



King & Ballow

Volume 31, Number 1

January 2017

# Construction Law Comment



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## INSURANCE CLAIMS

### Court of Appeals in Florida overturns trial court's leaky ruling

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A resident of Florida discovered that water from his kitchen sink leaked into his custom made kitchen cabinets. He filed an insurance claim with Prepared Insurance Company under his "replacement cost" insurance policy. The insurance company sent an adjuster to inspect the damages and the adjuster estimated the loss to be \$8,653.47. The payment for this amount, minus the deductible owed, was issued to the insured. The insured then

sued the insurance company claiming that the company had severely undervalued the loss by only looking at the cost to repair the custom cabinets and not the cost for a complete replacement.

Shortly before trial, the judge made a number of rulings that greatly impacted this case. As an initial matter, the judge ruled that since the policy was a "replacement cost" policy, the insurance company was required to replace the cabinets completely and

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## BREACH OF CONTRACT

### California court affirms contractor was fired "for cause"

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In November, a Court of Appeals in California affirmed that DLK Development, Inc. was dismissed "for cause" and, therefore, not entitled to any damages for breach of contract. In a topsy-turvy turn of events, it was actually DLK that sued a homeowner for breach of contract and money damages it incurred during an extensive remodel of the homeowner's Malibu home. The home-

owner cross-sued for breach of contract, fraud, and other damages.

At the outset of the remodel, the homeowner and DLK entered into an Agreement. Under the terms of the Agreement, DLK was permitted to acquire and negotiate bids from subcontractors, but was required to deliver those bids to the homeowner and her hired architects. The homeowner, with the advice of the

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could not instead pay for the cost of repairs. Failure to do so violated the insurance policy. Additionally, the court ruled that the insurance company's failure to pay a general contractor's overhead and profit as part of the insurance claim also violated the policy. Next, on the day of trial, the court ruled that since it found that a general contractor was required under the policy, only general contractors could testify as expert witnesses at the trial. As a result, both of the insurance company's witnesses were not permitted to testify. Finally, the court ruled that the insurance company could not cross examine the expert retained by the insured on certain issues relating to water damage that happened after the initial incident. The court found them to be irrelevant. Following a jury trial, the insured was awarded \$44,304.85 in damages.

On appeal, the insurance company primarily challenged the trial court's decisions made pre-trial. Ultimately the court of appeals agreed with the insurance company on all points. First, the court addressed the trial court's interpretation of the "replacement cost policy." The appellate court found that "replacement cost insurance is designed to cover the difference between what property is actually worth and what it would cost to rebuild or *repair* that property." The appellate court went on to state that both the

law and the insurer's own insurance policy expressly provided that an insurer may limit its liability to the "reasonable necessary cost to *repair* the damaged, destroyed, or stolen covered property." Therefore, the appellate court found that the trial court incorrectly ruled on this issue.

Next, the appellate court found that an insurance agency is only required to pay for a general contractor's overhead and profit under a replacement policy if necessary or reasonable to use a general contractor. In the current case, it was disputed whether a general contractor was necessary. The trial court should have allowed the insurance agency to present witnesses to testify on the matter regardless of whether the witnesses were general contractors and this issue should have been left to the jury to decide. The trial court's ruling on this matter was in error.

Finally, the appellate court found that banning any questioning regarding the second leak was also an error. Although the expert claimed that the second leak did not change his decision, the insurance agency should have been allowed to challenge this testimony and the issue should have been left to the jury. Based on the above rulings, the appeals court ordered a new trial. ■

## BAD FAITH

### Bad faith is a state of mind

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Compromise, by its very nature, often leaves people unsatisfied. You may be especially unsatisfied when someone purports to negotiate on your behalf, but obtains what you believe to be a bad deal. You may even think the settlement is so bad that the other person must have acted in bad faith. However, the Court of Appeals for the Sixth Circuit recently made clear that just because you are unhappy with a settlement does not mean you will succeed in a lawsuit alleging bad faith.

