importance within contract law derives from the manner in which the courts have adapted an abstract general principle of contract law to a particular industry context.

Impossibility, impracticality, and force majeure

Parties to ongoing contractual relationships often encounter situations that they neither anticipated nor can control. In the earliest era of contract law, courts might excuse performance based on events characterized as "Acts of God" narrowly defined.[101] Beyond that, however, the courts adhered rigidly to the principle that contract liability is strict liability. Over time, contract law evolved away from this formalistic commitment to sanctity of contract and adopted a more sympathetic judicial attitude. The early cases in this transition often involved supervening causes completely beyond the obligated party's control. Context, and especially commercial context, influenced the transition. "As business agreements became increasingly bilateral in character, the law of mutual independence began to conflict with the commercial practices and contractual expectations of the merchant class.... In the context of the impossibility doctrine, this manifested itself in courts recognizing an implied condition, or assumption, that the supervening event (e.g., war, fire, natural disaster) would not occur."[102] In these cases, the implication process was a form of contract interpretation under which the courts implied the condition based on what they inferred about the parties' expectations when they entered the agreement.

Unanticipated events attributable to external forces are particularly common and troublesome within the construction industry, where contractors, subcontractors, suppliers, and manufactures make commitments to

98 3 BRUNER & O'CONNOR, *supra* note 7, at § 9:92 (footnotes omitted).

99 *See* J. William Eshelman & Suzanne Langford Sanford, *The Superior Knowledge Doctrine: An Update*, 22 PUB. CONT. L.J. 477, 477–78 (1993); Edwin W. Patterson, *The Interpretation and Construction of Contracts*, 64 COLUM. L. REV. 833, 863–64 (1964) (citing to Helene Curtis Indus., Inc. v. United States, 312 F.2d 774 (Ct. Cl. 1963), commonly recognized as the seminal case on the superior knowledge doctrine).

100 1A BRUNER & O'CONNOR, supra note 7, at § 3:57.

101 *See* ALFRED W.B. SIMPSON, A HISTORY OF THE COMMON LAW OF CONTRACT 525-526 (1975).

102 14 CORBIN ON CONTRACTS, *supra* note 1, at § 74.1.

perform in a far-distant and uncertain future. For the most part, the early industry cases reflect the general and gradually softening general principles of contract law.[103] In one sense, the construction industry cases may be especially interesting because they "seem strongly influenced by perceived industry customs."[104] Even so, the extensive line of industry cases involving supervening events illustrate the evolution of the impossibility defense more than they account for that evolution.

On one important development, however, an industry case played an especially noteworthy role. At least through the turn of the twentieth century, the courts primarily responded to strict impossibility. Only later did they begin to allow for excuse based on practical impossibility. By many accounts, a compelling construction industry case led the way with the California Supreme Court's 1916 decision in *Mineral Park Land Co. v. Howard.*[105] There, the court relieved a builder from the obligation to take from the plaintiff's land all gravel and earth required for completion of a bridge construction project because unanticipated conditions increased the costs for extraction beyond a certain quantity of the material at the site by tenfold or more. The contractor's obligation was possible to perform because the site held the additional gravel and earth needed to complete the project, but water conditions made it economically impractical to continue taking the remaining materials. Thus arrived the impracticality doctrine as recognized under contemporary construction law.[106]

Although force majeure operates as an important doctrine in civil law, it's incorporation into U.S. contract law comes primarily through the practice of including in contracts provisions commonly referred to as force majeure clauses—provisions by which the parties attempt to allocate in advance the risks of supervening events. For many commercial contracts, the force majeure clause serves as the primary protection against litigation over impossibility and impracticality.[107] Construction industry contracts provide prime examples of the use of detailed and sophisticated force majeure clauses.[108] These clauses focus more on supervening events that may preclude liability for delays in performance rather than those that could completely discharge a party's obligations. For our purposes, this is primarily of interest as an important example of how industry participants have developed contracting practices that incorporate and adapt contract law principles to the construction process.

103 *See* 5 Bruner & O'Connor, *supra* note 7, at § 15:28.

104 14 Corbin on Contracts, *supra* note 1, at § 74.7.

105 156 P. 458 (Cal. 1916). *See generally* 14 Corbin on Contracts, *supra* note 1, at § 74.13.

106 *See* Restatement (Second) of Contracts § 266, illus. 5 & cmt. a (Am. Law Inst. 1981).

107 *See* 14 Corbin on Contracts, *supra* note 1, at § 74.19.

108 *See* 5 Bruner & O'Connor, *supra* note 7, at § 15:22.

Discussions of impossibility, impracticality, and force majeure usually also consider the somewhat more flexible frustration of purpose doctrine, which applies even though performance remains entirely feasible in a physical sense. Under the Restatement, a party may be discharged from further obligations under a contract if the "party's principal purpose is substantially frustrated without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made."[109] Construction industry cases, however, have not figured into the development or application of the frustration of purpose doctrine to an extent meriting further consideration here.

Other contract interpretation principles

The Bruner & O'Connor treatise discusses several other aspects of contract interpretation under construction law that arguably lend further support to a highly contextual framework or that otherwise distinguish construction law. The list includes several industry-specific warranties and conditions that courts often imply into construction contracts, giving special recognition to the way in which the courts have incorporated and adapted the implied duties of good faith and fair dealing to industry contracts. I ignore these additional matters here because most of them do not suggest implications beyond industry contracts, except for certain implied terms derived from federal cases, which I reserve for Chapter 5. The duties of good faith and fair dealing, of course, are general principles of contract law, but for the most part those duties as applied to construction industry contracts do not signal distinctive adaptations, nuances, or deviations.

Subcontracts

Construction projects, from small to massive, usually involve numerous relationships between prime contractors and their subcontractors. Because the construction industry cases regularly address the issues that spring from subcontract relationships, they have played a role in the development of those aspects of contract law.

The Restatement lays out the fundamental principle that a contracting party generally may delegate contract obligations to third parties, but that doing so does not discharge the original contracting party.[110] While the law recognizes exceptions for obligations of a personal nature or under contracts expressly prohibiting delegation, these restrictions have limited impact in the construction industry, where, by both custom and express agreement, prime

109 Restatement (Second) of Contracts § 265 (Am. Law Inst. 1981).
110 Restatement (Second) of Contracts § 318 (Am. Law Inst. 1981).

contractors ordinarily perform their obligations through subcontracts with many specialty trades and suppliers.

As already discussed, third-party beneficiary issues frequently arise in connection with subcontracts. A subcontractor may wish to enforce the owner's obligation under the prime contract to pay for the work or to provide sufficient specifications; an owner may seek remedies against a subcontractor for delays or defective work; and one subcontractor may wish to pursue a claim against another subcontractor for creating circumstances that adversely affect the progress of the work. As the earlier discussion explains, courts often have difficulty analyzing these third-party beneficiary claims, including when they involve subcontractors. In general, however, third-party beneficiary claims brought by subcontractors rarely succeed.[111] In this respect, the courts may have accurately conformed the legal analysis to the customs and likely expectations of the industry, at least under the traditional project delivery system that uses a series of bilateral contracts between the prime contractor and each specialty trade.

A related question is whether a prime contractor can assert against the owner claims on behalf of a subcontractor even if the terms of the subcontract immunize the prime contractor from liability to the subcontractor for the claim.[112] This pass-through claims issue may come up, for example, when a subcontractor asserts that the owner's wrongful acts or omissions forced the subcontractor to incur additional costs. Because the law on this topic derives primarily from federal contract cases, Chapter 5 considers this topic in greater detail.

The complex network of relationships by which a prime contractor divides its contract obligations via subcontracts into many critical specialty packages gives rise to another important line of cases. Because construction projects require careful coordination and integration of many overlapping activities, subcontracts must interface consistently with many terms of the prime contract. A popular way to achieve this objective is to incorporate by reference into the subcontract terms of the prime contract.[113] Similarly, subcontractors' rights often derive from and depend on the prime contractor's rights under the contract with the owner. The contracting techniques involved give rise to "flow-through" or "flow-down" or "flow-up" provisions that prove easier to write than to apply.[114] Courts sometimes face puzzling contract interpretation questions on such matters as whether or the extent to which indemnification provisions or dispute-resolution processes in the prime contract have

111 *See* John V. Burch, P.C., *Third-Party Beneficiaries to the Construction Contract Documents*, CONSTRUCTION LAW., April 1988, at 1, 23.

112 *See* 6 BRUNER & O'CONNOR, *supra* note 7, at § 19:25.

113 Stanley P. Sklar, *A Subcontractor's View of Construction Contracts*, CONSTRUCTION LAW., January 1988, at 1, 18-19.

114 *See* 2 BRUNER & O'CONNOR, *supra* note 7, at § 5:126.

been incorporated into a subcontractor under one of these clauses.[115] A series of annotations in *Corbin on Contracts* reflects the relevance of these cases to certain aspects of contract interpretation.[116]

Finally, one of the most interesting developments involving subcontracting in the construction industry concerns evolving collaborative technologies and project delivery systems that the courts have yet to address in detail. The alternative contracting structures involved go by such names as strategic alliances, public-private partnerships, and integrated project delivery. Through these creative arrangements, we find industry subcontracting practices on the leading edge of emerging contract law principles for complex, multi-party commercial relationships. Perhaps the near future will bring important cases that call on courts to enforce and interpret more of these arrangements, thereby continuing the evolution of contract law in new directions.[117]

And much more

The construction industry cases offer many other examples of contract law adaptations, refinements, and constraints. I omit discussing some of them in this chapter because their significance within contract law has diminished over time, others because they are peculiarly products of industry practices that contribute little to an appreciation of contract law writ large, and still others because of their greater relevance to topics discussed elsewhere in this book. I briefly mention just a few in this concluding section to acknowledge their importance within the construction industry. The treatises and practice manuals for the specialized construction bar address all of these at length.

The most obvious omissions from this chapter concern issues dominated by legislation expressly limited to the construction industry. Industry groups wield impressive lobbying power, which they have used effectively for decades. Some of the most significant laws in this category concern payment issues, from construction lien laws to prompt payment statutes, surety bonding requirements, legislation that alters the common law on conditional payment provisions, and statutory limits on amounts that may be withheld from contractors or subcontractors in the form of retainage. A growing number of states have also enacted statutes establishing procedures for construction defect claims, often for the purpose of attempting to avert litigation by assuring builders the opportunity to cure defects. State legislatures have intervened on a grand scale in other areas as well, including regulating contractual indemnities, enacting special statutes of repose applicable to construction claims, and

115 *See* 1A Bruner & O'Connor, *supra* note 7, at § 3:64.

116 *See* 5 Corbin on Contracts, *supra* note 1, at § 24.21.

117 *See generally* Carl J. Circo, *A Case Study in Collaborative Technology and the Intentionally Relational Contract: Building Information Modeling and Construction Industry Contracts*, 67 Ark. L Rev. 873 (2014).

setting procedures to govern competitive bidding, primarily for public projects. The licensing statutes that apply to most construction professions and trades also overshadow the common law of contracts in certain respects.

Beyond legislation inspired by industry group lobbies, most states have enacted consumer protection statutes that apply, to one extent or another, to disputes arising under residential construction contracts. Unfair trade or other general consumer protection statutes also may apply to construction work. Finally, in the legislative category are remedies under the Uniform Commercial Code, which sometimes apply to aspects of construction projects, although courts exclude most conventional construction contracts from the U.C.C. by categorizing them as being primarily for services rather than for the sale of goods.

In addition to omitting topics heavily governed by statutes, I have given light treatment to equitable remedies even though courts often resort to equity in construction contract cases, especially quantum meruit, unjust enrichment, and rescission. While equitable doctrines are important in construction law, they have more to do with the law of remedies than with the general principles of contract law. I also have not dealt with issues specific to contracts for professional design services. Design professionals are subject to special licensing statutes and regulations, and their liability more often develops in tort than in contract.

One omitted topic deserves a special note as a hybrid matter of tort and contract law that has been particularly troublesome for the courts. This is the economic loss rule, which often prevents participants in a construction project from recovering economic loss not accompanied by property damage or personal injury. The construction industry cases here are conflicting and confusing, and they offer no firm lessons about general principles of contract law. I choose, therefore, to discuss the economic loss rule in Chapter 6, as a matter of exploring contract theory from the perspective of the construction industry.

The next two chapters consider the special significance of the federal cases. Chapter 4 broadly looks at the construction industry cases decided by the U.S. Supreme Court. While only the Court's opinions dealing with construction contracts bear directly on the primary inquiry at hand, in the interests of completeness and perspective, Chapter 4 also explores how industry cases have figured into other aspects of the Court's jurisprudence. Chapter 5 addresses the federal contract cases in the lower federal courts, giving special attention to the influence of the U.S. Court of Federal Claims and the Court of Appeals for the Federal Circuit.

Part 3

The federal cases

4 The U.S. Supreme Court cases

The construction industry has generated a noteworthy array of Supreme Court cases. As one might expect, some of these cases came to the Court not because they presented contract law issues, but because contractual relations or other industry activities incidentally led to disputes implicating constitutional matters or federal statutes or regulations. The federal questions that brought these cases to the Court include the Contracts and Commerce Clauses, Due Process, Equal Protection, the Federal Arbitration Act, labor and environmental laws, and the rules of civil procedure, among others. More pertinent to this book's primary inquiry is that, until around the middle of the twentieth century, the Court also issued some important decisions on contract law issues in the construction industry context. Although the Court now rarely takes cases that involve only commercial issues, some of the Court's early construction contract cases retain notable influence. Taken as a whole, the Supreme Court's opinions with close ties to the construction industry cast a certain hue on the overall picture of the relationship between the industry and U.S. contract law.

This chapter first reviews the Court's contract law opinions arising out of the construction industry. Many of these opinions continue to influence state construction law as well as the law governing federal contracts. To provide a more complete picture, the final section of the Chapter briefly considers the federal constitutional decisions involving the construction industry.

In reviewing the Supreme Court decisions, I was especially interested in three questions. First, to what extent have the Court's decisions in construction contract cases contributed to the evolution of general principles of contract law? Second, which decisions have most directly affected the law of construction contracts specifically, whether or not they have filtered more widely into general principles? Third, how has the construction industry figured into other important Supreme Court cases? The third question represents a limited and temporary deviation from the contract law focus of this book. Although only a few of the Court's decisions register high on any one of these three questions, for me, and I trust for many readers, assessing the Court's construction industry cases qualifies as a worthy diversion, a matter of inherent interest.

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Owner's implied obligations

If asked to name an important Supreme Court ruling concerning construction contracts, an experienced construction lawyer would likely cite *United States v. Spearin* or the Spearin Doctrine.[1] To this day, state courts as well as lower federal courts invoke the concise language from this famous 1918 case, which holds that "if the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications."[2] The Court based its decision on the theory that the owner's act of furnishing design details for certain sewer work on the federal project involved "imported a warranty that if the specifications were complied with, the sewer would be adequate." The Court initially referred to the plans and specifications as having been "prepared by" the government, but in the next paragraph the Court used the phrase "furnished by the government." The holding is widely interpreted as implying a project owner's warranty of architectural or engineering plans even when the owner has no technical expertise and simply retains an independent design professional to prepare plans it then passes on to the builder. The Court further held that the "implied warranty is not overcome by the general clauses requiring the contractor to examine the site, to check up the plans, and to assume responsibility for the work until completion and acceptance."[3] The *Spearin* case involved a federal government project, but the Spearin Doctrine has been widely applied to private as well as public contracts.[4]

Spearin is one of four decisions closely related in time and significance in which the Court imposed implied obligations on a project owner. A few years earlier, in *Hollerbach v. United States* and in *Christie v. United States*, the Court held in favor of claimants seeking to recoup additional costs they incurred due to conditions at the project site differing significantly from the information provided to them in the government's specifications for the work.[5] In those cases, the Court characterized the inaccurate information as representations on which the contractors were entitled to rely. *Spearin* took the further step of implying a warranty by the government that the plans and specifications it provided were adequate for the intended purpose. Two years later, in *United States v. Atlantic Dredging Co.*, the Court relied on *Spearin* in holding the government liable to a contractor for extra costs incurred due to adverse soil conditions about which the government had information that it did not provide to the contractor and that conflicted with information in the

1 248 U.S. 132 (1918).

2 *Id.* at 136.

3 *Id.* at 137 (footnotes omitted).

4 *See generally* 3 Philip L. Bruner & Patrick J. O'Connor, Jr. Bruner and O'Connor on Construction Law § 9:81 (Westlaw 2018).

5 Christie v. United States, 237 U.S. 234 (1915); Hollerbach v. United States, 233 U.S. 165 (1914).

government's bidding documents.[6] *Atlantic Dredging* bears a close relationship to the superior knowledge doctrine briefly mentioned in Chapter 3 and discussed in greater detail in Chapter 5.

One might suspect that the one-sided leverage the United States enjoys in contracting for construction services influenced the Court in these cases to impose some heightened responsibility on the federal government as a project owner. State courts, however, widely rely on *Spearin* and *Atlantic Dredging* in resolving disputes in both public and private construction contracts. These two Supreme Court cases, along with *Christie* and *Hollerbach*, were part of a growing trend in the early twentieth century contracts cases by which courts invoked policy considerations to imply terms or duties into contracts.[7] Chapters 3, 5, and 6 explore that movement from different perspectives.

Dispute resolution

The Supreme Court's arbitration jurisprudence under the Federal Arbitration Act has been especially significant for the construction industry. Chapter 3 observes that, while the industry has long embraced arbitration as a means of resolving disputes, industry cases have not distinctly influenced the law governing arbitration of contract disputes. Similarly, relatively few of the Court's major arbitration decisions emerged from construction contract cases. Only one industry case, *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, stands out as especially important among the Court's arbitration decisions.[8] There, the Court held that the federal district court abused its discretion in staying arbitration under the FAA in deference to a pending state court suit. The Court used the occasion to recognize a federal policy favoring arbitration and to clarify that federal law governs the question of arbitrability under the FAA. While the case helped to settle important issues, nothing significant to the decision turned specifically on the construction industry context. The same conclusion applies to the Court's other significant decisions involving arbitration of construction industry disputes—the construction industry backgrounds of the cases did not materially influence any of these decisions.[9] For these reasons, I will not deal at any greater length here with the Court's arbitration cases.

6 253 U.S. 1 (1920).

7 *See generally* 4A BRUNER & O'CONNOR, *supra* note 4, at § 14:29.

8 Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1 (1983).

9 *See* Citizens Bank v. Alafabco, Inc., 539 U.S. 52 (2003) (holding that a debt restructuring agreement between an Alabama bank and an Alabama construction firm satisfied the FAA's "involving commerce" test); C & L Enterprises, Inc. v. Citizen Band Potawatomi Indian Tribe of Oklahoma, 532 U.S. 411 (2001) (holding that by entering into a construction contract that included a standard arbitration clause, the Tribe effectively waived its sovereign immunity); Volt Info. Scis., Inc. v. Bd. of Trustees of Leland Stanford Junior Univ., 489 U.S. 468 (1989) (holding that where parties chose state law to govern an arbitration agreement under a construction contract, state law applied to a motion to

Rather, the remainder of this discussion of the Court's dispute resolution decisions focuses on a claims process that federal agencies began to use in the nineteenth century and that has become prevalent throughout the industry. This practice vests significant authority for resolving disputes in a person or body closely connected to the project owner. Federal construction contracts commonly include such procedures, and the Court has generally endorsed them as legitimate and efficient means of resolving construction contract disputes.

In a series of cases decided over several decades, the Court enforced contract provisions authorizing third parties employed by or otherwise closely connected to the project owner to settle claims and resolve disputes. Two of the earliest cases involved federal contracts that designated a government official associated with the project to render decisions, in one case on the amount due for transporting goods according to a pricing formula, and in the other to determine whether construction was completed as required by the contract.[10] The Court promptly expanded this principle to a private construction contract in which a railroad designated its engineer to certify the amount due to the contractor under the terms of the contract.[11] The rationale was that "there is no averment that the engineer had been guilty of fraud, or had made such gross mistake in his estimates as necessarily implied bad faith, or had failed to exercise an honest judgment in discharging the duty imposed upon him."[12] Thus, the Court adopted a highly deferential standard that favored finality of the decision except in extraordinary circumstances. The Court adhered to this principle in a series of cases decided through the early part of the twentieth century.[13]

In the early 1950s, the Court's reliance on this principle in two cases involving government construction contracts generated sufficient criticism to attract the attention of Congress. By this time, many federal construction contracts included an agency dispute resolution provision as a standard term. Under a broad form of such a provision, the designated decision maker has authority to accept or reject the work and to determine the amount due to the contractor under the contract terms, and also, and most significantly, to resolve all claims and disputes that arise in connection with the contract.

In *United States v. Moorman*, the contract left it to the Secretary of War or his authorized representative not only to resolve any disputed factual

stay the arbitration); Commonwealth Coatings Corp. v. Cont'l Cas. Co., 393 U.S. 145 (1968) (setting aside an arbitration award in favor of a general contractor against a subcontractor due to an undisclosed business relationship between the general contractor and one of the arbitrators).

10 Sweeney v. United States, 109 U.S. 618 (1883) (construction work); Kihlberg v. United States, 97 U.S. 398 (1878) (transportation contract).

11 Martinsburg & P.R. Co. v. March, 114 U.S. 549 (1885).

12 *Id.* at 553.

13 *See, e.g.*, Goltra v. Weeks, 271 U.S. 536 (1926); Ripley v. United States, 223 U.S. 695 (1912); United States v. Gleason, 175 U.S. 588 (1900).

questions but also to resolve any claim such as the one being made by Moorman that certain work being demanded of him was beyond what the contract required.[14] Justice Black held that even if this matter was viewed as a question of law calling for an interpretation of the contract, the Court's long-established precedents justified enforcing the plain language of the contract that made the agency decision final and binding. As the primary authority for this holding, Justice Black cited the three nineteenth-century cases described above.

A year later, in *United States v. Wunderlich*, the Court considered a federal construction contract that referred all disputes to the government's contracting officer, with a right of appeal to the Secretary of the Interior, whose decision on behalf of the Department of the Interior would be "final and conclusive."[15] Justice Minton's opinion for the Court referred to this provision, in Article 15 of the contract, as usual for government construction contracts at that time. The contractor appealed an adverse agency decision to the Court of Claims, which held for the contractor on one claim on the basis "that the decision of the department head was 'arbitrary,' 'capricious,' and 'grossly erroneous.'"[16] Again relying on the line of cases dating back to the nineteenth century, the Supreme Court held that the Court of Claims applied the wrong standard. "Contracts, both governmental and private, have been before this Court in several cases in which provisions equivalent to Article 15 have been approved and enforced 'in the absence of fraud or such gross mistake as would necessarily imply bad faith, or a failure to exercise an honest judgment."[17] This, the Court explained, meant that the standard for overturning the agency decision was, in essence, fraud in a literal sense. "By fraud we mean conscious wrongdoing, an intention to cheat or be dishonest. The decision of the department head, absent fraudulent conduct, must stand under the plain meaning of the contract."[18] As the contractor did not assert fraud, the departmental decision stood. Justices Douglas, Reed, and Jackson dissented.

After the *Wunderlich* decision, Congress enacted legislation that effectively overruled that case and *Moorman* with respect to the degree courts should defer to an agency's factual findings. The new standard of review, now embodied in the Contract Disputes Act, roughly implements principles the *Wunderlich* dissenters advocated. [19] Under the normal disputes clause currently used in federal construction contracts, a contractor must first submit a claim to the designated contracting officer and may appeal that decision either to

14 338 U.S. 457 (1950).
15 342 U.S. 98 (1951).
16 *Id.* at 100.
17 *Id.* at 99.
18 *Id.* at 100.
19 41 U.S.C. § 7101-7109 (2011).

the United States Court of Federal Claims (formerly the Claims Court) or to the appropriate agency board. The Court of Appeals for the Federal Circuit has appellate jurisdiction over decisions of the Court of Federal Claims and those of agency boards. Under the statutory standard, an agency board decision on a finding of fact is final unless the Court of Appeals determines the decision to be "fraudulent, arbitrary, or capricious" or "so grossly erroneous as to necessarily imply bad faith," or "not supported by substantial evidence."[20] While the Supreme Court may grant certiorari to review decisions of the Court of Appeals for the Federal Circuit (just as with other federal Courts of Appeal), the Court is unlikely to grant review on findings of fact in cases decided under the Contract Disputes Act.[21]

The influence of the *Wunderlich* line of cases remains, however, in at least two respects. First, provisions in federal contracts designating government officials and agencies to settle claims and resolve disputes are unquestionably enforceable, subject to review pursuant to the Contract Disputes Act. The standard under that act for reviewing an agency board decision, while less deferential than the one the Court proclaimed in *Wunderlich*, remains restrictive. Second, in cases decided under state law, courts also often use a deferential standard when reviewing decisions that a construction contract entrusts to a person or agency closely related to the project owner.[22] At least some of these cases relied in part on the Supreme Court's early pronouncements on this issue.[23] Chapter 3 briefly discusses some of the considerations that explain why related-party dispute resolution processes are so popular in the construction industry. As suggested there, public contracts at all levels of government, as well as many private construction contracts, commonly entrust such decisions, to one extent or another, to persons closely related to one of the contracting parties, usually the owner.[24] Although the Contracts

20 41 U.S.C. § 7107(b) (2011). When the initial appeal of the contracting officer's decision is to the Court of Federal Claims under the Contract Disputes Act rather than to the agency board, the review by that court is de novo. Todd Const., L.P. v. United States, 88 Fed. Cl. 235, 242 (2009). The Court of Appeals for the Federal Circuit then uses a clearly erroneous standard to review fact findings made by the Court of Federal Claims. Bell BCI Co. v. United States, 570 F.3d 1337, 1340 (Fed. Cir. 2009); Seaboard Lumber Co. v. United States, 308 F.3d 1283, 1292 (Fed. Cir. 2002).

21 *See generally* Ryan Stephenson, *Federal Circuit Case Selection at the Supreme Court: An Empirical Analysis*, 102 GEO. L.J. 271, 280-83 (2013).

22 *See, e.g.*, Westinghouse Elec. Corp. v. New York City Transit Auth., 82 N.Y.2d 47, 53, 623 N.E.2d 531, 534 (1993); Anthony P. Miller, Inc. v. Wilmington Hous. Auth., 179 F. Supp. 199, 202 (D. Del. 1959).

23 Several of the cases, for example, relied on the rationale of Martinsburg & P.R. Co. v. March, 114 U.S. 549 (1885). *See, e.g.*, Parke Const. Co. v. Constr. Mgmt. Co., 246 S.E.2d 564, 568 (N.C. App. 1978); State Highway Dep't v. MacDougald Const. Co., 6 S.E.2d 570, 575 (Ga. 1939); Catanzano v. Jackson, 73 So. 510, 512 (Ala. 1916); Williams v. Chicago, *S.F. & C. Ry. Co.*, 20 S.W. 631, 637 (Mo. 1892).

24 *See generally* 5 BRUNER & O'CONNOR, *supra* note 4, at § 17:83; 8 CORBIN ON CONTRACTS § 31.14 (Lexis 2018).

Disputes Act now establishes a more meaningful standard of judicial review when a federal construction contract entrusts claims to a federal agency, courts continue to give significant deference to related-party decisions concerning construction contract disputes.

Construction liens

Construction liens, also called mechanics' and materialmen's liens, are legislative creations unknown to the common law. The statutes generally provide that those who perform work or services or provide materials for a construction project can obtain liens against the project as payment security. Construction lien law, with its statutory lineage, essentially exists outside the bounds of contract law as generally understood. The most commonly litigated issues call on courts to interpret state statutes. For these reasons, construction liens receive little attention in this book except at this point, as a relatively minor topic of the Supreme Court's construction industry opinions. The few cases discussed here arose under lien laws of states or, in one instance, congressional legislation for the District of Columbia. None of the cases involved federal government projects, because statutory payment security for subcontractors and suppliers to federal government contractors comes not in the form of statutory liens, but as claims against surety bonds that government contractors have long been required to provide, first under the Heard Act and later under the Miller Act. State legislatures generally have their own surety bond requirements for state and local government projects. While the federal statutes, and the Court's interpretations of them, have had significant influence on similar surety bond laws enacted by state legislatures and also constitute an independently significant aspect of construction law, the current discussion relates only to the Court's decisions concerning construction lien laws. The next section, which deals with construction contract issues more broadly defined, offers what little I have to say about the Court's cases concerning payment security on government construction projects.

The earliest construction lien cases called on the Court to interpret first-generation statutes from several jurisdictions. The basic structure of construction lien statutes in many jurisdictions has remained relatively stable over the decades, and similar issues continue to come before contemporary courts. One of the first cases, decided in 1852, required the Court to interpret a lien law passed by Congress concerning construction in the District of Columbia.[25] The Court held that the law did not afford lien protection to a master builder or a general contractor on a residential project having a direct contract with the owner, as contrasted to someone providing labor or materials for the project.[26] The Court reasoned that Congress did not

25 Winder v. Caldwell, 55 U.S. 434 (1852).
26 *Id.* at 444-45.

intend the lien law to protect a master builder, who could contract directly with the owner for payment security as appropriate. At a time when the notion of a construction lien was still a novel one, this opinion provided one of the first rulings on this important scope of protection issue. With the benefit of hindsight on the question of judicial interpretation, under modern construction lien statutes, legislatures commonly protect general contractors as well as subcontractors and suppliers.[27]

Over approximately the next 40 years, the Court ruled on several questions under state construction lien laws. The Court addressed such basic questions as whether or the extent to which a lien attached to particular property and whether a construction lien had priority over a mortgage lien.[28] These cases stand as little more than historical markers of a time when a relatively broad array of cases on routine matters of commercial law frequently made their way onto the Court's docket. Its current case selection practices make it highly unlikely that cases of this kind will again come before the Court.[29] Indeed, federal decisions at all levels on most matters of state construction lien laws rarely merit attention today because, when federal courts rule on contemporary cases, they have available to them the definitive interpretations of the applicable statute from the highest court of the jurisdiction involved.

