skellengerbender
ATTORNEYS

Pacific Northwest DESIGN PROFESSIONAL LEGAL UPDATE

Washington Oregon Alaska Idaho

APRIL 2008

Design and Construction Attorneys

Beth M. Andrus
William J. Bender
David K. Eckberg
Kara R. Masters
Peter A. Offenbecher
Lindsey M. Pflugrath
Terence J. Scanlan

1301 Fifth Avenue
Suite 3401
Seattle, Washington 98101
(206) 623-6501
www.skellengerbender.com

WHAT ARE THE TIME LIMITATIONS FOR BRINGING A CONSTRUCTION DEFECT LAWSUIT IN WASHINGTON?

The parties to a contract for professional services can bargain for any limitation on the time period for bringing a claim, as long as the bargained-for limitation does not violate public policy. Therefore, it is common for parties to design contracts to include limitations that are for a shorter period than the time limitations allowed by law.

Practice Pointer: If a design firm intends to bargain for a shortened statute of limitations on claims, we suggest the shortened time period be commercially reasonable, given the nature of the project and the nature of the services to be provided. The bargained for time limitation on legal actions should also clearly apply to all claims arising out of the contract or the professional services provided pursuant to the agreement. The firm's counsel can assist in drafting such a clause.

Be aware of statute of limitations clauses that are buried in "industry standard agreements."

Many industry standard agreements contain statute of limitations clauses. These clauses can be more, or less, protective of the design professional than the limitations allowed by controlling law. For example, the new AIA Contract documents contain a ten-year time limitation on all suits arising out of the contract due to construction defects. This new language has raised questions for many design professionals regarding the professional's window of liability under Washington law, especially for claims alleging construction defects.

The statute of limitations for construction defect lawsuits has been a confusing topic in Washington law for several years. There are a number of princi-

(Continued on page 2)

CAN PREJUDGEMENT INTEREST BE APPLIED TO AN ARBITRATION AWARD?

When considering inclusion of an arbitration clause in your next contract, it is worth knowing that a recent Washington decision clarified what can – and cannot – be recovered in arbitration; specifically, prejudgment interest will almost never be recoverable by the prevailing party.

Generally, a party is entitled to prejudgment interest *only* on damages which are "liquidated." "Liquidated damages" in the contractual context are typically those established within the contract in some proscribed amount or calculation (i.e. a contract clause expressly setting liquidated damages at a specific dollar amount or as a set percentage of an established sum). When damages are set according to a fixed term within the contract, then such damages are considered liquidated. When damages are liquidated, then prejudgment interest accrues from the date the damages were incurred. See, for example, *Hanson v. Rothaus,* 107 Wn.2d 468 (1986). Prejudgment interest is allowed and recoverable precisely because of the fixed, non-discretionary nature of the damages. When a court has no need to apply any discretion to the calculation, and in fact, the parties themselves have no genuine argument as to the calculation of damages, such liquid damages are fairly treated as ripe for an award of prejudgment interest.

However, damages, even those mandated by contract, which cannot be calculated without some exercise of discretion, are not liquidated. In a recent Washington Supreme Court case, *Department of Corrections v. Fluor Daniels, Inc. et al*, 160 Wn.2d 786 (2007), the Court was asked to consider whether the *character* of damages can change from "non-liquidated" to "liquidated" damages by virtue of an arbitrator's award. An arbitration award is a binding decision entered in a private, alternative dispute resolution process, but it is not a court-entered judgment. The question was whether an arbitrator's *decision* becomes the equivalent of a court's *judgment* for purposes of rendering damages certain and, therefore, subject to prejudgment interest. (After entry of judgment, a party entitled to damages may also recover post-judgment interest on the damages until satisfied by full payment.)

Fluor Daniels, Inc. (Fluor) and the Washington Department of Corrections (DOC) entered into a contract for Fluor to construct a new prison. Substantial cost-related disputes arose, which led to litigation; shortly before trial, the parties entered into a written, binding settlement agreement, which resolved some of the disputes and submitted the remaining issues to binding arbitration. The agreement included language that specifically waived any right of appeal from the arbitration. Fluor prevailed at arbitration and was awarded almost $6 million dollars in damages. Three weeks later, Fluor

(Continued on page 3)

TIME LIMITATIONS (cont'd)

ples at play:

The Washington Statute of Repose. The concept behind the Statute of Repose was that all claims involving defective construction should accrue **no later than** six years after substantial completion of the construction or six years after termination of services, which ever is later. This was the law created by the legislature in 1986 to protect participants in the construction process from stale claims. RCW 4.16.310. The idea behind the statute of repose was that at a clearly defined point in time after the project is done, any liability for construction defects should simply end, as a matter of public policy. This bar to legal action for claims that accrued after six years would also trump any statute of limitations.

