Supreme Court No. 98753-0
Court of Appeals No. 80649-1-I

IN THE SUPREME COURT OF THE STATE OF WASHINGTON

CITY OF PUYALLUP,

Petitioner,

vs.

CONWAY CONSTRUCTION COMPANY,

Respondent.

PETITION FOR REVIEW

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I. IDENTITY OF PETITIONER

The City of Puyallup ("City"), asks this court to accept review of the Court of Appeals decision terminating review designated in Part II of this petition.

II. COURT OF APPEALS DECISION

The City seeks review of a portion of the Court of Appeals Decision filed on May 4, 2020, a copy of which is in the Appendix at A-1 through A-13 (the "Decision"). The Petition is timely filed because a motion for reconsideration was filed by Respondent and the order denying the motion for reconsideration was filed on June 10, 2020. A copy of the order denying motion for reconsideration is in the Appendix at A-14.

The City specifically seeks review of the portions of the Decision concerning a) standard for termination, b) termination justification, and c) the City's right to a set-off for defective work.

III. ISSUES PRESENTED FOR REVIEW

1. Termination for Default.

Where a public works contract specifies certain conditions of default justifying termination and requires that any cure of those conditions be completed to the satisfaction of the owner's engineer, is the

engineer entitled to exercise his discretion in rejecting the contractor's tendered cure? Answer: Yes.

2. City Counterclaims for Defective Work.

Where a contractor has installed defective or unauthorized work before being terminated, should the owner be allowed to set-off the cost of correcting the defective work against amounts otherwise due the contractor? Answer: Yes.

IV. STATEMENT OF THE CASE

On or about September 21, 2015, the City and Conway Construction Company ("Conway") entered into a public works contract (the "Contract")[1] for significant road improvements to 39th Avenue Southwest in Puyallup, Washington (the "Project").[2]

The Contract between the City and Conway contains two provisions specifically dealing with termination of the Contract for default. Paragraph 22 of the Contract provides that violation of a statute or regulation is "good cause" for terminating the Contract:

[1] Contract. [CP 17-27; Trial Ex. 5]. The Contract includes the "Public Works Contract" form which was attached to Conway's initial complaint, (the "Contract Form") and several voluminous documents incorporated by reference. The referenced documents include the Washington State Department of Transportation ("WSDOT") Standard Specifications for Road, Bridge, and Municipal Construction (2014), [Trial Ex. 1] (the "Std. Specs.") and the Contract Special Provisions (the "Special Provisions") Project Manual, [Trial Ex. 2 pp.177-316].

> 22. Termination. The City shall be entitled to terminate this Contract for good cause. "Good cause" shall include, but shall not be limited to, any one or more of the following events . . .
> d. Contractor's failure to comply with Federal, state or local laws, rules or regulations[3]

The Contract also incorporates the Washington State Department of Transportation ("WSDOT") Standard Specifications for Road, Bridge, and Municipal Construction (2014).[4] Section 1-08.10(1) of the Std. Specs. provides that the Contracting Agency (in this case the City) may terminate the Contract upon the occurrence of any one or more of the following events:

> 1. If the Contractor fails to supply sufficient skilled workers or suitable materials or equipment;
> 2. [Inapplicable]
> 3. [Inapplicable]
> 4. If the Contractor disregards laws, ordinances, rules, codes, regulations, orders or similar requirements of any public entity having jurisdiction;
> 5. If the Contractor disregards the authority of the Contracting Agency;
> 6. If the Contractor performs Work which deviates from the Contract, and neglects or refuses to correct the rejected Work; or
> 7. If the Contractor otherwise violates in any material way any provisions or requirements of the Contract.

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[2] Finding of Fact (hereinafter referred to as "Finding") No. 3. [CP 2461; Apps. A-B].
[3] Contract Form. [Trial Ex. 5, p.8 ¶ 22].
[4] Std. Specs. [Trial Ex. 1].

> Once the Contracting Agency determines that sufficient cause exists to terminate the Contract, written notice shall be given to the Contractor and its Surety indicating that the Contractor is in breach of the Contract and that Contractor is to remedy the breach within 15 calendar days after the notice is sent. . . . If the remedy does not take place to the satisfaction of the Contracting Agency, the Engineer may, by serving written notice to the Contractor and Surety either:
> 1. Transfer the performance of the Work from the Contractor to the Surety; or
> 2. Terminate the Contract . . . .[5]

During the course of performance several issues arose concerning Conway's quality of work. The City issued notices to Conway called Non-Conformance Reports ("NCRs") detailing the City's concerns about the quality of concrete pavement, defects in utilities, and other construction defects.[6] In addition, the City observed unsafe work conditions, including lack of trench shoring, and reported those conditions to the Washington State Department of Labor & Industries.[7]

On March 9, 2016, the City issued its Notice of Suspension and Breach of Contract.[8] The City cited nine items that it considered to be breaches of the Contract. The nine items included defective and

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[5] Std. Specs., §1-08.10(1). [Trial Ex. 1, pp.1-80]. The Std. Specs are divided into 9 different "Divisions." Division 1 contains the Contract provisions that are a primary focus of this appeal, hence the page numbering for the quoted Section is read Division 1, page 80.

[6] Non Conformance Reports ("NCR's"). [Trial Ex. 69].

