No. 99119-7

SUPREME COURT
OF THE STATE OF WASHINGTON

LAKE HILLS INVESTMENTS LLC,
a Washington limited liability company,

Respondent,

v.

AP RUSHFORTH CONSTRUCTION CO., INC. d/b/a/
AP RUSHFORTH, a Washington corporation, and
ADOLFSON & PETERSON INC., a Minnesota corporation,

Petitioners.

ANSWER TO PETITION FOR REVIEW

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A. Introduction.

The Court of Appeals followed well-established law in holding that a contractor sued for construction defects bears the burden to prove the affirmative defense that the owner's erroneous plans and specifications were solely responsible for causing the defects. Petitioners AP Rushforth Construction Co., Inc., and Adolfson & Peterson, Inc. (collectively "AP") ignore the "well settled" rule applied in Washington and "practically every American jurisdiction" that a contractor can avoid liability for defective construction that "results *solely* from the defective or insufficient plans or specifications." *Kenney v. Abraham*, 199 Wash. 167, 170-73, 90 P.2d 713 (1939) (emphasis added).

While AP's petition presents no issue under RAP 13.4(b), should this Court review the Court of Appeals decision, it should also (1) review Court of Appeals' erroneous conclusion that Lake Hills was not prejudiced by the trial court's erroneous instructions on two other related principles of contract law, and (2) review the Court of Appeals' affirmance of the trial court's refusal to instruct the jury that a non-breaching party can waive a material breach of contract by then continuing to perform and accepting payments, as did AP for almost 17 months after claiming a material breach.

B. Restatement of Issue Raised by Petitioner.

Did the Court of Appeals correctly follow this Court's precedent in holding that a contractor can avoid liability for acknowledged construction defects only if the owner's plans and specifications were the sole cause of the construction defect?

C. Restatement of the Case.

Lake Hills contracted with AP to construct a mixed-use redevelopment project in Bellevue called Lake Hills Village.[1] (Op. 2) Lake Hills Village consists of a public library, two mixed-use residential/retail buildings, three commercial buildings, and townhouses. (Op. 2) Lake Hills Village has a large concrete plaza in its center, which Lake Hills described as the "heart and soul" of the project because it is the project's most visible and heavily used element. (Op. 2; RP 1141)

AP served as the general contractor for Lake Hills Village, which it constructed in phases over several years. (Op. 2) Lake Hills agreed to pay AP a set "lump sum" for parts of the project and on a time and materials "allowance" basis for others. (*See, e.g.*, Ex. 1 at 53, 57, 75; Ex. 7 at 1) Throughout the project the parties engaged in an iterative "value engineering" design process in which Lake Hills

[1] This Restatement of the Case is supported by citation to the Court of Appeals Opinion, cited as "Op.," and the record before the trial court.

proposed an initial design and AP, in consultation with subcontractors, suggested cost-reducing changes to the design. (RP 300, 2686-87, 2880-81) In addition, many elements of the project were on a "design-build" basis that required AP to both design and construct those elements. (*See, e.g.*, Ex. 1 at 71-73; RP 316)

AP failed to complete every phase of Lake Hills Village by the substantial-completion date in the parties' contract. (Op. 3) But even before AP missed construction deadlines, the parties' relationship had deteriorated sharply, beginning in the spring of 2014 when AP's project manager and senior project manager, who Lake Hills had successfully collaborated with on a previous project, both left AP. (RP 593, 2641, 3121; Ex. 566 at 1)

In late 2014 Lake Hills notified AP it had breached the contract schedule. (Op. 3) Ignoring the chaos caused by the turnover in its senior management, AP blamed the delays on Lake Hills cutting its payment applications, which AP alleged made it difficult to retain subcontractors. (Op. 3) Lake Hills advised AP that it would "formally reject more than half the central plaza" if AP did not address "major concrete Plaza issues that are not acceptable to the Owner . . . cracking, slopes, color variations, finish quality." (Ex. 92

at 1)[2] At trial, AP's concrete expert blamed Lake Hills' design for the "significant number of cracks" he conceded existed throughout the project. (RP 4170, 4265)

In late October of 2015, Lake Hills filed suit against AP for breach of contract based on the delays to the project and defective construction. (Op. 4) AP stopped work a few weeks later and filed its contractual counterclaim alleging underpayment. (Op. 4)