The Court's more recent cases of note dealing with construction liens are in the nature of summary confirmations that a typical lien statute does not violate either the Due Process Clause or the Takings Clause.[30] The most significant principle involving these issues appeared as dicta in a 1991 case in which the Court distinguished a construction lien statute, which the Court summarily condoned in an earlier case, from a civil litigation attachment statute: "Unlike the case before us, the mechanic's lien statute in *Spielman–Fond* required the creditor to have a pre-existing interest in the property at issue. As we explain below, a heightened plaintiff interest in certain circumstances can provide a ground for upholding procedures that are otherwise suspect."[31] While construction lien statutes typically afford limited procedural protections until after the lien has attached and the claimant commences action to foreclose the lien, the cases decided in the last three decades of the twentieth

27 *See generally* 3 BRUNER & O'CONNOR, *supra* note 4, at § 8:134.

28 *See, e.g.*, Toledo, D. & B.R. Co. v. Hamilton, 134 U.S. 296 (1890) (statutory or equitable lien priority under Ohio law); Commissioners of Buncombe Cty. v. Tommey, 115 U.S. 122 (1884) (extent of lien under North Carolina statute); Chicago & A.R. Co. v. Union Rolling-Mill Co., 109 U.S. 702 (1884) (validity and priority of lien under Illinois statute); Brooks v. Burlington & S.W.R. Co., 101 U.S. 443 (1879) (extent of lien under Iowa statute); S. Fork Canal Co. v. Gordon, 73 U.S. 561 (1867) (extent of lien under California statute).

29 *See generally* Kathryn A. Watts, *Constraining Certiorari Using Administrative Law Principles*, 160 U. PA. L. REV. 1, 14–18 (2011); *see* STEPHEN M. SHAPIRO ET AL., SUPREME COURT PRACTICE 262, 290-91 (10th ed. 2013).

30 *See, e.g.*, Roundhouse Const. Corp. v. Telesco Masons Supplies Co., 423 U.S. 809 (1975); Spielman-Fond, Inc. v. Hanson's Inc., 417 U.S. 901 (1974).

31 Connecticut v. Doehr, 501 U.S. 1, 12 n.4 (1991).

century largely lay to rest any due process concerns under the U.S. Constitution with respect to the modern statutes.[32]

The Court's construction contract jurisprudence

During the years following the Civil War and through the post-World War I era, the Court issued many opinions in construction industry cases that addressed general principles of contract law. Those opinions merit attention, if for no other reason, because they reflect some dominant themes and important developments during a formative period of contract law jurisprudence in the United States. During this timeframe, the Court contributed to the evolution of contract law as applied within the industry.

These cases, however, stand as relics of the Court's past. Contract law issues have essentially disappeared from the Court's docket for at least two reasons. First, post-Erie Doctrine, state court decisions dominate contract law developments. Second, beginning in the second half of the twentieth century, federal contract law increasingly became the bailiwick of specialized administrative bodies and lower federal courts. Especially in light of the growing expertise of the U.S. Court of Federal Claims (formerly the U.S. Claims Court) and the Court of Appeals for the Federal Circuit, the Court has had little reason to decide federal contract disputes. As Chapter 5 explains, opinions in federal construction contract cases decided by these two specialized courts have significantly influenced certain aspects of construction law. Aside from a handful of older opinions still frequently cited today, the Court's construction contract cases hold interest primarily for historical reasons.

This Chapter has already highlighted several of the Court's most important construction contract cases. In this section, I have chosen to highlight five of the earliest cases addressing other contract law issues in ways that seem to me to have anticipated if not informed future developments. I will also briefly note some other cases that dealt with routine issues in ways that seem merely to reflect evolving general principles of contract law at the time the Court decided them.

Clark v. United States, decided in 1867, involved a federal project to construct an embankment at a Navy yard.[33] The contract based compensation on the quantity of "materials and work delivered and executed."[34] The contractor claimed government interference with the progress of the work and that the government's measurement methodology did not properly account for waste, shrinkage, and settlement. The Court of Claims ruled for the government on both issues. The government argued that the contractor could not recover on the first claim because any interference occurred after the

32 *See generally* 3 BRUNER & O'CONNOR, *supra* note 4, at § 8:136.
33 73 U.S. 543 (1867).
34 *Id.*

contractor was already in default by failing to complete the work on time. The Court reversed on this issue, holding that the contractor's duty to complete the work on schedule was independent of any liability the government might have for wrongful interference. The Court explained that the contractor's default might give rise to a damage claim, but it would not relieve the government from its obligations under the contract. The Court cited no precedent and did not explicitly articulate a legal analysis for this holding. The result, however, logically follows from the now well-established substantial performance doctrine, which Chapter 2 explored in detail. In that sense, the Court's opinion comports with the developing contract law of the day, and it also holds up well under contemporary contract law.

On the second claim, concerning the measurement methodology, the Court held that the contractor was entitled to be paid for extra material deposited due to settlement of the embankment during construction. Again, the Court cited no precedent, offering only the rather formalistic analysis that whatever material the contractor deposited at the site of the embankment "had become the property of the government."[35] As to payment for material not necessarily deposited at the site but lost due to waste and shrinkage, the Court concluded that the record was insufficient, but that the issue could be addressed at the retrial on remand.

Several later cases cite *Clark* on the implied duty of an owner not to interfere with the progress of the work.[36] Additionally, at least one case places *Clark* among the early precedents establishing that when the government enters into a contract it generally subjects itself to the same principles that apply to contracts between private parties.[37] The decision also falls into a line of cases more broadly holding the government to the implied duties of good faith and fair dealing.

A case from 1919 stands out for the weight the Court gave to construction industry practices as a factor in holding that delayed payments by a general contractor to a subcontractor put the general contractor in material default and thus entitled the subcontractor to stop work and to recover damages.[38] Although the case arose out of a federal project in San Juan, Puerto Rico, the dispute concerned enforcement of the private contract between the general contractor and a subcontractor. The general contractor failed to make regularly scheduled progress payments on time. Additionally, defective foundation work by the general contractor led to an indefinite suspension of the subcontractor's work. In addressing whether the general contractor materially

35 *Id*. at 546.

36 *See, e.g.*, United States v. Barlow, 184 U.S. 123, 137 (1902); United States v. Smith, 94 U.S. 214, 217 (1876); Detroit Steel Prod. Co. v. United States, 62 Ct. Cl. 686, 698 (1926); Moore v. United States, 46 Ct. Cl. 139, 173 (1910); King v. United States, 37 Ct. Cl. 428, 436 (1902).

37 *See* Moore, 46 Ct. Cl. at 173. The court stated that principle directly in the *Smith* case. *See* Smith, 94 U.S. at 217.

38 Guerini Stone Co. v. P.J. Carlin Const. Co., 248 U.S. 334 (1919).

breached the subcontract, the Court approved the holding of the Court of Appeals "that in a building or construction contract like the one in question, calling for the performing of labor and furnishing of materials covering a long period of time and involving large expenditures, a stipulation for payments on account to be made from time to time during the progress of the work must be deemed so material that a substantial failure to pay would justify the contractor in declining to proceed."[39] The holding stands as early precedent on the materiality of progress payments under construction contracts.[40] The Court went on to observe that, as was "usually the case with building contracts," the parties evidently did not contemplate that the subcontractor would be obligated to finance the costs of construction without receiving the progress payments, and as a result, the Court held that "a substantial compliance as to advance payments is a condition precedent to the" subcontractor's obligation to continue working.[41] I find this opinion interesting as a relatively early example of a contemporary judicial approach that applies contract law in light of the particular transactional context in which a dispute arises.

The Court enforced a no-damage-for-delay clause in 1920.[42] The contractor based its claim on two separate and extended suspensions of the work, which the government ordered to allow for changes in the building plans and to secure additional Congressional appropriations. The Court held for the government on the basis that clear contract language placed the risk of such delays on the contractor. The Court gave considerable weight to the fact that the case arose in a construction industry context. "Men who take $1,000,000 contracts for government buildings are neither unsophisticated nor careless. Inexperience and inattention are more likely to be found in other parties to such contracts than the contractors, and the presumption is obvious and strong that the men signing such a contract as we have here protected themselves against such delays as are complained of by the higher price exacted for the work."[43] In support of the holding, the Court merely cited several cases strictly enforcing clear contractual terms. Subsequent cases, as well as secondary sources, have frequently cited this case as authority for the enforceability of express contractual allocation of risk and for no-damage-for-delay clauses in particular.[44]

In another one of its early federal construction contract cases, the Court enforced a liquidated damage provision. The Court held that the government

39 Id. at 344.

40 *See* 3 BRUNER & O'CONNOR, *supra* note 4, at § 8:2.

41 Guerini Stone, 248 U.S. at 345.

42 Wells Bros. Co. of New York v. United States, 254 U.S. 83 (1920).

43 *Id.* at 86-87.

44 *See, e.g.*, Cedar Lumber, Inc. v. United States, 5 Cl. Ct. 539, 552 (1984); W. C. James, Inc. v. Phillips Petroleum Co., 485 F.2d 22, 25 (10th Cir. 1973); 1A BRUNER & O'CONNOR, *supra* note 4, at § 3:1; 2 BRUNER & O'CONNOR, *supra* note 4, at § 7:229.

could collect damages at the contract rate for delays caused by the contractor even if the government itself caused other delays.[45] The Court took note that the case involved a construction contract. "In construction contracts a provision giving liquidated damages for each day's delay is an appropriate means of inducing due performance, or of giving compensation, in case of failure to perform, and courts give it effect in accordance with its terms."[46]

The final one of the early contract cases that I find especially interesting is *Robins Dry Dock & Repair Co. v. Flint*.[47] This was a maritime case involving repairs to a ship rather than a construction project in the usual sense, but it involved a situation analogous to one that often arises in the building industry. In the course of its maintenance work, the dry dock company caused damage that delayed the ship's return to service. The dry dock company settled with the ship owner, but the time charterers of the ship brought the case against the dry dock company to recover damages for loss of use of the ship during the delay. Because *Robins Dry Dock* has directly influenced how courts apply the economic loss rule to construction industry disputes, I cover it here as a quasi-construction contract case.[48] In denying the claim, Justice Holmes proclaimed this classic bright-line distinction between contract and tort liability: "a tort to the person or property of one man does not make the tortfeasor liable to another merely because the injured person was under a contract with that other unknown to the doer of the wrong. The law does not spread its protection so far."[49] *Robins Dry Dock* remains especially important today within the construction industry because when defective or delayed construction causes economic loss to those who are not parties to the relevant construction contract, courts remain sharply divided over whether to follow Justice Holmes's principle limiting recovery for purely economic loss.[50] Chapter 6 returns to *Robins Dry Dock* and the economic loss rule to explore what they reveal about contract law theory in construction industry cases.

Aside from these five cases (and, of course, *Spearin* and the related implied duty cases), the Court's other opinions during this era that involve contract law principles in the construction industry context have only modest precedential value. They generally reflect established law without introducing notable variations or advances. An 1886 opinion perhaps ploughed new ground by narrowly reading certain contractual limits on the owner's liability, issues

45 Robinson v. United States, 261 U.S. 486 (1923).

46 *Id*. at 488.

47 275 U.S. 303 (1927).

48 *See, e.g.*, Paul M. Hellegers, *Making Sense of the Economic Loss Rule in Construction Cases: Does the Draft Restatement (Third) of Torts Help? Part One*, Construction Law., Fall 2013, at 23, 26; Stewart W. Karge, *Admiralty Law's Application to Construction Contracts Can Affect Contractors' Rights and Remedies*, Construction Law., Spring 2016, at 3, 6.

49 Robins Dry Dock, 275 U.S. at 309.

50 *See* Carl J. Circo, *Placing the Commercial and Economic Loss Problem in the Construction Industry Context*, 41 J. Marshall L. Rev. 39 (2007).

on which little case law then existed.[51] But the Court offered only the briefest analysis, essentially treating the issues as matters of contract interpretation and fact finding. In other construction contract opinions, the Court flirted with issues that would later lead to important contract law developments, including the betterment doctrine examined in Chapter 3,[52] and contemporary principles concerning differing site conditions discussed in Chapters 2 and 5. [53] These cases, however, seem to have left but faint legal imprints on contemporary construction law.

Many other industry cases involving relatively mundane issues called on the Court to interpret contract terms, to pass on the sufficiency of the evidence, or to apply extant principles of contract law rather than to proclaim new precedent. For example, the Court's early cases resolved disputes over such basic questions as whether certain duties or activities were within the scope of work called for under the contract, a contractor's right to additional compensation due to unanticipated circumstances or delays, liability for defective construction or materials, excusable delay, contract formation, and whether a contract authorized the government to terminate the contractor due to delays in performance.[54] Three early cases involved architects' fee claims, and all three show the Court's reluctance during the classical period of U.S. contract law to defer to industry customs and practices that the contracting architects offered to alter or supplement standard contract law principles.[55] In another architect's fee case, the Court similarly adhered strictly to contract terms, but this time in the architect's favor, under circumstances in which Congress appropriated additional compensation payable to the contractor on a federal project following the 1906 San Francisco earthquake and fire.[56] The Court held that the architect was also entitled to additional compensation because the contract for the design services set the fee as a percentage of the cost of the construction work. In an analysis that arguably reflected the waning authority of the pre-existing duty rule discussed in Chapter 2, the Court reasoned that the increase in the contractor's

51 Wood v. City of Ft. Wayne, 119 U.S. 312 (1886).

52 District of Columbia v. Clephane, 110 U.S. 212 (1884).

53 United States v. Gibbons, 109 U.S. 200 (1883).

54 *See, e.g.*, United States v. Brooks-Callaway Co., 318 U.S. 120 (1943) (excusable versus non-excusable delays); Day v. United States, 245 U.S. 159 (1917) (scope of work and claim for additional compensation); United States v. California Bridge & Constr. Co., 245 U.S. 337 (1917) (contractor termination for delay); United States v. Normile, 239 U.S. 344 (1915) (claim for additional compensation); United States v. Barlow, 184 U.S. 123 (1902) (claim of defective materials and claim for additional compensation); Girard Life Ins. Annuity & Trust Co. v. Cooper, 162 U.S. 529 (1896) (contract formation); United States v. Mueller, 113 U.S. 153 (1885) (scope of work); Florida R. Co. v. Smith, 88 U.S. 255 (1874) (defective construction); Philadelphia, W. & B.R. Co. v. Howard, 54 U.S. 307 (1851) (wrongful termination of contract, among other issues).

55 Lord v. United States, 217 U.S. 340 (1910); Smithmeyer v. United States, 147 U.S. 342 (1893); Tilley v. Cook Cty., 103 U.S. 155 (1880).

56 United States v. Cook, 257 U.S. 523 (1922).

compensation was no mere gratuity to the contractor alone, but an enforceable modification of the payment terms of the construction contract, which in turn provided the basis for calculating the architect's fee.

In addition to those early cases dealing with general contract law principles, the Court has issued opinions in federal construction contract cases under the Heard Act and subsequently under the Miller Act, which govern payment security for subcontractors and suppliers on federal projects.[57] These opinions are important with reference to the public policies those laws serve, but not more broadly with respect to an assessment of contract law in the construction industry context.

Only two of the Court's relatively recent opinions on the enforceability or interpretation of the provisions of construction contracts suggest broad implications. In the first, decided in 1970, the Court limited the scope of a clause providing indemnity protection to the government.[58] In construing the indemnification provision, the Court essentially fell into line with similar cases decided by state courts.[59]

The second case, the *Atlantic Marine Construction* case, decided in 2013, addresses a procedural point. [60] A Texas subcontractor sued the Virginia general contractor for payment under a contract for work on a federal construction project in Texas. The contract included a forum-selection clause calling for all disputes to be litigated in either the Circuit Court for the City of Norfolk, Virginia or in the U.S. District Court for the Eastern District of Virginia, Norfolk Division. The subcontractor filed the case in federal court in Texas. The Court held that under the applicable federal transfer statute, the trial court should have granted the general contractor's motion to transfer the case to the federal district court in Virginia. The opinion came down strongly in favor of enforcing a valid forum-selection clause except "under extraordinary circumstances unrelated to the convenience of the parties."[61] Forum selection clauses are, of course, common in all kinds of contracts, and nothing in the opinion turned on the fact that the dispute involved a construction contract. Thus, although *Atlantic Marine Construction* is an important contract case on a procedural issue, it adds little to an assessment of the relationship between the construction industry and contract law.

In the past several decades, the Court has decided a few other cases involving the construction industry, but none that directly resolve disputes under construction contracts or that implicate general principles of contract

57 *See, e.g.*, J. W. Bateson Co. v. U.S. *ex rel.* Bd. of Trustees of Nat. Automatic Sprinkler Indus. Pension Fund, 434 U.S. 586, 586 (1978); F. D. Rich Co. v. U. S. *ex rel.* Indus. Lumber Co., 417 U.S. 116 (1974); Clifford F. MacEvoy Co. v. U.S. *ex rel.* Calvin Tomkins Co., 322 U.S. 102 (1944); Globe Indem. Co. v. United States, 291 U.S. 476 (1934).

58 United States v. Seckinger, 397 U.S. 203 (1970).

59 *Id.* at 211-12.

60 Atl. Marine Const. Co. v. U.S. Dist. Court for W. Dist. of Texas, 571 U.S. 49 (2013).

61 *Id.* at 62.

law.[62] Most of the recent industry cases coming before the Court have presented procedural questions and issues relating to constitutional rights and federal statutes and regulations, not matters of contract law. We can expect industry cases to make their way to the Court periodically in the future simply because the industry's pervasive importance in our society and economy assures that construction contract disputes will continue to be part of the overall development of commercial law. But it seems unlikely that industry cases coming before the Court will heavily influence future contract law developments. The next segment of this Part reviews a handful of industry-related Supreme Court decisions worth noting because they address issues under the U.S. Constitution.

Constitutional issues

Several of the Court's earliest decisions involving construction projects presented questions under the Contracts Clause. In particular, the new nation's transportation infrastructure projects led to a series of cases. These opinions figured into the Court's explication of the Contracts Clause at a time, prior to the adoption of the Fourteenth Amendment, when relatively few Constitutional restrictions affected the power of the states in relation to private economic rights. In that sense, these cases are foundational aspects of U.S. contract law. In the modern era, however, the Contracts Clause rarely comes up in construction industry disputes or in other commercial contract cases. I note here several early Contracts Clause rulings stemming from construction projects to recognize their historical place among the principles of U.S. contract law.

Chief among these decisions is the celebrated *Charles River Bridge* case, decided in 1837.[63] The dispute arose from Massachusetts legislation granting a charter to a company organized to build the Warren Bridge between Boston and Charlestown over the Charles River that would compete with the nearby Charles River Bridge operated pursuant to a charter granted to a different company years earlier. In the opinion for the majority, Chief Justice Taney held that Massachusetts had done nothing to impair contract obligations under the earlier charter because that franchise did not explicitly establish a monopoly in favor of The Proprietors of the Charles River Bridge. Although the case has only a tangential connection to the construction industry, it stands as a landmark Contracts Clause case, much noted by legal historians, in which the Court declined an invitation to imply terms into a state-granted transportation

62 *See, e.g.*, B&B Hardware, Inc. v. Hargis Indus., 135 S. Ct. 1293 (2015) (trademark case involving issue preclusion by agency action); Tex. Dep't of Hous. & Cmty. Affairs v. Inclusive Cmtys. Project, Inc., 135 S. Ct. 2507 (2015) (disparate impact claim under the Fair Housing Act); Rapanos v. United States, 547 U.S. 715 (2006) (involving the application of the Clean Water Act to land development activities).

63 Proprietors of Charles River Bridge v. Proprietors of Warren Bridge, 36 U.S. 420 (1837).

franchise, instead emphasizing a state's inherent power to act in the public interest even to the detriment of vested rights.[64]

In the mid-nineteenth century, four significant railroad cases generated Contracts Clause claims that made it to the Court. The first of the cases presented facts somewhat similar to those of the *Charles River Bridge* case, but with the critical distinction that the Court, applying established rules of contract interpretation, construed the legislation granting the earlier bridge franchise as conferring exclusive rights within a designated area.[65] Because the later franchise conflicted with those rights, the Court upheld the impairment of contract claim. A case decided four years later involved franchises to construct and operate a street railroad in Memphis, commencement of which was delayed during the Civil War.[66] The Court held that a subsequent act of the Tennessee legislature granting similar rights to a different company did not impair contract rights of the first company because no valid contract was ever concluded between the city and the first company. In a third case decided in the same year, the Court held that once a valid contract for the construction and operation of a street railroad in Chicago came into existence, neither the state legislature nor the courts could subsequently introduce new legal principles that would have the effect of invalidating rights under that contract.[67] In 1936, the Court again ruled on a Contracts Clause claim in connection with transportation infrastructure construction, this time a bridge project.[68] There, the Court held that an act of the State of Tennessee that permitted a new surety bond to substitute for the original bond on a bridge construction project impaired the contract rights of a subcontractor whose payment rights were protected under the original bond.

The construction industry provided many other opportunities for the Court to issue constitutional rulings, but unlike the early Contract Clause decisions, these cases bear less directly, if at all, on contract law and practices. A case decided in 1892 upheld New York City subway commission regulations governing installation of underground electric lines against challenges under the Due Process Clause as well as the Contracts Clause.[69] In 1926, the Court struck down an Oklahoma wage and hour law provision applicable to construction work on state projects on the basis that the law was void for vagueness under the Due Process Clause.[70] Construction activities also

64 *See generally* Robert E. Mensel, *"Privilege Against Public Right:" A Reappraisal of the Charles River Bridge Case*, 33 DUQ. L. REV. 1 (1994).

65 *In re* Binghamton Bridge, 70 U.S. 51 (1865).

66 People's Pass. R. Co. of Memphis v. Memphis City R. Co., 77 U.S. 38 (1869).

67 City of Chicago v. Sheldon, 76 U.S. 50 (1869).

68 Int'l Steel & Iron Co. v. Nat'l Sur. Co., 297 U.S. 657 (1936).

69 People *ex rel.* New York Elec. Lines Co. v. Newport & C. Bridge Co. v. United States, 105 U.S. 470 (1881); New York v. Squire, 145 U.S. 175 (1892).

70 Connally v. Gen. Const. Co., 269 U.S. 385 (1926).

produced challenges under the Takings Clause.[71] Construction projects figured into some Commerce Clause cases as well, including the Court's landmark decision in the 1936 Tennessee Valley Authority case upholding, among other things, the federal government's construction of the Wilson Dam.[72] The construction industry played a somewhat larger role in a 1983 decision rejecting a Commerce Clause challenge to an executive order the Mayor of Boston issued requiring certain city construction projects to be performed by a workforce consisting at least half of city residents.[73] Finally, some of the most significant affirmative action decisions arose out of the industry.[74] In these cases, however, construction projects and the construction industry served essentially as backdrops to the constitutional issues involved, not as dominant aspects of the disputes.

Perhaps more than anything else, the constitutional law rulings from the Court in construction industry cases show how this important industry has contributed to the development of some fundamental legal rules. The bridge and rail project cases gave the Court especially important opportunities to define the extent to which the Constitution requires states to honor their contractual obligations and restrains legislatures from altering private contract rights with impunity. Today, we take these Contracts Clause principles for granted, but we should not forget that they are foundational features of U.S. contract law. With the exception of those cases, however, the industry and its contracting practices have not played distinct roles in the course of constitutional developments.

Taking stock of the Court's industry cases

The U.S. Supreme Court's construction industry cases mainly hold interest for a relatively narrow band of construction contract principles. The four most important cases, (in chronological order, *Hollerbach*, *Chrisie*, *Spearin*, and *Atlantic Dredging*), fit neatly into the historical movement authorizing courts to imply terms into contracts. *Spearin* and *Atlantic Dredging* in particular have continuing force in construction law to counterbalance a government owner's power to use the competitive bidding process to impose one-sided terms on the contracting community.

Considering the Court's construction contract cases as a whole, four general observations stand out, although I can only speculate about any broad

71 Delaware River Joint Toll Bridge Comm'n, Pennsylvania-New Jersey v. Colburn, 310 U.S. 419 (1940); Newport & C. Bridge Co. v. United States, 105 U.S. 470 (1881). Many regulatory takings cases also involve construction, but only in the indirect sense that the challenged land use regulations restrict development activities on the land involved and thus prohibit or regulate construction activities. *See, e.g.*, Koontz v. St. Johns River Water Mgmt. Dist., 133 S. Ct. 2586 (2013); Tahoe-Sierra Pres. Council, Inc. v. Tahoe Reg'l Planning Agency, 535 U.S. 302 (2002).

72 Ashwander v. Tennessee Valley Auth., 297 U.S. 288 (1936).

73 White v. Massachusetts Council of Const. Employers, Inc., 460 U.S. 204 (1983).

74 Adarand Constructors, Inc. v. Pena, 515 U.S. 200 (1995); City of Richmond v. J.A. Croson Co., 488 U.S. 469 (1989); Fullilove v. Klutznick, 448 U.S. 448 (1980).

implications they may support. First, the Court sometimes cited little or no precedent for the contract law principles involved. The reason for this may be that the construction industry cases before the Court rarely presented novel issues or important policy implications. The Court's rulings provided finality with respect to each individual dispute, and that may have been all the situations required. Second, few of these cases would make it onto the Court's docket in the modern era. This reflects the impact of the Erie Doctrine as well as the evolution of the Court's docket practices and the increasing demands on the Court's resources as the country matured and its population, territory, and experiences expanded. Most construction contract disputes involve only issues of state law. As previously noted with respect to federal construction contracts, the rise and importance of the specialized federal contracts boards and courts account for the paucity of government contract cases coming before the Court. Third, with limited exceptions, and possibly as the result of the first two observations, the Court's construction contract cases do not seem to have directly influenced the evolution of contract law within or beyond the construction industry. Precious little reason exists to characterize the Court's early contract law cases as leading decisions (*Spearin* aside).[75] Finally, several of the cases demonstrated a perceptible, albeit inconsistent, interest in how construction industry customs and practices bear on contract interpretation. In this, the Court perhaps gestured ever so slightly toward the contextual and relational contract notions that now manifest themselves in construction law at least as much as in any other area of contract law.[76] Chapter 6, which explores contract theory in the construction industry cases, has more to say on this possibility.

To be sure, even though the era of U.S. Supreme Court opinions on matters of contract law ended decades ago, the industry may yet contribute future cases on points of federal procedure and the interpretation and application of constitutional, statutory, and regulatory issues of general interest. But these will most likely reflect nothing more than the industry's pervasiveness in the nation's economy. For the more significant federal side of the story of the construction industry and U.S. construction law, the next chapter turns to matters that rarely have made their way to the U.S. Supreme Court. As we will see, construction contract cases from lower federal courts, which owe much to the early Supreme Court decisions, have been part of the fabric of contract law in the construction industry context.

75 Contemporary authorities cite *Day v. United States*, 245 U.S. 159 (1917) as important precedent. *See e.g.*, 1A Bruner & O'Connor, *supra* note 4, at §§ 3:5, 4:3; 30 Williston on Contracts § 77:38 n.65, 77:85 n.78 (4th ed. 2018). Citations to *Philadelphia, W. & B.R. Co. v. Howard*, 54 U.S. 307 (1851) continue to the present, but primarily with respect to certain procedural points. *See, e.g.*, Charles Alan Wright *et al.*, 18B Fed. Prac. & Proc. Juris. § 4477, n.12 (2d ed. 2018); 5 Cyc. of Federal Proc. § 15:588 n.1 (3d ed. 2018).

76 *See generally* Carl J. Circo, *A Case Study in Collaborative Technology and the Intentionally Relational Contract: Building Information Modeling and Construction Industry Contracts*, 67 Ark. L. Rev. 873, 889-92 (2014).

5 Federal construction contract law today

The special place of the federal construction contract cases

Federal construction contract disputes constitute a significant category of reported construction contract cases, both in number and in the dollar value of the projects involved. Federal construction projects assure a steady stream of cases raising a broad range of contract issues. Furthermore, the relative volume of opinions results not simply from the federal government's status as one of the most important industry participants, but also from differences in dispute resolution practices. Construction disputes involving government projects, as distinguished from private ones, produce a disproportionate number of judicial opinions on important legal issues because parties to private construction disputes have increasingly relied during recent decades on arbitration and other non-judicial dispute resolution processes.

Moreover, the federal decisions stand out among all construction contract cases because they represent a more highly developed and coherent body of case law on certain key issues. Three considerations especially explain the enhanced value of the federal cases. First, a comprehensive administrative structure at the federal level facilitates the ongoing development of consistent contracting practices. This stands in stark contrast to the variations in practices for private projects and for public projects at the state and local levels. Second, the detailed laws and regulations governing federal disputes generate recurring dispute patterns for judicial elaboration. Third, the specialized federal agencies and courts that handle these matters have developed unparalleled expertise dealing with many of the issues that commonly arise under industry contracts. As a consequence, the reported decisions of federal agency boards and federal courts represent a rare level of subject matter specialization and legal expertise.

As a result of these circumstances, important legal developments sometimes emerge, manifest, or ferment in the federal cases, and those cases often achieve special significance for construction contract law. Some of the leading construction contract opinions from the federal agency boards and the federal courts establish or refine principles that have broader implications for state law on construction contracts or for contract law writ large. Even when the

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federal construction contract cases do not directly alter or refine general principles, they regularly provide grist for the mills of future evolution in contract law. Other federal cases hold interest simply because they contribute to the evolution of general principles of contract law as applied to construction contract disputes.