[7] [Trial Exs. 55, 56, 57, 61, and 62].

uncorrected work and safety concerns.[9] In accord with the terms of the Contract, the City informed Conway that it had "fifteen (15) calendar days from the date of [the] letter to remedy the issues listed below."[10] In regard to safety violations the City's letter stated:

> **9. Job site safety**: There have been numerous occasions that the City has observed un-safe site conditions (such as improper shoring) but the City does not have the authority to penalize the contractor for safety violations. It is very clear in the contract under 1-07.1 that the contractor must obey and follow all Federal and State regulations. Safety violations were brought to the attention of the contractor by the Engineer without response. After such attempt, the Engineer did ask the Department of Labor and Industries for assistance in achieving compliance.[11]

In response to the City's safety concerns, Conway responded with what amounts to a general denial:

> CCC values safety. I have interviewed Ken Conway and McKenzie Baker. None of us are aware of 'numerous occasions that the City has observed unsafe site conditions.' Ken does recall one instance when the Engineer noted an unsafe condition. We welcome assistance from the Department of Labor and Industries.[12]

On March 10, 2016, the City responded to Conway saying that "if the Contractor does not correct the deficiency to L&I's satisfaction, the

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[8] March 9, 2016, Notice of Suspension and Breach of Contract. [Trial Ex. 44].
[9] *Id.*
[10] *Id.*, p.1.
[11] *Id.*
[12] March 9, 2016 Conway Letter, [Trial Ex. 45, p.3].

City will suspend operation until the work site is deemed safe again by L&I."[13] Various letters and emails were then exchanged between Conway and the City concerning defective work and safety concerns.[14] On March 21, 2015, the City informed Conway that it still needed to "completely remedy" all nine items in the Suspension Letter.[15] The letter also informed Conway that the City had received further reports of safety violations:

> In regards to item #9, I have received further reports of unsafe practices on the job site, the most recent report of an instance of improper practices in working with asbestos cement concrete water pipe in the vicinity of the day care facility. The lack of standard safe practices by Conway Construction Company continues to be a significant concern of the City, both for Conway Construction Company employees, sub-contractors, and City employees, but also the general public within the project area.[16]

The same day, March 21, 2016, Conway responded by denying it had cut asbestos pipe.[17] Part of the City's investigation into Conway's safety violations included reviewing photos taken by the City's on-site

[13] March 10, 2016 City Letter, [Trial Ex. 46, p.2].
[14] [Trial Exs. 46 thru 57].
[15] March 21, 2016 City Letter, [Trial Ex. 53, p.1].
[16] March 21, 2016 City Letter, [Trial Ex. 53].
[17] March 21, 2016 Conway Letter, [Trial Ex. 54, p.2].

Inspector, Steve Cox.[18] The photographs show a deep trench without shoring and an excavator parked immediately above the worker.[19]

On March 25, 2016, the City issued a Notice of Termination.[20] In regard to safety (or lack thereof) the City stated in its termination letter:

> Conway Construction Company has failed to obey all laws, ordinance, rules, codes, regulations and orders of public entities by numerous safety unsafe construction practices, illicit discharges, and poor traffic control implementation.[21]

In accord with Std. Spec. 1-08.10(1), the City withheld further payments due to Conway under the Contract.[22] On April 13, 2016, the Department of Labor & Industries issued a Citation and Notice of Assessment to Conway.[23] The L&I Citation was for a "serious" safety violation endangering the safety of Conway's workers.[24]

A. <u>Conway Files for Declaratory Relief.</u>

On May 10, 2016, Conway filed a "Petition for Declaratory Judgment" in Pierce County Superior Court seeking to have the

[18] *See, e.g.* Inspector Reports, [Trial Ex. 55]. The photograph on p.2 of the Exhibit shows a deep trench well over the head of the worker at the head of the trench. [Trial Ex. 55, p.2].
[19] *Id*.
[20] March 25, 2016 Termination Letter, [Trial Ex. 58].
[21] *Id*. at p. 1.
[22] *Id*.
[23] April 13, 2016 L&I Citation and Notice of Assessment, [Trial Ex. 59].
[24] *Id*.

termination declared improper and deemed to be one of public convenience.[25]

B. <u>The City Discovers Defective Work and Right to Set-Off</u>

Four months after Conway was terminated and a replacement contractor started work, the City discovered that Conway had performed defective work, including significant defective concrete roadway panels that were installed with the wrong slope.[26] The slope defect affected almost all of the roadway that was installed by Conway before termination.[27] The City asserted a counterclaim for defective work.

The City based its claims for set-off upon *Ducolon Mech., Inc. v. Shinstine/Forness, Inc.*, 77 Wn. App. 707, 893 P.2d 1127 (1995) which held that even where a subcontractor has been improperly terminated, the general contractor is entitled to a set-off for the cost of correcting the subcontractor's defective work. Relying on an Oregon court of appeals case, *Shelter Products, Inc. v. Steelwood Construction, Inc.*, 257 Or. App. 382, 402, 307 P.3d 449 (2013), the trial court ruled as a matter of law that the City was not entitled to recover anything for defective work that was

[25] Conway Petition, [CP 1-39].
[26] Finding 162 [CP 2697] and Findings 167 thru 171 [CP 2698]. Trial Ex. 172 contains a summary of the City's counterclaims for defective work discovered after March 25, 2016; Parametrix Report, [Trial Ex. 85].
[27] Parametrix Report, [Trial Ex. 85].

not discovered before termination.[28] The Court of Appeals adopted the reasoning of *Shelter Products* and affirmed the decision of the trial court.

V. WHY REVIEW SHOULD BE ACCEPTED

If accepted, this Court will be faced with two issues of first impression in Washington. First, what is the correct legal standard for determining whether a city properly terminates a contractor for cause, and what discretion should the project engineer be afforded in making that determination. Second, even if a city improperly terminates a contractor for cause, must the city be forced to pay for defective work installed by the contractor, functionally requiring the public to pay for the same work twice.

