

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

Robert L. Pratter, Acting Insurance
Commissioner of the Commonwealth
of Pennsylvania,
Plaintiff

v.

No. 269 M.D. 2001

RELIANCE INSURANCE COMPANY,
Defendant

*Re: Basketball Properties Limited/Arquitectonica International, Inc.
POC 2082141*

OPINION NOT REPORTED

MEMORANDUM OPINION BY
PRESIDENT JUDGE LEADBETTER

FILED: November 18, 2010

Basketball Properties Limited (BPL), owner of a sports arena, objects to the notice of claim determination issued by the Insurance Commissioner, in his capacity as Liquidator of Reliance Insurance Company. BPL filed a proof of claim for damages arising from malpractice on the part of the stadium architect's Reliance's insured. In the notice of determination, the Liquidator assigned the claim a priority level (b) and valued only the portion of the claim that concerned improper stadium seat covers. BPL not only challenged the valuation of that portion of the claim but objected to the Liquidator's failure to value remaining aspects of the claim. At this point, two aspects of the claim have been subject to proposed adjudication by a referee, who determined that architects were liable but

recommended damages less in amount than sought by BPL. Each party filed cross-exceptions to the report and recommendation. After consideration, this court sustains BPL's exceptions.

In 1996, Arquitectonica International, Inc. (ARQ), an architectural, interior design and planning firm, began providing architecture and design services to BPL in connection with construction of a new sports arena in Miami, Florida. In view of a 1999 project completion target, ARQ and BPL began work together without a written contract. ARQ completed a significant amount of the design development phase of the arena project before the contractual relationship with BPL was formalized by a written agreement. BPL and ARQ signed a contract on May 22, 1998, and provided a retroactive effective date of April 25, 1997. The arena was completed in December 1999.

In connection with the arena project, ARQ's President submitted to Reliance an application, dated January 21, 1998, for professional liability insurance and Reliance issued a policy covering the period from April 17, 1998, through June 30, 2001. In March of 2000, BPL, as an additional named insured under the policy, notified Reliance of probable claims. BPL asserted that by May of 1998, ARQ began to fall behind schedule and in November 1998, failed to provide when due the construction documents required by the project contractor in order to coordinate work by subcontractors. BPL asserted that the failure to produce the documents on schedule resulted in the incursion of additional costs associated with rescheduling subcontractors and executing change orders. BPL pointed to added expense to complete the project due to changes to electrical, mechanical and plumbing design and specifications. BPL also asserted that when ARQ eventually

provided the construction documents they were negligently prepared and contained design flaws.

In October of 2001, Reliance was placed into liquidation by this court and the Pennsylvania Insurance Commissioner became the statutory liquidator. In December 2003, BPL submitted a Proof of Claim (POC) in accordance with the procedures established for the liquidation. In December of 2007, the Liquidator issued a Notice of Determination (NOD) accepting only that portion of BPL's claim seeking recovery for inadequate stadium seat upholstery coverings and specifically reasserting its right to otherwise deny coverage on the grounds stated in an April 2001- Reservation of Rights letter.¹ Among the reasons for refusal to value all of BPL's elements of damages, the Liquidator stated it had not been established that the damages had been caused by any negligence on the part of ARQ. In accordance with the prescribed claim dispute procedures, BPL filed objections to the Liquidator's NOD. BPL objected to the Liquidator's failure to make a merits determination and valuation on all of the elements of damages

¹ The notice of determination assigned the claim to priority level (b) with a value of \$750,000.00 and further stated:

The above allowed amount is for the seat fabric claim as to which you have established that an act, error or omission on the part of ARQ was the cause of the claimed damages. As to the remainder of your claim, you have not established that ARQ is liable for the claimed damages nor that the amount of damages claimed are reasonable or appropriate, particularly in light of Article 17.3 of the contract between ARQ and you. The cause of the claimed damages is critical to a determination of ARQ's liability as well as to a determination of coverage. Thus, significant coverage issues, as outlined in the April 3, 2001 Reservation of Rights letter addressed to ARQ, which is incorporated by reference, remain which cannot be resolved or determined until there is a finding of ARQ's liability which has not been established. A copy of the reservation of rights letter is believed to be in your possession, but is available upon request.

claimed. Upon the parties' joint request, this court assigned the objections to a referee to make findings and issue a recommended decision.

The referee scheduled a hearing on December 8, 2008, asking BPL to present proof as to liability and damages on the two elements of the claim it considered to be particularly strongly supported by the evidence. BPL presented claims that: (1) the architect created a design flaw which constituted an electrical code violation, thereby necessitating correction of the problem at an additional cost of \$251,526.00; and, (2) the architect failed to ensure that the air handling units fit into the area designated for them thereby necessitating their relocation at an additional cost of \$1,174,201.93. There exists no dispute that the construction documents located unprotected water, sanitary and gas pipes directly over electric substation rooms and no dispute that the air handling units were too large for the intended placement area. There is also no dispute that the eventual cure for the problematic location of the pipes was to enclose them, inserting a waterproof barrier between the pipes and the substations and no dispute that the cure for the over-sized air handling units was to relocate them from the too small area on the press level to an adequately sized area on the balcony level. Finally, there was no dispute that in an earlier design phase the architect had proposed placement of the air handling units on the balcony level but on the construction documents, changed this location to save on construction costs.