Within a common law system characterized by jurisdictional variation and uneven trends, therefore, the federal construction contract cases represent a unique sample for a scholarly inquiry into contract law. Furthermore, because state, local, and private contracting practices often follow trends in federal contract terms, the federal courts' rulings based on those terms sometimes set precedent and elucidate policies that reach far beyond federal government contract disputes. Given these factors, the federal construction contract cases make up an important part of the fabric of U.S. contract law, particularly with respect to construction contracts. At the same time, some factors keep federal government contract law apart from the general body of contract law. No other project owner matches the federal government's advantage as a contracting party, and no other project owner presents to courts a comparable litigant. The relevant policy considerations stemming from these factors point in alternative directions, sometimes encouraging courts to protect the government's economic interests and thereby protect the public, but at other times begging for a refined sense of fairness for contracting parties who deal with the government from positions of relative weakness and dependence. For these reasons, it is important to scrutinize the precedential value of the federal construction contract cases rather than simply to assume it.

Given the historical impact and potential future influence of the federal agency boards and federal courts on contract law in the construction industry context, this chapter reviews selected developments from those tribunals. From among the many issues that the federal construction contract cases have addressed, I have selected five broad categories for review. Some show federal contract law principles that have affected the law beyond government contracts. Some reflect how federal precedents have contributed to already extant trends in contract law. Others merely support limited observations about contract law in the construction industry context. While several of the issues covered here are also briefly mentioned in other chapters, and some of the issues could logically have been relegated to those other chapters, I choose to deal with them primarily here to highlight the role that federal contract law has played.

The first of these five topics—implied obligations—carries forward themes articulated in early U.S. Supreme Court cases discussed in Chapter 4 that have broadly influenced contract law as applied in the construction industry. The next two—changes to the contractor's obligations and contractor termination—illustrate the symbiotic process by which contract law can influence contracting practices, which in turn can lead courts to reciprocate by adjusting the law to the economic behavior of contracting parties. The fourth

category of cases explores a few specialized principles federal courts have developed concerning a contractor's measure and proof of damages. Finally, this chapter discusses the *Severin* doctrine, a principle with limited standing beyond federal contract law, but one that again illustrates the potential for an adaptive relationship to develop between contract law and contract behavior.

Implied obligations

While the Supreme Court's *Spearin* decision, discussed in Chapter 4, stands on its own as one of the most prominent contributions to contract law in the construction industry context, a full understanding of the *Spearin* doctrine's impact requires consideration of *Spearin's* progeny.[1] The cases have both expanded and limited the principle that the government impliedly warrants the designs it furnishes to contractors. The leading cases include many decided as a matter of federal contract law, as well as others arising under state law but that deserve mention here because they fall under the *Spearin* doctrine's umbrella.

Most immediately, the federal construction contract cases rounded out the *Spearin* holding by making explicit a subsidiary aspect implicit in the Supreme Court's opinion. A line of cases dating back to at least as early as 1932 clarifies that a contractor may invoke the owner's implied design warranty both to defend against liability for corrective work and as a basis for additional compensation for delay or other costs attributable to the design flaws.[2] Aside from this refinement, which flows almost literally from the language Justice Brandeis used in *Spearin*, for more than three decades scores of federal contract cases simply applied the *Spearin* holding without introducing significant refinements to the principle.[3]

Eventually, federal contract disputes presented more complex situations that required the courts to determine the contours of the owner's implied warranty of plans and specifications. Some of the earliest of these established the unsurprising rule that a *Spearin* defense or claim will fail if the contractor did not actually rely on the government-supplied design details or knew or should have known that they were defective.[4] Similarly, a contractor seeking to take advantage of the implied warranty must prove that the defects in the government's design are substantial.[5] Other cases establish that the government only warrants the sufficiency of design specifications, which instruct the contractor in detail how to build the project, and not performance specifications, which direct the contractor

1 *See* United States v. Spearin, 248 U.S. 132 (1918); Lorence H. Slutzky & Dennis J. Powers, *The Owner's Role, in* CONSTRUCTION LAW, at 35, 43-49 (William Allensworth et al. eds., 2009).

2 *See, e.g.*, Hol-Gar Mfg. Corp. v. United States, 360 F.2d 634, 638 (Ct. Cl. 1966); Laburnum Const. Corp. v. United States, 325 F.2d 451, 457 (Ct. Cl. 1963); Levering & Garrigues Co. v. United States, 73 Ct. Cl. 566, 574 (1932).

3 *See* George H. Dygert, *Implied Warranties in Government Contracts*, 53 MIL. L. REV. 39 (1971).

4 *See, e.g.*, J. D. Hedin Const. Co. v. United States, 347 F.2d 235, 241 (Ct. Cl. 1965); Anthony M. Meyerstein, Inc. v. United States, 137 F. Supp. 427, 430-31 (Ct. Cl. 1956).

5 Wunderlich Contracting Co. v. United States, 351 F.2d 956, 964 (Ct. Cl. 1965).

to build a project that meets contractually defined performance criteria while leaving it to the contractor to determine how to achieve those results.[6] Another line of federal contract cases establishes that a contractor's (or its subcontractor's) failure to follow the government's defective plans will also defeat the implied warranty claim.[7] Finally, while the federal contract cases consistently adhere to *Spearin's* principle that the government cannot avoid the implied warranty through general or vague disclaimers,[8] they acknowledge that a carefully crafted express provision can effectively disclaim the warranty.[9]

Despite the extensive line of federal contract cases applying and refining *Spearin*, the owner's implied warranty of plans and specifications exists in contract law today as a nearly seamless continuum of state, as well as federal, cases. Indeed, as explained in Chapter 4, from an early date, before the Supreme Court took up the issue, some state courts had already proclaimed the general principle that an owner is responsible in some sense for defective designs it furnishes to a contractor.[10] *Spearin* and its progeny in the federal contract cases, however, properly claim much of the credit for the widespread acceptance of this principle in the form of an implied warranty, which construction lawyers universally know simply as the *Spearin* doctrine. Although many (but not all) of the earliest state law cases involved public construction projects,[11] later cases have regularly extended the principle to private contracts as well.[12] Today, the construction cases applying state contract law generally adhere to the federal courts' understanding of the principle that when an owner, public or private, supplies detailed plans and specifications for a project, the owner impliedly warrants that the design is sufficient for construction of the project. Arguably, the contemporary *Spearin* doctrine in its fully developed form stands as the most influential federal principle in all of construction contract law.

The state law cases conform to most of the nuances of the *Spearin* doctrine as reflected in the federal contract cases.[13] The one issue on which state law

6 *See* Hardwick Bros. Co., II v. United States, 36 Fed. Cl. 347, 411 (1996); Aleutian Constructors v. United States, 24 Cl. Ct. 372, 378 (1991); J. L. Simmons Co. v. United States, 412 F.2d 1360, 1362 (Ct. Cl. 1969).

7 *See, e.g.*, Tyger Const. Co. v. United States, 31 Fed. Cl. 177, 243 (1994); Al Johnson Const. Co. v. United States, 854 F.2d 467, 468 (Fed. Cir. 1988).

8 *See, e.g.*, White v. Edsall Const. Co., 296 F.3d 1081, 1085 (Fed. Cir. 2002); Al Johnson Const., 854 F.2d at 468; N. Am. Philips Co. v. United States, 358 F.2d 980, 986 (Ct. Cl. 1966).

9 *See* White, 296 F.3d at 1085.

10 *See* MacKnight Flintic Stone Co. v. City of New York, 54 N.E. 661 (N.Y. 1899); Bentley v. State, 41 N.W. 338 (Wis. 1889); Filbert v. Philadelphia, 37 A. 545 (Pa. 1897).

11 *See, e.g.*, Baber v. Baessell, 85 F.2d 725, 728 (D.C. Cir. 1936) (private project); Montrose Contracting Co. v. Westchester Cty., 80 F.2d 841, 842 (2d Cir. 1936) (public project); State v. Commercial Cas. Ins. Co., 248 N.W. 807 (1933) (public project); Friederick v. Redwood Cty., 190 N.W. 801, 802 (Minn. 1922) (public project).

12 *See, e.g.*, Marine Colloids, Inc. v. M. D. Hardy, Inc., 433 A.2d 402 (Me. 1981); M. L. Shalloo, Inc. v. Ricciardi & Sons Const., Inc., 205 N.E.2d 239 (Ma.1965).

13 *See generally* 3 PHILIP L. BRUNER & PATRICK J. O'CONNOR, JR., BRUNER AND O'CONNOR ON CONSTRUCTION LAW § 9:81(Westlaw 2018).

cases have been more important than the federal contract cases concerns the effectiveness of specific contractual disclaimers of the implied warranty of the owner's plans and specifications.[14] At least in part, this may be because state and local government construction contracts and private construction contracts are not subject to standardization to the same extent as are contemporary federal construction contracts.

The *Spearin* doctrine, embodied in an extensive line of cases decided under both federal and state contract law, stands as an especially coherent example of the process by which courts imply terms into contracts. Despite the earlier state law roots of the judicial analysis underlying the implied warranty of owner-supplied design, state law cases have overwhelmingly recognized *Spearin* as the leading precedent on the point, and they have largely paralleled the contours of the doctrine delineated by the federal contract cases applying *Spearin*.[15] In this way, the federal cases have contributed significantly to an important development in the evolution of U.S. contract law.

While the decisions implementing the *Spearin* doctrine represent the most prominent line of federal cases implying obligations into construction contracts, other federal cases also merit attention in this category. The opinions implying the government's obligation to disclose material information to bidders and contractors are among the broadest holdings on the topic.[16] The closely related superior knowledge doctrine operates as a more specific application of the owner's implied obligation to disclose information uniquely within the government's knowledge when a failure to disclose the information misleads a bidder or a contractor.[17] A more limited line of federal contract cases implies an owner's warranty of the availability of a supplier that the government designates as the sole source of equipment or material for a project.[18] Other applications of similar principles include a range of cases holding the government liable under a misrepresentation theory for providing

14 *See, e.g.*, Coghlin Elec. Contractors, Inc. v. Gilbane Bldg. Co., 36 N.E.3d 505 (Ma. 2015); Cent. Ohio Joint Vocational Sch. Dist. Bd. of Edn. v. Peterson Constr. Co., 716 N.E.2d 1210 (Oh. App.1998); Brant Const. Co. v. Metro. Water Reclamation Dist. of Greater Chicago, 967 F.2d 244 (7th Cir. 1992) (applying Illinois law).

15 *See, e.g.*, BRW, Inc. v. Dufficy & Sons, Inc., 99 P.3d 66 (Colo. 2004); W. H. Lyman Const. Co. v. Vill. of Gurnee, 403 N.E.2d 1325 (Ill. App. 1980); Burgess Mining & Const. Corp. v. City of Bessemer, 312 So. 2d 24 (Ala. 1975).

16 One of the leading cases implying a duty to disclose involved a government contract for the supply of a chemical compound about which the government had vital data, not available to the contractor, relevant to the costs of production. *See* Helene Curtis Indus., Inc. v. United States, 312 F.2d 774, 778 (Ct. Cl. 1963). The federal construction contract cases broadly endorse this same principle. *See generally* JUSTIN SWEET & MARC M SCHNEIER, LEGAL ASPECTS OF ARCHITECTURE, ENGINEERING AND THE CONSTRUCTION PROCESS § 18.04.B (7th ed. 2004).

17 *See, e.g.*, Aleutian Constructors v. United States, 24 Cl. Ct. 372 (1991). *See generally* 1A BRUNER & O'CONNOR, *supra* note 13, at § 3:57.

18 *See* Edward M. Crough, Inc. v. Dep't of Gen. Servs. of D.C., 572 A.2d 457, 463 (D.C. 1990); Aerodex, Inc. v. United States, 417 F.2d 1361, 1366 (Ct. Cl. 1969).

misleading or incomplete information about site conditions or other details material to the contractor's performance.[19]

All of these cases, and others implying owner obligations into federal construction contracts, give rise to a full complement of nuances, refinements, and exceptions similar to those that surround the *Spearin* doctrine. For present purposes, however, it is sufficient to note that the construction industry cases, and especially the federal contract cases, make up an important part of the common law process by which courts imply terms into contracts based on the contexts in which contract disputes arise.

As the discussion to this point shows, obligations imposed on governmental owners have dominated the implied contract holdings under the federal cases. Some evidence suggests that this reflects a judicial attitude that a public owner holds more leverage and often possesses greater expertise, than owners developing private projects.[20] Even if this is so, the cases do not often turn explicitly on that rationale. Moreover, many state courts, in deciding private construction contract cases as well as those involving state and local public owners, have broadly drawn on the federal contract precedents to adopt their own versions of the *Spearin* doctrine, the superior knowledge doctrine, and other implied obligations of owners. [21] Perhaps no other topic so clearly illustrates the federal contract cases as threads in the general fabric of contract law.

Nor have the courts limited the process of implying obligations into construction contracts to owner obligations alone. The construction industry cases, led again at times by the federal contract cases, have imposed implied obligations on contractors as well. One of the earliest of these, the implied warranty of sound construction or workmanlike performance, arises primarily out of state law cases.[22] The federal contract cases have played a more significant role in imposing on a contractor an implied duty to seek clarifications of apparent ambiguities or conflicts in the owner's plans and specifications.[23] The federal construction contract cases have also recognized a reciprocal implied duty of the owner and the contractor to cooperate and to avoid hindering the other party's performance.[24] This last implied obligation, however, derives perhaps as much from the more general implied duties of good faith and fair dealing and not from the construction industry cases in particular.[25]

19 *See generally* 4A Bruner & O'Connor, *supra* note 13, at §14:29; Michael J. Hoover, USAF, *Government Affirmative Misrepresentation in Federal Contracting*, 25 A.F. L. Rev. 183 (1985).

20 *See, e.g.*, Big Chief Drilling Co. v. United States, 26 Cl. Ct. 1276, 1294 (1992); J. L. Simmons Co. v. United States, 412 F.2d 1360, 1373 (Ct. Cl. 1969). *See also* Restatement (Second) of Contracts § 161 (Am. Law Inst. 1981).

21 *See generally* 1A Bruner & O'Connor, *supra* note 13, at § 3:57; Justin Sweet & Marc M Schneier, *supra* note 16, at § 18.04.B.

22 *See* 3 Bruner & O'Connor, *supra* note 13, at § 9:67.

23 *See id.* at § 9:64.

24 *See, e.g.*, Luria Bros. & Co. v. United States, 369 F.2d 701, 708 (Ct. Cl. 1966).

25 *See* Restatement (Second) of Contracts § 205 (Am. Law Inst. 1981).

Therefore, among the implied terms that construction law recognizes, the obligations imposed on owners owe the most to the federal contract cases.

Before we leave the implied obligations topic, the superior knowledge doctrine merits a final comment. The doctrine is firmly established as a matter of federal contract law, and state courts have frequently applied the doctrine to other public contract cases as well.[26] Courts have also applied the doctrine to construction contracts between private parties.[27] Of special note here are discussions of the superior knowledge doctrine in the construction law literature suggesting that the principle may have, or should have, force as a general principle of contract law.[28] To date, the doctrine does not appear as a general principle of contract law, at least not under the precise label or with the general recognition the doctrine has achieved in the construction industry. Rather, construction law's superior knowledge doctrine manifests essentially as a particularized extension of generally applicable principles concerning unilateral mistake and non-disclosure. With reference to mistake, the second Restatement provides that a party may avoid a contract when one party caused the mistake or knew or had reason to know that the other party's agreement was based on a material mistake or where enforcing the contract under the mistaken circumstances would be unconscionable.[29] Moreover, the second Restatement also provides that non-disclosure equates to asserting the fact does not exist in limited circumstances. These include where the person knows disclosure "would correct a mistake of the other party as to a basic assumption on which that party is making the contract" and the non-disclosure violates the duties of good faith and fair dealing and also situations in which the parties are in a relationship of trust and confidence.[30] The federal superior knowledge cases reflect similar sentiments, although not always ones articulated in these specific terms. In brief, the superior knowledge doctrine has not achieved acceptance as a general principle of contract law, but the doctrine's development in the construction industry context illustrates the expansive potential of some of the most flexible and contextual principles of contemporary contract law.

Changes to the contractor's obligations

While the traditional common law conceived a contract essentially as a static relationship governed by fixed terms of the parties' bargain, the construction industry requires flexibility. The dynamic nature of the construction process and the relationships among project participants challenge the contracting

26 *See* 1A Bruner & O'Connor, *supra* note 13, at § 3:57.

27 *See, e.g.*, Am. Rock Mechanics, Inc. v. Thermex Energy Corp., 608 N.E.2d 830 (Ohio App. 1992).

28 *See, e.g.*, 1A Bruner & O'Connor, *supra* note 13, at § 3:57.

29 Restatement (Second) of Contracts § 153 (Am. Law Inst. 1981).

30 Id. at § 161(b) & (d).

parties to plan for evolving needs and changing or unanticipated circumstances over long-term relationships. Both owners and contractors benefit from more adaptable contractual practices. In dealing with changes and unanticipated circumstances, the owner wants to establish an adjustable contractual structure that still maintains reasonable controls over budget and schedule impacts, while the contractor wants to maintain a controlled relationship that allows for appropriate compensation and schedule extensions. Thus emerged the practice of including detailed provisions in construction contracts to anticipate and manage changes to the contractor's obligations.[31] For federal projects, two especially significant contracting practices developed for this purpose—the changes clause and the differing site conditions clause.

As these clauses became standardized in federal contracts, federal agency boards and federal courts adapted contract law accordingly. Contracts governed by state law, for private as well as for public projects, also now routinely include similar provisions concerning changes to the contractor's obligations. The case law on changes clauses and differing site conditions clauses stands as a relatively consistent blend of federal and state law developments, but the federal cases on these topics are sufficiently prominent to justify giving them the lead billing. Viewed broadly, the principles emerging from these federal decisions stand out more for how they helped to instigate a distinct brand of contract law for the construction industry than for their contributions to generally applicable principles of contract law.

The changes clause in the federal decisions

From the owner's perspective, the need for flexibility especially leads to contractual provisions reserving an owner's right to make changes to the project as construction progresses. A changes clause, which has been a common feature of construction contracts for decades, gives the owner a unilateral right to order changes to the work. In contemporary practice, a changes clause comprises extensive provisions that set forth procedures that allow, at a minimum, for the owner to alter, add, and delete details of the contractor's work, and that govern how those changes will affect price and schedule. Through an evolving history of contracting practices and procurement regulations, the federal government helped standardize the salient features of a workable approach through the "changes clause" of the Federal Acquisition Regulation.[32] The details of any changes clause itself (federal or otherwise) is of limited interest in a study of construction industry contract cases, because those details mostly concern the mechanics of documenting design and construction changes and the resulting price and schedule updates. What is of great interest, however, is how courts react to changes clauses as devices for flexibility in ongoing contractual relationships. The

31 *See* 1A Bruner & O'Connor, *supra* note 13, at § 4:1.

32 *See id.* at § 4:3.

federal cases account for some of the most important precedents interpreting and enforcing changes clauses. In particular, the federal contract cases introduced two concepts for interpreting and administering changes clauses that alternatively restrict or reinforce their flexibility. The first is the cardinal change doctrine, and the second is the constructive change doctrine.

The courts created each doctrine in response to jurisdictional rules governing federal contractors' claims against contracting agencies.[33] The legal fictions of cardinal change and constructive change function to classify contractors' claims in one of two ways, depending on which forum and remedies a court deems appropriate for the circumstances presented. As with most legal fictions, the cardinal change and constructive change labels primarily serve to confirm judicial conclusions about appropriate rights and remedies, not to justify those conclusions.

Under the procedures in effect when the federal courts developed these doctrines, the judicial forum and appropriate remedies depended on how federal law characterized a particular claim stemming from an owner-initiated change. The federal contract procurement cases distinguished between rights asserted under the terms of the contract and those alleging a contractual breach by the owner.[34] A claim for additional compensation due to a government-ordered change constituted a claim under the contract, to be addressed pursuant to the changes clause. If a contractor wished to enforce rights under the changes clause, the appropriate federal agency board had jurisdiction to rule on the matter in the first instance. In that situation, the applicable claims procedures and the contractor's remedies derived from the changes clause, and the remedies were often less generous than those available for breach of contract.[35] If, however, the court viewed the claim as one for breach of the contract, rather than an assertion of rights under the contract, it fell outside of the changes clause. The operative notion was that the government could breach the contract by demanding a change not contemplated by the changes clause. In that circumstance, the United States Claims Court (now the United States Court of Federal Claims), and not the administrative agency, had original jurisdiction and could provide the appropriate remedy.[36] Although Congress enacted legislative reforms in 1978 rendering these jurisdictional distinctions irrelevant, the cardinal change and constructive change doctrines remain important to the judicial enforcement of changes clauses in the federal contract cases. As discussed below, state contract law adopts these concepts, if not the federal terminology itself, in varying degrees.

Under the federal contract cases, a cardinal change constitutes a breach of contract that falls outside the changes clause's ambit.[37] A changes clause typically authorizes the owner to order changes that fall within the "general scope" of the

33 *See* JUSTIN SWEET & MARC M SCHNEIER, *supra* note 16, at § 21.03.

34 *See id*. at §§ 18.03A, 18.03B.

35 *See* 1A BRUNER & O'CONNOR, *supra* note 13, at § 4:9.

36 *See* Morrison-Knudsen Co. v. United States, 345 F.2d 833 (Ct. Cl. 1965).

37 *See generally* 1A BRUNER & O'CONNOR, *supra* note 13, at § 4:13.

project the contract defines.[38] The cardinal change doctrine presumes a limit on the owner's right to make unilateral changes pursuant to the changes clause. The fuzzy phrase *within the general scope* stands in contrast to the far more definite concept of the actual scope of the work that the contract specifies for the contractor to perform. In effect, the word *general* empowers courts to determine, after the fact, whether or not changes the owner demanded were within the parties' contemplation at the time they entered the contract.[39] Detailed plans and specifications fix the actual, contractual scope of the work, which the changes clause allows the owner to adjust unilaterally, but only within the general scope of the contract. By agreeing to a changes clause, the contractor acknowledges the owner's right to alter the plans and specifications, and thereby to change the work the contractor must perform. The notion that one contracting party may unilaterally change the other party's obligations, however, logically implies some limits. When a contract to build a barn includes a changes clause, the parties do not have in mind that the owner might later substitute plans and specifications for a factory instead.

The owner and the contractor, being hard pressed to fix exact limits on the owner's power to make unilateral changes, employ the phrase *within the general scope* of the contract as a serviceable, if indefinite, formula. "Although changes are foreseeable on every construction project, parties are not deemed to have contemplated changes that alter the character and cost of the contractual undertaking within its 'general scope' unless the risk of such changes was expressly or impliedly assumed."[40] In this respect, the parties agree to leave an important contract term incomplete. Judicial acceptance of this vague notion to avoid the illusory contract trap provides an important example of contract law's accommodation to construction industry circumstances. Judicial respect for the verbal sleight of hand allows parties to construction contracts needed flexibility in the form of an elastic, yet modestly circumscribed, concept for defining the work that can, as the project progresses over time, become the subject of the contract.

When the owner orders changes within the general scope of the contract pursuant to the changes clause, the contractor must perform the changed work. In that case, the terms and procedures of the clause establish the process for effecting and documenting the change and for determining any resulting adjustments to the contract price and schedule. The federal cardinal change doctrine provides a remedy when the owner orders a change that the court determines to be beyond the general scope of the work that the parties contemplated in the first instance.[41] A cardinal change alters the essence of the bargain beyond what the changes clause permits. Under those circumstances, the owner's demand

38 *See* Wunderlich Contracting Co. v. United States, 351 F.2d 956, 965 (Ct. Cl. 1965); *see generally* 1A Bruner & O'Connor, *supra* note 13, at § 4:9.

39 *See generally* 1A Bruner & O'Connor, *supra* note 13, at § 4:10.

40 *Id*. at § 4:11.

41 *See generally id*. at § 4:12.

constitutes a breach of contract, and the court may award damages and grant other relief on that basis.[42] Because a cardinal change is not within the general scope of the work defined by the contract, the changes clause does not apply.[43] A cardinal change may result from a single demand or change order, or it may result from the cumulative effect of many changes, any one of which alone might be appropriate under the changes clause.[44]

Construction contract cases decided under state law have sometimes adopted the cardinal change doctrine from the federal cases.[45] Others have rejected it, or at least have declined to follow the federal cases explicitly.[46] Unimpaired by the jurisdictional problems that the federal contract cases initially faced, however, some state courts have achieved the same result without declaring any special doctrine. For example, they may simply hold that changes beyond the general scope of the work constitute a breach or abandonment of the contract by the owner.[47] No matter how these cases deal with the cardinal change doctrine, the same concept first articulated by the federal contract cases now broadly appears in some form under state law to set boundaries around the typical changes clause. On this aspect of contract law in the construction industry, the federal contract cases initiated and then elaborated on a concept that ultimately became an accepted principle as well under state law.

The constructive change doctrine of the federal contract cases also polices the changes clause, but in a much different way from the cardinal change concept. This doctrine permits a contractor to invoke the changes clause to seek adjustments to the contract price or the contract schedule, or both, even though the owner did not explicitly order a change.[48] Under the federal contract cases, a constructive change occurs when the owner's action, inaction, or other behavior requires the contractor to perform work or incur expenses or delay for which the owner should have issued a change order pursuant to the changes clause.[49] This allows a contractor to secure the benefits of the changes clause when the government owner wrongly denies that it has demanded a change to the contractor's work or responsibility. In this way, notwithstanding the restrictive jurisdictional principles in effect when the doctrine developed, federal agency boards and federal courts were able to grant relief by treating the contractor's claim in

42 *See generally* JUSTIN SWEET & MARC M SCHNEIER, *supra* note 16, at § 18.03A.

43 Edward R. Marden Corp. v. United States, 442 F.2d 364, 369 (Ct. Cl. 1971).

44 *See* Wunderlich Contracting, 351 F.2d at 966.

45 *See, e.g.*, Crane-Hogan Structural Sys., Inc. v. State, 930 N.Y.S.2d 713, 715 (App. Div. 2011); J. A. Jones Const. Co. v. Lehrer McGovern Bovis, Inc., 89 P.3d 1009, 1020 (Nev. 2004); Hous. Auth. of City of Texarkana v. E. W. Johnson Const. Co., 573 S.W.2d 316, 321-22 (Ark. 1978).

46 Amelco Elec. v. City of Thousand Oaks, 38 P.3d 1120, 1126-27 (Cal. 2002); Claude Dubois Excavating, Inc. v. Town of Kittery, 634 A.2d 1299, 1301-02 (Me. 1993); Hensel Phelps Const. Co. v. King Cty., 787 P.2d 58, 65 (Wash. App. 1990).

47 1A BRUNER & O'CONNOR, *supra* note 13, at § 4:13.

48 *See id.* at § 4:25.

49 *See, e.g.*, Chris Berg, Inc. v. United States, 455 F.2d 1037, 1051 (Ct. Cl. 1972); J. L. Simmons Co. v. United States, 412 F.2d 1360, 1378. (Ct. Cl. 1969).

these situations as being governed by the changes clauses and, therefore, arising under the contract.[50] Although the Contract Disputes Act long ago resolved the jurisdictional problem, the constructive change concept survives in the federal contract cases in much the same way as with cardinal changes.

Today, courts use the constructive change fiction to provide relief to a contractor in several common circumstances. "The classic examples of 'constructive' changes arise out of disputes over (1) contract interpretation, and changes in laws or regulations or their enforcement, (2) defective plans and specifications, (3) acceleration or suspension of the work, (4) interference or failure to cooperate, and (5) misrepresentation or nondisclosure of superior knowledge, where in each case the owner contends that the disputed extra work is within the contract 'scope' and the contractor claims to the contrary."[51] An extensive line of federal contract cases applies the constructive change doctrine to protect the contractor in each of those situations.[52] Under the doctrine, the court may adjust the contract price and relieve the contractor from delay liability to the extent that the owner should have formally directed the disputed work pursuant to a change order under the changes clause.

The federal constructive change doctrine seems to have had a much smaller impact on state law than the cardinal change doctrine. Only a few state law cases invoke the term *constructive change*.[53] Some jurisdictions expressly disclaim the need for a distinct doctrine for these situations, choosing instead the more direct route of analyzing whether a contractor has a valid contract defense or claim when an owner demands performance at variance with the contract without following the changes clause procedures.[54] Contemporary industry contracts facilitate this approach by broadly defining claims for purposes of the contract's dispute resolution procedures.[55]

Two related doctrines that invoke a "constructive" device also merit brief attention at this point. Although neither operates directly via a standard changes clause, each arises when a contractor claims that the project owner effectively altered the contractor's obligations without following appropriate contractual procedures. The first is the constructive suspension doctrine. The other is the constructive acceleration doctrine.

The constructive suspension doctrine arose primarily out of federal cases interpreting a common provision in federal construction contracts that

50 *See* 1A BRUNER & O'CONNOR, *supra* note 13, at § 4:25.

51 *Id.* at § 4:25.

52 *Id.* at §§ 4:26-4:34.

53 *See, e.g.*, Julian Speer Co. v. Ohio State Univ., 680 N.E.2d 254, 257 (Ohio Ct. Cl. 1997); Global Const., Inc. v. Missouri Highway & Transp. Comm'n, 963 S.W.2d 340, 343 (Mo. Ct. App. 1997).

54 *See, e.g.*, Sentinel Indus. Contracting Corp. v. Kimmins Indus. Serv. Corp., 743 So. 2d 954, 965 (Miss. 1999); *see generally* 1A BRUNER & O'CONNOR, *supra* note 13, at § 4:25.