A. The Court of Appeals Applied the Wrong Legal Test in Determining Whether the City Properly Terminated Conway.

The Court of Appeals adopted the wrong legal test for whether Conway should be terminated due to a serious safety violation. The Court of Appeals held that "the City was only justified in terminating the contract for rejected work if Conway neglected or refused to correct the rejected work." (A-7). The proper test is whether Conway was in default

[28] Conclusions 16-19 [CP 2701-2704].

(which it was) and whether the City was satisfied with Conway's efforts to remedy the breach (which it was not).

Under the Contract, the City is required to provide notice to Conway of potential breaches justifying termination.[29] Conway is then required to remedy those breaches. The City Engineer had discretion to reject Conway's tendered cure. Specifically, the Contract provides that "if the remedy does not take place to the satisfaction of the Contracting Agency, the Engineer may . . . Terminate the Contract."[30] By applying the wrong test, the Court of Appeals ignored the requirements of the Contract and shifted Conway's burden of proof to the City.

The Court of Appeals did not even address the issue of whether the City had discretion to terminate if it was not satisfied with whatever remedy was tendered by Conway. The Court of Appeals incorrectly ruled that "neglects or refuses to correct rejected [w]ork" applies in the instance of safety violations. (A-7). The Court of Appeals reasoned that safety breaches are a "work breach" and not "violation of law breaches." (A-7). There is no such distinction in the Contract, and "work breach" is not a defined contract term.

[29] Std. Specs., §1-08.10(1).

Further, lack of evidence of further safety violations after the initial notice of default does not address any of the Contract's requirements for termination. While the Court of Appeals is correct that no additional safety violations occurred after the notice of termination was sent, it is because there was no ongoing work that might lead to additional safety violations. As the trial court notes in Finding No. 43, only work on the nine default items were permitted after the City issued its March 9, 2016 Notice of Suspension.[31] The only issue for determining whether the City properly terminated Conway is whether there was a default (which there was) and whether it was somehow cured to the satisfaction of the City (which it was not.)

The applicable federal case law addressing this issue supports the City. Once the City shows that there was a default (defined by contract or otherwise) the City Engineer has broad discretion whether to terminate:

> A contracting officer possesses "broad discretion" when deciding whether to terminate a contract for default. *Consol. Indus., Inc. v. United States,* 195 F.3d 1341, 1343 (Fed.Cir.1999). This discretion, however, is not boundless.

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[30] Washington State Department of Transportation Standard Specifications 2014 (hereinafter the "Std. Specs.") §1-08.10(1) [CP 976] and [Trial Ex. 1, p.1-80] also contained in Appendix J to Appellant's Appellate Opening Brief.

[31] Finding No. 43 [CP 2470].

> A default termination will be overturned if it is "'arbitrary, capricious, or constitutes an abuse of discretion.'"[32]

The Court of Appeals' reliance on *Lisbon Contractors, Inc. v. United States*, 828 F.2d 759 (Fed. Cir. 1987) is misplaced. The federal case law is clear that once a breach of a specific default provision has been established, the liability phase of the case ends:

> [D]etermining whether a termination is appropriate is a two-stage process: **First, the court examines whether defendant has demonstrated that the default was proper under clauses in the contract providing for specific events of default. If defendant makes such a showing, the liability phase of the case ends.**[33]

The court in *Lisbon* simply says that "the government should bear the burden of proof with respect to the issue of whether termination for default was justified."[34] It also held that all the government needed to show was "a reasonable belief on the part of the contracting officer that there was no reasonable likelihood [of performance.]"[35] In *Lisbon* the government's failure to provide any direct testimony of delay was fatal to

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[32] *Takota Corp. v. United States*, 90 Fed. Cl. 11, 16 (Fed. Cl. 2009) (upholding a default termination where "the contracting officer exercised reasoned judgment and did not act arbitrarily")

[33] *5860 Chicago Ridge, LLC v. United States*, 104 Fed. Cl. 740, 757 (Fed. Cl. 2012) (emphasis added).

[34] *Lisbon*, 828 F.2d at 765.

[35] *Id.*

the government's case.[36] This is a far cry from this case where there is ample evidence of safety violations, in particular the citation by L&I for a serious safety violation endangering the life of a worker. The City also had unrebutted reports of other safety violations.

In its Phase I Findings and Conclusions, the trial court found that Conway committed a serious safety violation.[37] The trial court further found that the safety violation in question was deemed by the Department of Labor and Industries as a "serious" safety violation endangering the life of workers on the job.[38] The trial court found that Conway had breached the Contract. Thus there was unquestionably a breach justifying termination.

The City was only required to show that Conway breached a specific condition of default under the Contract in order to justify termination. As held in *5860 Chicago Ridge, LLC v. U.S.*, a recent federal Court of Claims case:

> Accordingly, the burden of proof placed on defendant in a given case depends upon the particular contract clause involved and, specifically, whether thereunder the default arises from: (i) a failure to perform a contract requirement enumerated in the default provision (as was the case in

[36] *Id.*
[37] Finding 14 [CP 2464].
[38] L&I Citation, [Trial Ex. 59]. A photograph of the offending trench is included in Ex. 37, Photo 21. *See also*, Citation and Notice of Assessment [CP 1088].

> *Kelso*); or (ii) a failure to perform one of the "other provisions" in the contract. Cibinic & Nash, "Default Termination for Failure to Comply with 'Other Provisions,' " *supra.* In the former instance, defendant need not show that the failure constituted a material breach; in the latter, it must show that the breach was material.[39]

The only remaining question is whether the City should have been satisfied with Conway's performance. The accepted law in Washington regarding "satisfaction" clauses is that if the satisfaction deals with judgment, then what is required is good faith exercise of that discretion.