The Liquidator maintained that inasmuch as the project was on an extreme fast track,² the failure to include in the construction documents the

² According to both parties' experts, a fast track process overlaps the design and the construction phases of the project so that construction can begin before all construction documents are completed. Hearing of December 8, 2009, Notes of Testimony (N.T.) at 36 (Senn) and 422 (Boland).

waterproof barrier for the piping, and the failure to ensure that the air handling units were properly sized for installation on the press level were in the nature of events that should be expected and did not constitute a breach of the standard of care under the circumstances. As to the location of water and gas lines near electrical substations, the Liquidator asserted that, any safety or electrical code violation was cured by the placement of the waterproof barrier and, given that the pipes could not be relocated without major redesign, the cost of adding the barrier would have been born by BPL regardless of any error in the construction documents. As to the Air Handling Units (AHUs), the Liquidator asserted that BPL incurred little or no extra cost due to the sizing error that prevented placement of the AHUs on the press level because the over-sized units were relocated to the balcony level where they had originally been located in the design documents. Hearing of December 8, 2008, Notes of Testimony (N.T.) at 256-59.

Following receipt of evidence as to liability and damages, the referee reported as follows:

As to the first issue, the evidence presented at the hearing established that the architect created a design which called for the main piping loop on the event level of the arena to run over two electrical substation rooms. The experts who testified for each party agreed that said design would be in violation of the National Electrical Code.

The Liquidator's experts testified that neither substation room could have been moved away from the service line looping area without major modifications to the other areas of the arena. The Liquidator's conclusion, based upon this circumstance, is that the design oversight would not result in significant damages (other than a premium payment) because the waterproofing construction would have occurred anyway.

However, the same experts testified that [but for the negligence in preparation of the construction documents] it could have been possible to reroute all of the service lines away from the substations except for the sanitary lines, which infers (sic) that it would potentially have been less costly to waterproof the substations if that had occurred.

In light of the above, it is my recommendation that the Claimant should be entitled to recover a portion of its claim, which I suggest should be \$150,000.

Referee's Report and Recommendation at 2. Regarding the AHUs, the referee stated:

Both parties' experts testified that the architect had been notified of the (VE) [value engineering³] suggestion to relocate the AHU from the balcony level to the press level, and also that the architect had not informed the Claimant that it was unworkable.

Additionally, both experts testified had the Claimant been notified by the architect of the non-workability of the suggestion, it would have had the option of either keeping the AHU on the balcony level or adjust the design of the units to make them smaller so that they could be located at the press level, which was of greater benefit to the Claimant.

The Liquidator argued that the damages associated with either option were too speculative because the Claimant had never performed any analysis to determine the costs associated with them.

....
Upon reflection and analyzation (sic), the issue distills to its essence between the architect's clear error and the Claimant's speculative damages. It would be my

³ "Value engineering" refers to a process whereby contractors and others on the construction team proffer suggestions for plan revisions that will achieve construction cost savings while maintaining overall design intentions. N.T. 43.

recommendation that the Claimant be entitled to recover \$730,804.00.

Id. at 2-3.

Following receipt of the referee's report, the parties filed cross-exceptions. In his exceptions, the Liquidator challenges the sufficiency of the evidence supporting the referee's findings of negligence. The Liquidator argues that the architects did not breach the standard of care applicable to projects constructed on an extremely fast track, such as the arena, where construction began before all construction documents had been completed and where BPL directed value engineering design changes as the project proceeded. The Liquidator further challenges the sufficiency of evidence supporting causation. Regarding the waterproof barrier between the pipes and the substations, the Liquidator again argues that, because the pipes could not be relocated, BPL would have incurred the cost of installing the barrier regardless of any deficiency in the construction documents. As for the AHUs, the Liquidator similarly maintains that BPL's evidence of the cost of installation on the balcony level addresses the wrong measure of damages. The Liquidator asserts that if damages are warranted, the measure must be what BPL lost as a result of the inability to achieve the value engineering savings that were anticipated in placing the AHUs on the press level and that BPL produced no such evidence. Alternatively, the Liquidator suggests that BPL was required to submit evidence as to the cost of making the AHUs fit on the press level by either obtaining smaller AHUs or altering the available space on that level. In its exceptions, BPL challenges the referee's recommendation on the amount of damages, contending that without explanation he recommended less than the amounts established by the evidence.