55 *See generally* 2 BRUNER & O'CONNOR, *supra* note 13, at § 5:16 (noting the breadth of the claims concept under the General Conditions of the Contract for Construction promulgated by the American Institute of Architects).

accommodates the government's desire for flexibility to respond to changing circumstances during the course of a project. The federal suspension of work clause authorizes the government, for its convenience, to direct the contractor to stop all or part of the work temporarily.[56] If the suspension period is unreasonable, the clause provides for an adjustment to the contractor's compensation to account for the increased cost of performance attributable to the suspension. Where the government's action or failure to act causes an unreasonable delay, the federal contract cases use the constructive suspension fiction to treat the situation as a suspension under the clause even though the contracting officer did not issue an order under the clause.[57] Some of the most egregious cases arise when the contracting officer has refused to issue an order after the contractor asserts that the government effectively forced a suspension.[58] As with a constructive change, when a court characterizes the government's acts or omissions as a constructive suspension, the contractor's remedy is one under the contract rather than for a breach of the contract. The doctrine has not achieved widespread acceptance by state courts.[59]

Courts have also developed a constructive acceleration doctrine for situations in which an owner wrongfully forces the contractor to accelerate the progress of the work without issuing any express order changing the schedule.[60] The issue usually arises when problems arguably beyond the contractor's control create delays and the owner refuses to extend the schedule. As with constructive change and constructive suspension, federal courts have used the doctrine to characterize the contractor's claim as one under the contract rather than for breach.[61] There is much less evidence, however, that this doctrine primarily emanates either from federal contracting practices or distinct precedents from the federal contract cases. In fact, state courts have rendered some of the leading decisions.[62]

Differing site conditions

The differing site conditions clause has generated another notable line of federal cases implicating changes to the contractor's obligations. Chapter 2 notes the role federal contracting practices played in popularizing the differing site

56 *See generally* 5 BRUNER & O'CONNOR, *supra* note 13, at § 15:85.

57 *See, e.g.*, CCM Corp. v. United States, 20 Cl. Ct. 649, 657 (1990); *see generally* 5 BRUNER & O'CONNOR, *supra* note 13, at § 15:87.

58 *See, e.g.*, Fruehauf Corp. v. United States, 587 F.2d 486, 493-94 (Ct. Cl. 1978).

59 *See* Bonacorso Const. Corp. v. Commonwealth., 668 N.E.2d 366 (Mass. App. Ct.1996) (holding that Massachusetts does not recognize the doctrine); *see generally* 5 BRUNER & O'CONNOR, *supra* note 13, at § 15:87.

60 *See* 5 BRUNER & O'CONNOR, *supra* note 13, at § 15:94.

61 *See* JUSTIN SWEET & MARC M. SCHNEIER, *supra* note 16, at § 21.10B.

62 *See, e.g.*, Sherman R. Smoot Co. v. Ohio Dep't of Adm. Serv., 736 N.E.2d 69, 78 (Ohio App. 2000); Bat Masonry Co. v. Pike-Paschen Joint Venture III, 842 F. Supp. 174, 181 (D. Md. 1993).

conditions clause to help manage common risks of unforeseen underground conditions or other concealed problems at the project site. Chapter 2 discussed how the widespread adoption of these clauses in industry contracts contributed to the eclipse of the pre-existing duty role in the construction contract cases. In the present discussion, the focus turns to the federal construction contract cases resolving claims under differing site conditions clauses.

Differing site conditions problems most often involve such matters as hidden or buried obstructions, unanticipated quantities of underground rock, or other adverse soil conditions not indicated by available geotechnical reports and not disclosed by routine site inspections.[63] Before the advent of the differing site conditions clause, courts (both state and federal) rigidly adhered to common law principles to assign these risks to the builder under fixed price construction contracts in the absence of express contractual terms to the contrary.[64] In an 1864 dispute over defects allegedly attributable to unforeseen soil problems on a residential construction project, the U.S. Supreme Court concisely articulated the controlling law: "It is a well-settled rule of law, that if a party by his contract charge himself with an obligation possible to be performed, he must make it good, unless its performance is rendered impossible by the act of God, the law, or the other party. Unforeseen difficulties, however great, will not excuse him."[65]

In response to this state of the law, bidders on federal projects often inflated their price proposals with substantial contingency amounts to account for the differing site conditions risk.[66] Complicating matters, construction contract cases in the early twentieth century, led by a trilogy of Supreme Court cases, articulated unruly misrepresentation theories that could, under ill-defined circumstances, reallocate to the owner the risk of unanticipated site conditions.[67] Under these circumstances, problems of concealed, latent, or unanticipated conditions created serious risk management challenges for owners and contractors alike.

The federal government introduced the differing site conditions clause to address the risk more efficiently.[68] Construction contracts governed by state law,

63 *See generally* 4A BRUNER & O'CONNOR, *supra* note 13, at §§ 14:3-14:16.

64 *See, e.g.*, Simpson v. United States, 172 U.S. 372 (1899); Harrison Granite Co. v. Stephens, 125 N. W. 36 (Mich. 1910); Lonergan v. San Antonio Loan & Tr. Co., 104 S.W. 1061 (Tex. 1907); *see generally* 4A BRUNER & O'CONNOR, *supra* note 13, at § 14:24.

65 Dermott v. Jones, 69 U.S. 1, 7 (1864).

66 *See* 4A BRUNER & O'CONNOR, *supra* note 13, at § 14:45; Hazel Glenn Beh, *Allocating the Risk of the Unforeseen, Subsurface and Latent Conditions in Construction Contracts: Is There Room for the Common Law?*, 46 U. KAN. L. REV. 115, 132-34 (1997).

67 *See* 4A BRUNER & O'CONNOR, *supra* note 13, at § 14:45 (referring to Hollerbach v. U.S., 233 U.S. 165 (1914); Christie v. U.S., 237 U.S. 234 (1915); and U.S. v. Atlantic Dredging Co., 253 U.S. 1 (1920)). *See also* Beh, *supra note 66*, at 135 (noting that the common law afforded "abundant escape valves for the contractor trapped in a losing contract as a result of unforeseen conditions at the work site.").

68 *See* 4A BRUNER & O'CONNOR, *supra* note 13, at § 14:45.

both for public projects and private ones, now also routinely include similar provisions concerning differing site conditions.[69] A typical differing site conditions clause allows for an adjustment to the contract price or the schedule, or both, when conditions that the contractor encounters at the project site during performance of the work differ materially either from the conditions indicated by the contract documents or from conditions ordinarily encountered in like circumstances.[70] At least in theory, a differing site conditions clause obviates the need for bidders to include a site conditions contingency for every project.

An extensive body of case law applies and interprets differing site conditions clauses in a range of circumstances. [71] The elements required to establish a valid claim vary depending on whether the claim asserts that conditions differ from what the contract documents indicate (commonly called a Type I claim) or that they are unusual for the kind of project involved (Type II). Some differences also derive from the precise terms of the standard clauses articulated under the federal formula or the alternative, but similar, versions promulgated by other public owners or in various industry contracts. In all events, the elements include some subjective factors and fact issues courts must assess. These can include matters such as whether the differences involved are material, what conditions are indicated by the contract documents or are unusual, whether the contractor reasonably drew certain inferences or made certain assumptions, and whether the contractor justifiably relied on those inferences or assumptions.[72] Due to the subjectivity involved and the fact-intensive nature of the elements, differing site conditions clauses produce extensive litigation and some inconsistent results. Variations in contractual disclaimers by owners also sometimes create difficult questions for courts to resolve.[73] Even so, the cases establish a relatively stable and manageable framework for arguing and analyzing differing site condition claims.

As with the cases arising under provisions dealing with changes, suspension, and acceleration, the differing site conditions cases allow for a nuanced, and sometimes expansive, reading of a standard clause. Overall, the federal and state law cases have taken similar approaches.[74] Because the federal government

69 *See* JUSTIN SWEET & MARC M. SCHNEIER, *supra* note 16, at § 25.06.

70 *See* Jeffery M. Chu, *Differing Site Conditions: Whose Risk Are They?*, CONSTRUCTION LAW., Apr. 2000, at 5.

71 4A BRUNER & O'CONNOR, *supra* note 13, at §§ 14:45-14:59.

72 *See* 4A BRUNER & O'CONNOR, *supra* note 13, at §§ 14:49-14:55; Jeffery M. Chu, *supra* note 70, at 5, 6-10.

73 *See* JUSTIN SWEET & MARC M. SCHNEIER, *supra* note 16, at § 25.05.

74 *See, e.g.*, H.B. Mac, Inc. v. United States, 153 F.3d 1338 (Fed. Cir. 1998); Servidone Const. Corp. v. United States, 19 Cl. Ct. 346 (1990), aff'd, 931 F.2d 860 (Fed. Cir. 1991); Foster Const. C. A. & Williams Bros. Co. v. United States, 435 F.2d 873 (Ct. Cl. 1970); Metropolitan Sewerage Commission of Milwaukee County v. R. W. Const., Inc., 241 N.W.2d 371 (Wis. 1976); Teodori v. Penn Hills Sch. Dist. Auth., 196 A.2d 306 (Pa. 1964); URS Grp., Inc. v. Tetra Tech FW, Inc., 181 P.3d 380 (Colo. App. 2008); Sherman R. Smoot Co. v. Ohio Dep't of Adm. Serv., 736 N.E.2d 69, 78. (Ohio App. 2000).

pioneered the differing site conditions clause, and because the federal clause has produced a large volume of litigation, the federal construction contract cases provide some of the earliest precedents, as well as many leading opinions on the topic. The federal cases, however, do not comprise a distinct line of cases in the same way as do the federal cases that introduced the cardinal change and constructive change doctrines.

Termination

As was true with changes clauses and differing site conditions clauses, federal government contracting practices on termination, along with the federal cases addressing those practices, account for some important developments.[75] To begin with, the federal cases helped to establish basic principles concerning the right of an owner to terminate a contract due to the contractor's breach. As one might expect, the impact has been especially strong with respect to public contracts. "Most of the law on terminations of public contracts is concerned with the federal government's termination of prime contractors. Where there are no state law decisions that directly involve the termination of contractors by public agencies, state courts will likely find federal decisions persuasive."[76] In some respects, however, and particularly with reference to private projects, termination provisions in federal construction contracts vary from the approaches taken in popular industry contracts, especially because federal contracts deal at length with the government's right to terminate but not the contractor's.[77] The case law on termination of a construction contract for cause—that is based on a contractual breach by one party—does not bear a federal imprint to the same extent as does the law on changes and differing site conditions. The federal contract cases contribute to judicial approaches to an owner's right to terminate for cause, but they have not promulgated distinct doctrines on the subject.

The introduction of termination for convenience clauses in federal construction contracts afforded a greater opportunity for federal contract cases to influence the law on termination. The federal government first introduced these provisions in military supply contracts during wartime.[78] Given the complexity of many federal construction projects and the government's interest in maximum freedom to react to changing circumstances, termination for convenience clauses eventually became routine in federal construction contracts.[79] Note the significance of this development as a matter of contract theory (addressed more

75 *See* 5 BRUNER & O'CONNOR, *supra* note 13, at §§ 18:33, 18:37.

76 Aaron P. Silberman, *How State and Local Public Agencies May (or May Not) Terminate Construction Contracts*, CONSTRUCTION LAW., Spring 2016, at 16.

77 *See* 5 BRUNER & O'CONNOR, *supra* note 13, at §§ 18:33-18:37.

78 *See* JUSTIN SWEET & MARC M. SCHNEIER, *supra* note 16, at § 33.03B.

79 5 BRUNER & O'CONNOR, *supra* note 13, at § 18:37; Joseph D. West, *Practical Advice Concerning the Federal Government's Termination for Convenience Clause*, CONSTRUCTION LAW., Oct. 1997, at 10-97.

comprehensively in Chapter 6). The very notion of one party reserving the option to terminate a contractual relationship without cause or justification might seem to run afoul of concerns such as mutuality and illusory promises.[80] Relying on the implied duties of good faith and fair dealing as sufficient constraints, however, the federal construction contract cases acquiesced in these provisions with scarcely a concern over such considerations.[81]

From the government's perspective, a chief advantage of the termination for convenience right is that it provides an economically favorable exit strategy. The federal clause contemplates a termination settlement payment to the contractor that essentially pays the contractor for work and services performed to the date of the termination and reimburses the contractor's reasonable costs incurred because of the termination, but excludes recovery of anticipated profits and consequential damages.[82] The federal cases strongly favor the government's right to terminate for convenience so long as the evidence does not show bad faith or an abuse of discretion.[83]

Termination for convenience clauses now commonly appear throughout the construction industry, including in private contracts, and the courts typically enforce them, albeit subject to some qualifications that vary from one jurisdiction to another.[84] In varying degrees, state cases applying termination for convenience clauses rely on the federal contract precedents. Some seem even more deferential to a decision to terminate.[85] Other state courts, however, impose greater restrictions on an owner's right to terminate for convenience than the federal contract cases require. Under these cases, a termination for convenience may require evidence of a significant change in circumstances that justifies the termination[86] or may lead a court to apply a heightened standard of good faith.[87]

One further aspect of the federal government's right to terminate a contract for convenience merits attention. Having introduced the termination for convenience clause as a standard term, federal contracting practices took an interesting next step by introducing a breach of contract conversion concept into the standard termination for cause provision. Under this approach, the government

80 *See, e.g.*, Torncello v. United States, 681 F.2d 756, 769 (Ct. Cl. 1982).

81 *See, e.g.*, Krygoski Const. Co. v. United States, 94 F.3d 1537, 1540-41 (Fed. Cir. 1996); John Reiner & Co. v. United States, 325 F.2d 438, 442 (Ct. Cl. 1963).

82 *See* Mark B. Chassman & Debra Tilson Lambeck, *Termination for Convenience-Costs Recoverable*, CONSTRUCTION LAW., Aug. 1987, at 3; 6 BRUNER & O'CONNOR, *supra* note 13, at § 19:61.

83 *See* Krygoski, 94 F.3d at 1543.

84 *See, e.g.*, Questar Builders, Inc. v. CB Flooring, LLC, 978 A.2d 651 (Md. Ct App. 2009); Desco Vitro Glaze of Schenectady, Inc. v. Mech. Const. Corp., 552 N.Y.S.2d 185 (App. Div.1990); Dalton Properties, Inc. v. Jones, 683 P.2d 30 (Nev. 1984).

85 *See, e.g.*, Vila & Son Landscaping Corp. v. Posen Const., Inc., 99 So. 3d 563, 568 (Fla. Dist. Ct. App. 2012); Avatar Dev. Corp. v. De Pani Const., Inc., 834 So. 2d 873, 875-76 (Fla. Dist. Ct. App. 2002). *See also*, Silberman, *supra* note 76, at 20.

86 RAM Engineering & Const., Inc. v. University of Louisville, 127 S.W.3d 579 (Ky. 2003).

87 Questar Builders, 978 A.2d at 669-70.

can convert what otherwise would be a contractual breach in the form of wrongful action under the termination for cause clause into an after-the-fact exercise of the termination for convenience clause.[88] The federal courts routinely recognize this option to transform an arguably wrongful termination into a contractually permissible one for convenience.[89] Even before federal contracting practices explicitly provided for this option, some federal decisions allowed the government to avoid breach of contract damages when a wrongful termination could have been accomplished properly as a termination for convenience.[90] In an apparent acknowledgment of the legal fiction at work in this maneuver, cases and commentators have referred to this as "constructive termination" for convenience.[91] The constructive termination principle seems to have some standing under state law, albeit rather limited and tentative.[92]

Contractor's measure and proof of damages

Complex principles govern the measure and proof of damages in construction contract cases. "The need for damage measurement approaches suited to the construction process has resulted in the development of construction contract remedies and damage measures unique in contract law."[93] This is especially true for contractor damages for breach by the owner because construction cost accounting involves intricate details and difficult matters of causation, quantification, and recordkeeping.

While most of the case law has developed incrementally through a combination of state and federal contract cases, several reasons account for the special significance of the federal contract cases on principles governing contractor damage claims. First, federal procurement practices and the Federal Acquisition Regulation (the F.A.R.) provide an especially comprehensive and coherent framework for analyzing contractor damage claims. Second, the federal government, with its extraordinary volume of claims, has an abiding interest in controlling damage awards while at the same time treating contractor claims consistently and with a degree of fairness. Third, specialized federal agencies, boards, and courts have unique and extensive experience in addressing contractor damage claims. The federal contract cases, therefore, constitute an important source of law on measuring and proving contractor damages. At the same time, the F.A.R., with its detailed rules implementing federal procurement and dispute resolution policies, sets the federal contract damage cases somewhat apart from the

88 *See* 5 BRUNER & O'CONNOR, *supra* note 13, at §§ 18:37, 18:45, 18:45.50.

89 *See, e.g.*, TGC Contracting Corp. v. United States, 736 F.2d 1512, 1515 (Fed. Cir. 1984); Axion Corp. v. United States, 75 Fed. Cl. 99, 117 (2007).

90 Coll. Point Boat Corp. v. United States, 267 U.S. 12, 15-16 (1925); John Reiner, 325 F.2d at 443.

91 *See* 5 BRUNER & O'CONNOR, *supra* note 13, at §§ 18:45, 18:45.50.

92 *See* Daniel E. Terreri & Sons, Inc. v. Mahoning Cty. Bd. of Commrs., 786 N.E.2d 921, 932-35 (Ohio App. 2003); *see generally* 5 BRUNER & O'CONNOR, *supra* note 13, at § 18:45.50.

93 6 BRUNER & O'CONNOR, *supra* note 13, at § 19:75.

corresponding general principles of contract law. In assessing the federal standards, formulas, and tests, one must always consider the extent to which some peculiar federal statute, regulation, or policy may have affected the result.

The federal contract cases have figured prominently in establishing the strong judicial preference for thoroughly documented records of the actual costs associated with a contractor's claims.[94] Under this approach, the contractor's evidence should consist of detailed records, segregated by specific categories of costs attributable to the owner's breach, such as direct and indirect labor costs, material and equipment costs, insurance and surety bond premiums, profit, and overhead. For the most part, the case law setting the standards for measuring and proving these elements of damages emerges from a relatively homogenous body of state and federal cases, subject to ordinary jurisdictional variations (including variations dictated for federal contracts under the F.A.R.).[95] Accurate and complete cost accounting on a fully segregated and documented basis for contractor claims, however, notoriously involves many practical challenges. In particular, the difficulties include "the complexity of segregating and allocating construction costs to activities causing their incurrence" and "the uniqueness of accounting for and proving construction contract cost elements under variable job conditions for activity-related and time-related direct costs and indirect costs, such as pricing of contractor-owned equipment and home office overhead expenses."[96] The federal cases also provide many of the leading precedents on the circumstances under which courts may approve alternative methods for proving damages when the contractor can establish a right to damages but cannot prove the exact or full amount of damages via the actual cost method.[97]

The influence of the federal contract cases appears most clearly with respect to contractors' time impact or disruption claims. In these situations the federal boards of contract appeal, the U. S. Court of Federal Claims, passing on such claims without juries, along with the Court of Appeals for the Federal Circuit, "have developed high competence in deciding time impact claims and routinely debunk proffered 'experts' who offer opinions based on less than complete analyses."[98] In particular, the federal contract cases introduced and popularized a method facilitating, while at the same time circumscribing, a contractor's recovery of indirect home office overhead costs attributable to delays, suspensions, and disruptions caused by an owner.[99] A contractor's home office overhead includes such costs as home office facilities and equipment and general staff and administrative expenses incurred in maintaining

94 *See* Allen L. Overcash, Jack W. Harris, *Measuring the Contractor's Damages by "Actual Costs"—Can It Be Done?*, CONSTRUCTION LAW., Winter 2005, at 31, 32-34.

95 *See* 6 BRUNER & O'CONNOR, *supra* note 13, at §§ 19:96-19:115.

96 *Id.* at § 19:75 (footnotes omitted).

97 *Id.* at §§ 19:116-19:119.

98 *See generally* 5 BRUNER & O'CONNOR, *supra* note 13, at § 15:123.

99 *See* 6 BRUNER & O'CONNOR, *supra* note 13, at § 19:108.

the contractor's business but not directly associated with a particular construction project. A contractor can normally assign a share of these costs to each project by allocating total home office overhead proportionately among all projects during a given accounting period. But that normal approach to accounting for home office overhead breaks down if a project's duration is unexpectedly extended due to suspensions, delays, or schedule disruptions that force the contractor to go on standby or to suffer extended idle periods. "Such extended costs relate to the passage of time, and are not susceptible of direct allocation to individual contracts without extraordinary analysis of the extent to which home office management has been involved, if at all, in addressing problems arising under that individual contract."[100]

Federal and state cases alike refer to the dominate method for resolving this accounting dilemma as the "Eichleay formula," an approach that derives from a long line of federal construction cases, including an influential decision rendered in 1960 by the Armed Services Board of Contract Appeals.[101] The U.S. Court of Federal Claims and the U.S. Court of Appeals for the Federal Circuit have repeatedly reaffirmed use of the Eichleay formula, and the method has been used extensively in cases governed by state law.[102] State courts have generally given the Eichleay formula a positive reception as an appropriate method for recovering unabsorbed home office expenses.[103] Some states, however, have adopted the formula with modification, including adjustments reflecting distinctions between state and federal procurement policies and regulations.[104] Other state courts have declined to adopt the federal formula, at least in particular situations.[105]

The Severin doctrine

The doctrine the Court of Claims proclaimed in *Severin v. United States* stands as a unique federal contribution to a narrow issue of subcontract law.[106] It limits liability for damages that the government causes to a subcontractor. The rule arguably derives logically from contract law's traditional privity notion. When one party to a contract, here the prime contractor, delegates aspects of performance to another by subcontract, no privity exists between the subcontractor and

100 *Id.*

101 Appeal of Eichleay Corp., ASBCA No. 5183, 60-2 B.C.A. (CCH) ¶ 2688 (July 29, 1960).

102 *See* 6 BRUNER & O'CONNOR, *supra* note 13, at § 19:108.

103 *See, e.g.*, JMR Constr. Corp. v. Envtl. Assessment & Remediation Mgmt., Inc., 243 Cal. App. 4th 571, 587, 198 Cal. Rptr. 3d 47, 60-61 (2015), *as modified on denial of reh'g* (Jan. 28, 2016); Broward Cty. v. Brooks Builders, Inc., 908 So. 2d 536, 539 (Fla. Dist. Ct. App. 2005). *See generally* John D. Darling, *Delay of Game*, CONSTRUCTION LAW., Spring 2006, at 5, 7.

104 *See, e.g*, Complete Gen. Constr. Co. v. Ohio Dep't of Transp., 760 N.E.2d 364, 371 (Ohio 2002).

105 Hugh Reynolds, Jr., *Is Eichleay the Answer? An in-Depth Look at Home Office Overhead Claims*, CONSTRUCTION LAW., April 1987, at 1.

106 Severin v. United States, 99 Ct. Cl. 435 (1943).

the other party to the prime contract, here the project owner. As a result, the subcontractor has no direct remedy against the owner for damages the owner's breach of the prime contract may cause. The subcontractor's rights arise solely against the prime contractor under the subcontract.

In theory, however, even though lack of privity prevents the subcontractor from suing the project owner directly, the prime contractor might assert its own claim against the owner indirectly on the subcontractor's behalf. A simple linear analysis applies. Contractually, the owner is liable for all damages the prime contractor incurs due to the owner's breach. This liability should extend to any additional compensation or damages the prime contractor owes under the subcontract for costs or losses beyond the subcontractor's control, which typically would include additional amounts the prime owes to the subcontractor on account of the owner's breach of the prime contract. As a result, in a standard arrangement, the subcontractor could present its claim to the prime contractor, who could then incorporate the subcontractor's damages into the prime's own claim against the owner.

Subcontracting practices that developed especially on federal projects added a critical wrinkle to this logic. Federal contractors often include provisions in subcontracts limiting their liability for damages that the government causes to whatever amount, if any, the prime contractor can recover from the government on the claim. Presumably, this practice stems from the special procedures and limitations that apply to claims against the government under federal procurement laws and regulations. A government contractor naturally wishes to avoid liability to a subcontractor for damages the government causes except to the extent the contractor recovers those damages from the government.

In *Severin*, decided in 1943, the prime contractor's claim for damages due to the government's delay included losses suffered by a subcontractor. Because the subcontract provided that the prime would not be responsible for any damages that the government caused, the court only allowed recovery of the modest damages the government's delay caused directly to the prime. It denied recovery for the more substantial damages the prime sought on the subcontractor's behalf attributable to the same delay. Using the formalistic reasoning common in contract cases of the time, the Court of Claims gave a literal reading to the subcontract provision exonerating the prime contractor from liability for damages the government caused. Under what subsequently became known as the *Severin* doctrine, when a subcontract provides a defense to the subcontractor's claim against the prime, it also bars the prime from including in its own claim against the government damages the subcontractor incurred. The court did not bother to inquire why a contractor and subcontractor would choose to confer such a windfall benefit on the government. A contemporary approach to contract interpretation might have read into the subcontract's exculpatory clause the probable intent that damages the government caused would only be recoverable to the extent secured via a successful claim by the contractor against the government.

The *Severin* doctrine strikes an especially brutal blow in light of other aspects of federal procurement law. In a private construction project, even if the owner could raise a similar privity defense, state lien laws would ordinarily provide security to subcontractors for payment of valid claims. Because a construction lien attaches to the owner's property, a privity defense may be worthless to a private owner. An entirely different analysis applies on federal projects, as to which no construction lien rights arise.[107] A contractor's surety bond commonly affords payment security to subcontractors on a federal project, but the surety generally can raise contract defenses available to the contractor.[108] Beyond that, sovereign immunity precludes a third-party beneficiary claim because the applicable statutory waiver of immunity in the case of a federal construction contract extends only to those with whom the government directly contracts.[109] In short, if the subcontract on a federal construction project exonerates the prime contractor from liability for damages the government causes, the *Severin* doctrine seems to leave the subcontractor out in the cold.

The federal cases applying the *Severin* doctrine eventually recognized a viable option for protecting a subcontractor without exposing a prime contractor to independent liability for damages the government causes.[110] In its modern form, *Severin* prevents the prime from asserting the subcontractor's damages against the government only to the precise extent that the subcontract exonerates the prime. Thus, a carefully crafted agreement between the subcontractor and the prime can fall outside the *Severin* doctrine simply by limiting the subcontractor's recovery to whatever amount the prime contractor secures as part of its own claim against the government. Industry contracting practices routinely implement this pass-through claim arrangement in either of two ways expressly designed to avoid the *Severin* defense.[111] The first method uses qualified exculpatory language that fixes the prime contractor's liability for damages the government causes to whatever amount the prime recovers from the government for the subcontractor's damages. The

107 *See* 6 BRUNER & O'CONNOR, *supra* note 13, at § 19:2, n.3; 3 BRUNER & O'CONNOR, *supra* note 13, at § 8:136.

108 *See, e.g.*, Arrow Plumbing & Heating, Inc. v. N. Am. Mech. Servs. Corp., 810 F. Supp. 369, 372 (D.R.I. 1993); *but cf.* United States *ex rel.* Kitchens To Go v. John C. Grimberg Co., 283 F. Supp. 3d 476 (Va. 2017) (holding that a prime contractor's surety could not rely on the subcontract's no-damage-for-delay clause to deny a Miller Act bond claim for delay damages); Moore Bros. Co. v. Brown & Root, Inc., 207 F.3d 717, 723 (4th Cir. 2000) (holding that under Virginia law a prime contractor's surety could not assert a defense based on the subcontract's pay-when-paid clause).

109 Severin, 99 Ct. Cl. at 442; Blake Const. Co. v. United States, 28 Fed. Cl. 672, 680-81 (1993), *aff'd* Blake Const. Co. v. United States, 29 F.3d 645 (Fed. Cir. 1994).

110 *See, e.g.*, Folk Const. Co. v. United States, 2 Cl. Ct. 681, 685 (1983); Seger v. United States, 469 F.2d 292, 300 (Ct. Cl. 1972); J. L. Simmons Co. v. United States, 304 F.2d 886, 889 (Ct. Cl. 1962).

111 *See generally* 6 BRUNER & O'CONNOR, *supra* note 13, at § 19:25.

other uses a separate agreement, known as a liquidating agreement, by which the prime contractor agrees to sponsor the subcontractor's legitimate claims against the government in exchange for the subcontractor's agreement to limit its recovery from the prime to that same extent. Each solution limits the prime contractor's liability to the subcontractor for damages the government causes to the amount, if any, the prime recovers from the government under the applicable federal procurement rules and procedures.

Throughout the industry, and not just on federal construction projects, prime contractors often insist on provisions limiting their liability to subcontractors for damages that owners cause.[112] In these situations, courts applying state contract law sometimes adopt, either explicitly or by parallel reasoning, the modern version of the *Severin* doctrine, which bars the claim only if the subcontract includes an absolute, unconditional release of the prime's liability to the subcontractor.[113] Others reject the *Severin* rationale as a matter of state contract law, sometimes viewing the doctrine as a peculiar offshoot of federal contract law that has no place in state law.[114] For public construction projects governed by state law, reliance on *Severin* may make sense in light of applicable state sovereign immunity principles. To apply the *Severin* doctrine in private contract cases, however, smacks of a highly formalistic and outdated notion of contractual privity. A more direct and logical approach simply interprets exculpatory language in a subcontract in accordance with the parties' probable intent, which is not to grant the owner an unearned defense, but to avoid duplicative litigation and to share the claims risk.[115]

The *Severin* story offers an especially concrete example of the interplay between industry risk management practices and the common law. Stimulated at least to some extent by practices popularized in federal construction projects, contractors and subcontractors throughout the industry embraced carefully limited exculpation clauses and liquidating agreements to manage risks of owner default. The *Severin* doctrine alerted contractors and subcontractors to the potential contractual privity trap involved. In response, construction industry lawyers learned to craft exculpatory provisions that fall outside *Severin's* formalistic contours. Courts rather easily obliged by limiting the *Severin* defense to unconditional releases of the prime's potential liability for damages the owner causes. In effect, the contemporary industry practice relying on

112 *See* Interstate Contracting Corp. v. City of Dallas, 135 S.W.3d 605, 617 (Tex. 2004) ("the contracting industry has become comfortable with pass-through claims as an efficient means of dispute resolution"); *see generally* 3 BRUNER & O'CONNOR, *supra* note 13, at § 8:51.