The statute of repose embodies a different concept than the statute of limitations. Under the Washington statute of limitations, a claim for breach of a written contract was barred after six years and a tort claim was barred after three years. Thus, to determine the time limitations for claims arising out of improvements to real property, one first had to determine if the claim was controlled by a written contract between the parties or, if the claim was brought by a third party, whether the three year statue of limitations for torts controlled.

Thus, for either breach of contract claims or third party tort claims, there was a two step analysis: 1) Under the statute of repose, the claim must have accrued within the six year statute of repose; and 2) the law suit must then be filed within the applicable statute of limitations (6 years for breach of a written contract and 3 years for a tort claim).

The Discovery Rule. The application of the "discovery rule" to construction defect claims by the Washington Court of Appeals in 2002 dramatically expanded the window of liability for design professionals. In *Architechtronics Construction Management v. Khorran* , 111 Wn.App. 725 (Div. 1, 2002), the Court ruled that the "discovery rule" should apply to breach of contract claims, as well as tort claims. Under this important holding, as long as the claim accrued within 6 years of the completion of the construction or completion of the services, the breach of contract claim could be brought within 6 years of the date when the claimant "discovered" the elements of the claim.

An example will help understand the significant expansion of risk for design professionals caused by this decision.

> Assume that there was water intrusion into a building envelope due to faulty design within 6 years of completion of construction, but that the Owner did not **discover** the water intrusion and the resulting dry-rot and mold until 10 years after completion of the project.
>
> Under the 6 year statute of limitations for breach of contract claims, the claim would have been time-barred. The *Architechtronics* decision changed this result. Now, if the claim accrued, meaning the damage occurred, during the 6 year statute of repose, the claimant who had not discovered the claim until after the 6 year statute of limitations had run, could still bring the claim within 6 years of discovery.

The Legislative Fix. The construction and design professional industries were understandably outraged by the extension of the discovery rule to breach of contract cases. There was no longer a practical way to bargain for a time limit on actions as part of reasonable risk allocation between the parties.

The Washington legislature was asked to cure the problem caused by the *Architechtronics* decision. In 2003, the Washington Legislature adopted the following amendment to the Statute of Repose:

> In contract actions the applicable contract statute of limitations expires, **regardless of discovery,** six years after substantial completion of construction, or during the period within six years after the termination of the services enumerated in RCW 4.16.300 whichever is later.

As a result of this new amendment to the statute, causes of action for construction defects have to both accrue within the 6 year statute of repose and, be brought within the six years of substantial completion of construction or termination of services. The discovery rule no longer applies.

Recommendations.

1. Understand the controlling statute of limitations and statute of repose in the jurisdiction where the project will be built. Do not agree to statutes of limitations that are less protective than controlling law.

2. Carefully review boiler plate contract provisions to understand what you are being asked to agree to.

3. Consider bargaining for statute of limitations that are more protective than controlling law.

Lindsey M. Pflugrath
& William J. Bender

WASHINGTON UPDATE ON ELECTRONIC SIGNATURE

In the May 2007 Pacific Northwest Construction Law News, we reported on electronic signatures and stamps and discussed the federal "E-SIGN" Act (15 U.S.C. Sec. 7001) and its relation to Washington engineering licensing regulations. In particular, we questioned how the Washington engineering licensing requirement for seals/stamps, which allows for either a wet signature and a handwritten date or an encrypted digital signature and handwritten date, was consistent with the E-SIGN Act, which provides that a signature in electronic format, regardless of whether it is encrypted, and any document in electronic format, cannot be denied legal effect simply because they exist in electronic format.