> Where the question is one of judgment, the promisor's determination that he is not satisfied, when made in good faith, has been held to be a defense to an action on the contract.... Although these decisions do not expressly discuss the issues of mutuality of obligation or illusory promises, they necessarily imply that the promisor's duty to exercise his judgment in good faith is an adequate consideration to support the contract.[40]

There is no finding by the trial court, or the Court of Appeals, that the City Engineer exercised bad faith in terminating Conway, and it was improper for the Court of Appeals to find that Conway substantially cured its breach.

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[39] *5860 Chicago Ridge, LLC* 104 Fed. Cl. at 756.

[40] *Omni Grp., Inc. v. Seattle-First Nat. Bank*, 32 Wn. App. 22, 26, 645 P.2d 727, 730 (1982)

This Court should reverse the Court of Appeals and find that the decision to terminate by the City was in accord with the requirements of the Contract.

It is also improper for the Court of Appeals to essentially read Paragraph 22 out of the Contract. (A-6.). First, Conway has admitted that the Contract includes two provisions specifically dealing with termination for default.[41] Paragraph 22 of the Contract provides that violation of a statute or regulation (i.e. safety) constitutes "good cause" for terminating the Contract:

> 22. Termination. The City shall be entitled to terminate this Contract for good cause. "Good cause" shall include, but shall not be limited to, any one or more of the following events . . .
> d. **Contractor's failure to comply with Federal, state or local laws, rules or regulations**[42]

Conway's Amended Complaint admitted that the terms of the Public Works Contract[43] (including Paragraph 22) controls any attachments or incorporated documents including the WSDOT Std. Specs.[44] Thus by Conway's own admission, the violation of safety

[41] Conway App. Resp. Brief, p.6, fn.5.
[42] Public Works Contract. [Trial Ex. 5, p.8 ¶ 22] [CP 26] (Emphasis Added.)
[43] *Id*. This refers to the contract form signed by the parties that in turn incorporates by reference the Std. Specs. and the other incorporated documents that form the Contract Documents and the entire Contract.
[44] Conway Amended Complaint, ¶ 4.21 [CP 157].

regulations is a default under the Contract and provides "good cause" for termination. Moreover, it is well-established law that applicable statutes and regulations are part of any contract. *Cornish Coll. of the Arts v. 1000 Virginia Ltd. P'ship*, 158 Wash. App. 203, 223, 242 P.3d 1 (2010).

The Contract provides that the terms of the Public Works Contract supersede any conflicting terms in the Contract Documents:

> "34. This Contract, and any attachments contain the entire Contract between the parties. Should any language in any attachment conflict with any language contained in this Contract, the terms of this Contract shall prevail."[45]

Thus, according to the Contract's terms, Paragraph 22 supersedes Std. Spec. 1-0-8.10(1) as a matter of law, and by definition under the terms of the Contract, the City was justified in terminating Conway. Because Conway failed to comply with federal, state, or local laws, the City was justified in terminated the contract.

B. <u>The Court of Appeal Should Have Allowed Set-off for the Cost of Correcting Conway's Defective Work Discovered After Conway Was Terminated.</u>

The City also seeks review of the Court of Appeals decision regarding the City's right to set-off pursuant to RAP 13.4(b)(2) and (b)(4). The Court of Appeals' decision is inapposite with *Ducolon*, and its

[45] Public Works Contract, [Trial Ex. 5, p. 10, ¶ 34].

adoption of *Shelter Products* has broad implications regarding the spending of taxpayer money on publicly funded projects. For this case alone, the City's counterclaims and set-offs totaled $388,784.78, as detailed at trial.[46]

The Court of Appeals adopted the holding of an Oregon case, *Shelter Products, Inc. v. Steelwood*, which disallowed any recovery against a subcontractor for defective work discovered after the subcontractor was terminated for convenience.[47] The Court of Appeals argues that Conway should have had "an opportunity to cure, or timely investigate, the alleged defects as required by the contract." (A-10.)

The Court's of Appeal's decision fails to recognize established law in Washington that even a defaulting owner is entitled to set-off for defective work.

> "In Washington and most jurisdictions, the cost of completion and correction are remedies available to building contractors upon a subcontractor's default. *Eastlake Constr. Co. v. Hess*, 102 Wash.2d 30, 686 P.2d 465 (1984) (adopting Restatement 2d § 348 (1981) and allowing contractor to recover cost of completion and repair); *J & J Elec., Inc. v. Gilbert H. Moen Co.*, 9

[46] Increased Costs [Trial Ex. 43].

[47] *Shelter Products*, 257 Or. App. at 402 (2013) (holding that a general contractor that terminated a subcontractor for convenience was barred from recovering the cost of correcting the subcontractor's work when the defects were discovered after the date the subcontractor was terminated and no notice of the alleged defective work or opportunity to cure was provided to the subcontractor.)

> Wash.App. 954, 516 P.2d 217 (1973), *review denied,* 83 Wash.2d 1008 (1974); *see generally* Dobbs, at § 12.19(1)."[48]

The Contract in this case provides that the City will not pay for defective work.[49] The Contract also provides that where a termination for default has been issued and it is later determined that the Contractor was not in default, the termination shall be treated as one for public convenience.[50]

Under a termination for convenience, the Std. Specs. require that Conway may only recover "for the actual work performed" and that "payment will be made in accordance with Section 1-09.5."[51] The Contract specifically allows a set-off for defective work, even where the termination is one for convenience:

> 4. The total payment for any one item in the case of a deletion or partial termination shall not exceed the Bid price as modified by approved change orders **less the estimated cost (including overhead and profit) to complete the Work** and less any amount paid to the Contractor for the item.[52]

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[48] *Ducolon*, 77 Wn. App. at 714 (Breaching general contractor entitled to set off for defective work by defaulting subcontractor.)
[49] Std. Spec. 1-05.7, [Trial Ex. 1, p.1-28[.
[50] Std. Spec. 1-08.10(2), [Trial Ex. 1, p.1-81].
[51] Std. Spec. 1-08.10(4), [Trial Ex. 1, p.1-82].
[52] Std. Spec. 1-09.5 [Trial Ex. 1, p.1-88].