113 *See, e.g.*, North Moore Street Developers, LLC v. Meltzer/Mandl Architects, P.C., 799 N.Y.S.2d 485 (N.Y. App. Div. 2005); Interstate Contracting Corp., 135 S.W.3d at 605; Aetna Bridge Co. v. State Dep't of Transp., 795 A.2d 517, 524 (R.I. 2002).

114 *See* Fid. & Deposit Co. of Maryland v. Casey Indus., Inc., No. 8:12CV70, 2014 WL 1096355, at 19 (D. Neb. 2014); Metric Constructors, Inc. v. Hawker Siddeley Power Eng'g, Inc., 468 S.E.2d 435, 437-39 (N.C. App. 1996).

115 Metric Constructors, 468 S.E.2d at 437-39.

some form of pass-through or liquidating arrangement operates as a judicially endorsed conditional payment clause partially transferring the risk of owner default to the subcontractor.[116] Thus, the *Severin* doctrine, although introduced as a formalistic application of the contractual privity concept, now operates to accommodate a flexible and practical risk management device well suited to the construction industry.

Lessons from the federal cases

The federal cases discussed in this chapter confirm several trends in contract law from the nineteenth century to the present. In the first place, they illustrate a judicial tendency to tailor contract principles to a particular context. As federal agency boards and federal courts reacted to the construction industry experiences that brought disputes to them, they helped to define an increasingly flexible and contextual understanding of contractual relationships in the construction industry context. The implied obligations cases reflect the evolution of contract law away from relatively rigid rules toward broader principles, such as good faith and fair dealing. Those same cases demonstrate how courts can use such broad principles to develop flexible rules to govern recurring situations for a particular industry. Other federal cases discussed in this chapter show that when contracting parties introduce new practices in response to general rules courts may refine contract law both to accommodate and to constrain those practices. We see this especially in the decisions arising under the federal government's contract terms governing changes, differing site conditions, and termination, which then became standard practices in the industry. We also see it in the judicially sanctioned decline of the *Severin* doctrine. These cases illustrate the cyclical process by which contract law and the behavior of those subject to it progressively influence each other. The cases on the contractor's measure and proof of damages show a subtler contextual aspect of contract law—how courts manage to refine basic contract principles to the circumstances of recurring industry disputes. As noted at the beginning of this chapter, the most notable impact of the federal cases has been to establish a highly developed branch of contract law for the construction industry.

At a more general level, the federal contract cases have provided leading precedents on a few discrete aspects of contract law and, to a much greater degree, they have contributed to the process by which contract law has continuously evolved through the common law process. Most significantly, they have helped to move contract law along an arc that is increasingly flexible, relational, and contextual. On that claim, Chapter 6 has much more to say.

116 *See generally* 3 BRUNER & O'CONNOR, *supra* note 13, at § 8:51.

Part 4

Assessing contract law in the construction industry context

6 Contract theory and the construction industry cases

Danger awaits those who venture too far into contract's theoretical waters. Great minds differ not only about organizing principles in this field, but even over whether any coherent theory exists. Thankfully, I need not dive too deeply. I seek not to justify or even to explain contract theory in the construction industry cases, but only to observe the theoretical underpinnings discoverable there and to locate the industry cases within contract law's theoretical continuum. Indeed, *theory* perhaps connotes too much for my purposes. This chapter concerns alternative conceptions of contract more than contract theory in the purest sense. For this task, a relatively brief recap, relying heavily on Professor Murray's concise and pragmatic overview written at the beginning of the current century, suffices to launch the inquiry.[1]

Competing conceptions of contract

In contrast to other core fields of the common law, including property, criminal law, and even torts, a coherent body of contract law began to develop in a meaningful way only recently. According to Professor Farnsworth, before the sixteenth century, the common law did not widely enforce voluntary obligations other than those made under the formality of seal, for which the action of covenant was available.[2] Thus, the common law initially dealt with exchange transactions in a highly formalistic way, a characteristic that dominated into the twentieth century and that retains force even today. The common law actions of assumpsit, which originated in tort law, and of debt initially applied only in narrow circumstances.[3] Courts gradually began to enforce voluntary obligations based on promise-for-promise exchanges, but a general body of contract law as we know it today hardly existed until well into the eighteenth century. Blackstone, for example, had little to say on the

1 *See* John E. Murray, Jr., *Contract Theories and the Rise of Neoformalism*, 71 FORDHAM L. REV. 869 (2002).

2 *See* 1 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 1.5 (3d ed. 2004).

3 *Id.* at § 1.6.

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law of voluntary obligations under the common law of England. In the United States, no popular treatise on contract law emerged until Williston's in the late nineteenth century. At this same time, the construction industry emerged as a remarkably important component of commerce. In a coincidence that guaranteed reciprocal influence, U.S. courts started to address fundamental contract issues in construction industry disputes at the same time as they struggled to define modern contract law. As a result, the industry's contracting practices and its recurring, high-stakes dispute patterns constantly nourished the formative era of U.S. contract law.

Scholars often classify contract theory through a chronology of schools of thought. While this approach overstates the dividing lines and distinctions, it helps to bring the most significant factors into focus. This chapter relies on a conventional classification for the limited purpose of assessing different lines of construction industry cases with reference to a continuum of theoretical frames scholars commonly use. The conventional account begins with the classical conception of contract, which it then contrasts with several more or less stylized alternative theories promoted over time.

Classical theory embodied liberal notions of law as a social institution. In the United States, nineteenth-century individualism and the American laissez-faire attitude toward exchange transactions also figured mightily into the classical notion. The law prioritized individual freedom of contract and the sanctity of express contractual obligations. Conceptually, classical theory aimed to establish contract law as a scientific field. Its patrons valued certainty and predictability. They favored relatively inflexible rules and general principles intended to apply to all forms of exchange transactions. Key characteristics included the fixed roles of offer and acceptance, a requirement of consideration to support enforceable agreements, and the mutual exchange of promises in contract formation. The classical theory promoted a limited number of general principles and abstract concepts from which courts and commentators could deduce more specific rules. The classical model asserted that, by understanding and logically applying its rules and general principles, courts could reach objectively correct results in cases. The net result yielded dogma and legal formalism. The classical framework of the late nineteenth and early twentieth centuries found its most elegant expression in Williston and in the first Restatement of Contracts. The print had yet to dry on the Restatement text, however, before the classical conception came under fierce attack.

Early in the twentieth century, the legal realists, including Oliver Wendell Holmes, Jr. and Karl Llewellyn, challenged classical contract law.[4] They reacted especially against its dogmatic approach to resolving legal disputes and its failure to accept that concepts of fairness and justice, and not simply rules of law, would and should guide judges in deciding cases. In time, the realists largely succeeded in discrediting classical contract's rigid formalism.

4 *See generally* Murray, Jr., *supra* note 1, at 870–71, 886–91.

The legal realists' most prominent reform in contract law came through the U.C.C.'s Article 2, which reimagined the law of sales. Article 2, whose architect was Llewellyn, codified such innovations as the implied duties of good faith and fair dealing, a relaxed version of the parol-evidence rule, regard for trade usage, course of dealing, and course of performance in interpreting agreements, and reliance on indeterminate standards, such as unconscionability and reasonableness, over fixed rules. Because Article 2 applies to contracts for the sale of goods but not to those for services, the common law continues to govern the general field of construction contracts. The same criticisms of classical contract that gave rise to Article 2, however, also motivated a broader reaction, affecting all of contract law.

This more sweeping movement, which scholars commonly call neoclassical contract, asserted dominance over U.S. contract law writ large through the second Restatement of Contracts. As the label "neoclassical" suggests, the new concept retained much of the classical framework but addressed many of its most troubling shortcomings, often in ways that mirrored or adapted U.C.C. principles.[5] While courts often still resort to classical rules to decide contract cases, in the academy, neoclassical contract achieved widespread respect by early in the second half of the twentieth century, culminating with the adoption and broad acceptance of the second Restatement.

Some distinctions between the classical and neoclassical approaches are subtle. For example, both concepts adopt doctrinal approaches in the sense of articulating rules or standards that courts apply to resolve disputes. The classical version, however, is far more dogmatic than is the neoclassical in its use of doctrine. Many neoclassical rules operate more as flexible standards or guidelines than as universal rules. Other differences are more radical, at least when viewed through a classical lens. For example, the U.C.C. and the second Restatement invoke anti-formalistic tones that frequently rely on the exercise of judicial discretion. As explained in greater detail later in this chapter, the contemporary construction industry cases have contributed to some of the most significant contrasts between the classical and neoclassical perspectives. For example, as Chapter 2 details, industry cases have played a leading role in the judiciary's willingness to substitute reliance for consideration as a basis for enforcing obligations. They also have influenced courts to adjust rules and adapt principles to particular circumstances by considering the specific context in which an exchange transaction occurs.

As a practical matter, contract theory in the construction industry cases today remains tethered to neoclassical contract, with occasional ties to specific, hard-to-shake classical rules. To stop with that observation, however, would be to ignore decades of fascinating debates among those seeking to justify, or if not to justify, at least to explain and criticize, U.S. contract law. While I conclude that none of these alternative theories overshadows the

5 *See generally id.* at 886–91.

neoclassical influence in the construction industry cases, some of them leave noteworthy marks. The chronology, therefore, continues.

In time, the critical legal studies movement (CLS) radically revived and expanded some themes from legal realism that had faded after Willistonian concepts had succumbed to the neoclassical version of contract. CLS scholars criticize all law as a cultural tool hiding behind a façade of rules that function to preserve the dominant social order. They see neoclassical theory as nothing more than an updated version of classical contract, still tied to indefensible dogma. According to Professor Murray, "CLS is designed to prove that any rule, principle or standard of contract law as well as other doctrinal norms can be deconstructed (read 'destroyed')."[6] I do not dwell on the theory here, and merely acknowledge it with these incomplete remarks, because I see no CLS imprint in the construction industry contract cases. I do not argue against CLS, but only conclude that it has failed to infiltrate contract law as applied to construction industry disputes in the courts. Indeed, the overwhelming scholarly judgment holds that CLS has been singularly ineffective in altering contract law in action. Accordingly, CLS theory plays no further part in this chapter's review of contract theory in the construction industry cases.

Economic analysis offers the most popular alternative to neoclassical contract theory. For the past several decades, law and economics scholarship has flourished. Professor Eric Posner explains that economic analysis of contract law often proceeds in either a descriptive or a normative manner.[7] A descriptive approach assumes "that judges decide cases (and/or choose doctrine) in a manner that maximizes efficiency."[8] A descriptive analysis begins by constructing "a model in which parties would maximize their utility if they could enter an optimal contract," and then it posits a rule that facilitates that optimal contract, which the analysis then compares to the rule that contract law actually provides.[9] A normative analysis, by contrast, assumes that legal rules ought to be efficient, and it assesses legal rules accordingly. "Typically, the author recommends one rule as efficient, or shows that different rules are efficient under different assumptions, or else criticizes various existing rules because they do not enable the parties to achieve the optimal outcome."[10]

Much early economic analysis followed the descriptive route. This work often argued convincingly that contract law lines up reasonably well with the efficiency principle. One commentator concludes that Richard Posner's early writings on contract law illustrate just such an approach in the sense that "Posner takes the explanatory success of economic analysis to consist in its

6 *Id*. at 874.

7 Eric A. Posner, *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, 112 YALE L.J. 829, 833-34 (2003).

8 *Id*. at 833.

9 *Id*. at 833-34.

10 *Id*. at 834.

ability to correctly determine case outcomes."[11] Interestingly, the specific example used to support this conclusion is Posner's assessment of a nineteenth-century dispute over responsibility for the costs of rebuilding an addition to the Wisconsin state capital damaged during construction.[12] The court upheld the builder's claim for additional compensation against the state's demurer, essentially reasoning that the architect who allegedly furnished defective plans that caused part of the building to collapse was the state's agent. While the court's explicit holding reflects an early version of the *Spearin* doctrine under which an owner impliedly warrants the sufficiency of plans it provides to a builder, the alternative economic analysis explains the result on the basis that, as between the state and the builder, the state was in the better position to insure against a defective design.

Eventually, the law and economics literature became more normative and began proposing reforms designed to make contract law serve the efficiency objective more precisely or consistently. The efficient breach theory, for example, emerged as one of the most significant reform proposals. According to a prevailing view in the law and economics literature, contract law should approve of a breach when it is efficient in the sense that "the net gains from nonperformance exceed the net gains from performance, that is, when performing the contract would reduce overall social welfare."[13] Scholars sometimes advance the efficient breach analysis to justify the principle that a liquidated damage provision should not be enforced if it amounts to a penalty for breach of contract.[14] Although that rationale does not seem evident in the construction contract cases on liquidated damages, the discussion later in this chapter acknowledges that industry cases occasionally do reflect the influence of economic analysis on certain other issues. I do not, however, see evidence that the central themes of economic theory have explicitly accounted for distinct developments in the industry cases. The law and economics literature seems most relevant to construction industry contracts where it overlaps with relational contract theory, to which I now turn.

Relational contract theory stems from the considerable work of Professor Ian Macneil, which in turn reflects the influence of Professor Stewart Macaulay's empirical studies of contract.[15] Classical, neoclassical, and economic

11 Jody S. Kraus, *From Langdell to Law and Economics: Two Conceptions of Stare Decisis in Contract Law and Theory*, 94 VA. L. REV. 157, 192 (2008).

12 Bentley v. State, 41 N.W. 338 (Wis. 1889).

13 Gregory Klass, *The Rules of the Game and the Morality of Efficient Breach*, 29 YALE J.L. & HUMAN. 71, 81 (2017).

14 *See* W. Alexander Moseley, *How Can the Construction Industry Better Manage Consequential Damages for Delay? And Will the Courts Cooperate?*, 3 J. AM. C. CONSTRUCTION LAW. 3 (2009).

15 *See* IAN MACNEIL, THE NEW SOCIAL CONTRACT: AN INQUIRY INTO MODERN CONTRACT RELATIONS (1980); Stewart Macaulay, *Relational Contracts Floating on a Sea of Custom? Thoughts About the Ideas of Ian Macneil and Lisa Bernstein*, 94 NW. U. L. REV. 775 (2000); Ian R. Macneil, *Relational Contract Theory: Challenges and Queries*, 94 NW. U. L. REV. 877 (2000); Ian R. Macneil, *Relational Contract: What We Do and Do Not Know*, 1985 WIS. L REV. 483; Ian R. Macneil, *Values in Contract: Internal and External*, 78 NW. U. L. REV. 340 (1983).

theory, all consider contractual arrangements essentially as discrete transactions defined by the fixed terms the parties negotiate and governed by the controlling principles of contract law. By contrast, "relational theories assign a central role to the overall context that generates the dynamic and interdependent relationship between the parties."[16] Relational theory "focuses much more on customs, usage, and behavioral considerations and much less on legal rules and principles, consent, expressed or presumed intent, and the language the parties used to establish the arrangement at its inception."[17] The relational concept of contract favors highly flexible legal principles designed to preserve exchange relationships in the face of changing circumstances. It promotes the benefits of incomplete contracts and, in some iterations, is especially open to processes for filling in the gaps those contracts routinely leave open.

Construction industry contracting practices often illustrate relational contract objectives. These practices include such devices as provisions anticipating changed circumstances during the course of the performance period, procedures for making equitable adjustments to the project budget and schedule, and comprehensive claims and dispute management procedures designed to maintain the relationship in the face of disagreement between the parties.[18] The fact that courts routinely enforce these more collaborative and adaptive provisions arguably demonstrates the relational concept in the industry cases. For the most part, however, relational contract theory is more concerned with a socioeconomic understanding of exchange arrangements than with contract law as applied in the cases. Relational theorists define "contract" to cover a broad spectrum of interactions that extend far beyond the customary scope of contract law.[19] As a result, the theory often concerns itself more with behavioral factors common to exchange arrangements in the abstract than with contract law specifically. Much as is true with economic analysis, the relational contract perspective may sometimes help to explain, justify, or assess contract law principles, but it does not directly account for major aspects of the common law of contract. As noted later in this chapter, however, some leading construction contract cases reflect relational attitudes.

The most recent development in contract theory to receive extensive attention returns to some tenets of classical contract law, particularly a preference for clear rules over flexible standards or guidelines, a devotion to certainty and predictability, and a desire to curb judicial discretion in matters of contract interpretation. This approach reacts against some of the innovations that the U.C.C. and the second Restatement embody. Scholars call

16 Carl J. Circo, *A Case Study in Collaborative Technology and the Intentionally Relational Contract: Building Information Modeling and Construction Industry Contracts*, 67 Ark. L. Rev. 873, 889 (2014).

17 *Id*. at 889-890.

18 *Id*. at 894-96.

19 *See* Ian R. Macneil, *Relational Contract Theory: Challenges and Queries*, 94 Nw. U. L. Rev. 877, 878 (2000).

this the new formalism movement or neoformalism. The neoformalist literature advocates "much-reduced roles for trade usage and course of performance evidence in commercial contracts governed by the U.C.C., and new life for the 'plain meaning rule.'"[20]

The neoformalists focus especially on contract interpretation, and they question whether courts should fill in gaps in the parties' contractual language. They correctly point out that common law cases involving these issues continue to adhere in significant ways to such formal stalwarts as the plain-meaning rule, the parol-evidence rule, and the principle that judges will not remake the parties' agreement.[21] In practice, even under the considerable influence of the second Restatement, the courts have not strayed far from formalism in routine matters of contract interpretation. In this sense, neoformalism (or perhaps, more simply, formalism) exerts a discernable hold on the contemporary contract cases. As noted later in this chapter, formalism continues to play a role in the construction industry cases. This fact, however, does not diminish the dominance of the U.C.C., the second Restatement, and the neoclassical concept of contract in the industry cases.

In summary, debates over competing contract theories tend, quite logically, to be—well, to be highly theoretical. This chapter's interest in theory (or more modestly, in conceptions of contract), however, is more pragmatic because the judicial opinions themselves rarely endorse or even perceptibly acknowledge any of the modern theories of contract. For my purposes, I need not take sides on the empirical or normative questions that dominate the contemporary literature. I have simpler questions in mind. To what extent does theory matter in the construction industry cases, especially those cases applying the common law of contract (as distinguished from the U.C.C.)? Which conceptions of contract do the cases manifest, and how so? How have the industry cases contributed to our evolving understanding of contract?

On all these questions, distinctions between classical and neoclassical contract stand out. As the terminology itself implies, classical and neoclassical contract occupy closely related doctrinal territories. They differ not so much in how they conceptualize contract law as in the emphasis they place on the issues and principles most important to a shared concept. Both approaches base contract law on doctrine expressed as "blackletter" rules and principles, albeit in contrasting degrees of flexibility. In a practical sense, the U.C.C. and the second Restatement mark the triumph of the neoclassical approach over the classical in establishing contract law doctrine at a level of detail intended to guide courts in resolving contract disputes. As explained later in this chapter, the main area in which classical contract retains vitality concerns how

20 William J. Woodward, Jr., *Neoformalism in A Real World of Forms*, 2001 WIS. L. REV. 971, 973 (footnotes omitted).

21 *See* Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. U. L. REV. 847, 869-71 (2000).

courts approach contract interpretation problems. Even there, neoclassical principles constantly challenge the classical dogma, and those alternative principles often prevail. Thus, with contract interpretation as only a partial exception, the U.C.C. and the second Restatement have succeeded in establishing a body of contract law based far more on flexible standards and judicial discretion sensitive to context than on the more rigid rules and perspectives of the earlier era.

The surviving contest among theories in the contemporary cases, if there is one, pits the dominant neoclassical approach against its modern competitors—especially economic analysis, relational contract, and neoformalism. These alternative theories share some broad themes. For example, proponents of neoformalism frequently present empirical studies "and an economic-type of analysis asserting that, ultimately, it is better—because it is more efficient—for courts to interpret contracts using a more formal approach and it would be better if our governing law would prompt or compel them to do so."[22] This marks neoformalism as at least partially supported by the efficiency thesis of economic analysis. Additionally, some versions of neoformalism converge with relational contract in their shared concern over the proper judicial role in interpreting incomplete contracts. In this vein, an argument for formalism in relational contract has been advanced.[23] The literature reveals an even stronger correspondence between economic analysis and relational theory. Again, the shared interest in empirical research and efficient results permeates much of the work in both schools of thought.

Thus, although the three leading alternative theories proceed from distinct organizing principles, they coexist as competing reactions against the dominant, neoclassical model. While this competition rages among scholars, it barely registers in the reported cases. At least as reflected in a practical sense through the contemporary construction industry cases, the economic, relational, and neoformalist frameworks—which I will sometimes refer to collectively as the modern theories—tend to supplement the neoclassical conception of contract more than they contradict it.

In concluding this highly abbreviated overview of contract theory, I wish to reemphasize a core feature that separates classical contract and neoformalism not only from the neoclassical conception, but also from the economic and relational theories. Rejecting the classical commitment to universal principles, these alternative theories incorporate significant contextual considerations. "The contextual approach focuses upon particular types of contracts within a relevant business or social setting rather than upon contracts in general.... If, because of abstractness, formality, or rigidity, the theory is neither fungible from context to context nor responsive to the realities of the particular case, the result is likely to be 'hard cases make bad law,' judicial fudging,

22 Wood, *supra* note 20, at 973.

23 *See* Scott, *supra* note 21, at 848.

or rejection."[24] While the neoclassical perspective first promoted the idea that context matters, in some respects, the relational literature, with its emphasis on flexibility, customs, and the behavioral dynamics of ongoing exchange transactions, evinces an even greater contextual approach. To one extent or another, however, all the alternatives to classical contract theory (save neoformalism) emphasize the context in which transactions and transactional disputes occur. Thus, contextualization stands as one of the most prominent characteristics of the reactions against classical contract. Contract law has moved distinctly from abstract rules of general application to more particularized principles applied to distinct kinds of contracts.[25] The remainder of this chapter repeatedly calls attention to the proposition that contemporary construction contract law in particular demonstrates a highly contextual flare. In this sense, the construction industry cases have often stood in the forefront of contract's evolutionary story.

Before turning to the theoretical underpinnings of selected contemporary trends in contract law, the next section further examines the period commonly regarded as the classical era. Cases decided from the middle of the nineteenth century to nearly the middle of the twentieth gave birth to the classical framework of the first Restatement. Contract law during that time, however, was hardly monolithic in its theoretical framework.

The dubious reign of classical contract

Whether there ever was a golden era of classical contract remains an open question. Until well into the nineteenth century, a coherent body of contract law either did not exist or it lacked adequate articulation. Williston, and later the first Restatement, for which he served as chief reporter, crystalized the classical framework. For at least a few decades, under Williston's influence, contract law allegedly embodied classical contract's general principles and its derivative doctrinal rules designed to determine the outcomes of all kinds of contract disputes. This it purported to accomplish mostly without deliberate reference to context.

Assuming classical contract principles reigned when Williston first published his treatise, a treasonous conspiracy lurked close behind. As already noted, competing theories began to emerge by early in the twentieth century, and the classical conception has fomented debate and dissent ever since. In 1974, amidst the academic rejection of classical contract and the corresponding ascendancy of the neoclassical and modern theories, Grant Gilmore famously indicted the whole of contract law. He purported to demonstrate that Langdell, Williston, and Holmes had fraudulently manufactured the field in

24 Richard E. Speidel, *An Essay on the Reported Death and Continued Vitality of Contract*, 27 STAN. L. REV. 1161, 1173–74 (1975).

25 *See, e.g., id.*

service of commercial interests. Gilmore's accusations, while deliberately overstated for his purposes, helped focus scholarly attention on the law's conception of contract. It did little to reform contract theory, however, nor did it need to perform that function. By the time Gilmore published *The Death of Contract*, the theoretical debate had reached full bloom in multiple arenas. The legal realists had long before created widespread suspicion of the prevailing contract doctrine, the Uniform Commercial Code had already conquered the law of sales, and drafts of the second Restatement promised to legitimize Corbin's reconstituted conception. To make matters even less settled, CLS was seeking to topple the entire structure, and the economists and other social scientists were creating new and compelling methodologies for explaining and reassessing contract along with every other aspect of the law.

These fascinating challenges to classical contract's legitimacy, however, cannot deny its reflection in cases decided from at least the final decades of the nineteenth century until well into the twentieth. Many leading construction industry cases from this period reinforce the impression that the courts generally accepted the classical conception even while they also sometimes hinted at alternative notions. Cases from this purportedly classical period include the seeds of the neoclassical conception. In effect, the classical-neoclassical debate played out in subtle ways throughout the period. As the following discussion shows, while classical contract theory officially claimed the throne for a time, it never ruled over the realm in peace.

The two sections that follow consider discrete aspects of the construction industry story during the classical era. Even then, construction industry cases and industry contracting practices were demonstrating a bent suggestive of neoclassical values and contextualism. The first of these two sections considers leading construction contract decisions from the U.S. Supreme Court to demonstrate that neoclassical tendencies have a long history in the industry cases. The second one shows how the industry developed flexible (and more efficient and relational) practices that successfully evaded two inaptly rigid rules of classical contract.

Contract theory and the U.S. Supreme Court cases

The U.S. Supreme Court's construction contract cases provide a unique opportunity to examine early deviations from the classical perspective. These cases are interesting in their own right simply because they came down from our highest court at a time when ordinary contract cases still seasoned its docket. Moreover, they provide a unique opportunity to characterize U.S. contract law during its formative years because they constitute a line of cases reflecting a singular judicial perspective on U.S. contract law that would not otherwise have been possible under our system, in which the common law varies from one state to another. During the nineteenth and early twentieth centuries, the U.S. Supreme Court decided many construction contract cases, only a relatively small number of which receive attention in Chapter 4 as leading or

particularly influential. Some of the Court's more routine contract decisions also disclose something about how contract law evolved even as Langdell and Williston promoted their vision. Although the Court's contract jurisprudence provides considerable support for the classical conception of the time, it also anticipates a more flexible and contextual framework. The tension between classical and neoclassical principles, and perhaps even elements of the modern theories, was already in the air.

To be sure, some of the Court's decisions manifest a thoroughly classical strain. Language from an 1864 case, for example, articulates the classical commitment to the sanctity of contract: "It is a well-settled rule of law, that if a party by his contract charge himself with an obligation possible to be performed, he must make it good, unless its performance is rendered impossible by the act of God, the law, or the other party. Unforeseen difficulties, however great, will not excuse him."[26] On this basis, the Court left the risk of unanticipated site conditions on a builder who had agreed to perform the work for a fixed price under a contract that did not expressly contemplate pricing adjustments for changing circumstances. Later cases rejecting contractors' claims for additional compensation due to developments not expressly contemplated by the contract language reflect a similar attitude.[27] The Court also evidenced its commitment to conventional doctrine in early cases enforcing provisions in construction contracts that granted broad discretion to an individual beholden to the government owner to determine whether contractual conditions had been satisfied.[28] As recounted in Chapter 4, the Court continued to confirm its holdings on this issue well into the twentieth century, until Congress intervened to provide limited protections against potential abuses. Also, in a series of cases involving compensation for architectural services, the Court followed the classical resistance to accepting evidence of trade custom and usage to vary established rules of contract law.[29] Other cases the Court decided well into the twentieth century equally demonstrate the classical penchant for formalistic reasoning based on fixed rules.[30]

Some cases, however, hinted at more flexible possibilities even as they invoked classical rules. For example, in *Clark v. United States*, decided in 1867, the Court used a classical framework to analyze a contractor's damage claim under a federal construction contract.[31] The decision upheld a contractor's right to recover for damages the government caused after the

26 Dermott v. Jones, 69 U.S. 1, 7 (1864).

27 *See* Day v. United States, 245 U.S. 159 (1917); United States v. Normile, 239 U.S. 344 (1915).

28 Martinsburg & P.R. Co. v. March, 114 U.S. 549 (1885); Sweeney v. United States, 109 U.S. 618 (1883).

29 United States v. Cook, 257 U.S. 523 (1922); Lord v. United States, 217 U.S. 34 (1910); Smithmeyer v. United States, 147 U.S. 342 (1893); Tilley v. Cook Cty., 103 U.S. 155 (1880).

30 *See, e.g.*, United States v. Howard P. Foley Co., 329 U.S. 64 (1946); United States v. Blair, 321 U.S. 730 (1944); United States v. Rice, 317 U.S. 61 (1942).

31 Clark v. United States, 73 U.S. 543 (1867).

claimant's own default. The Court reasoned that the contractor's obligations under the contract were independent of the government's. In a step beyond this formalistic analysis, the Court arguably signaled a willingness to impose a duty of good faith on the government as a contracting party. The Court explained that once the government decided to allow the contractor to continue working on the project beyond the agreed completion date, the government "surely had acquired no right to compel him to do it in a manner which necessarily involved him in great loss."[32] In that regard, the case seems surprisingly indicative of neoclassical and even relational contract principles. The Court arguably sent similar signals in an 1883 case treating decisions by government officials and agents as implied representations upon which the building contractor had a right to rely.[33] The written terms of the contract could be read to place on the contractor the risk of certain site conditions upon which the claim for additional compensation depended. The Court, however, declined the invitation to interpret the contractual language in isolation, concluding instead that "the meaning of the parties, explained by the circumstances attending the transaction, is sufficiently plain, and determines satisfactorily their relative rights and obligations." [34]

The results of several early twentieth century decisions also sowed seeds of reform. For example, while a conventional perspective on material default apparently determined a 1919 case excusing a subcontractor's failure to perform after the prime contractor withheld payments, the Court's opinion twice referred to its understanding of how parties to a long-term construction contract presumably view the role of regular progress payments.[35] A year later, in enforcing a no-damage-for-delay clause, the Court also reflected the sanctity of contract mentality.[36] But once again the opinion's regard for context and its attention to relational considerations deviate notably from the classical mindset: "Men who take $1,000,000 contracts for government buildings are neither unsophisticated nor careless. Inexperience and inattention are more likely to be found in other parties to such contracts than the contractors, and the presumption is obvious and strong that the men signing such a contract as we have here protected themselves against such delays as are complained of by the higher price exacted for the work."[37] A few years later, the Court employed a similar doctrinal approach to enforce a liquidated damages clause, but only after taking note of the specific role that such a provision plays among participants in a construction project.[38]

32 *Id*. at 546.
33 United States v. Gibbons, 109 U.S. 200, 204-05 (1883).
34 *Id*. at 203.
35 Guerini Stone Co. v. P.J. Carlin Const. Co., 248 U.S. 334, 344-45 (1919).
36 Wells Bros. Co. of New York v. United States, 254 U.S. 83 (1920).
37 *Id*. at 86-87.
38 Robinson v. United States, 261 U.S. 486, 488 (1923).

