Legal Issues Arising Out of Construction Inspection

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Most articles on construction law focus on the owner/contractor relationship, undoubtedly because that relationship involves contracts with the largest dollar values and because the very nature of that relationship can make it more adversarial than an owner/consultant relationship or a prime contractor/subcontractor relationship. Several times in 2018, in this Legal Update column, we will explore legal issues that entities other than owners and contractors may encounter.

Let's begin with legal issues that consultant inspectors may face from time to time.

Construction contracts are somewhat unique in that one party's contractual performance is under constant scrutiny by the other party. Conversely, in many other commercial contracts, the contractual obligations of one party are performed entirely outside the view of another party, and in many instances all that the party paying for the contractual performance sees is the end result of the performance by the other party.

The use of a large inspection force is a double-edged sword for the owner. On one hand, it is a crucial quality-control mechanism that helps assure the owner receives a quality project.On the other hand, use of a large construction inspection staff can create unnecessary liability risks. This is true regardless of whether the inspectors are either the:

1. Employees of an owner
2. A full-time independent "clerk of the works" hired by the owner
3. Employees of an owner's design professional
4. Employees of a consultant inspector and/or construction manager hired by the owner

Obviously, the owner itself will face liability for any breaches of contract committed by its own employees. However, given that virtually all consultant inspectors are considered to be an agent of the owner, their contractual duties run to the owner, and therefore it would be a highly unusual situation for a contractor who believes it was somehow wronged by a consultant inspector to bring a direct claim against that firm. However, the lack of contractual privity between a contractor and a consultant inspector does not mean that the consultant inspector is absolved of liability for all of their decisions. To the contrary, the potential liability of a consultant inspector is intertwined with that of the owner on inspection-related issues.

Interestingly, there is not a large body of case law involving actual formal lawsuits filed against consultant inspectors. There are several likely explanations for that phenomena. First, an owner is not typically inclined to sue one of its consultants. Second, when issues give rise to a contractor dispute with an owner that may be the result of actions of the consultant inspector, the contractor is invariably legally required to pursue its rights directly against the owner. In those instances, it is often counterproductive for an owner to bring a third-party claim against one of its consultants in the same legal action, and thus it often does not occur. However, that does not mean that the owner may not separately pursue rights against the consultant inspector once its liability to a contractor is resolved – either through a formal court decision or settlement. When owners choose to do so, that process typically is handled informally. Finally, claims by a sophisticated owner (such as PennDOT or the Turnpike Commission) against consultant inspectors are often difficult because full-time owner employees frequently have a fair amount of control over the consultant inspection staff, and those inspectors are usually acting at the owner's direction, making pursuit of a separate claim difficult.

Given the sparse amount of reported cases brought directly against a consultant inspector, to understand the potential contractual liability that a consultant inspector may have, it is necessary to evaluate the body of case law that has developed with respect to owner inspection issues arising on public construction projects. There are two principal-related legal theories which have evolved, particularly in the Federal Court, with respect to construction inspection issues: (1) over inspection, and (2) maladministration. These two legal concepts are treated as types of constructive changes to a construction contract, and they have their legal underpinnings in the theory of the owner's duty not to hinder or delay the contractor.

Under Pennsylvania law, every party to a contract has a duty of good faith and fair dealing. On construction projects, one of the most fundamental aspects of that duty of good faith and fair dealing on the owner's part is to cooperate with the contractor, and to not do anything to unnecessarily hinder

or delay the contractor. As the agent of the owner, a consultant inspector thus has the same obligation not to hinder or delay the contractor. It is important to note, however, that this duty is not absolute. For example, the owner/consultant inspector does not have a duty to make work easier where the specifications contain certain specific-defined requirements. It is also an inherent right of the owner and/or its agents to inspect the work at any time until that work is accepted.

The legal theories of over inspection and maladministration have primarily been recognized in construction disputes arising out of federal projects, and there are many cases decided either by the United States Court of Claims or by the Armed Services Board of Contract Appeals in which these legal principles have been discussed. For example, in the United States Court of Claims case Adams v. United States, the Court of Claims dealt with the issue of the effects of unfair inspections on contractors. In this case, the Court of Claims attributed "extensive delay … to the arbitrary and unreasonable action of" an inspector. The inspector in Adams visually inspected and deemed defective as many as 50 percent of the tent pins produced by the contractor. The Court explained that the inspector considered pins to be defective "even though some of the particular defects they contained were not specifically prohibited by the contract specifications." Ultimately, the Court determined that a portion of the contractor's loss was due to the "erroneous and unwarranted rejection or discard of tent pins under inspection procedures followed by" the inspector employed by the owner. As such, the owner was required to compensate the contractor for such costs.

Another example of an owner being found responsible for extra costs as a result of over inspection issues is the seminal case of W.F. Kilbride Construction Inc., a case before the Armed Services Board of Contract Appeals. In that case, the Board analyzed paint inspection procedures used by the Navy on 72 buildings on a housing complex on a base in Key West, Fla. The Board found that after the first five buildings were inspected, the inspection standards were changed by "an overzealous attempt by the inexperienced assistant officer … to obtain perfection." The Board also found that the Navy subsequently improperly used multiple punch lists on the remaining 55 buildings. Accordingly, the Board of Contract Appeals noted that its inspection procedures utilized by the owner were "confusing and vacillating," and that the contractor's completed work was subject to "multiple inspections and to differing standards by different officials." Thus, the Board ruled that the contractor was entitled to additional payment.

One final example of "over inspection" by an owner's representative can be found in the case of Neal & Company v. United States, another Federal Court of Claims decision. In that case, a contractor sued the U.S. Coast Guard on a project involving a housing subdivision on a Coast Guard base in Alaska. Part of the claim involved the issuance of unreasonable punch lists. The Court found that in many cases the punch lists were unreasonably picky, and often asked the contractor to fix things that could not be fixed short of a change in design. Because such directives were unreasonable, the Court found that final completion was delayed, and that the contractor was entitled to compensation.

Based on the body of case law that has developed in over inspection/maladministration cases, a consultant inspector runs the risk of being brought into a dispute, or having a subsequent claim brought against it by an owner, for a range of inspection-related issues. Some examples that have been the subject of several court cases include:

1. The issuance of multiple and unreasonable punch lists
2. Refusal to perform inspections of completed work, and/or perform those inspections so as not to delay the contractor
3. Overly close surveillance on the contractor's work
4. Employing dozens of inspectors with varying standards as to what constitutes satisfactory performance
5. Imposing standards on the contractor that are more stringent than required by the specifications
6. Imposing standards on the contractor that are higher than those recognized in the industry
7. The failure to reasonably exercise discretion in inspecting work
8. Substituting the inspector's judgment for the means and methods utilized by the contractor
9. Failure to prevent other contractors working for the owner from interfering with the contractor
10. Directing removal and replacement of material that substantially complies with the contract requirements

Consultant inspectors are faced with the difficult task of enforcing voluminous specifications and keeping their owner client happy. However, in order to minimize liability risks for both themselves and the owner, it is important to make sure that both the daily inspection process and the project close-out process are performed timely and reasonably.

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