Over Lake Hills' objection, the trial court instructed the jury that AP was not liable for a delay unless it was "*solely* caused by AP." (CP 357 (emphasis added); RP 4827-29, 4867-68) The trial court, however, rejected Lake Hills' request to instruct the jury on AP's affirmative defense that AP was liable for defective construction unless it "*solely* resulted from" an error in Lake Hills' plans or specifications. (RP 4106, 4861-62 (emphasis added)) The trial court instead gave Instruction 9, which absolved AP of liability for a defect if AP proved "the defect resulted from defects in the plans and specifications." (Instruction 9, CP 348)

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[2] Without providing any context, AP cites "certifications" Lake Hills submitted to its lender as purported proof that AP's "work was in accordance with the contract documents." (Pet. 9, n.3) The parties' contract recognized that the certifications were only preliminary and authorized Lake Hills to withhold or nullify certifications if "subsequently discovered evidence" showed AP's work was defective or that AP failed properly pay subcontractors. (*See* Ex. 1 at 37-38, § 9.5.1) That is exactly what happened—Lake Hills withheld money, as allowed by the contract, to protect itself and the subcontractors AP refused to pay. (RP 2043-44, 2054, 2197, 2206-07)

The trial court also instructed the jury that AP's performance was excused if Lake Hills did anything to "hinder, prevent, or interfere" with AP's performance (CP 356), over Lake Hills' exception that only a *material* breach of the implied contractual duty of good faith can excuse a party's performance. (RP 4864-65) The trial court likewise rejected Lake Hills' proposed instruction stating that although a material breach by one party to a contract can excuse the other party's performance, the non-breaching party can waive that excuse by continuing to perform. (RP 4832-33, 4863-64, 4874-75)

The jury found in its special verdict that AP breached the contract by performing defective work, but awarded zero damages for two of the eight allegedly defective areas of work. (Op. 4; CP 370, 375) The jury also found each project phase was completed after its substantial completion date, Lake Hills was responsible for most delays, and AP did not breach the contract by stopping work. (Op. 4) The jury further found that Lake Hills materially breached the contract on July 25, 2014 (CP 374), despite the undisputed fact that AP continued work on the project for nearly 17 months, receiving over $20 million from the Lake Hills project. (Ex. 1007 at 2) Based on that finding, the trial court barred Lake Hills from recovering for

years of delay, including 108 days of delay AP *admitted* it caused. (*See* RP 4451; Ex. 586 (summary of delays); Ex. 2882)

The Court of Appeals reversed and ordered a new trial, agreeing with Lake Hills that Instruction 9 misstated AP's burden of proving its affirmative defense that the plans and specifications provided by Lake Hills caused the defects. (Op. 6-14)

The Court of Appeals also held the trial court erroneously allowed the jury to excuse AP for delays caused by anything other than its own actions, even if the delays were caused by AP's own subcontractors, and that the jury should have been instructed that only a *material* breach of the duty of good faith and fair dealing could excuse AP's performance. However, viewing the evidence in the light most favorable to AP, the Court of Appeals held that Lake Hills was not prejudiced by either error. (Op. 14-24) The Court of Appeals likewise rejected Lake Hills' argument the jury should have been instructed that a non-breaching party can waive a material breach as an excuse for its own performance. (Op. 24-26)

D. Argument Why Review Should Be Denied.

1. The Court of Appeals properly held, consistent with "well settled" law, that Instruction 9 misstated AP's burden of proving its defective plans defense.

The Court of Appeals correctly held that Instruction 9 "understated AP's burden of proof" because it "let AP avoid *all* liability" for defective construction if "any defect in the plans and specifications . . . contribut[ed] to a construction defect . . . even if Lake Hills proved AP's deficient performance caused *some* of the damage." (Op. 9 (emphasis added)) This analysis follows established law and does not warrant review under RAP 13.4(b).

The Court of Appeals did not misinterpret the "actual holding" of *Kenney* (Pet. 8), in which the defendant contractor claimed he could not be liable for severe damage to plaintiff's house from settling because he built the house according to the plaintiff's plans and specifications. This Court rejected that argument factually, because "the foundation of the house was not built in accordance with the plans and specifications," *Kenney,* 199 Wash. at 171, and legally, because "[t]he rule . . . that a contractor will not be responsible to the owner for loss or damage which results *solely* from the defective or insufficient plans or specifications . . . . is not applicable where there is negligence, as in the case at bar, on the contractor's part." 199 Wash. at 173.