The Court made its most important and lasting contribution to the law governing construction industry contracts in a series of cases spread over 15 years, ending in 1920. These decisions imposed implied obligations on the federal government in its role as a contracting owner. The first two cases held the government responsible for inaccurate information the government included in the contract documents and upon which the contractors relied.[39] Then in *Spearin*, the most famous of the cases, the Court announced a rule of general application in such cases.[40] *Spearin* holds that by specifying detailed design information to direct the contractor's work, the government impliedly warrants the adequacy of those plans and specifications for the project. Finally, in *United States v. Atlantic Dredging Co.*, the court held the government liable for extra costs where the government had important details about site conditions that it failed to include in the site information provided to the contractor.[41] None of the opinions cite express contractual language supporting the holdings. Chapter 4 has already addressed these decisions, and I mention them again here only to note their implications for contract theory.

These four opinions, whether considered individually or collectively, represent no open departure from the contract law of the time. Nor do they explicitly proceed from any novel conception of contract. Common law courts have been implying terms into contracts as far back as Lord Mansfield's announcement of the constructive conditions of exchange doctrine.[42] In several senses, however, these decisions tend toward more modern, contextual notions. First, all four cases place controlling weight on the contractor's reasonable reliance on the statements or behavior of the government as a justification for imposing a contractual obligation. Second, in each case, the Court resisted the government's appeal to adhere rigidly to the express terms of the parties' written agreement—an argument squarely aligned with classical contract. This appears most clearly in *Spearin*, where the Court reasoned: "This implied warranty is not overcome by the general clauses requiring the contractor to examine the site, to check up the plans, and to assume responsibility for the work until completion and acceptance."[43] Finally, in each case the Court took note of the transactional context, particularly observing the logical connection between the government's behavior in its role as project owner and the contractor's reliance on that behavior in light of the situation. Owners furnish design details and site-condition information to prospective contractors as a basis for pricing the work. The Court recognized that those circumstances anticipate a degree of reasonable reliance notwithstanding contractual disclaimers.

39 Christie v. United States, 237 U.S. 234 (1915); Hollerbach v. United States, 233 U.S. 165 (1914).

40 United States v. Spearin, 248 U.S. 132 (1918).

41 United States v. Atl. Dredging Co., 253 U.S. 1 (1920).

42 *See* Kingston v. Preston (1773) 99 Eng. Rep. 437; 2 Doug. 689 (KB).

43 *Spearin*, 248 U.S. at 137 (footnotes omitted).

The Court's implied duty holdings might have been limited strictly to public contract cases, reflecting some special judicial concern for governmental overreaching. Instead, in many jurisdictions, they serve as the precedents for any situation in which a contractor accuses a project owner of unfairly providing inaccurate information or failing to provide important information uniquely within the owner's knowledge. Properly understood, the rules from these decisions do not determine outcomes in future cases. They provide guidance, but courts must use judgment to apply the holdings to particular disputes. By definition, this process assumes the neoclassical and contextual concept of contract.

This account has focused on selected U.S. Supreme Court construction contract cases from the late nineteenth and early twentieth centuries as an especially accessible sampling of opinions presaging neoclassical notions. During that same period, state court opinions showed similar inclinations. Indeed, state courts provided the earliest authority for reading implied duties into construction contracts.[44] A few other prominent examples will suffice to conclude this discussion. A Minnesota Supreme Court decision in 1895 applied the formalistic preexisting duty rule to invalidate a contract modification not supported by fresh consideration while also articulating the changed circumstances exception that ultimately helped to bring about the rule's demise.[45] Another leading example is the California Supreme Court's analysis in 1916 accepting a defense of commercial impracticality as the legal equivalent of impossibility.[46] Finally, some of the early bidding error cases signaled a relaxation of the first Restatement's more rigid rules on the defense of mistake by emphasizing considerations of unconscionability or general concepts of fairness.[47]

The cases in this section show notable deviations from the classical conception even before the publication of the first Restatement, but they do not deny that classical contract dominated the jurisprudence of the time. Before moving on to the role construction industry cases played in the actual transition toward the modern understanding of contract, the next section briefly recounts two significant instances in which the consistent allegiance of courts to rigid rules during the classical era inspired reforms in industry practices.

The industry rejects two classical rules

These two lines of construction contract cases reflecting classical principles stand out because of how contracting parties in the construction industry

44 *See* MacKnight Flintic Stone Co. v. City of New York, 160 N.Y. 72, 54 N.E. 661 (1899); Bentley v. State, 41 N.W. 338 (1889); Filbert v. Philadelphia, 181 Pa. 530, 37 A. 545 (1897).

45 King v. Duluth, M. & N. Ry. Co., 63 N.W. 1105 (1895).

46 Mineral Park Land Co. v. Howard, 156 P. 458 (Cal. 1916).

47 *See, e.g.*, Barlow v. Jones, 87 A. 649, 650 (N.J. Ch. 1913); Bd. of Sch. Comm'rs of City of Indianapolis v. Bender, 72 N.E. 154 (Ind. App. 1904). *See generally* 7 CORBIN ON CONTRACTS § 28.40 (Lexis 2018).

reacted to them. The rules involved were so inapt as a practical matter that the industry developed alternative contracting practices to work around them.

The first in this category involves cases in which builders sought relief after discovering conditions at the project site that differed materially from what they anticipated. These circumstances often threatened devastating financial consequences for a builder operating under a fixed-price contract. Invariably, the contractor had based its bid or price proposal on some assumptions about site conditions. The unexpected conditions typically involved underground conditions, such as excess rock that the builder had to remove. The early cases on differing site conditions generally applied a harsh rule that left the risk of most unanticipated site conditions on the contractor if the contract provided for a fixed price.[48] The preceding section of this chapter has already noted the U.S. Supreme Court's reliance on this rule. Under this classical concept, even when an owner agreed to a post-contract price increase after the contractor complained about the unanticipated condition, another stalwart principle of classical contract, the pre-existing duty rule, threatened to render the contract modification unenforceable.[49]

Although the courts began to grant relief in limited circumstances in which the contractor could make a credible claim of owner misrepresentation or deficient owner-furnished plans and specifications, the general rule of the cases remained relatively inflexible. So much so that contractors routinely started to include large contingencies in their bids and price proposals to cover the risk of differing site conditions. Project owners eventually realized that it was more efficient for them to avoid these contingency pricing practices by retaining a properly defined risk of differing site conditions. As Chapter 5 explains in greater detail, the federal government led in this movement to include differing-site-conditions clauses in most contracts to allow for price adjustments when the circumstances warranted. Other owners, public and private, soon followed suit. Arguably, under an approach influenced by evolving neoclassical contract principles concerning changed circumstances, courts may eventually have developed better alternative rules granting relief to contractors under appropriate conditions. The change in contracting practices in the industry, however, obviated any need for such reform.

The *Severin* doctrine, also covered in Chapter 5, represents a similar line of cases evidencing a classical approach, albeit one that involves a much narrower problem in the industry. The situation can arise when a subcontractor has a legitimate claim against the prime contractor for additional compensation for which the project owner should ultimately be responsible to the prime contractor. Industry subcontracts sometimes limit the prime contractor's obligation on the claim to whatever amount the prime can collect from

48 *See, e.g.*, Harrison Granite Co. v. Stephens, 125 N.W. 36 (Mich. 1910); Lonergan v. San Antonio Loan & Tr. Co., 104 S.W. 1061 (Tex. 1907).

49 *See, e.g.*, King, 63 N.W. 1105.

the owner. In *Severin v. United States*, the United States Court of Claims used a literal interpretation of subcontract language under these circumstances to prevent a prime contractor from pursuing a claim on a subcontractor's behalf.[50] The court read the subcontract as completely exculpating the prime contractor from liability for any damages the owner caused to the subcontractor. On that basis, the court held that the prime could not sponsor the claim against the owner for the subcontractor's benefit. A highly formalistic analysis determined the result in the case, which in turn gave rise to the *Severin* doctrine being recognized in many similar instances. Although a modern view of contract might have encouraged a more contextual approach to interpreting a provision limiting a prime contractor's potential liability to a subcontractor, *stare decisis* made that problematic, at least in the federal contract cases, where the doctrine most commonly arose.

Construction lawyers eventually learned to solve this problem by drafting subcontracts more carefully. One successful technique, for example, explicitly preserves the subcontractor's claim against the prime contractor for damage caused by the owner, but limits recovery to whatever amount the prime is ultimately successful in securing on that claim from the owner. The courts have not hesitated to honor these arrangements. One might even say that, with the help of clever lawyers, the federal courts adopted a more flexible (neoclassical) understanding of the *Severin* Doctrine.

Those who would promote the value of certainty in the law of contracts, including perhaps the neoformalists, might use these two developments in industry contracting practices to defend inflexible rules. When contract law follows fixed rules, the argument goes, contracting parties are forewarned and remain free to adjust the express terms of their bargains accordingly. Those with a more particularized vision for contract law would respond that when courts develop or apply a fixed rule without regard to context they needlessly make law irrational, inefficient, and unjust. Contemporary contract law leans toward the latter view. As the balance of this chapter demonstrates, in the transition away from the classical conception, several prominent construction industry cases have led the way, and others have helped solidify neoclassical (and occasionally other more modern) sensibilities. It will not be surprising that the most significant of these cases concern topics already noted above or covered in earlier chapters.

Evolving trends, the U.C.C., the second Restatement, and the influence of industry cases

The substantial performance cases discussed in Chapter 2 offer some of the earliest examples of this phenomenon. Section 237 of the second Restatement conditions a party's obligation to perform under an exchange of promises on

50 Severin v. United States, 99 Ct. Cl. 435 (1943).

the absence of any "uncured material failure by the other party to render any such performance due at an earlier time."[51] Section 241 of the second Restatement provides notoriously subjective (neoclassical) guidelines for determining when a breach is material.[52] The substantial performance doctrine addresses that subjective concept. Cardozo popularized the modern understanding of substantial performance with his analysis in the famous residential building case *Jacob & Youngs, Inc. v. Kent*.[53] His explanation in that case, decided well before the neoclassical conception had achieved recognition, manifested a modern judicial tolerance for applying an indeterminate standard to particular circumstances. "The rule that gives a remedy in cases of substantial performance with compensation for defects of trivial or inappreciable importance has been developed by the courts as an instrument of justice."[54] The conclusion that the builder's breach was not fatal turned on evidence that pipe the builder used was functionally comparable to what the owner's design had specified. Ever since, building contractors have succeeded in enforcing their contractual payment rights notwithstanding their own failures to perform fully. In other transactions, the substantial-performance doctrine may still seem too indeterminate, but it has produced this well-understood application in industry cases. Substantial performance generally occurs when the builder has completed the work to such an extent that the owner can use the project for its intended purpose.

The economic-waste doctrine, again discussed in Chapter 2, bears a close relationship to the substantial-performance doctrine, both logically and theoretically. The doctrine also achieved widespread acceptance following Cardozo's *Jacob & Youngs* opinion. This principle alters the measure of damages for an immaterial breach when the court determines that an award equal to the costs of correcting the defective performance would be unfairly disproportionate to the economic loss involved. Under those circumstances, the economic waste cases limit the non-breaching party's recovery to the difference between the value of the promised and the defective performance. [55] Commentators level harsh criticisms against many opinions applying the economic waste doctrine outside of the construction industry.[56] Within the industry, however, this discretionary standard for avoiding disproportionate damages when a builder substantially performs enjoys broad acceptance as a practical

51 RESTATEMENT (SECOND) OF CONTRACTS § 237 (Am. Law Inst.1981).

52 Id. at § 241.

53 Jacob & Youngs, Inc. v. Kent, 129 N.E. 889 (N.Y. 1921).

54 *Id*. at 892.

55 *Id*. at 889-891.

56 *See, e.g.*, Alan Schwartz & Robert E. Scott, *Market Damages, Efficient Contracting, and the Economic Waste Fallacy*, 108 COLUM. L. REV. 1610 (2008); Juanda Lowder Daniel & Kevin Scott Marshall, *Avoiding Economic Waste in Contract Damages: Myths, Misunderstanding, and Malcontent*, 85 NEB. L. REV. 875 (2007); Carol Chomsky, *Of Spoil Pits and Swimming Pools: Reconsidering the Measure of Damages for Construction Contracts*, 75 MINN. L. REV. 1445 (1991).

and fair check against excessive awards.[57] To the extent that the critics correctly attack the doctrine, they cast doubt on its efficacy as a general principle of contract law, but not necessarily as a sensible standard in the industry cases. The doctrine's acceptance in the construction industry setting illustrates the neoclassical (and relational) idea that justice and efficiency sometimes require particularized rules rather than generalized ones. As if to underscore that point, the second Restatement's section 348(a) expressly links the economic waste limit on damages to the construction industry.

Perhaps no single case from any segment of commerce symbolizes the transition away from classical contract any better than does *Drennan v. Star Paving Co.*[58] Once again, Chapter 2 has already highlighted this important development. The case held that a subcontractor's price proposal to a prime contractor became irrevocable when the prime relied on it in calculating its own proposal in a competitive bidding process. Justice Traynor penned this influential decision just as the jurisprudence of the legal realists and the U.C.C. were coming to the fore. It drew whatever claim it had to legitimacy from a creative embellishment of the promissory estoppel principle of Section 90 of the first Restatement. In turn, it inspired the second Restatement to elevate the reliance principle in its new Section 87(2). There, the Restatement essentially paraphrases Traynor's formula in this way: "An offer which the offeror should reasonably expect to induce action or forbearance of a substantial character on the part of the offeree before acceptance and which does induce such action or forbearance is binding as an option contract to the extent necessary to avoid injustice." Section 87(2) and *Drennan* remarkably reformed the common law principles of offer and acceptance and bargained-for consideration. The decision is not only neoclassical, but also distinctly relational. Traynor explained that the subcontractor "presented its bid with knowledge of the substantial possibility that it would be used by plaintiff; it could foresee the harm that would ensue from an erroneous underestimate of the cost. Moreover, it was motivated by its own business interest."[59] The opinion also suggests an economic rationale. "As between the subcontractor who made the bid and the general contractor who reasonably relied on it, the loss resulting from the mistake should fall on the party who caused it." Critics continue to debate both the legitimacy of Traynor's analysis and the wisdom of Section 87(2) as a general principle of contract law. Just as is true of the economic waste doctrine, however, the *Drennan* principle stands as a fundamental precept of contract law in the construction industry cases. For better or for worse, it also continues to exercise considerable influence in other settings.

57 *See* 5 Philip L. Bruner & Patrick J. O'Connor, Jr., Bruner and O'Connor on Construction Law § 18:13 (Westlaw 2018).

58 Drennan v. Star Paving Co., 333 P.2d 757 (Cal. 1958).

59 *Id.* at 761.

As also suggested by their inclusion in Chapter 2 and their mention previously in this chapter, the industry cases on two other issues deserve recognition for influencing the modern direction of contract law, although the connecting lines are not as direct as those attached to *Jacob & Youngs* and *Drennan v. Star Paving Co.* I speak of the cases promoting the contemporary principles governing unilateral mistake and those that helped inflict a mortal wound to the pre-existing duty rule.

At least through the early decades of the twentieth century, contract law recognized no coherent defense based on unilateral mistake. The very idea clashed at its core with the objective-intent principle of the first Restatement. Even so, commentators at the time had to contend with a line of cases that hinted at the defense.[60] Construction industry cases were among the most prominent ones questioning the prevailing rule. The situations typically involved substantial but innocent and understandable errors in a competitive bid calculation. When the evidence showed that the other party knew or had reason to know of the mistake, courts sometimes excused the mistaken party on the formalistic basis that the parties had not reached a meeting of the minds. That reasoning comported well enough with the objective, bargained-for exchange theory of the time. A pattern of cases on facts especially sympathetic to the mistaken party, however, continued to press the argument for a more flexible rule.[61] Industry cases planted the seeds for a revised standard on unilateral mistake that refused to hold the mistaken bidder to the contract when the court concluded that doing so would be unconscionable.[62] If ever the common law of contract prior to the second Restatement admitted of an indeterminate and flexible principle, this was it. The idea took hold in Section 153 of the second Restatement. Under that section, where a mistake as to a basic and material assumption has an adverse effect on the mistaken party, the court will grant relief if "the effect of the mistake is such that enforcement of the contract would be unconscionable."[63] That unabashed commitment to the vague idea of conscionability, so frightful to the world of classical contract, fit comfortably into the new era of the U.C.C. and the second Restatement.

The assault on the pre-existing duty rule has a longer and more varied history, but the industry cases also distinctly influenced that reform. The pre-existing duty rule derived logically from the centrality of consideration under classical contract principles. Because, under the traditional formula, an enforceable promise requires consideration, the rule provided that a contracting party's

60 Edwin W. Patterson, *Equitable Relief for Unilateral Mistake*, 28 COL. L. REV. 859 (1928); Roland R. Foulke, *Mistake in the Formation and Performance of a Contract*, 11 COL. L. REV. 197, 197 (1911).

61 *See, e.g.*, Barlow v. Jones, 87 A. 649 (N.J. Ch. 1913); Bd. of Sch. Comm'rs of City of Indianapolis v. Bender, 72 N.E. 154 (Ind. App. 1904).

62 *See* Wil-Fred's, Inc. v. Metropolitan Sanitary Dist., 372 N.E.2d 946 (Ill. Ct. App. 1978).

63 RESTATEMENT (SECOND) OF CONTRACTS § 153 (Am. Law Inst.1981).

mere commitment to perform an already binding duty could not support a modification to the contract. Some of the earliest cases testing the rule involved seamen who negotiated for pay increases mid-voyage, often under circumstances suggesting the exercise of duress against their captains.[64] Understandably, courts showed little sympathy. Given a classical contract mentality that required fixed, universal rules, the courts announced a broad principle that required new consideration for a contract modification. As a result, the party who agreed to the modification could later refuse to honor the new terms by showing that it received nothing in exchange for the concession beyond the other party's promise to perform its already enforceable obligations.

In the construction industry, however, changing or unanticipated circumstances frequently occur that can affect the intended bargain in ways that the parties may wish to address through seemingly one-sided modifications. Under those circumstances, why should the parties' ability to adjust the terms of their contract in a sensible way be subject to a rule developed for different circumstances? As noted earlier in this chapter, one such situation regularly occurs under a fixed-price contract when the contractor discovers unusual site conditions. In time, courts began to enforce these modifications to construction contracts when the specific circumstances warranted.[65] Owing in no small measure to the experience in construction industry cases, the second Restatement adapted accordingly via its Section 89(a). According to the Restatement, an agreed modification to a party's obligations under an executory contract is binding without consideration "if the modification is fair and equitable in view of circumstances not anticipated by the parties when the contract was made."[66] In this way, a rule too indeterminate for the classical mindset now performs a journeyman's work. Today, the pre-existing duty rule has lost the force of a general rule of contract law.[67] Indeed, influenced by the UCC's outright abandonment of the rule, it has simply disappeared in many jurisdictions for all purposes.[68]

As time went on, construction industry cases contributed to many other rules and principles that help define modern contract law in a neoclassical frame, albeit with less impact than those discussed to this point. Chapters 3 and 5 cover several of these topics. Drawing primarily on those lines of cases, the next section provides an overview of neoclassical and other modern elements that are more specific to the construction industry.

64 *See* Burton F. Brody, *Performance of a Pre-Existing Contractual Duty as Consideration: The Actual Criteria for the Efficacy of an Agreement Altering Contractual Obligation*, 52 DENVER L.J. 433, 436-37 (1975); Alaska Packers' Ass'n. v. Domenico, 117 F. 99 (9th Cir. 1902).

65 *See* Hazel Glenn Beh, *Allocating the Risk of the Unforeseen, Subsurface and Latent Conditions in Construction Contracts: Is There Room for the Common Law?*, 46 KAN. L. REV. 115, 120-24 (1997).

66 *See* RESTATEMENT (SECOND) OF CONTRACTS § 89(a) (Am. Law Inst.1981).

67 *See* Corneill A. Stephens, *Abandoning the Pre-Existing Duty Rule: Eliminating the Unnecessary*, 8 HOUS. BUS. & TAX L. J. 355 (2008).

68 *See* U.C.C. § 2-209(1).

Distinctive trends in the industry cases

Several of the most controversial or distinctive contract issues present in the industry cases underscore a text versus context divide. A few even suggest judicial inclinations toward economic or relational analysis, although the overwhelming majority stay well within the bounds of the classical and neo-classical conceptions. This section briefly highlights the most contentious or peculiar of these issues in the contemporary cases. Because courts sometimes disagree radically on these topics—some might even say the cases are in disarray—the discussion here will be on the major themes the cases present rather than on the details of the law in any jurisdiction.

In the contemporary cases, the enforceability of conditional payment clauses stands first among these controversial issues.[69] Judicial perspectives vary greatly on these contractual provisions, which typically take the form of "pay-when-paid" or "pay-if-paid" clauses in contracts between general contractors and their subcontractors. General contractors use conditional payment provisions to shift to subcontractors part of the credit risk of dealing with the project owner, with whom only the general contractor and not the subcontractor has a direct relationship. Invoking a strong commitment to freedom of contract, some courts defend a formalistic approach that honors these provisions as written. Many other courts, however, severely restrict these clauses. Justifications for limiting enforceability range from strained interpretations of clear contract language to forthright rejection of the intended risk reallocation on public policy grounds. Sounding a refrain common to economic analysis, arguments to limit enforceability often seem influenced by the objective of "visiting a loss on that party best able to control and bear it."[70] A leading decision refusing to give literal force to a conditional payment clause emphasized what the court perceived to be the normal and logical expectations created by the owner-contractor-subcontractor structure.[71] In this, the court embraced a contextual approach and even arguably implied sensitivity to economic analysis or relational contract notions.

Cases ruling on the enforceability of no-damage-for-delay clauses similarly illustrate the ongoing battle between textual and contextual approaches in industry cases.[72] Owners use these clauses to protect themselves from having to pay delay damages to contractors. Once again, in the name of freedom of contract, some courts take a strictly formalistic view and honor an unambiguous limitation on damage liability. Other courts curtail enforceability of these clauses on context-laden policy grounds, including "overarching implied

69 1A Bruner & O'Connor, *supra* note 57, at § 3:48; William M. Hill & Mary-Beth McCormack, *Pay-If-Paid Clauses: Freedom of Contract or Protecting the Subcontractor from Itself*, Construction Law., Winter 2011, at 26.

70 1A Bruner & O'Connor, *supra* note 57, at § 3:48.

71 *See* Thos. J. Dyer Co. v. Bishop Int'l Eng'g Co., 303 F.2d 655, 660-61 (6th Cir. 1962).

72 *See* 5 Bruner & O'Connor, *supra* note 57, at §§ 15:75-15:79.

obligations read into every express contract; namely, (1) the implied obligation of good faith and fair dealing, (2) the implied obligation of cooperation and (3) the implied obligation of noninterference."[73] These cases, therefore, align with a neoclassical approach.

Next, consider a group of loosely related breach of contract doctrines developed in the construction industry cases that also reflect a markedly contextual approach. Each of these doctrines uses a semantic device or legal fiction to afford one of the parties a remedy seemingly in conflict with an express contract provision. Because the federal contract cases have played a special role in developing these doctrines, Chapter 5 deals with them at some length. While each of these doctrines holds a settled place under federal contract law, the state law cases vary considerably, with some jurisdictions using a classical framework to reject one or more of these doctrines. It will suffice here merely to note how the cases that endorse each doctrine employ contextual approaches that eschew formalistic rules in favor of a flexible principle in keeping with the neoclassical framework.

The cardinal change doctrine relieves a contractor from the most extreme risks of an owner's unilateral right to insist on modifications pursuant to a contract's changes clause.[74] Most construction contracts give the owner broad authority to direct changes to plans and specifications and otherwise to modify the work and other obligations the contractor must perform. When a court characterizes an owner's order or conduct as a "cardinal change," it usually means that the owner has materially breached the contract by requiring a change to the contractor's obligations that goes too far in some ill-defined sense. As a result, the offended contractor need not comply and may even have a defense to continued performance under the contract. The underlying reasoning is that the change goes beyond what the parties contemplated when they agreed to the contract's changes clause. The analysis is often distinctly contextual because it relies on customary understandings, industry practices, or judicial common sense to impose a limit on the owner's right to make unilateral changes to the contract. Consider, for example, a Nevada case in which a contractor complained about the cumulative effects of several instructions that the project's construction manager gave and various "obstructions, hindrances, and inefficiencies that rendered its work more difficult and costly as a result of these changes and other major problems, as well as more minor inconveniences."[75] In holding for the contractor, the court forthrightly acknowledged that the precedents offered no precise formula to identify a cardinal change. As the controlling consideration, the court offered this manifestly indeterminate standard: "a cardinal change occurs when the work is so drastically altered that the contractor effectively performs

73 *Id.* at § 15:75.

74 *See generally*, 1A BRUNER & O'CONNOR, *supra* note 57 at § 4:13.

75 J.A. Jones Const. Co. v. Lehrer McGovern Bovis, Inc., 89 P.3d 1009, 1012 (Nev. 2004).

duties that are materially different from those for which the contractor originally bargained."[76] Such a test revolts against the fixed rules of the classical conception of contract.

The constructive change doctrine operates as a kind of counterpart to the cardinal change idea by allowing a contractor to seek relief under a contractual changes clause even though no change was directed or agreed to in accordance with the express terms of the contract.[77] A contractor may claim a constructive change when the owner interprets the plans and specifications to require something different from the contractor's reading or when the contractor believes that the owner's acts or omissions in some other way impair or complicate performance of the work. Some state courts have resisted the constructive change analysis and instead have approached these disputes by an alternative route that does not require a relaxed reading of the contractual text. Proceeding along these lines, the Mississippi Supreme Court held that Mississippi does not recognize the constructive change doctrine, but it does allow for "extra compensation without regard for written change orders where the owner imposes extra-contractual work while denying change order requests."[78] The constructive suspension and constructive acceleration doctrines are analogous to the constructive change doctrine, but with reference to two other provisions commonly included in construction contracts. These doctrines allow a contractor to prosecute a claim under a contract's suspension or schedule acceleration clauses or its claims procedures even though the owner has not openly directed suspension of work or accelerated performance under the applicable contractual provisions.[79] Finally, the constructive termination for convenience doctrine gives the owner the option to convert a wrongful termination into a contractually permitted one.[80] This doctrine is primarily a creation of federal contract law practices, and it effectively permits the government to reduce its liability for having terminated the contractor wrongfully under the contract's termination for cause procedures. It works this trick by retroactively recharacterizing the termination as one pursuant to the contract's termination for convenience clause. Note that under each of these doctrines, the adjective "constructive" signals that the court is engaging in creative rationalization. Although the owner has explicitly, often adamantly, refused to invoke the changes, suspension, acceleration, or at-will termination provision of the contract, the court enters a judgment as if the owner had done so.

To a more limited extent, some of the specialized damages principles developed in the federal cases, which Chapter 5 also covers in greater detail,

76 *Id*. at 1020.

77 *See* 1A BRUNER & O'CONNOR, *supra* note 57, at § 4:25.

78 Sentinel Indus. Contracting Corp. v. Kimmins Indus. Serv. Corp., 743 So. 2d 954, 965 (Miss. 1999).

79 *See generally* 5 BRUNER & O'CONNOR, *supra* note 57, at §§ 15:87, 15:94.

80 *See Id*. at §§ 18:37, 18:45 & 18:45.50.

reflect similar contextual maneuvers. These include instances in which the courts have relaxed the standards for proving damages that are undeniable but difficult to establish with certainty,[81] as well as those in which the courts have tailored damage methodologies, such as through the Eichleay formula,[82] based on construction industry accounting practices. Beyond the federal contract cases, a contextual approach was also at work when the courts developed the economic waste doctrine to constrain damages recoverable when a builder substantially performs yet technically fails to comply precisely with contractual plans and specifications.[83] While these damage issues do not necessarily implicate fundamental conceptions of contract to the same extent as do the other topics discussed in this section, they have inspired highly contextual analyses. "The need for damage measurement approaches suited to the construction process has resulted in the development of construction contract remedies and damage measures unique in contract law."[84]

With reference to theoretical considerations, what is most significant about all the issues this section considers is the way in which the courts have drawn on the construction industry experience to refine general principles of contract law. That is, on these matters the courts have not used abstract or fixed rules to resolve contractual disputes that incidentally involve the construction industry. Instead, the courts used particular industry practices and the distinct characteristics of industry relationships to craft specialized rules. The process is flexible, contextual, and arguably relational; it modulates rather than mechanically applies contract law.

The next section delves at some length into one of the most popular topics in the contemporary literature on contract theory—contract interpretation. While the industry cases do not generally stand out as distinctive in their approach to contract interpretation, they have provided fertile opportunities to challenge the classical proposition favoring a grand theory of contract law.

The special story of contract interpretation

Neoclassical contract and the modern theories diverge most often and most fundamentally over contract interpretation and related matters, such as whether or how courts should fill in gaps in written agreements. Just a few years ago, Professors Gilson, Sabel, and Scott called contract interpretation "the least settled, most contentious area of contemporary contract doctrine and scholarship."[85] Even more recently, Professors Ben-Shahar and

81 *See, e.g.*, 6 Bruner & O'Connor, *supra* note 57, at §§ 19:75, 19:116-19:119.

