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Indiana Court of Appeals Once More Asked to Interpret AIA Standard Construction Contract

After a week off, the Hoosier Litigation Blog returns with a case of contract interpretation. Of course we have discussed contract law numerous times before on the HLB, but today's case is a bit different from our prior discussions. In the past, we have discussed general concepts including damages for breach of contract, the role of disclaimers and integration clauses, and the use of parol evidence. Today's discussion does not primarily focus upon general concepts of contract law. Rather, it merits discussion because the contract at issue is a widely used standard construction contract promulgated by the American Institute of Architects (AIA). The specific portions of the contract at issue are the clauses that require the property owner to purchase insurance for the project and the waiver of subrogation rights. Because this is now the third Indiana decision interpreting these provisions, and there have been at least two other courts outside of Indiana tasked with interpreting these provisions, we shall dedicate today's post to *Allen County Public Library v. Shambaugh & Son, L.P.*

The library assembled a cadre of construction companies to renovate and add to the library. A part of the renovation included the instillation of an emergency diesel generator and two fuel storage tanks in the basement. After completion of the construction work, the library discovered a hole in the newly installed piping that

had caused approximately three thousand gallons of diesel fuel to leak into the ground. The cost to remediate the contamination, according to the library, is $490,000. Though the library had acquired a substantial insurance policy in accordance with the terms of the AIA standard construction contract, the policy only provided up to $5,000 in pollution cleanup coverage. Consequently, the library filed a lawsuit against the construction companies to recover the cost of cleanup. The trial court granted summary judgment to the construction companies finding the contract barred the claim.

An interesting note is the peculiarity that this $5,000 existed at all. The general coverage limit was $54,920,000. Thus, it seems odd that there was such an incredibly small amount of cleanup coverage provided. It would seem that there either would have been no coverage at all or something that was greater than a mere one one-hundredth of a percent of the general coverage.

The issue of the case was whether the provisions mandating insurance and waiving the rights to subrogation acted as a contractual bar to future recovery against the construction companies. The two most important provisions of the AIA construction contract were sections 11.3.1.1 and 11.3.7.

> **11.3.1.1** Property insurance shall be on an "all-risk" policy form and shall insure against the perils of fire and extended coverage and physical loss or damage including, without duplication of coverage, theft, vandalism, malicious mischief, collapse, falsework, temporary buildings and debris removal including demolition occasioned by enforcement of any applicable legal requirements, and shall cover reasonable compensation for Architect's services and expenses required as a result of such insured loss. Coverage for other perils shall not be required unless otherwise provided in the Contract Documents.
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> **11.3.7 Waivers of Subrogation.** The Owner and Contractor waive all rights against each other and against the Construction Manager, Architect, Owner's other Contractors and own forces . . . if any, and the subcontractors, sub-subcontractors, consultants, agents and employees of any of them, for damages caused by fire or other perils to the extent covered by property insurance obtained pursuant to this Paragraph 11.3 or other property insurance applicable to the Work, except such rights as the Owner and Contractor may have to the proceeds of such insurance held by the Owner as fiduciary. . . .

As you may have gathered by the word being capitalized, "the Work" was a defined term meaning:

> [T]he construction and services required by the Contract Documents, whether completed or partially completed, and includes all other labor, materials, equipment and services provided or to be provided by the Contractor to fulfill the Contractor's obligations. The Work may constitute the whole or part of the Project.

The court's analysis began by looking to a 1979 Indiana case that interpreted virtually identical provisions of an older version of the AIA construction contract. In *South Tippecanoe School Building Corp. v. Shambaugh & Son, Inc.*, the court held that "an agreement to provide insurance constitutes an agreement to limit recourse of the party acquiring the policy solely to its proceeds even though the loss may be caused by the negligence of the other party to the agreement." The court also decided that the AIA standard contract provisions "reveal a 'studied attempt' by the parties to require construction project risks to be covered by insurance and to 'allocate among the parties the burden of acquiring such insurance.'" Consequently, the construction contractors were not liable when a gas explosion damaged a high school that was under construction. Importantly, the holding stemmed from the fact that the damage was to the school itself – i.e. the under-construction building – and not to property outside of the project.

The analysis then looked to a second, more recent – 2004, Indiana case. In *Midwestern Indemnity Co. v. Systems Builders, Inc.*, the court addressed the exact same provisions of the AIA standard contract in the context of a completed project. In that case, it was the collapse of the roof on the new addition after a snowstorm that caused the problem. Due to the specific language of the AIA standard contract, the contract still applied even though the project had been completed. Unlike *South Tippecanoe* before, in *Midwestern*, the court found that "the waiver of subrogation is limited in scope as to what property is covered." Specifically, the waiver only applied to the actual "Work" that was done. The court found that this "by definition," did not include "the contents that were placed in the building after it was completed."

The court in *Allen County Public Library* found the damage from contamination to be in line with the *Midwestern* case and not *South Tippecanoe*. This is because the "diesel fuel leak spread beyond the strict confines of the library construction project and seeped into the surrounding land[.]" Because "the Work" is limited to "the construction and services required by the" AIA standard contract, the intent of the contract was "that the Library was under no obligation to procure insurance for damage to property *surrounding* the jobsite or to property outside of

the building project itself."

The court rejected the trial court's finding and the defendants' argument that the damages were consequential and flowing from a mishap related to "the Work." The court, aptly, recognized that such a conclusion could have easily been found in *Midwestern* were the assertion sound. The court also rejected the contention that Section 11.3.7 acts to limit recovery to the loss of the contents of the fuel tanks.

It bears mention that the court also found guidance in two decisions from other states. Notably, these cases were relied on in arriving at the decision in *Midwestern*. Nevertheless, the court found reason to once more cite to them and discuss them directly in *Allen County Public Library*. The cases were: *Town of Silverton v. Phoenix Heat Source Systems, Inc.* from Colorado's intermediary court and *S.S.D.W. Co. v. Brisk Waterproofing Co., Inc.* from New York's highest court. The citation to these cases is illustrative of the impact of this decision far beyond the borders of Indiana. This is made even more clear when examined in the light of the fact that virtually identical language was found in the AIA standard contract in a 1979 decision as it was in a 2013 decision.

Because the subrogation waiver did not apply, the case was reversed and remanded to the trial court to allow the library to continue its claims. The case stands as a reminder of the danger in using form contracts, or at least in not revising the form despite having been dinged by a handful of courts already.

Join us again next time for further discussion of developments in the law.

Sources

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- *South Tippecanoe Sch. Bldg. Corp. v. Shambaugh & Son, Inc.*, 182 Ind.App. 350, 395 N.E.2d 320 (1979).
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