The Court of Appeals thus correctly recognized that "the ultimate holding in *Kenney* was *both* that the contractor did not 'buil[d] in accordance with the plans and specifications'" and that because there was "negligence . . . on the contractor's part" the contractor could not assert as a defense the "damages . . . result[ed] solely from defective plans or specifications." (Op. 11, quoting *Kenney*, 199 Wash. at 173 (emphasis added)) This was *Kenney's* "actual holding" (Pet. 8) because it rejected the contractor's attempt to avoid liability based on the owner's plans and specifications. *See Allen v. Dameron*, 187 Wn.2d 692, 708, ¶ 28, 389 P.3d 487 (2017) (statement that was "a necessary . . . step in the court's analysis" was not dicta). The fact that *Kenney* rejected the contractor's argument for two related reasons does not render either of them dicta. *See In re Heidari*, 174 Wn.2d 288, 293, ¶ 7, 274 P.3d 366 (2012) (statement is not dicta "because it was one of two reasons given for the holding of this court").

As the Court of Appeals explained, Instruction 9 conflicted with *Kenney* because it allowed the jury to excuse AP for its own negligence if Lake Hills' plans and specifications in *any way* contributed to a defect even though "AP's affirmative defense theory was that a *single cause*, defective plans or specifications, injured Lake Hills." (Op. 13 (emphasis added); *see also* Op. 9 (Under

Instruction 9 "proof of *any* defect in the plans and specifications . . . contributing to a construction defect would let AP avoid *all* liability") (emphasis added)) The trial court thus should have—as Lake Hills requested—instructed the jury that "AP had to prove Lake Hills' defective designs 'solely' caused the plaintiff's damages." (Op. 14)

White v. Mitchell, 123 Wash. 630, 213 P. 10 (1923) did not, as AP asserts, "absolve[] a contractor from liability for defects that result from something other than defective plans or specifications, including 'acts of God, impossibility of performance, or acts of the other party to the contract, preventing performance.'" (Pet. 7, quoting *White*, 123 Wash. at 634-35; *see* Op. 11) Like *Kenney*, *White* involved a suit against contractors that built a house on soft soil. Far from absolving the contractors, *White* reversed a judgment in their favor, holding that a change in the plans and specifications made by the owners could not "relieve the [contractors]" of liability because "[i]t was their duty to examine into the condition of the soil and know the difficulties they might encounter." 123 Wash. at 637. *White*—like *Kenney*—thus rejected AP's contention that a contractor is not liable for its defective work simply because an owner's plans and specifications contribute to a defect in some manner.

AP erroneously asserts that *Maryland Casualty Co. v. City of Seattle*, 9 Wn.2d 666, 116 P.2d 280 (1941), not *Kenney*, established the burden of proof on AP's defective plans defense. (Pet. 5-6) *Maryland Casualty* held contractors were not entitled to compensation for additional expense they incurred using a construction method, unauthorized by contract, that was more expensive than the authorized method. 9 Wn.2d at 679-80. It did not address whether a contractor is excused for a breach if an owner's plans and specifications contribute in *any* fashion to a defect and thus "does not conflict with the rule identified and applied in *Kenney*." (Op. 12) AP notes *Kenney* predates *Maryland Casualty* (Pet. 6), but then ignores that 25 years after *Maryland Casualty* this Court affirmed the rule that a contractor is relieved of liability for defective construction only if it "result[ed] . . . solely from the defective or insufficient plans or specifications" in *Valley Const. Co. v. Lake Hills Sewer Dist.*, 67 Wn.2d 910, 915, 410 P.2d 796 (1965).

Indeed, the rule articulated in *Kenney* is so "well settled" that it is followed "in practically every American jurisdiction in which the matter has been involved." 3 Philip L. Bruner & Patrick S. O'Connor Jr., *Construction Law* § 9:59 (2018); *see also* Michael T. Callahan, Et Al., *Construction Disputes: Representing the Contractor* § 20.02

(4th ed. Supp. 2020) ("It is equally well-established that if a contractor builds in a workmanlike manner according to plans or specifications furnished by the owner, the contractor will not be responsible for damages resulting *solely* from defects in the plans or specifications . . . .") (emphasis added); Schwarzkopf, *Calculating Construction Damages* § 1.07 (3d ed. Supp. 2020) ("Damages that are calculated even to the smallest degree of detail are of no value if the damages are not causally linked to the entitlement claimed.") (both cited at Op. 14 n.42).