82 Appeal of Eichleay Corp., ASBCA No. 5183, 60-2 B.C.A. (CCH) ¶ 2688 (July 29, 1960).

83 *See* 6 Bruner & O'Connor, *supra* note 57, at § 19:81; Jacob & Youngs, 129 N.E. at 889.

84 6 Bruner & O'Connor, *supra* note 57, at § 19:75.

85 Ronald J. Gilson, Charles F. Sabel, & Robert E. Scott, *Text and Context: Contract Interpretation As Contract Design*, 100 Cornell L. Rev. 23, 31 (2014).

Strahilevitz conclude that interpretation "may be the most common and least satisfactory task courts perform in contract disputes."[86] The law and economics, relational contract, and neoformalist schools all generate distinct and intriguing literature on contract interpretation.[87] As far as I can discern, however, none of these alternative conceptions of contract have left an appreciable imprint on how courts interpret contracts. In practice, judges operate within the bounds of classical and neoclassical conceptions, with only an occasional nod to economic analysis and an even rarer reflection of a relational framework.[88] With these observations in mind, I am devoting considerable attention to the ways in which the construction industry cases conform to or deviate from the interpretation principles of contract law writ large.

The scholarly debate on these topics took on its current form with the advent of Article 2 of the U.C.C., and it continues unabated to the present. Although the second Restatement generally aligns with the U.C.C.'s approach, contract interpretation in judicial practice under the common law, as distinct from the U.C.C.'s law of sales, lacks a coherent anchor. The cases disclose a theoretical continuum rather than a distinct evolution.[89] Broadly speaking, the cases divide into two imperfectly defined camps. The majority perspective still leans toward the classical framework of the first Restatement. The alternative responds, to one degree or another, to the second Restatement's more flexible approach. Contemporary scholars promote a bewildering collection of alternative contract interpretation frameworks, only some of which explicitly reflect an overarching contract theory. For the most part, the construction industry cases reflect the same range of problems and approaches that the vast literature on contract interpretation explores. Accordingly, in the present discussion, I seek only to locate the construction industry cases within that continuum. Mercifully, my objective requires neither a comprehensive review of the competing scholarly notions nor a full-throated defense of any one of them.

Text and context

Setting aside, for the moment, the many interesting academic nuances that rarely figure openly into the actual process courts use to interpret contracts, the essential

86 Omri Ben-Shahar & Lior Jacob Strahilevitz, *Interpreting Contracts Via Surveys and Experiments*, 92 N. Y.U. L. Rev. 1753, 1756 (2017).

87 *See, e.g.*, Andrew Verstein, *Ex Tempore Contracting*, 55 Wm. & Mary L. Rev. 1869 (2014); Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 Tex. L. Rev. 1581 (2005); David Campbell, *The Incompleteness of our Understanding of the Law and Economics of Relational Contract*, 2004 Wis. L. Rev. 645; Juliet P. Kostritsky, *Taxonomy for Justifying Legal Intervention in an Imperfect World: What to Do When Parties Have Not Achieved Bargains or Have Drafted Incomplete Contracts*, 2004 Wis. L. Rev. 323; Robert E. Scott, *supra* note 21, at 869.

88 *See* Murray, Jr., *supra* note 1, at 869.

89 *See* Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 Cal. L. Rev. 261 (1985).

divide pits text against context.[90] Some theoretical aspects of the debate are apparent.[91] Classical theory and neoformalism assert that courts should interpret written contracts solely, or at least primarily, by reference to the words the parties choose to express their agreement. This is the textual approach, characterized by the traditional plain meaning and parol-evidence rules. Especially as articulated by the neoformalists, considerations of certainty and predictability motivate the textual approach.[92] Neoclassical theory, by contrast, advises courts to consider the circumstances of the transaction, including such factors as the behavior of the parties in the performance of their agreement, relevant trade usage and customs, and the full relational environment in which the exchange transaction occurs. This is the contextual approach, with its greatly relaxed versions of the plain meaning and parol-evidence rules.[93]

The competing approaches also divide over whether contract interpretation problems call for courts to consider objective or subjective intent. The classical conception seeks to interpret contracts objectively by asking what a reasonable person would understand the parties' expression to mean. The neoclassical approach aims to discover the parties' true or subjective intent. For this purpose, however, the neoclassical perspective does not contemplate a judicial investigation of the wholly internal thought processes of the parties; instead, the methodology typically looks to the objectively knowable circumstances of the transaction to determine whether the contracting parties shared a subjective meaning.[94] In other words, the inquiry considers manifestations of the intended or true meaning, which may or may not have been entirely expressed in words. I consider the distinction between objective and subjective meaning a secondary factor, not because it is less important as a theoretical matter, but because it figures less prominently into the process courts routinely use to analyze interpretive disputes. That is, the decisions most often turn on what case-specific evidence and general transactional considerations the courts take into account. For courts, the question becomes whether to refer exclusively or primarily to the text or also to consider contextual factors.

Judicial inclinations on matters of interpretation are not consistently textual, contextual, objective, or subjective. This is most evident when a court concludes that, despite the arguments of one of the parties, the disputed contract language is clear rather than ambiguous and therefore is subject to the plain-meaning rule. In that situation, for example, even a court that acknowledges a relaxed parol-evidence rule may nonetheless adhere strictly to the plain-meaning rule.[95] To

90 *See generally* 5 CORBIN ON CONTRACTS, *supra* note 47, at §§ 24.6, 24.7, & 24.9; Robert Braucher, *Interpretation and Legal Effect in the Second Restatement of Contracts*, 81 COLUM. L. REV. 13 (1981).

91 *See generally* Gilson, Sabel, & Scott, *supra* note 85, at 23; David Campbell, *The Incompleteness of our Understanding of the Law and Economics of Relational Contract*, 2004 WIS. L. REV. 645.

92 Murray, Jr., *supra* note 1, at 870.

93 *See* 5 CORBIN ON CONTRACTS, *supra* note 47, at §§ 24.7, 24.9, & 24.10.

94 *See* Braucher, *supra* note 90, at 13-14.

95 Goetz & Scott, *supra note* 89, at 309.

put the point more broadly, courts sometimes mix and match the rigid interpretative rules of the first Restatement, which still hold much influence in the cases, with the far more flexible ones of the second Restatement. "No one, with the possible exception of disappointed litigants, subscribes to a wholly subjective theory of contract interpretation."[96] Similarly, even the most earnest advocates for a contextual approach do not expect courts to ignore text.

Although I started this section by setting aside "the many interesting conceptual nuances that rarely figure openly into the actual process courts use to interpret contracts," I can hardly ignore those distinctions entirely. I choose not to focus on them because judicial analysis in the construction industry cases usually follows either the classical or the neoclassical approach to contract interpretation. These two competing notions about how courts should interpret express contractual language date back at least to the legal realists, but differences over the interpretive process did not end with the realist era. In one way or another, economic analysis and relational theory alter or challenge aspects of these classical and neoclassical principles.[97]

Drawing on these alternative contract theories and analytic perspectives, scholars have introduced and explored at great length many competing frameworks for contract interpretation. Thus, relational theory embraces an especially broad consideration of the circumstances of the exchange transaction as they evolve over the course of a dynamic interaction between the parties. This may point to a contextual approach to contract interpretation, although that is not an inevitable consequence of relational theory.[98] Economic analysis seeks rules of contract interpretation that maximize value and that promote efficiency, both in the form of incentives for socially beneficial ex ante negotiating and drafting practices and in the best use of judicial resources in ex post dispute resolution. While the cost-benefit methodology of economic analysis sometimes points toward a relatively textual approach, at other times it supports a more contextual one.[99] Perspectives on contract interpretation from economic analysis, relational contract, and neoformalism sometimes overlap and influence each other to an extent that blurs purely theoretical distinctions.[100] To the extent that these competing frameworks take the interpretation problem beyond the classical and neoclassical distinctions, they tend to complicate rather than clarify the process. Economic analysis and relational theory add complex empirical questions and elaborate hypotheses to the text-versus-context debate, but as far as I can discern from reading the cases, they do not offer distinctive approaches that courts can

96 1A BRUNER & O'CONNOR, *supra* note 57, at § 3:36.

97 *See* Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581 (2005).

98 Scott, *supra* note 21, at 850-53.

99 Posner, *supra* note 97, at 158.

100 *See, e.g.*, Eric Posner, *A Theory of Contract Under Conditions of Radical Judicial Error*, 94 NW. U. L. REV. 749 (2000); Scott, *supra* note 21, at 847.

readily use to decide whether, when, or to what extent they should consider context as well as text to resolve actual disputes.

As a practical matter, contract disputes in the construction industry often involve contract terms best understood with reference to trade customs and practices and common usage in the industry. For that reason, industry cases regularly present especially strong bases for a contextual approach to interpretation. Even when a court starts its interpretive analysis by invoking the plain-meaning rule, the reality of the industry's technically specialized environment may still convince the court to permit a party to introduce evidence that the contract should be interpreted in light of custom, practice, and usage. Thus, a specification in a government contract requiring a contractor to wrap all "metallic pipe" with tape may not apply to a certain kind of metal pipe if industry practice is not to wrap that kind of pipe and the government agency issuing the contract has even accepted that industry practice in other similar projects.[101] The point here is not that courts should always use a contextual approach to contract interpretation. Rather, it is that a contextual approach is often the most sensible one to use in interpreting disputes over the proper interpretation of construction industry contracts.

Given the indeterminate implications of the alternative theories for the interpretive process, I assess the contract interpretation problem as it manifests in the construction industry cases primarily as a debate over text and context, as now carried on between adherents of neoclassical theory and the proponents of neoformalism, who are the modern heirs to classical theory. The more detailed look at the interpretive process that follows, therefore, maintains that focus.

The interpretive process

To recap, classical contract's approach to interpretation stems from its dedication to text over context. From that organizing principle, the classical theory derived its strict versions of the plain-meaning and parol-evidence rules, and it directed courts to employ an objective standard to determine what meaning a reasonable person would attach to the text.[102] The neoclassical innovations, by contrast, not only resort to context to promote a relaxed version of the plain-meaning and parol-evidence rules, but they also use a more subjective standard that focuses on what the contracting parties probably intended.[103] Neoformalism rejects the neoclassical approach outright, advocating a return to the classical principles and rules of interpretation in the name of predictability, certainty, and judicial integrity.[104]

101 W. States Const. Co. v. United States, 26 Cl. Ct. 818, 819 (1992).

102 *See generally* Goetz & Scott, *supra* note 89, at 273 (1985).

103 5 Corbin on Contracts, *supra* note 47, at § 24.6.

104 *See* Scott, *supra* note 21, 847.

The interpretive process, therefore, typically begins with the plain-meaning and parol-evidence rules in effect in a particular jurisdiction. Formalist courts continue to articulate traditional, strict versions of those rules.[105] Because the U.C.C. rejects the plain-meaning rule and includes a radically contextualized version of the parol-evidence rule, formalist courts must approach contract interpretation differently depending on whether the U.C.C. applies. In the common-law cases, these formalist courts most commonly rely on cases and other authorities that trace their origins back to the classical conception of the first Restatement.[106] To be sure, neoformalists offer updated rationales for the traditional rules, often based on economic analysis or relational theory, but the courts typically resort to precedent without exploring the relative merits of the neoformalist literature.[107] Jurisdictions that take a more flexible approach to interpretation often do so based on the plain-meaning and parol-evidence rules of the second Restatement, which derive from the same neo-classical perspective that informs the U.C.C.[108] "Perhaps the most significant change from the original Restatement is an increased emphasis on the context in which a contract is made and on the meanings attached by the parties to their words and conduct."[109] In these jurisdictions, the interpretation process need not vary significantly between disputes governed by the U.C.C. and those under the common law of contracts.

At this point, it is useful to highlight two related interpretive operations, each of which generates much theoretical controversy among contemporary contract scholars.[110] These two operations go beyond determining what express language means, and they involve more than the competing versions of rules of interpretation. As Professor Peter Linzer has explained, although lawyers, commentators, and courts often use the phrase "the implication process" to encompass these two functions, neither necessarily presents a situation in which a court itself implies, rather than determines, what the contract means.[111] More precisely, through these operations, a court either infers or imposes (rather than implies) an obligation or other contractual term. The "implication process" remains a convenient shorthand label. For that reason, I sometimes continue to use that terminology, although I deem it wise to keep Professor's Linzer's distinctions in mind.

105 *See* Goetz & Scott, *supra* note 89, *at* 273-76.

106 *See generally* F. Allan Farnsworth, *"Meaning" in the Law of Contracts*, 76 YALE L.J. 939, 957-65 (1967).

107 *See generally* Scott, *supra* note 21, at 869.

108 *See* RESTATEMENT (SECOND) OF CONTRACTS §§ 213-223 (Am. Law Inst.1981); U.C.C. § 2-202.

109 Braucher, *supra* note 90, at 14.

110 *See generally* 6 CORBIN ON CONTRACTS, *supra* note 47, at § 26.1; Peter Linzer, *"Implied," "Inferred," and "Imposed": Default Rules and Adhesion Contracts-the Need for Radical Surgery*, 28 PACE L. REV. 195 (2008).

111 Linzer, *supra* note 110.

When a court infers that a contract includes an obligation or other term, it draws the inference that the contract includes the term by deciding that the contract language, the parties' behavior, or some feature of the surrounding circumstances indirectly suggests that the parties intended, or at least would logically have expected, that term to apply even though the contract language does not explicitly say so. Thus, because the court believes that certain words, behavior, or circumstances imply a particular meaning, the court infers that meaning and interprets the contract accordingly. An inferred obligation or other term may be one that the court believes the parties probably intended, or it may represent the court's judgment about how best to fill in a gap with respect to a matter that the parties did not consider. An inference based on the words the parties used may fall somewhere along the continuum from textual to contextual, while an inference derived from behavior or the surrounding circumstances implements the contextual approach of neoclassical contract. In gap-filling decisions, a court might attempt to discern what the specific parties probably intended or would have intended had they anticipated the problem (a more or less subjective inquiry), or it might instead select the interpretation that the court concludes similarly situated parties would logically have intended (an objective inquiry). The scholarly writings exploring rationales for and against judicial gap-filling and proposing or assessing alternative frameworks for filling gaps have absorbed an ocean of ink, but they have received scant judicial attention to date.[112]

When a court imposes rather than infers an obligation or other term, it does so to implement a policy that may have little or nothing to do with the parties' intentions or inclinations. The imposition process is policy making rather than contract interpretation. As a result, the practice of imposing terms involves different theoretical rationales than does the process of inferring terms. The judicial practice of imposing significant duties on parties as a matter of policy took on special significance in late nineteenth and early twentieth century sales cases. The movement to imply (that is, to impose) warranties of quality, for example, constituted a significant assault on the classical preference for freedom of contract and its laissez-faire attitude toward legal intervention in private contractual relations. With the advent of the UCC's Article 2, the idea of implied warranties of quality in the sale of goods had taken firm control.

The next segment looks at the implication process in the construction industry cases specifically. First, it offers some general observations about the

112 *See* 6 CORBIN ON CONTRACTS, *supra* note 47, at §§ 26.1-26.4; Omri Ben-Shahar, *"Agreeing to Disagree": Filling Gaps in Deliberately Incomplete Contracts*, 2004 WIS. L. REV. 389; Juliet P. Kostritsky, *Taxonomy for Justifying Legal Intervention in an Imperfect World: What to Do When Parties Have Not Achieved Bargains or Have Drafted Incomplete Contracts*, 2004 WIS. L. REV. 323; Robert Gertner & Ian Ayres, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989).

interpretive process in the industry cases. Then, it reviews cases in which courts have drawn inferences about contractual intent. Finally, it looks at decisions using the interpretive process to impose obligations on the contracting parties.

Contract interpretation principles in industry cases

On matters of contract interpretation, the industry cases reflect the same ongoing tension and debate between text and context that marks the evolution of contract interpretation law generally.[113] Of course, the plain meaning and parol-evidence rules in the construction industry cases, as elsewhere, vary depending on whether or not the U.C.C. governs the dispute. This section addresses construction contract decisions applying common-law interpretative principles rather than the Code's distinctly contextual approach. The majority of these cases declare allegiance to relatively traditional versions of the plain-meaning and parol-evidence rules. At the same time, and also in keeping with general trends, a growing minority of jurisdictions embrace the second Restatement's more contextual approach to interpreting construction contracts. In close cases, however, the opinions rarely line up cleanly with one approach over the other—instead, they negotiate uneasy compromises between the two.

At times, the struggle between text and context is palpable. A 2007 case from the United States Court of Federal Claims provides an unusually extended discussion of the tension between the classical and neoclassical approaches to interpretation in construction industry cases, concluding somewhat uncomfortably that precedent required adherence to a mostly classical approach.[114] Similarly, in considering how the parol-evidence rule should apply to a contractual obligation "to fill" a sewage lagoon, the Missouri Court of Appeals made this candid admission in *Jake C. Byers, Inc. v. J.B.C. Investments*: "we, in Missouri, no different than the courts in most other jurisdictions, have used a variety of principles, chosen randomly with no consistency, from the common law, the treatises of Professor Williston and Corbin, and the First and Second Restatement of the Law of Contracts."[115]

Some cases demonstrate that experience with construction contracts at times invites a more flexible framework for contract interpretation and a heightened regard for contextual considerations. Several construction industry characteristics support a strong argument for the neoclassical perspective. The transactional relationships between participants to a construction project are complex and of long duration under constantly changing, risky, and unpredictable conditions. Construction contracts and the activities they

113 *See* 1A Bruner & O'Connor, *supra* note 57, at §§ 3:1-3:4, 3:33-3:34, 3:49.

114 *See* Travelers Cas. & Sur. Co. of Am. v. United States, 75 Fed. Cl. 696, 707-15 (2007).

115 Jake C. Byers, Inc. v. J.B.C. Investments, 834 S.W.2d 806, 811 (Mo. Ct. App. 1992).

govern involve a challenging array of specialized industry terms and practices. A leading treatise on construction law observes: "Construction contracts necessarily must be construed in transactional context, because they address a host of complex issues unique to construction."[116]

There are, for example, many cases interpreting construction specifications in light of usage of trade, trade custom, course of dealing, or course of performance.[117] Indeed, the *J.B.C. Investments* case cited above illustrates how a court can declare allegiance to text at the same time that it acknowledges the contextual basis for resorting to custom and usage. In that case, the contract specified that filling a lagoon meant to fill it with dirt compressed by a tractor. The court adhered to the traditional, textual approach, rejecting the argument that under the circumstances the jury should have been allowed to consider evidence of trade custom and usage in similar situations that called for filling in multiple layers of about one foot in depth, with each layer being compressed by a tractor. The court, however, gave alternative reasons for the holding. First, the court explained that the contract unambiguously specified that "to fill" simply meant to fill the lagoon with dirt and compact the fill by tractor. The court went on, however, to indicate that Missouri law might have permitted consideration of a different meaning if the defendant had proffered sufficient evidence "that 'fill' had a particular meaning in the construction industry, or in any industry or trade."[118] The latter explanation suggests that the court might have recharacterized the same contract provision as ambiguous if the defendant had presented a stronger evidentiary basis for considering context. The following two sections (separately covering inferred and imposed terms) further consider the extent to which the construction industry cases evince a distinctly contextual trend even as they continue to repeat textual slogans.

Inferring obligations in industry cases

Courts interpreting construction industry contracts were comfortably inferring certain basic terms at least as early as the constructive conditions of exchange doctrine, which solidified well before the neoclassical contract movement. Indeed, as Chapter 2 recounts, construction industry cases played a leading role in defining the contours and legal consequences of that important development. The constructive-conditions doctrine rubs roughly against classical contract's textual bias. Presumably, judges committed to the classical conception of contract tolerated this contextual maneuver as merely a compellingly logical conclusion about what the parties must have intended by their evidently incomplete contractual language. To do so, they did not need to consider evidence of the parties' subjective intent. The constructive-conditions

116 1A Bruner & O'Connor, *supra* note 57, at § 3:2.
117 *See id.* at §§ 3:74–3:80.
118 Byers, 834 S.W.2d at 817.

doctrine derived from an objective analysis of the contract nominally based on the perspective of a reasonable person. In other words, even classical principles permitted a court to attach a reasonable and logical condition to a contractual obligation that was, on its face, unconditional.

Another matter on which the industry cases during the classical contract era anticipated contextual movements in contract law in general concerns the consequences of impossibility and impracticality. In the earliest cases, before contract law developed the modern doctrines governing these defenses, the courts merely inferred that the parties must have intended a condition that circumstances beyond one party's control would not occur that would make performance impossible. In principle, the inferred condition referred to impossibility in a strict sense, and the rule was rigid, in keeping with the classical concept. In time, however, impracticality rather than true impossibility became the standard. *Mineral Park Land Co. v. Howard*, an industry case that the California Supreme Court decided in 1916, helped to lead the way.[119] There, a contract required the contractor to take all gravel and soil required for a project from the land of the other contracting party. The court relieved the contractor from the obligation when unforeseen water conditions of the soil made it economically impractical, but not impossible, to continue taking the required materials from the site. In time, this contextual defense achieved the status of a general principle of contract law, as did the related doctrine of frustration of purpose.[120] Section 266(1) of the second Restatement, which incorporates the impracticality doctrine, includes an example of the principle (illustration 5) based on the *Mineral Park* case.

Throughout the twentieth century, courts continued to infer meaning based on the transactional circumstances surrounding disputes stemming from construction contracts. These cases routinely show courts extracting unexpressed understandings from commercial characteristics of the transactions involved. In one noteworthy per curiam opinion, the United States Court of Claims interpreted a specification to paint "all previously painted or varnished surfaces" in a U.S. Post Office as excluding baked enamel surfaces.[121] The government argued, and the contracting officer and the GSA Board of Contract Appeals had agreed, that the specification was unambiguous because enamel is paint. The court, however, adopted the trial commissioner's opinion in the contractor's favor based on evidence of the custom among painting contractors. The court explained "that trade usage or custom may show that language which appears on its face to be perfectly clear and unambiguous has, in fact, a meaning different from its ordinary meaning."[122] The court held

119 156 P. 458 (Cal. 1916). *See generally* 7 CORBIN ON CONTRACTS, *supra* note 47, at § 74.13.

120 *See generally* Melvin A. Eisenberg, *Impossibility, Impracticability, and Frustration*, 1 J. LEGAL ANALYSIS 207 (2009).

121 Gholson, Byars & Holmes Const. Co. v. United States, 351 F.2d 987, 989 (Ct. Cl. 1965).

122 *Id.* at 999.

that it was not even relevant whether the government was aware of the trade practice or custom.

Industry cases also have recognized the judicial option to fill gaps in construction contracts, although the industry cases have not been especially influential in this regard.[123] As has been noted, contract scholars fiercely debate whether and how courts should fill in gaps in incomplete agreements. Several commentators correctly observe that the circumstances under which transactions occur in the construction industry present special challenges for the development of contracts that are complete in the sense that they anticipate and adequately address every potentially relevant contingency.[124] Construction projects are complex and must be performed over extended periods under unpredictable and constantly changing conditions that make it difficult for even the most experienced lawyers to anticipate all potentially significant risks. The contracts frequently rely on indeterminate standards, such as reasonableness, and they routinely defer some potential problems to be addressed if and when they arise. Additionally, many project participants of varying degrees of sophistication choose to rely heavily on standard industry contracts. While these industry-endorsed templates adequately cover the most common contingencies, the contracting parties often either do not have the expertise or cannot justify the cost of tailoring the form contracts to fit the unique circumstances and objectives that always attend a particular project. The parties, mediators, courts, arbitrators, and other decision-makers must often determine how to resolve differences resulting from gaps in these contracts.

The intense debate in the literature over how contract law should deal with contractual gaps might predict a similar degree of controversy in the construction industry cases. My research, however, shows that when courts have before them incomplete construction contracts, they ordinarily operate comfortably within the same text versus context continuum that characterizes other aspects of the interpretive process. Of course, if the court views the omission as material and neither party presents a credible reliance claim, the court may hold that there was no enforceable contract at all and therefore decline the invitation to fill in the gap.[125] In such a situation, an opinion may fall squarely in the classical camp. But when the parties, by express concession or by performance, acknowledge that they have a binding contract, judges resolve the disputed point as best they can. Some opinions expressly invoke Section 204 of the second Restatement, which calls on the court to add a missing term if it is essential.[126] The Restatement's guidance is slim, and

123 *See generally* 1A Bruner & O'Connor, *supra* note 57, at §§ 3:3, 3:50, 3:77.

124 *See, e.g., id.* at §§ 2:5, 3:50; *Andrew Verstein, Ex Tempore Contracting*, 55 Wm. & Mary L. Rev. 1869, 1890–91 (2014); Scott, *supra* note 21, at 869.

125 *See generally* 1A Bruner & O'Connor, *supra* note 57, at §§ 2:5, 3:50.

126 Hutton Contracting Co. v. City of Coffeyville, 487 F.3d 772, 784 (10th Cir. 2007); L & L Excavating Corp. v. Abcon Assocs., Inc., 594 N.Y.S.2d 818, 820-21 (N.Y. App. Div.1993).

distinctly neoclassical, providing for the court to supply a term that "is reasonable in the circumstances."

One of the most common contractual lapses in the cases involves a failure to state a project completion date. The predictable answer here is for the court to infer an obligation to perform within a reasonable time and to use evidence based on industry experience and the testimony of the disputing parties to fix a deadline.[127] Similarly, when a court decides that the parties reached a binding agreement without specifying a contract price, the court will establish a reasonable price relying on evidence of costs of performance or a similar basis.[128] Other cases use evidence of industry standards or trade customs and usage to supply performance details that a contract does not adequately cover or to avoid a literal reading of a contract provision that the court concludes leads to an absurd result.[129] While cases such as these confirm that disputes over missing terms in construction contracts are relatively common, I find little indication that the courts perceive the problem of filling gaps in construction contracts to present the kind of first-principle dilemma that the scholarly literature suggests. In effect, common sense seems to prevail, with the court relying to one degree or another on classical or neoclassical principles, or a compromise between the two, to resolve the dispute. On this basis, I can draw no important theoretical conclusions from the industry's gap-filling cases.

Some of the most interesting and extreme contract-interpretation decisions emerging from construction contract disputes involve provisions that test the limits of fairness or that raise policy considerations. This category includes broad indemnities, no-damage-for-delay clauses, requirements for claims or disputes to be submitted to an agent, employee, or representative of one of the parties before they can be litigated or arbitrated, and pay-when-paid and pay-if-paid clauses.[130] The most controversial of these decisions concern pay-if-paid clauses and no-damage-for-delay clauses, which, as explained previously in this chapter, courts frequently limit and sometimes refuse to enforce.[131]

127 *See, e.g.*, M.J. Sheridan & Son Co. v. Seminole Pipeline Co., 731 S.W.2d 620, 622 (Tex. App. 1987).

128 *See, e.g.*, Howell v. United States, 51 Fed. Cl. 516, 520–21 (2002); I-D Elec. Inc v. Gillman, 402 P.3d 802, 810 (UT App. 2017), *cert. denied sub nom.* I-D Elec. v. Gillman, 412 P.3d 1255 (Utah 2018).

129 *See, e.g.*, Appeals of Hogan Const., Inc., ASBCA No. 38801, 90-3 B.C.A. (CCH) ¶ 22969 (May 14, 1990); Tumlinson v. Norfolk & W. Ry. Co., 775 S.W.2d 251, 252-53 (Mo. Ct. App. 1989); *see generally* 1A Bruner & O'Connor, *supra* note 57, at § 3:77.

130 *See* 1A Bruner & O'Connor, *supra* note 57, at § 3:41.

131 *See generally* Hill & McCormack, *supra* note 69, at 26; Carl S. Beattie, *Apportioning the Risk of Delay in Construction Projects: A Proposed Alternative to the Inadequate "No Damages for Delay" Clause*, 46 Wm. & Mary L. Rev. 1857 (2005).

Although I mention all these cases under the inference heading, they do not uniformly fall into that category. Some, particularly those in which a court identifies and resolves an ambiguity in the disputed language, arguably involve little more than creative applications of the jurisdiction's plain-meaning rule. In others, the courts seem to be drawing inferences about what the parties probably intended based on surrounding circumstances. And in some other instances, including some of the gap-filling decisions, the courts use policy grounds to determine the legal effect of contractual provisions with little or no regard to how clear the contractual language seems. Decisions in that last category align more closely with the imposed obligations cases, which the next section covers.

Taken as a whole, these cases in which courts draw inferences about the meaning of terms in construction contracts illustrate a feature common to many other contract-interpretation problems—the blurring of distinctions between the interpretive principles involved. In other words, the construction industry cases teach the same lessons about contract interpretation as do cases on inference drawing throughout contract law. The courts continually struggle to balance older, classical perspectives, with contemporary, neoclassical ones.

Imposing obligations in industry cases

As already mentioned, and as more fully discussed in earlier chapters, a series of cases decided by the U.S. Supreme Court, together with a line of government contract cases from the lower federal courts, illustrate how judges were imposing duties on parties to construction contracts well before the main assault began on classical contract doctrine.[132] For the construction industry, the *Spearin* case and its progeny constitute the most significant examples of judicially imposed obligations predating neoclassical contract's popularity.