Thus under the terms of the Contract, the City is only obligated to pay for completed work and is not required to pay for defective work. In addition, under Std. Spec. 1-09.5, the City is entitled to set-off the cost to complete defective work against amounts otherwise due for completed Work. The provisions of 1-09.5 directly undercut the trial court's ruling that Conway was somehow entitled to notice and opportunity to cure under a termination for convenience.[53]

Moreover, under generally applicable Washington law, the City was entitled to set off its costs to complete and repair Conway's Work. In *Ducolon,*[54] a subcontractor was held liable for defective work discovered after the subcontractor had been terminated from the project. This was the case even though it was eventually determined that the general contractor had improperly terminated the subcontractor due to inadequate notice.

> Under the Restatement 2d, a defaulting party's award is offset by the loss caused by his or her part performance. Offsetting the award by the defendant's damages is appropriate because restitution under § 374(1) is measured by the *benefit conferred to the defendant.* Thus, there can be no recovery unless the value of the plaintiff's part performance exceeds the amount of the defendant's injury. Simpson, at § 204. As a result, whether the defendant elects to affirm or disaffirm the contract is irrelevant to

[53] Conclusion No. 19 [CP 2704].
[54] *Ducolon.*, 77 Wn. App. at 713-14.

> calculating the value of the benefit conferred to the defendant.[55]

The Court of Appeals' affirmation, are contrary to the provisions of the Contract and applicable Washington law and should be reversed.[56] If left to stand, any municipality that is found to have improperly terminated a contractor for cause will be forced to incur the extra expense of fixing defective work *and* paying the terminated contractor. This is clear waste of taxpayer money, and should not be the law.

VI. CONCLUSION

The City Engineer met all of the Contract and legal requirements to terminate Conway for cause. The Court of Appeals utilized the wrong test in holding that Conway cured all of its default conditions. Instead, The proper test is whether Conway was in default (which it was) and whether the City was satisfied with Conway's efforts to remedy the breach (which it was not). The Court of Appeals and the trial court should be reversed and judgment entered finding the City properly terminated Conway.

The Contract provides that the City is not obligated to pay for defective work. The Court of Appeals improperly relied on an out of state

[55] *Id.*

case to circumvent the clear language of the Contract and *Ducolon.* The Court of Appeals should be reversed and the case remanded to determine the amount recoverable by the City.

Respectfully submitted this 10th day of July, 2020.

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[56] *Id.*; *see also Eastlake Const. Co., Inc. v. Hess,* 102 Wn.2d 30, 686 P.2d 465 (1984).

DECLARATION OF SERVICE

I, Christopher W. Pirnke, under penalty of perjury under the laws of the State of Washington, hereby declare that on July 10, 2020, the following documents were served on the following individuals in the manner indicated below:

1. *Petition for Review.*

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DATED this 10th day of July, 2020, at Bellevue, Washington

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APPENDICES

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Court of Appeals
Division I
State of Washington

IN THE COURT OF APPEALS FOR THE STATE OF WASHINGTON

CONWAY CONSTRUCTION COMPANY, Respondent, v. CITY OF PUYALLUP, Appellant.	No. 80649-1-I DIVISION ONE PUBLISHED OPINION

LEACH, J. — In this public works contract case, the City of Puyallup (the City) appeals a trial court decision finding that it improperly terminated Conway Construction Company's (Conway) contract for road improvements and awarding Conway damages plus attorney fees and costs. Substantial evidence supports the trial court's findings of fact and they support its legal conclusions. But, Conway was not entitled to recover attorney fees because it did not submit an offer of settlement as required by statute. So, we affirm the trial court's judgment for damages but reverse its award of attorney fees to Conway.

FACTS

The City and Conway contracted for road improvements (the project). The public works contract included a "Public Works Contract" form and incorporated by reference several voluminous documents, including the Washington State Department of Transportation Standard Specifications for Road, Bridge, and Municipal Construction.

During construction, the City became concerned about the quality of pavement concrete, defects in utilities, and other construction defects, and issued notices to Conway describing these concerns. The City also observed unsafe work conditions, such as lack of trench shoring, and reported those concerns to the Washington State Department of Labor & Industries (L&I).

On March 9, 2016, the City gave Conway a notice of suspension and breach of contract.[1] This notice identified nine items that it deemed contract breaches. These included defective and uncorrected work and safety concerns. It advised Conway that it had 15 days to remedy the listed issues. Conway denied any wrongdoing.

On March 21, 2016, the City informed Conway that it still needed to remedy the same nine items and that it had received further reports of safety violations. Conway again denied the safety violation allegations.

On March 25, 2016, the City issued a notice of termination for default to Conway. The City also withheld payments due to Conway.

On April 23, 2016, L&I issued a citation to Conway for a "serious" safety violation endangering Conway workers.