As the Court of Appeals reasoned, these authorities reflect "the basic contract principle that a party must perform its duties and that a failure to perform entitles the injured party to damages proximately caused by the breach." (Op. 14) Rather than follow this basic principle, Instruction 9 allowed the jury to absolve AP of *all* liability for a defect if Lake Hills' plans and specifications played *any* role in the defect, no matter how minor or inconsequential. Instruction 9 thus did not—as AP asserts—"permit[] the jury to appropriately apportion liability between the parties based on each party's fault." (Pet. 10, n.4 (quoting RP 2402))

Although the trial court *intended* to craft an instruction that allowed apportionment (RP 2402), as it later acknowledged,

Instruction 9 gave AP "a complete affirmative defense" even if a defect was "also due to other causal factors." (RP 4110) The Court of Appeals thus correctly noted that "instruction 9 did not accomplish the court's stated goal of limiting AP's exposure to only damages resulting from AP's defective performance." (Op. 9, n.25)

Instruction 9 was not harmless, as AP now asserts. (Pet. 9-10) Consistent with the Court of Appeals' and trial court's shared observation that Instruction 9 gave AP an "absolute" and "complete" defense (Op. 8; RP 4110), the jury awarded *nothing* on two of Lake Hills' defect claims despite the fact "there was evidence of . . . deficient performance by AP." (Op. 10) Moreover, AP did not—as it now asserts—admit at trial "that [it] did not follow the plans." (Pet. 9) AP instead stressed to the jury that it "built . . . in accordance with the plans given to AP" and that "[e]verybody knew it." (RP 4987) Indeed, AP's primary defense to Lake Hills' concrete defect claim—by far the largest claim at trial—was that "the design [was] responsible" for "the amount of cracking" in the concrete. (RP 4992)

Because the Court of Appeals decision is consistent with Washington's "well settled" law, it does not, as AP alleges, "threaten[] to upset the allocation of risk" in construction contracts, nor is there any need for this Court to "address[] the legal principles" in this case.

(Pet. 11-12 (citing RAP 13.4(b)(4)) Instruction 9, not the Court of Appeals decision, mandated that liability "be viewed as an all-or-nothing" proposition. (Pet. 11) The Court of Appeals reversed because Instruction 9 erroneously "relieved [AP] of *all* liability for its breaches." (Op. 13-14 (emphasis added)) The Court of Appeals' analysis of Instruction 9 does not warrant review under RAP 13.4(b).

E. Statement of Issues for Conditional Cross-Review.

In the event this Court accepts review, it should also consider: (1) whether the Court of Appeals failed to apply the presumption of prejudice arising from instructions that misstated the law and misled the jury, and (2) whether the Court of Appeals erroneously held that Lake Hills was not prejudiced by the failure to give an instruction that correctly stated the law of material-breach waiver.

F. Argument in Support of Conditional Cross-Review.

While correctly holding Instruction 9 required reversal, the Court of Appeals misapplied this Court's harmless-error precedent in holding the trial court's other instructional errors did not. Should this Court grant review on AP's petition, it should review and reverse the trial court's additional erroneous contract instructions.

"Prejudice is presumed if the instruction contains a clear misstatement of law; prejudice must be demonstrated if the

instruction is merely misleading." *Anfinson v. FedEx Ground Package Sys., Inc.*, 174 Wn.2d 851, 860, ¶ 10, 281 P.3d 289 (2012). Where a misleading instruction is actively urged on the jury, "[n]o greater showing of prejudice . . . is possible without impermissibly impeaching a jury's verdict." *Anfinson*, 174 Wn.2d at 876-77, ¶ 45; *see also Thola v. Henschell*, 140 Wn. App. 70, 85, ¶ 29, 164 P.3d 524 (2007) (reversing because "it is highly likely that the jury did as . . . urged" and relied on evidence it should have been instructed to ignore).