As significant as those instances of judicially imposed obligations in construction contracts are, the evolving law of sales, and ultimately Karl Llewellyn and Article 2 of the U.C.C., provided the most important impetus for injecting terms into contracts on policy grounds. Inspired by that movement, judges started implying (imposing) warranties of quality under the common law of contracts. Chapter 3 documents how rapidly the process blossomed once courts began to apply the implied warranty concept to construction contracts. Many courts comfortably proclaimed that under every construction contract, the builder impliedly warrants that the work will be of good quality and sound construction. Soon, swept up by the prevailing consumer protection spirit and influenced also by products liability theory, the courts developed more specific and significant implied warranties of quality in residential construction contracts. The cases implying warranties of quality into construction contracts function as important examples of the common law of

132 *See, e.g.*, 1A Bruner & O'Connor, *supra* note 57, at §§ 3:4-3:7, 3:34.

contracts adapting the U.C.C philosophy on sales of goods to other transactional contexts. Thus, while the U.C.C promulgated the implied warranty movement, the construction industry cases participated in the trend of drawing on experience from specific exchange transaction types to imply warranties under the common law.

Decisions implying warranties in construction contracts helped to transplant Llewellyn's vision from the legislative realm to the common law of contracts. These cases operate as variations on the U.C.C.'s implied warranty theme, in effect particularizing the implied warranty of quality to reflect the judicial understanding of the owner-contractor relationship. Thus, in residential construction contracts, courts typically extrapolate from the implied warranty of sound construction and workmanlike performance a warranty that the residence will be habitable.[133] For design-build contracts, some cases modulate the contractor's implied warranty of quality to warrant the suitability of the work for the owner's particular purpose.[134] This is no mere adoption of a U.C.C. warranty as to the fitness of a specific product, but encompasses the quality of the work performed (the service) itself.

In addition to implying warranties of quality, the industry cases also predictably embraced the implied duties of good faith and fair dealing.[135] In fact, while the U.C.C. rightfully claims the credit for the widespread acceptance of these implied (imposed) duties, pre-Code precedent exists for implying a duty of good faith in construction contract cases, at least with respect to the behavior of the federal government as a project owner.[136] Today, one of the most controversial applications of the implied duty of good faith and fair dealing to construction contracts imposes limits on the enforceability of broadly worded termination for convenience clauses, a topic previously noted in this chapter.[137]

Moreover, the industry cases have gone far beyond merely adapting the judicially imposed warranties of quality and the general duties of good faith and fair dealing as popularized by the U.C.C. The most significant holdings impose terms that constrain the behavior of the contracting parties in light of industry characteristics. For example, several courts, including the Court of Appeals for the Federal Circuit, have held that general contractors and their subcontractors must make reasonable inquiries to clarify ambiguities in plans and specifications.[138] This implied duty affords owners a potential defense against liability under the *Spearin* doctrine. One of the most significant duties

133 3 BRUNER & O'CONNOR, *supra* note 57, at § 9:72.

134 *Id.* at § 9:91.

135 *Id.* at § 9:103.

136 *See* Clark v. United States, 73 U.S. 543 (1867); Roni Adil Radi Elias, *How Good Must the Government's Good Faith Be? Defining the Boundaries of the Contractual Duty of Good Faith and Fair Dealing in Public Contracts*, 10 CHARLESTON L. REV. 105, 136-40 (2016).

137 *See* 5 BRUNER & O'CONNOR, *supra* note 57, at § 18:47.

138 *See* 3 BRUNER & O'CONNOR, *supra* note 57, at § 9:64.

the courts have imposed on owners is the superior knowledge doctrine, which Chapter 5 explores. Building on the superior knowledge rationale, some courts have proclaimed an even more expansive duty of "full disclosure," which requires the owner to provide to the contractor all information known to the owner that is material to the contractor's performance and that the contractor cannot otherwise discover through reasonable means.[139] Another equally significant line of cases imposes on the contracting parties a reciprocal implied duty to cooperate and to avoid hindering the other party's performance.[140] In each instant, the judicial analysis justifying the imposed duty draws on a relatively sophisticated appreciation of the transactional context involved.

Text and context revisited

The cases show that contract law continues to respect classical principles of interpretation, especially under the traditional versions of the plain-meaning and parol-evidence rules. The majority of courts still invoke textualism over contextualism when interpreting express contractual language.[141] The holdings, however, are often inconsistent, and the judicial allegiance sometimes hesitant or apologetic. These observations apply to the construction industry cases as well as to other common-law cases. But the construction contract decisions often express a more pronounced recognition that relational aspects of the underlying transactions can justify a more flexible attitude toward contextual considerations. The contextual approach appears regularly in the construction contract cases, but it does not dominate.[142]

The net result of studying contract interpretation cases from the industry stimulates rather than resolves the debate over the interpretive process. On the one hand, critics of neoclassical contract point to case after case in which courts have declined the invitation to relax formalistic rules of contract interpretation.[143] On the other hand, none can deny that many contemporary cases implement the more relaxed approach to contract interpretation of neoclassical contract.[144] To the uncertain extent that contract theory affects the judicial analysis of interpretation questions, the impact more often seems *sub rosa*. This appears most clearly when judges address the conflicting policies involved as they struggle to decide closely contested cases.[145] Overall, perhaps

139 *See id.* at § 9:92.

140 *See, e.g.*, Luria Bros. & Co. v. United States, 369 F.2d 701, 708 (Ct. Cl. 1966); *see generally* 3 BRUNER & O'CONNOR, *supra* note 57, at § 9:99.

141 *See* Scott, *supra* note 21, at 869.

142 *See* BRUNER & O'CONNOR, *supra* note 57, at §§ 3:2, 3:33.

143 *See* Goetz & Scott, *supra* note 89, at 307.

144 *See* 1A BRUNER & O'CONNOR, *supra* note 57, at § 3:2.

145 *See, e.g.*, Travelers Cas. & Sur. Co. of Am. v. United States, 75 Fed. Cl. 696, 707-15 (2007); *see generally* 1A BRUNER & O'CONNOR, *supra* note 57, at §§ 3:34-3:52.

the neoformalists can claim an empirically demonstrable victory, but only a qualified one.

What accounts for the inconsistent approaches to contract interpretation in the common law of contract generally and in the industry cases in particular? The U.C.C. provides one obvious basis for reconciling cases. When the Code applies, courts should exhibit a greater allegiance to its neoclassical approach. Transactions beyond the Code's scope, however, present a far more complicated question. As we have seen, in appropriate circumstances, courts interpreting construction contracts under the common law sometimes apply the second Restatement's flexible principles that closely resemble the Code's, but they do not do so consistently enough to support meaningful generalizations about when common law interpretation principles are or should be relatively flexible and contextual. Unquestionably, in many jurisdictions *stare decisis* explains adherence to traditional versions of the plain-meaning and parol-evidence rules, especially in routine interpretation cases. But even in jurisdictions in which classical thought dominates the formal principles of contract interpretation, the courts regularly engage in analytic shenanigans that allow them to take context into account. The court finds ambiguity in apparently clear language, creatively infers meaning to rationalize the desired interpretation, or invokes policy to impose obligations.

What, then, most significantly triggers neoclassical contract's interpretive approach in one case but not in another? To this question, I offer a seemingly tautological response: the context of the dispute guides courts in identifying those cases calling for contextual interpretation. In other words, the controlling consideration, I submit, is that the cases often, although not invariably or expressly, recognize that characteristics of specific transactional relationships matter for purposes of contract interpretation. The construction industry in particular regularly presents disputes calling for a more flexible and relationally aware approach to interpretation. If the circumstances offer no compelling reasons to use context to alter reasonably clear contractual language or to fill in contractual gaps, the old rules suffice. When, however, the party asking the court for a more activist reading of the contract shows trade customs, course of dealing, course of performance, relational factors, or some other logically compelling circumstances justifying resort to context, courts sometimes invoke the second Restatement's more flexible contract-interpretation principles. The decisions tend to be more pragmatic than theoretical.

In their intriguing article cited at the beginning of this discussion of contract interpretation, Professors Gilson, Sabel, and Scott argue that under limited circumstances courts "have developed expertise in particular domains of commerce, and by entering the parties' epistemic community can create an interpretive regime that effectively accommodates ex post review of their practices."[146] Later in the same article, they note that the judicial process can

146 Gilson, Sabel, & Scott, *supra* note 85, at 31-32.

benefit when courts acquire sufficient experience and expertise in dealing with a specific context. They go on to argue that "the larger the number of parties contracting over similar transactions, the more feasible it is to have collective determinations of context other than by means of formal adjudication, as through the adoption of industry standards or other joint efforts."[147] I think that these same considerations may suggest that courts addressing recurring patterns of construction industry disputes can wisely decide when and how to consider the specific circumstances of industry relationships to interpret construction contracts. This seems most evident in the decisions of the U.S. Court of Federal Claims and the Court of Appeals for the Federal Circuit, which deal so extensively with federal construction contract disputes.

In any event, contemporary courts do not commit once and for all time to implement a textual or contextual approach. The interpretative process, even within a single jurisdiction or a specific jurisprudential era, operates along a continuum from mostly textual to highly contextual. In the industry cases more than in many other segments of commerce, we see the dominance of experience over logic in the development of the common law of contract.

I leave it to those more qualified in economic analysis or other social sciences to develop and promote coherent and elegant frameworks to explain and assess contract interpretation. Perhaps such frameworks will emerge from logic, either of the precise, mathematical variety popularized by law and economics research, or the more inductive logic of the law and social science branches that sometimes inform species of relational theory and neoformalism. For me, it suffices to conclude that the experience of litigated construction industry disputes has produced a highly nuanced range of interpretive responses in the courts in which context plays an increasingly important role.

An aside: The economic loss rule of tort law

Before I conclude this consideration of contract theory, tort law's economic-loss rule deserves brief mention, primarily because it allegedly stands as a theory-based line dividing tort law from contract law.[148] As such, it concerns the legal conception of contract as well as of tort. Simply stated, the rule generally prohibits tort recovery for a plaintiff's economic losses attributable to the defendant's breach of contract unless the economic losses are accompanied by damage to property or personal injury.[149] The rule admits of a long and growing list of exceptions, including circumstances in which the contract breach also violates some independent duty owed to the plaintiff.

147 *Id.* at 57.

148 *See, e.g.*, E. River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 866 (1986); Ins. Co. of N. Am. v. Cease Elec., Inc., 688 N.W.2d 462, 472 (Wis. 2004).

149 *See generally* Robert L. Rabin, *Tort Recovery for Negligently Inflicted Economic Loss: A Reassessment*, 37 STAN. L. REV. 1512 (1985).

For example, alternative versions of the rule may or may not apply in a construction industry setting if a plaintiff involved with the project can prove damages suffered as the result of negligence arising out of an act or omission in the performance of the defendant's contractual obligations owed to a project participant other than the plaintiff.

While the rule claims a distinguished pedigree in products liability law, where it implements both tort and contract policies that favor setting rational limits on a manufacturer's liability for purely economic losses incurred by a plaintiff remotely connected to the manufacturer, its judicial application in many other circumstances has become confoundingly inconsistent and incoherent. The construction industry cases in which defendants raise the economic loss rule as a defense have generated some of the most confusing and contradictory opinions. Elsewhere, I have argued that these cases show that, for the construction industry, courts need not define or fortify some mystical line to distinguish claims as either sounding in contract or in tort; rather, they "should hold construction industry participants to the risk allocation compact of the commercial relationships determined by a specific project structure."[150] This admonition calls for a contextual analysis of the contractual obligation allegedly breached. In particular, when a participant in a construction project sues another participant for causing purely economic harm, courts should assess that claim after taking into account the complete web of contractual and other relationships involved.

For example, when a contractor or subcontractor sues an engineer in tort over a mistake that breaches the engineer's obligations under a design contract solely between the engineer and the project owner, a court should analyze the tort claim in light of the network of relationships among all of the relevant project participants. In most commercial construction projects, those relationships are complex and are subject to deliberately coordinated risk-management devices. Under those circumstances, the court should give due regard to the "precise allocation of risk as secured by contract,"[151] among all the project participants. This requires understanding the "network of agreements of which all parties had notice that defined the commercial relationships."[152] In other words, tort law should respect the overall structure of industry relationships.

Unfortunately, it appears that the Restatement of Torts (Third) may be heading in the opposite direction, embracing a rule-driven framework rather than contextual principles. The current draft states the basic rule to be that, except as provided for under other sections, "there is no liability in tort for economic loss caused by negligence in the performance or negotiation of a contract between the parties."[153] This provides a narrow version of the rule because it only

150 Carl J. Circo, *Placing the Commercial and Economic Loss Problem in the Construction Industry Context*, J. Marshall L. Rev. 39, 103 (2007).

151 Berschauer/Phillips Construction Co. v. Seattle Sch. Dist., 881 P.2d 986, 992 (Wash. 1994).

152 BRW, Inc. F. Dufficy & Sons, Inc., 99 P.3d 66, 73 (Colo. 2004).

153 Restatement (Third) of Torts: Liab. for Econ. Harm § 3 TD No 1 (Am. Law Inst. 2012).

precludes recovery when the plaintiff and defendant are in a contractual relationship that provides the basis for the claim. While the proposed economic loss rule so stated would have some relevance in construction industry disputes, it would not apply to the most controversial claims for purely economic loss arising out of construction activities. The claims that produce the greatest number of confusing and inconsistent opinions pit a plaintiff against a defendant who has a contract concerning the construction project only with someone other than the plaintiff. For example, the general contractor may sue the owner's architect due to allegedly defective designs, inaccurate information, or actions relating to project administration, or one subcontractor may sue another subcontractor over acts or omissions that allegedly caused delays. For these situations, the draft recognizes two especially significant bases for liability in tort: negligent misrepresentation[154] and negligent performance of services.[155]

How courts ultimately apply the proposed rules under the draft Restatement of Torts (Third) to claims by one project participant against another will depend in the first place on how judges understand what the Restatement drafters mean by the phrases "supplies false information for the guidance of others" (with reference to negligent misrepresentation) and "performs a service for the benefit of others" (with reference to the negligent performance of services). The draft Restatement's rules do not necessarily seem to invite courts to consider the context in which construction occurs, with its complex network of relationships characterized by contractual indemnities, insurance, liability limitations, and other risk-management devices that form the bases of the web of primary economic relationships. The draft comments support, perhaps somewhat dogmatically, expansive tort liability for economic loss claims against design professionals but broad protection for other project participants.[156] The merits of these predilections must await experience under the restated economic loss rule, but my initial reaction doubts their contextual credentials.

We must await the final version and the decisions that it inspires to know whether the proposed restated principles of tort law concerning purely economic loss will bring order and justice, or either, to the construction industry. In the meantime, however, construction lawyers negotiating contracts, as well as industry organizations promulgating standard forms and alternative delivery systems, are becoming more and more concerned with the risks and uncertainty that the current economic loss rule creates. We may eventually see contracting practicing, including more integrative and collaborative project delivery systems and technology, emerge to do more to solve the economic loss problem in the industry than any restatement of the law, judicial development, or contract theory will ever achieve.[157]

154 *Id.* § 5 TD No 1.
155 *Id.*§ 6 TD No 2 (Am. Law Inst. 2014).
156 *Id.* § 6 TD No 1, cmt. b (2012).
157 *See* Circo, *supra* note 16, at 915-916.

Detecting contract theory in the industry context

As viewed through the lens of the construction industry cases, contemporary contract law seems less a body of general doctrine and more a series of contextualized applications of broad principles or, as some might say, a more relational or transaction-specific field of law. In reacting to Grant Gilmore's classic indictment of contract law, *The Death of Contract*, Professor Richard Speidel explained the core problem with any grand theory of contract.[158] Gilmore's provocative attack and Speidel's insightful response came during the period of theoretical turmoil marking the transition between the first Restatement and the final publication of the second. Tort law's spectacular expansion at that time (which continues to the present—as with the economic loss rule) threatened to render contract law insignificant or, as Gilmore would sardonically claim, even to assassinate it. For my purpose of assessing what the construction industry cases teach about contract theory, because I cannot improve on Speidel's observations, I here content myself to recall and reflect on them. The problem—now just as then—is not that contract law fails to serve a distinct function in modern society, but that the classical conception misperceives contract's proper role. When "abstractness, formality, or rigidity" (i.e., the first Restatement's approach) renders contract law "neither fungible from context to context nor responsive to the realities of the particular case, the result is likely to be 'hard cases make bad law,' judicial fudging, or rejection."[159] The construction industry cases have been instrumental in demonstrating the folly of unadulterated dogma. Consider, for example, what the industry experience taught about the doctrine of dependent conditions of exchange, the revocability of unaccepted offers, and the pre-existing duty rule.

Professor Speidel went on to explain the perceived advantages of an alternative conception in words that ring true today as a characterization of contract law in the construction industry. A more contextual framework "focuses upon particular types of contracts within a relevant business or social setting rather than upon contracts in general. Instead of just contracts, there are contracts for the sale or lease of personal and real property, construction, personal and professional services, transportation, the creation of security interests, the organization of businesses, and the settlement of disputes."[160] Contextual contract, he further explains, credits the "patterns, practices, and problems" important in specific transactions. The construction industry cases demonstrate that attribute at least as much as does any other line of cases.

Differentiating contract law in its construction industry context, however, does not refute contract law writ large. Rather, it helps us understand contract law in that broader sense. As Professor Speidel concluded in

158 *See* Speidel, *supra* note 24, at 1161.
159 *Id.* at 1173.
160 *Id.*

the very same passage quoted above, "the pressure of reality has, among other things, influenced the courts and the legislatures to develop special rules for special problems and broad standards which are capable of particularization in each case."[161] This framework enables "the relevant context to illuminate determinations of liability and remedy and, at the same time, facilitates efforts to determine what, if anything, is common among the various contexts."[162]

Contract law as developed through the construction industry cases, however, is not thoroughly contextual. If it were, the industry cases would stand out as perhaps the only victory relational contract theory could claim within the common law of contract. I have elsewhere argued against assigning a relational label to contract law in the industry.[163] As shown throughout this chapter, while relational concepts appear sporadically in the cases, as does economic analysis, the primary battle remains that between classical and neoclassical conceptions. For the most part, the opinions engage in the text-versus-context debate through the terminology and perspectives of the first Restatement, on the one side, and the U.C.C. and the second Restatement on the other. The steady evolution advances neoclassical contract and diminishes classical, except in the instance of contract interpretation, where many courts maintain allegiance, and many more continue to give lip service, to classical rules. I concur with Professor Murray, whose review of contract theory so richly informed this chapter's introduction, in his realistic rapprochement with the modern theories. He concludes that contemporary adherents of neoclassical contract recognize both "the potential contributions of the relationists, empiricists, and economists" as well as "the insuperable obstacles" that those theorists have too often erected.[164] The chief problems with these modern theories, according to Professor Murray, derive from "their insistence that they have discovered unitary truth, their corresponding rejection of on-going neoclassical theory that prevails in the real world, and their failure to provide even hints of functional substitutes in an ambience of practical judicial reasoning."[165]

Whether the construction industry cases may someday, either independently or as part of a broader movement, move contract law beyond its current status as one of the most highly contextual aspects of the common law is a matter of speculation. To that tantalizing exercise, the next and final chapter turns.

161 *Id.* at 1174.

162 *Id.*

163 *See* Carl J. Circo, *The Evolving Role of Relational Contract in Construction Law*, CONSTRUCTION LAW., Fall 2012, at 16.

164 Murray, Jr., *supra* note 1, at 913.

165 *Id.*

7 A backward glance and a forward glimpse

The industry cases in retrospect

In the United States, contract law and the construction industry matured together. Contract law crystalized during the Industrial Age, beginning to season just as the construction industry came to the fore in the ambitious nation. As an instrument of society, contract law gradually became more responsive to commercial stimuli. Contract law started to play a larger role in facilitating commerce, and construction contracts steadily contributed their industry-specific versions of transactional disputes, dramatizing in court some of the most significant legal issues for which an increasingly transactional society required contract law. The industry's progressively more complex, interdependent and long-term relationships provided important occasions for courts to develop principles suitable for acknowledging and regulating exchange transactions.

These circumstances yielded a reciprocal dynamic. As much as contract law informed industry contracting practices and defined its dispute patterns, those very practices and patterns helped contract law evolve effectively and efficiently. In this, the construction industry cases channel Holmes: experience nourished the life of the common law.[1] While contract doctrine, both then and now, serves the essential goals of consistency and certainty in transactional relationships, judges do not resolve contract disputes simply by finding the facts of a case and logically applying doctrinal rules to those facts. As every first-year law student soon learns, common law principles, rules, and doctrine remain ever tentative. The process requires judges to test and refine the hypotheses of legal theory in the reality of the facts cases present. When a rule derived from precedent suggests an unfair or nonsensical result in a given case when judged against societal goals, courts should and do re-examine, clarify, refine, and sometimes overrule.

1 "The life of the law has not been logic: it has been experience." O. W. Holmes, Jr., The Common Law 1 (1881).

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Construction industry contract disputes played an important role in this iterative process. They inspired the substantial performance doctrine, encouraged a more nuanced approach to bargains marred by mistake or infected by changed circumstances, and stimulated judicial regard for commercial relationships stemming as much from reliance as from promise. Construction industry disputes also invited courts to supplement express contract terms with judicially imposed duties, to draw on customs and practices of a competitive and pragmatic industry to interpret and even to modify those terms, and to align remedies more closely with transactional behavior.

As important as the construction industry cases have been to contract law's development over the past century, other segments of commerce, of course, have also provided much of the energy that fueled the process. The law of sales stands out in this regard. But because contracts for the sale of goods frequently occur in isolated and modest transactional relationships of short duration, reform for that branch of contract law could advance legislatively, first through the promulgation of the Uniform Sales Act and then in Llewellyn's more comprehensive and imaginative Article 2 of the U.C.C. Today, Article 2 functions as a semi-autonomous branch of U.S. contract law. Many other forms of exchange relationships also either derive from or operate largely within the contractual realm. These include employment, business organizations, leasing, different forms of agency, common interest communities, trusts, debtor-creditor arrangements, finance, and even aspects of family obligations and consumer protection.[2] Viewed from this expansive perspective, vast swaths of exchange relations have emerged as more or less distinct branches of the law of voluntary obligations, often eventually succumbing in varying degrees to legislative domination. These developments left but a narrow band of exchange transactions to the common law of contracts, and it is there that construction industry contract cases played a singular role.

Post-U.C.C., contracts for services now furnish much of the material for courts to carry on the common law of contracts. The construction industry consistently provides an especially rich source of disputes under contracts for services. Industry contracts display attributes that challenge courts in particularly significant ways. The construction experience tests the common law process as few other fields of commercial exchange can. Even the simplest of construction projects features long-term relationships subject to constantly changing circumstances under conditions of extreme performance risk. With considerable help from construction industry disputes, the residual common law of contracts broadly accepted the second Restatement's neoclassical framework, which owes so much to Llewellyn and the legal realists.

2 *See* Ian R. MacNeil, *Relational Contract: What We Do and Do Not Know*, 1985 WIS. L. REV. 483, 494 (1985).

Indeed, leading industry cases document the transition from a classical to a neoclassical conception of contract as well as any group of common law cases can. Those who argued for a scientific version of contract law featuring relatively few, highly determinate principles of general application across all forms of exchange began losing the war with the legal realists' revolution. As this book chronicles, the construction industry cases of the late nineteenth and early twentieth century helped fuel contract law's progression toward a more flexible, contextual, and relational framework. Industry cases presented some of the contractual disputes that encouraged courts to invoke public policy justifications for expanding implied warranties and for deriving specific obligations from the generic duties of good faith and fair dealing. They contributed to the progression from the limited law of impossibility to the broader concepts of impracticability and frustration of purpose, and they altered how contract law reacts to changed circumstances. As we have seen, however, the neoclassical victory remains incomplete in one heated area of scholarly debate—matters of contract interpretation. In particular, countless contract cases, including many from the construction industry, continue to invoke competing variations on the classical plain meaning and parol evidence rules and to struggle with the interpretive problems of incomplete contracts. On these perennial issues, classical contract's formalism retains its most pronounced status (or, as some would argue, neoformalism has had its greatest impact).

What is just as important is that the construction industry cases confirm the common law's resistance to the grandest theoretical movements in contemporary contract scholarship. Aside from whatever limited victories the neoformalist can properly claim (primarily involving contract interpretation) and occasional judicial nods to economic analysis and relational theory, the raging debates among contract scholars barely register in the case law. Perhaps others can find greater evidence of the impact contemporary contract theories have had in other transactional settings, but I find little trace of it in the industry cases. From the construction industry perspective, the common law remains firmly entrenched within the classical-neoclassical spectrum. I offer this conclusion not to impugn the scholarly relevance of the more recent theoretical work, but merely to assert its limited influence over contract law in the courts.

The future of contract law in the industry and beyond

My central claim has been, and remains, that the scholarly enterprise gains much from examining contract law in the construction industry context. As for the future, industry contract disputes will continue to deserve special attention from contract law scholars for the same reasons that they were important during the classical-to-neoclassical transition. This may, however, become less significant in the continuing development of the common law than it has been in the past. In the private sector, arbitration and other alternative dispute resolution mechanisms divert a growing proportion of contract disputes within the industry away from the courts. The past several

decades have seen declining litigation (in proportion to all construction industry claims and disputes) as alternative dispute resolution mechanisms have continued to gain popularity. The percentage of these disputes resolved in appellate decisions will likely continue to decline, especially for the most complex commercial projects. As a result, public construction projects and relatively small private projects will account for a large proportion of the reported cases that will provide the precedents to mold the common law. Additionally, legislatures will continue to intervene to regulate contracting practices throughout the construction industry, thereby narrowing the reach of the common law with respect to some specific contract law issues. Currently, legislators debate whether or how to regulate such hot topics as pay-when-paid, termination-for-convenience, no-damage-for-delay, and broad indemnity terms. Finally, and perhaps most importantly, sophisticated participants in the industry, with advice from experienced legal counsel, will continue to experiment with more highly collaborative project delivery systems designed to manage disputes through entirely private structures, sidestepping not only the courts but all forms of law-focused dispute resolution. There will continue to be a distinguishable branch of contract law for the construction industry, but it will increasingly be more visible and important as a facet of the industry itself than as a researchable aspect of our legal institutions.

In assessing exchange transactions in the construction industry, contract scholars in the twenty-first century should be looking beyond the common law. Tomorrow's construction projects will be even more complex than those of the past century, and they will generate even more intricately interdependent relationships than those we see today. Contract scholars, therefore, should pay greater attention to how the industry and experienced lawyers craft interrelated contracts for the design and construction of complex projects. This should include a close study of the terms of the growing number of standard contract documents promulgated by industry groups, some of which compete intensely for market share. Professor Justin Sweet, the academic godfather of construction law, has called on academics to undertake studies of such contracts because standard contracts are so important to our understanding of construction law.[3] I agree that this is a promising area of construction law scholarship. Other aspects of contracting practices in the industry suggest more theoretical research projects. Technologies such as building information modeling, and advanced delivery systems such as integrated project delivery, will continue to emerge to drive the industry toward more collaborative and efficient contracting practices.[4] Innovative project

3 Justin Sweet, *Standard Construction Contracts: Academic Orphan*, CONSTRUCTION LAW., Winter 2011, at 38.

4 *See* Carl J. Circo, *A Case Study in Collaborative Technology and the Intentionally Relational Contract: Building Information Modeling and Construction Industry Contracts*, 67 ARK. L. REV. 873, 898-925 (2014).

administration devices such as proactive project neutrals and dispute adjudication boards will insulate many high-value problems from the risks of traditional legal institutions. In an ironic twist, these forces may mean that economic analysis and relational contract theory may become more important to the study of contracting practices in the construction industry than they have ever been to the study of the common law of contracts. The "braiding theory" that Professors Gilson, Sabel, and Scott have advanced comes to mind in this regard.[5]

The future of construction law scholarship

The story of contract law in the construction industry context demonstrates at least two important reasons to enhance scholarly interest in construction law in the future. First, the contract cases from the industry help us understand how courts treat contract disputes that commonly arise in this especially important segment of the economy. In that way, the cases suggest that we can learn much from assessing contract law comparatively in different contexts. Second, the industry cases enhance our appreciation of how the common law's mandatory and default rules for contractual obligations inspire lawyers experienced in a distinct field of exchange relations to develop particularized contracting practices to allocate and manage transactional risks more efficiently. Those two components—industry dispute patterns and industry contracting practices—work together to reward the scholarly endeavor.

Assessing the industry cases can improve our understanding of how contract law has developed, continues to develop, and may further develop. Examining industry contracting practices highlights some flaws, loopholes, and gaps in contract law doctrine and tells us something about the behavioral aspects of exchange relationships. Studying how courts resolve contract disputes in the industry and how industry participants structure their exchange relations also have salutary practical advantages, sometimes leading to judicial endorsements of practices that have doctrinal implications, and other times facilitating the expansion and incorporation of those implications for other types of exchanges. The academic inquiry can also suggest innovative frameworks for legislators and for arbitrators, mediators, and other dispute resolution professionals.

Construction law, however, involves far more than contract disputes. Indeed, if the industry continues to move, as I believe it will, toward more collaborative exchange structures, construction law scholarship should focus less on contract law and more on other areas in which law intersects with the construction industry. For example, as noted in Chapter 6, the industry cases present special challenges for the economic loss rule of tort law. Construction

5 Ronald J. Gilson et al., *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, and Doctrine*, 110 Colum. L. Rev. 1377 (2010).

industry relationships produce some of the most confounding problems about the outer reaches of the economic loss rule. Scholars should also revisit the contours of professional malpractice law for architects, engineers, construction managers, and other industry professionals. The role of insurance and surety bonds in the construction industry also deserves more scholarly attention, as do the influences of laws and regulations specifically governing public projects, such as the federal Miller Act (addressing payment bonds on federal projects) and the Federal Acquisition Regulation (governing terms and practices under federal procurement contracts). Trends in public-private partnerships to finance public projects raise a host of important policy questions that deserve greater scholarly attention, as do public incentives and private practices relating to sustainable development and green buildings. The role of government regulation of safety and environmental risks, and for consumer protection purposes, also merits greater attention from construction law scholars.

For legal practitioners, construction law exists as a fully developed specialty. For academic lawyers, construction law remains a frontier yet to be thoroughly explored.

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