#### Background

A general contracting company in Michigan entered into a \$5 million contract with the State of Michigan to build a prison kitchen. The company obtained surety bonds from Great American Insurance Company (GAIC). The project was plagued by lengthy delays in the construction process, causing the company to fail to complete the project timely. The company blamed the State of

Michigan for the delays and the State of Michigan blamed the company. A mediator apportioned most of the blame to the company, but did not let the State of Michigan off the hook entirely. The mediator recommended that the State of Michigan to pay \$220,000, but the State of Michigan balked.

The dispute was set to go to another form of dispute resolution called facilitation. Before the dispute proceeded to facilitation, GAIC settled the company's claim with the State of Michigan for \$358,000, pursuant to a provision in the surety agreement that allowed GAIC to settle claims on the company's behalf. GAIC then sued the company that it had the right to settle on the company's behalf. In response to GAIC's lawsuit, the company alleged that GAIC had settled its claims with the State of Michigan in bad faith. The trial court granted summary judgment for GAIC, holding that GAIC had the authority to settle on the company's behalf

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architects and DLK, was the only ones who could ultimately approve hiring of a subcontractor.

Despite this requirement, DLK hired a subcontractor to complete the demolition phase of the remodel. Afterwards, DLK also hired other subcontractors to begin reframing the home. DLK did not seek approval for the subcontractors. In fact, the homeowner did not even discover that any subcontractors had been hired until she saw them working on her home. The architect emailed DLK that the plans for the framing and the subcontractors had not been approved by the architects and the homeowner. The architect stated that the framing needed to cease immediately. The work continued. The work done, however, was not to specs and was done in such a way as to make repairs impossible.

After consulting with the architect, the homeowner decided to terminate DLK "for cause" for violating the Agreement by not seeking approval for the demolition, framing, subcontractors, and failing to follow the architectural plans.

DLK, ignoring the arbitration provision of the Agreement, filed a lawsuit alleging that the home-

owner owed them damages incurred during the early phases of the construction project. The trial court determined that there were sufficient grounds to warrant the termination "for cause." Not only did the trial court rule that DLK would have to bear the costs of materials and labor already performed, the court noted that the homeowner was also entitled to roughly \$40,000 of damages associated with excessive charges she had already paid.

DLK appealed, but was equally unsuccessful on appeal. Under California law, findings of fact at a bench trial are giving great deference on appeal. DLK was tasked with bringing forth "substantial evidence" to challenge the judgment. The appellate court found that the aforementioned breaches justified the trial court's finding that there were grounds to terminate "for cause."

The take-away here is that general contractors need to ensure that they receive all approvals required of them under their contracts—otherwise they could be left bearing the cost of materials and labor themselves. ■

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and also rejecting any argument that GAIC settled in bad faith. The company appealed.

#### Unhappy? Not enough

On appeal, the company challenged the trial court's ruling that GAIC did not settle with the state in bad faith. In support of its argument, the company argued that GAIC kept its settlement negotiations with the State of Michigan secret. It also asserted that GAIC failed to investigate Michigan law on liquidated damages before obtaining a settlement.

The appellate court rejected the company's arguments, and held that the company had failed to prove that GAIC negotiated the settlement in bad faith. The court wrote that bad faith must be proved with evidence of an actor's state of mind, and the company failed to offer enough evidence to prove such a state of mind. First, the court expressed some discomfort with GAIC's secret negotiations with the State of Michigan. The court,

however, noted that the company itself barely negotiated with the state, and could have regained control of its claims if it had posted collateral to GAIC. Second, the court found the company's argument concerning Michigan's liquidated damages law to be little more than an argument that the settlement amount should have been higher. The court also noted that GAIC obtained a larger settlement than what the mediator had previously recommended, hardly evidence of bad faith. Accordingly, the court held that there was not sufficient proof of bad faith to defeat summary judgment.

#### Take-away

The holding in this case shows that parties have a high bar to meet if they allege that a party to a contract acted in bad faith. Being unhappy with a result is common, but just because you may not like the outcome does not mean someone else acted in bad faith. ■



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