"Failure to permit instructions on a party's theory of the case, where there is evidence supporting the theory, is reversible error." *Barrett v. Lucky Seven Saloon, Inc.*, 152 Wn.2d 259, 266-67, 96 P.3d 386 (2004). Likewise, if an instruction is necessary to "inform[] the jury of the applicable law" refusing to give it requires reversal. *Barrett*, 152 Wn.2d at 274; *see also Farm Crop Energy, Inc. v. Old Nat. Bank of WA*, 109 Wn.2d 923, 9334, 750 P.2d 231 (1988) (reversing because "the trial court failed to inform the jury of the applicable law"). The court below incorrectly weighed the evidence in the light most favorable to AP, rather than assessing whether the erroneous instructions impeded Lake Hills' theory of the case:

1. The Court of Appeals decision conflicts with Washington precedent requiring a presumption of prejudice when a jury instruction misstates the law.

The Court of Appeals correctly held that the trial court's Instruction 15 misstated the law by allowing the jury to "improperly excuse[] AP's performance due to a nonmaterial breach of the duties of good faith and fair dealing" because it did not state, as Lake Hills requested, that "only a *material* breach . . . could excuse performance by AP." (Op. 21, 23 (emphasis added)) But the Court of Appeals then erroneously held "[u]nder the very particular facts presented here, Lake Hills was not prejudiced" on its claim that AP breached the contract by stopping work in November 2015. (Op. 23)

The Court of Appeals' holding conflicts with precedent requiring an appellate court to presume prejudice when a jury instruction misstates the law. *See, e.g.*, *Keller v. City of Spokane,* 146 Wn.2d 237, 249, 44 P.3d 845 (2002); *Flyte v. Summit View Clinic*, 183 Wn. App. 559, 578, ¶ 38, 333 P.3d 566 (2014) (citing *Anfinson*, 174 Wn.2d at 860). The presumption of prejudice requires a reviewing court to reverse if it is possible a misstatement of the law prejudiced the appellant *even if* "it is unclear whether the jury would have reached a different conclusion had it been properly instructed."

Keller, 146 Wn.2d at 251 (erroneous instruction made it "possible for the jury to conclude that the [defendant] owed . . . no duty at all.").

Here, the Court of Appeals flipped the presumption of prejudice on its head, reviewing the evidence in the light most favorable to AP, reasoning that "if the jury accepted AP's theory of excuse, it necessarily was based upon a material breach by Lake Hills" because "the sole theory of excuse before the jury was based upon massive underpayment by Lake Hills that devastated AP's ability to continue working, the very essence of a material breach." (Op. 24) The jury could have found that any breach by Lake Hills of its duty of good faith was not material given AP's continued performance of the contract for nearly 17 months after the claimed breach.

For example, while AP argued to the jury that Lake Hills' alleged underpayments in May 2014 violated the duty of good faith and "devastated" the project (RP 4955-56, 4965-66, 4984), its senior project manager told Lake Hills in June 2014 that "we will make the [payment] work." (Ex. 805; RP 1273-75, 3280) AP's former senior project manager also conceded he routinely inflated subcontractor invoices to provide a "buffer" in AP's payment applications for any

cuts made by Lake Hills. (RP 2655-56, 2943)[3] At the same time, AP rebuffed Lake Hills requests for documentation supporting its admittedly inflated costs. (Ex. 1025 at 3; RP 1074-75, 1081, 1996-2008, 3071) The jury could have found under a proper instruction that Lake Hills' refusal to pay the full amount of AP's payment applications was not material because AP was willing to continue performing, "padding" its payment applications as it had in the past.

2. The Court of Appeals decision conflicts with Washington precedent holding that a misleading instruction requires reversal where that instruction is actively urged upon the jury.

Instruction 16 governed Lake Hills' claim for liquidated damages for delay, instructing the jury that AP could avoid liability for delays by proving they "were not *solely* caused by AP." (CP 357 (emphasis added)) The Court of Appeals held that this instruction erroneously "let the jury excuse AP from any day of delay caused by anything other than itself, including its own agents," but again found Lake Hills was not prejudiced, reasoning "[t]he jury's findings match the testimony from AP's scheduling expert" and thus "reflect a credibility determination," not "prejudice from a misleading instruction." (Op. 19-20)

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[3] AP also admitted that three of its supervisors charged *100%* of their time to allowance work despite performing lump sum work that was not paid on a time and materials basis. (Ex. 565 at 5-6; *see also* RP 4532; Ex. 1322) AP's contention that Lake Hills cut AP's payment applications "[n]o matter what AP did" (Pet. 2-3), ignores these valid reasons to question AP's costs.