Conway sued the City asking the court to declare termination for default improper and deemed it to be for public convenience. Conway later amended its request to include breach of contract and unjust enrichment claims. After a bench trial, the court found the City breached the contract when it terminated Conway. It awarded Conway damages,

[1] This exhibit is dated March 9, 2015. This is an obvious scrivener's error because it references a Non-Conformance Report dated March 3,2016 and the parties had not yet entered their contract on March 9, 2015. Exhibits 53, 58, and 59 contain similar dating errors.

attorney fees, and costs. The City appeals.

STANDARD OF REVIEW

We review a party's challenge to a trial court's decision when the trial court has evaluated the evidence to determine whether substantial evidence supports the trial court's findings of fact and whether those findings support the court's conclusions of law.[2] Substantial evidence is evidence sufficient to persuade a fair-minded person of its truth.[3] Evidence may be substantial even if there are other reasonable interpretations of the evidence.[4]

We defer to the trial court's determinations about persuasiveness of the evidence, witness credibility, and conflicting testimony.[5] We will not disturb a trial court's ruling if substantial, though conflicting, evidence supports its findings of fact.[6]

ANALYSIS

The City raises three issues on appeal. First, it claims the trial court used the wrong test to determine if the City properly terminated the project contract for default. Next, it claims the contract entitles it to an offset for Conway's defective work. Finally, it contends Conway is not entitled to recover attorney fees because it did not make a statutorily required offer of settlement. We agree that Conway is not entitled to recover attorney fees, but we reject the City's other claims.

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[2] Standing Rock Homeowners Ass'n v. Misich, 106 Wn. App. 231, 242-43, 23 P.3d 520 (2001).
[3] Hegwine v. Longview Fibre Co., Inc., 132 Wn. App. 546, 555-56, 132 P.3d 789 (2006).
[4] Sherrell v. Selfors, 73 Wn. App. 596, 600-01, 871 P.2d 168 (1994).
[5] Snyder v. Haynes, 152 Wn. App. 774, 779, 217 P.3d 787 (2009).
[6] Merriman v. Cokeley, 168 Wn.2d 627, 631, 230 P.3d 162 (2010).

Contract Termination – Breach of Contract

Standard for Termination

We first address the City's claim that the trial court did not use the correct test to decide whether the City properly terminated Conway for default. The City contends the trial court should have used the following two part test (1) was Conway in default, and (2) was the City satisfied with Conway's efforts to remedy the breach. Conway claims the City had to satisfy a different two part test (1) was Conway in default, and (2) did Conway neglect or refuse to correct rejected work. Conway also asserts that any error the trial court made in applying the correct test was harmless.

The City correctly notes the parties' contract form contains two termination provisions. First, paragraph 22 of the contract provides that violation of a statute or regulation is "good cause" for terminating the contract:

> 22. Termination. The City shall be entitled to terminate this Contract for good cause. "Good cause" shall include, but shall not be limited to, any one or more of the following events:
>
> d. Contractor's failure to comply with Federal, state or local laws, rules or regulations

Second, the contract incorporates the Washington State Department of Transportation ("WSDOT") Standard Specifications for Road, Bridge, and Municipal Construction (2014), which provided the general terms of the contract. Section 1-08.10(1) of these specifications contains terms relating to termination of the contract and allows the contracting agency to terminate the contract upon the occurrence of any one or more of the following events:

1. If the Contractor fails to supply sufficient skilled workers or suitable materials or equipment;

2. [Inapplicable]

3. [Inapplicable]

4. If the Contractor disregards laws, ordinances, rules, codes, regulations, orders or similar requirements of any public entity having jurisdiction;

5. If the Contractor disregards the authority of the Contracting Agency;

6. If the Contractor performs Work which deviates from the Contract, and neglects or refuses to correct the rejected Work; or

7. If the Contractor otherwise violates in any material way any provisions or requirements of the Contract.

Once the Contracting Agency determines that sufficient cause exists to terminate the Contract, written notice shall be given to the Contractor and its Surety indicating that the Contractor is in breach of the Contract and that the Contractor is to remedy the breach within 15 calendar days after the notice is sent.... If the remedy does not take place to the satisfaction of the Contracting Agency, the Engineer may, by serving written notice to the Contractor and Surety either:

1. Transfer the performance of the Work from the Contractor to the Surety; or

2. Terminate the Contract …

The contract form contains the following provision addressing conflicts between the form and the attached specifications, "This Contract and any attachments contain the entire Contract between the parties. Should any language in any attachment conflict with any language contained in this Contract, the terms of this Contract shall prevail." So, if any provision of the specifications conflicts with paragraph 22, then paragraph 22 controls. The City relies on this conflict coordination provision to assert that once Conway violated a state safety regulation, paragraph 22 gave it the right to terminate the contract without providing the cure opportunity found in Section 1-08.10(1). We disagree.

Washington courts "'follow the objective manifestation theory of contracts.'"[7] So, we "focus on the agreement's objective manifestations to ascertain the parties' intent."[8] We look to the face of the agreement, but when the language is ambiguous, we may also look to extrinsic evidence of intent.[9]

Paragraph 22 and section 1-08.10(1) do not conflict in the way asserted by the City. Paragraph 22 defines one act of default, and section 1-08.10(1) identifies additional acts of default. Paragraph 22 is silent about termination procedure and opportunity for cure. This silence does not place paragraph 22 in conflict with section 1-08.10(1)'s procedural and cure provisions. Instead, section 1-08.10(1) supplements paragraph 22 by providing specific procedures and timelines for action. The City's own conduct before termination shows that it understood this to be the relationship between these provisions. Its notices and correspondence with Conway repeatedly referenced section 1-08.10(1) and never relied on paragraph 22. These notices also identified a cure period. Only in litigation did the City discover a conflict.