Since the May publication, the Washington State Board of Registration for Professional Engineers and Land Surveyors initiated a rule-making and adopted changes to the sealing and signing requirements for licensed engineers and land surveyors. The new rule (1) eliminates the requirement of a handwritten expiration date on seals, and (2) provides that a signature can include a "scanned or digitized signature." However, the new rule maintains the requirement that the signature must be "linked to a document in such a manner that the digital identification is invalidated if any data in the document is changed." WAC 196-23-070(2)(d). Arguably, this means that the signature, while scanned, must still be encrypted.

The new rule was adopted by the Board at its March meeting and is expected to be filed by the end of March. It should be available on the Board website in early April.

David K. Eckberg

PREJUDGEMENT INTEREST (cont'd)

reduced the arbitration award to a judgment which was entered by the trial court.

In so doing, Fluor also asked the trial court to award *prejudgment* interest from the date of the arbitration until the judgment (interest for this 21-day period was more than $43,000). The trial court granted this request. DOC appealed this award of prejudgment interest, challenging the trial court's decision that an arbitration award converted non-liquidated damages to liquidated, thus allowing for prejudgment interest to accrue.

The Supreme Court reversed the trial court and held that an arbitrator's award did not convert the nature of the damages to a "liquidated" status, and accordingly, that Fluor was not entitled to an award of pre-judgment interest.

Fluor had presented several arguments as to why it was entitled to prejudgment interest on the arbitration award. First, it asserted that because any arbitration award is generally not subject to appeal under most all circumstances, any such award becomes fixed as the equivalent of a contractually-established liquidated amount and, therefore, subject to treatment as a liquidated damage. The Court rejected this argument, stating that the degree of discretion inherent to the arbitrator's powers is exactly the type of discretion that renders potential damages as non-liquidated.

Fluor also argued that the specific arbitration agreement in that case, effected as part of the settlement with DOC, expressly made the award nonappealable and, therefore, liquidated. The Court noted that the "vast majority" of jurisdictions reject this approach as an "impermissible modification of the [arbitrator's] award."

Fluor argued that the arbitrator's decision is the equivalent of a court's judgment. But the Court pointed out that the correct analogy is to compare an arbitration award to a jury's verdict. A verdict still awaits a final judgment entered subsequently by the court. Prejudgment interest does not accrue upon a verdict in anticipation of entry of the judgment; likewise, it will not accrue following an arbitration award. Fluor specifically claimed that unlike a jury verdict, which can be modified by the trial court prior to entry of final judgment, an arbitration award is not subject to modification prior to being reduced to a judgment, and that, in fact, Washington statutory law expressly provides for such changes to arbitration awards. Further, in this case, the Court noted that in entering into the settlement agreement, which provided for binding arbitration on the remaining unsettled issues while the parties agreed to waive the right to appeal the arbitrator's decision, they did not waive other statutory rights (see RCW 4.76.030 and former RCW 7.04.170) – essentially, that while an appeal was not possible, the trial court's right to modify the arbitration award remained and, thus, the award was not fixed and, therefore, "liquidated."

Finally, the Court noted that because the parties negotiated a settlement agreement with terms setting forth the arbitration procedures, under Washington contract interpretation law, the settlement agreement had to be read consistent with the intent expressed within it, which made clear that neither party anticipated seeking, or asserting a right to, any prejudgment interest following an arbitration award.

The significance of this case for design professionals and contractors giving careful consideration to the choice of inclusion of arbitration clauses in contracts is simply an additional factor to be aware of when considering alternative dispute clauses versus traditional litigation. Once viewed as a panacea for cheaper, quicker and more correct results to construction disputes, arbitration has proven to be advantageous for some parties under certain circumstances and disadvantageous in others. While the *Fluor* decision is of limited importance relative to other substantive considerations to be weighed when evaluating whether an arbitration clause is appropriate for your contract, it does help inform the choice in terms of what to expect from an arbitration process. Parties are advised to remember that even when prevailing at arbitration, it is almost certain that any arbitration award will not be considered as a liquidated award, entitling the prevailing party to prejudgment interest. However, if the underlying claim that is being arbitrated is a liquidated claim, such as a claim for monies due where the amount is not in dispute, we see no reason why the fact that the claim is being arbitrated, as opposed to being litigated in a court, should deprive the prevailing party of prejudgment interest as would be available for any other liquidated or liquidatable claim.

Terence J. Scanlan