This harmless error analysis again conflicts with Washington precedent. RAP 13.4(b)(1)-(2). Here, as in *Anfinson* and *Thola*, AP stressed the erroneous instruction to the jury, arguing that AP only "need[ed] to show . . . the delay[s] to phase 2C were not caused *solely* by AP." (RP 4972 (emphasis added)) AP relied on its scheduling expert to support this argument, insisting that Lake Hills could not prove it was the "sole" cause of any delays associated with the value engineering process. (RP 4979 ("[AP's expert] finds all of this evidence of value engineering. So not only were they performing it, but that's what was delaying the schedule. . . . It operates as a *total* elimination of liquidated damages") (emphasis added))

AP's own employees and expert[4] affirmed that AP bore responsibility under this "design-build" contract[5] for the value engineering process and that delays were caused by, among other things, AP's failure to manage an electrical subcontractor during that process. (*See* RP 4929-30) Under Instruction 16 the jury could have agreed with Lake Hills that AP's subcontractor caused the delays but

[4] (*E.g.*, RP 4004 (AP's "design/build contract[or] ha[d] to complete the meter boxes and the switch gear"); RP 4499-500 (AP responsible for electrical work))

[5] "By taking 'control' of the preparation of any portion of the detailed design for the project, the contractor necessarily assumes responsibility for the adequacy and timeliness of its design, and is liable for delay to the project caused by its design delays." 5 Bruner & O'Connor, *supra*, § 15:40.

nonetheless excused AP for a breach because AP itself, as opposed to its agent, was not the "sole" cause of delays.

This was the precise risk identified by the Court of Appeals when it concluded that Instruction 16 was misleading—that the jury would excuse AP for a "delay caused by anything other than itself, including its own agents." (Op. 19) The Court of Appeals' holding that Lake Hills was not prejudiced by Instruction 16 cannot be squared with *Anfinson* and *Thola*. RAP 13.4(b)(1), (2).

3. The Court of Appeals decision conflicts with Washington precedent requiring instructions that inform the jury of the applicable law.

The Court of Appeals rejected Lake Hills' argument that the jury should have been instructed that although a material breach by one party to a contract can excuse the other party's performance, the non-breaching party can waive that excuse if it "continue[s] to accept the benefit of [the other party's] performance" "with full knowledge of the breach." *Longenecker v. Brommer*, 59 Wn.2d 552, 557, 368 P.2d 900 (1962); (RP 4874-75) The Court of Appeals again erroneously reasoned that Lake Hills was not prejudiced by the failure to give its instruction. (Op. 26)

Without its proposed waiver instruction Lake Hills could not argue its theory of the case. AP stressed to the jury that its decision

to suspend work in November 2015 was excused by Lake Hills' alleged material breach, underpaying AP on July 25, 2014, the date the trial court used to cut off any liability for AP's delays.[6] (RP 4955-56) It was thus critical to Lake Hills' theory to instruct the jury that AP could not "sit on" an alleged material breach and then claim more than a year later—after accepting over $20 million in contract payments—that the breach excused its own performance willingly rendered with full knowledge of the earlier alleged breach.

G. Conclusion.

This Court should deny AP's petition, as the Court of Appeals decision follows settled law. In the unlikely event this Court grants AP's petition, it should also review the issues raised by Lake Hills.

Dated this 14th day of December, 2020.

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[6] AP successfully argued the jury's finding that a "material breach occurred on July 25, 2014" and its finding "that AP was not the sole cause of delay on any of the phases . . . preclude any assessment of liquidated damages whatsoever," including 108 days of delay AP *admitted* it caused. (CP 3244 (*see also* RP 4451; Ex. 2882))

DECLARATION OF SERVICE

The undersigned declares under penalty of perjury, under the laws of the State of Washington, that the following is true and correct:

That on December 14, 2020, I arranged for service of the foregoing Answer to Petition for Review, to the Court and to the parties to this action as follows:

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/s/ Andrienne E. Pilapil
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