The City also claims Conway had to remedy all asserted breaches within 15 days to satisfaction. The contract allows the City to terminate "if the [c]ontractor performs [w]ork which deviates from the [c]ontract, and neglects or refuses to correct rejected [w]ork." It also states that once the City gives notice, Conway "is to remedy the breach within 15 calendar days after the notice is sent . . . [and] [i]f the remedy does not take place to the satisfaction of the [c]ontracting agency, the [e]ngineer may . . . [t]erminate

[7] Kelley v. Tonda, 198 Wn. App. 303, 311, 393 P.3d 824 (2017) (quoting Hearst Commc'ns, Inc. v. Seattle Times Co., 154 Wn.2d 493, 503, 115 P.3d 262 (2005).
[8] Martin v. Smith, 192 Wn. App. 527, 532, 368 P.3d 227 (2016).
[9] Kelley, 198 Wn. App. at 312.

the [c]ontract." So, the City was only justified in terminating the contract for rejected work if Conway neglected or refused to correct the rejected work. The trial court used the appropriate test in determining whether the City was justified in terminating Conway for rejected work.

As the City notes, the "neglect or refuses to correct" provision applies only to rejected work breaches and not violation of law breaches. So, Conway had 15 days to cure the safety breach. But, to the extent the trial court used the wrong test for the safety violation, that error was harmless because Conway cured the only safety breach within 15 days.

Termination Justification

The City claims that once it demonstrated that Conway defaulted due to the safety violation, the liability phase of the case should have ended.

In contract disputes like this one, where the Government is a party, the Government has the burden of proving whether termination of a contract for default was justified.[10]

The trial court found the City was unjustified in terminating Conway because Conway addressed the safety issues when it worked directly with L&I:

> Finding of Fact No. 59: While the City complains of ongoing safety concerns existing on the site, **at the time of termination the unsafe trench detailed in these findings was being addressed** during the suspension period between Conway and the Department of Labor and Industries. In Remedy Item No. 9 of Exhibit 44, **the City essentially deferred the safety issue to the Department of Labor and Industries,** stating, "If the contractor does not correct the deficiency to L&I's satisfaction, the City will suspend operation until the work site is deemed safe again by L&I." After at least two inspections of the Project site and meetings with Conway's principals, the Department of Labor and Industries perceived no ongoing safety issues. In

[10] Lisbon Contractors, Inc. v. U.S., 828 F.2d 759, 765 (Fed. Cir. 1987).

> Exhibit 119, the City admitted there were no further safety issues on site after March 9, 2016. **This item consequently is found to have been cured by the end of the suspension period**.

After the City provided notice to Conway, that it had breached the contract, Conway had 15 days to cure the identified safety breach. It did so by working with L&I to address the safety concerns and then by notifying the City about its actions.

Because L&I detected no ongoing safety issues after the original safety issue, which Conway addressed, the court found any breach by Conway was resolved. Substantial evidence established that Conway resolved the safety regulation breach, which the City asserts justified termination.

Subsequently Discovered Evidence

The City next claims it can justify termination with subsequently discovered evidence. It relies on Mega Construction Company, Inc. v. United States[11] as support for the claim that L&I's citation for the safety violation after the City terminated the contract justified the decision to terminate. But, Mega Construction explains how the termination was justified because of not only discovered violations after the termination, but because of the violations discovered before the termination.[12]

In this case, the trial court held that Conway cured the pre-termination breach within 15 days of notice. So, any post-termination violations are irrelevant and Mega Construction is not analogous.

[11] 29 Fed. Cl. 396 (Fed. Cl. 1993).
[12] 29 Fed. Cl. at 421-22.

Good Faith

The City also asserts that because Conway breached a specific condition of default, the only remaining questions were whether the City was satisfied with Conway's performance and whether the City exercised good faith in its exercise of discretion. It claims the trial court made no finding that the City acted in bad faith. But, the trial court found that Conway was not in breach at the time of termination, so the trial court did not err in failing to make a good faith effort analysis.

Set-Off for Defective Work

The City next claims the trial court should have considered claims for replacing the defective work it discovered after it terminated Conway. The City asserts the contract "specifically allows a set-off for defective work, even where the termination is one for convenience."

The relevant contract provision states:

> The total payment for any one item in the case of a deletion or partial termination shall not exceed the Bid price as modified by approved change orders less the estimated cost (including overhead and profit) to complete the Work and less any amount paid to the Contractor for the item.

This contract provision applies only to cases involving deletion, such as when the "[e]ngineer may delete [w]ork by change order," or partial termination. Here, the City completely terminated the entire contract, so no "deletion" or "partial termination" occurred. This provision does not apply.

The City also claims the trial court refused to consider claims for replacing defective work first discovered after the City terminated Conway. The City frames this defect issue as a timing issue. But, the trial court did not rely on timing of discovery to reject this claim. It rejected it because the City did not provide Conway an opportunity to

cure, or timely investigate, the alleged defects as required by the contract.[13] No Washington case law addresses whether a breaching party is entitled to a set-off when it did not give the other non-breaching party an opportunity to cure alleged defects. But, Shelter Products, Inc. v. Steelwood Construction, Inc.[14] addressed this issue. We find this case persuasive and follow it here. There, the court held that a breaching party is not entitled to a set-off for allegedly defective work upon the breaching party's termination for convenience where the breaching party did not give the other party notice of defects and opportunity to inspect, cure, or complete work.[15]

The City acknowledges that it did not give Conway an opportunity to cure or investigate these defects. And, the City provides no persuasive reason why we should not follow Shelter Products.[16] The City's assertion that Ducolon Mech. Inc., v. Shinstine/Forness, Inc. entitles it to set-off its costs for Conway's defective work lacks merit because both parties breached the contract.[17] Here, only the City failed to cure a breach, so Ducolon is not analogous or helpful.

Because the City breached by terminating the contract, and did not provide Conway an opportunity to cure alleged defects, the City was not entitled to its claimed post-termination damages and costs.

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[13] The contract provides that upon Conway performing work that deviates from the contract that it neglects or refuses to correct, it has 15 days to cure. So, this contract provision requires the City to inform Conway of defects and give them an opportunity to cure.
[14] 257 Or. App. 382, 402, 307 P.3d 449 (2013).
[15] Shelter Products, 257 Or. App. at 398-99.
[16] The trial court cited to Shelter Products in its conclusion of law that the City's claim for post-termination damages and costs are denied.
[17] 77 Wn. App. 707, 713, 893 P.2d 1127 (1995).

Attorneys' Fees

The City asserts the trial court should not have awarded Conway attorney fees because Conway was required to make an offer of settlement. As a result, Conway is not the prevailing party for purposes of awarding fees. We agree.

An appellate court reviews de novo whether the prevailing party was entitled to attorney fees.[18] RCW 39.04.240(1) states, "[t]he provisions of RCW 4.84.250 through 4.84.280 shall apply to an action arising out of a public works contract in which the state or a municipality, or other public body that contracts for public works, is a party." This statute also creates two exceptions (1) the maximum dollar limitation in RCW 4.84.250 does not apply, and (2) the time period for serving offers of settlement on the adverse party is not less than 30 days and not more than one 120 days after completion of the service and filing of the summons and complaint.

RCW 4.84.260 states, "The plaintiff . . . shall be deemed the prevailing party . . . when the recovery, exclusive of costs, is as much as or more than the amount offered in settlement by the plaintiff . . . as set forth in RCW 4.84.280."[19] When a party does not make an offer of settlement in a lawsuit involving a public works contract, it cannot recover attorney fees.[20]

[18] Ethridge v. Hwang, 105 Wn. App. 447, 459-60, 20 P.3d 958 (2001).
[19] RCW 4.84.260.
[20] Hertz v. Riebe, 86 Wn. App. 102, 107, 936 P.2d 24 (1997); Filipino American League v. Carino, 183 Wn. App. 122, 130, 332 P.3d 1150 (2014) ("the unambiguous language of RCW 4.84.290 authorizes an award of fees on appeal only where the party is eligible for an award under RCW 4.84.250. RCW 4.84.250 and RCW 4.84.260 required the League to make an offer of settlement to become a prevailing party. The League made no such offer. Therefore, it is not the prevailing party within the meaning of RCW 4.84.250 and RCW 4.84.290.").

Conway claims that "[i]t was not necessary for Conway to make an offer of settlement under RCW 39.04.240 in order to obtain a fee award" because "RCW 39.04.240 is not an exclusive remedy." Conway asserts the contract's fee provision provides a different remedy than RCW 39.04.240. Conway relies on King County v. Vinci Construction Grands Projects/Parsons RCI/Frontier-Kemper, JV.[21]

The City asserts this response is precluded by RCW 39.04.240(2), which states:

> The rights provided for under this section may not be waived by the parties to a public works contract that is entered into on or after June 11, 1992, and a provision in such a contract that provides for waiver of these rights is void as against public policy. However, this subsection shall not be construed as prohibiting the parties from mutually agreeing to a clause in a public works contract that requires submission of a dispute arising under the contract to arbitration.

The City claims this statute voids the parties' contract to the extent it waives the City's statutory right, under RCW 4.84.260, to receive an offer of settlement before being exposed to an attorney fee claim. Conway does not respond directly to this argument.

King County v. Vinci does not support Conway's position. There, our Supreme Court considered whether RCW 39.04.240(1) abrogated a common law right of attorney recovery available in certain types of insurance litigation. The court did not address any argument involving the anti-waiver provisions of RCW 39.04.240(2).

Our legislature has determined that government entities should receive an early opportunity to settle public works contract litigation by requiring an early settlement offer from a claimant who wishes to preserve a claim for attorney fees. And, the legislature has declared void any contract provision waiving the government entity's right to receive an early settlement offer before being exposed to an attorney fee claim as part of the

[21] 188 Wn.2d 627, 398 P.3d 1093 (2017).

consequences of losing a lawsuit involving a public works contract. The statute is unambiguous. So, because Conway did not make a timely settlement offer, it was not a prevailing party for purposes of awarding attorney fees. We reverse the trial court's fee award to Conway.

The City Attorney's Fees

The City requests attorney fees if it prevails on the contract termination issue. Because it does not, we deny the City's request for attorney fees.

CONCLUSION

We affirm in part and reverse in part. Substantial evidence supports the trial court decision that the City failed to justify its contract termination. Also, the City was not entitled to post-termination damages, because it did not give Conway an opportunity to cure alleged defects.

We reverse on the trial court's award of attorney fees to Conway and otherwise affirm the trial court. We deny attorney fees for both parties on appeal.

Leach, J.

WE CONCUR:

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON
DIVISION ONE

CITY OF PUYALLUP, Appellant, v. CONWAY CONSTRUCTION COMPANY, Respondent.	)	No. 80649-1-I ORDER DENYING MOTION FOR RECONSIDERATION

The respondent, Conway Construction Company, having filed a motion for reconsideration herein, and a majority of the panel having determined that the motion should be denied; now, therefore, it is hereby

ORDERED that the motion for reconsideration be, and the same is, hereby denied.

FOR THE COURT:

Leach, J.

INSLEE BEST DOEZIE & RYDER, P.S.

July 10, 2020 - 3:13 PM

Filing Petition for Review

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