There is no dispute that the burden falls on BPL to establish by way of expert testimony that BPL incurred additional costs as a result of ARQ's failure to use reasonable and ordinary care and diligence in the application of its professional expertise to accomplish the purpose for which it was retained. *See Bloomsburg Mills Inc. v. Sordoni Constr. Co.*, 401 Pa. 358, 361, 164 A.2d 201, 203 (1960). BPL met this burden with the testimony of Bill Senn, BPL's construction executive, and Mark Giannecchini, an expert in construction and project management with a degree in Architectural Technology, both of whom opined that, even considering the demands imposed by fast tracking and value engineering design changes, ARQ deviated from the standard of care resulting in errors regarding placement of both the water, sanitary and gas pipes and the AHUs, thereby causing BPL to incur additional expenses to remedy the errors. N.T. at 65, 87, 94-95, 257, 263-64, 280. This evidence sufficiently established ARQ's negligence and causation.

Damages caused by an architect's negligence are appropriately measured by the cost of reasonable efforts to remedy the resulting construction defect. *Bloomsburg Mills*, 401 Pa. 358, 364, 164 A.2d 201, 204.⁴ Here, BPL produced the Work Authorizations (WA) for the additional work required to correct the defective design that placed the water, sanitary and gas pipes in proximity to the electrical substations and that required repositioning of the AHUs to the balcony level due to a sizing error. Following review of these work authorizations, BPL's expert, Mark Giannecchini, submitted a report explaining in

⁴ The choice of law provision in the Reliance policy directs application of New York law. As acknowledged by the parties, the pertinent law does not differ between this Commonwealth and New York. *See Bd. of Educ. of Hudson City Sch. Dist. v. Sargent, Webster, Crenshaw & Folley*, 539 N.Y.S.2d 814, 146 A.D.2d 190 (N.Y.A.D. 1989).

aspects of the work indicated on those authorizations related to the correction of the defects at issue here and prepared a chart listing each WA and the amount paid for relevant corrections.⁵ Mr. Giannecchini's testimony and report establish damages of \$251,526.00 for the addition of a waterproof barrier over substations and \$1,174,201.93 for the repositioning of the AHUs. This evidence fully and accurately establishes the amount of BPL's damages and, thus, this court finds that BPL incurred damages accordingly.

The Liquidator's contention that the substations would have required waterproofing regardless of any error in construction documents was a point over which the parties produced conflicting expert testimony. BPL's expert opined that had the faulty pipe placement near substations been identified earlier, minimal cost alternatives to routing the pipes could have been implemented and the Liquidator's expert opined to the contrary.⁶ The Liquidator now contends that the failure of BPL's expert to specify where the pipes or the substations could have been relocated renders the opinion insufficient to support a finding. This contention is meritless; the specificity with which BPL's expert rendered his opinion goes to the weight to be afforded his testimony not its competence to support a finding. After


⁵ BPL submitted and Giannecchini reviewed work authorizations numbered: 310, the only WA related to the addition of waterproof protection for electrical substations, totaling \$251,526.00; 176, 179, 194, 215, 273, 358, 363R, 364 and 828, all relating to relocation of the AHUs. The total costs reported on WA 194, 273, 363R and 364 were discounted to reflect only that portion of costs related to correction of the defects at issue here. An additional discount, in the total amount of \$152,320.73, was applied to costs listed in WA 194, 358, 363R and 364 to reflect the recovery of a portion of the correction costs already recovered in a settlement with JJ Kirlin, the builder.

⁶ Specifically, Mr. Senn stated that had the architects earlier discovered and addressed the problem presented by the proposed location of the pipes prior to proceeding with construction, the design could have been modified to alleviate the problem by rerouting the pipes at little or no expense and without the need to create waterproof structures around the pipes. N.T. at 87.

review of all the testimony, I find that BPL's expert persuasively opined that but for the error in pipe placement BPL would not have incurred the cost to waterproof the substations.

Further, with regard to the repositioning of the AHUs, there is no merit in the Liquidator's assertion that: "Because BPL cannot establish what VE savings it lost, it cannot turn to Reliance now to recoup these speculative savings." Liquidator's Brief in Support of Exceptions at 13. BPL's expert explained that the documents guiding construction, which he also referred to as the "OGMP [original guaranteed maximum price] drawings," were the drawings put out to bid. These drawings incorporated VE changes to the earlier design documents, such as relocation of the AHUs from the balcony to the press level, and set the baseline for what would be constructed and at what cost. The incursion of additional costs associated with the reasonable measures taken here to correct problems caused by errors in these construction documents is the proper measure of BPL's damages.⁷ The additional cost of relocating the AHUs after establishment of the OGMP constitutes the proper measure of damages.

For the reasons set forth, BPL's exceptions are sustained. The two elements of BPL's claim at issue here shall be valued in the total amount of \$1,425,727.93 (\$1,174,201.93 + \$251,526.00) and the Liquidator shall amend the NOD accordingly.



BONNIE BRIGANCE LEADBETTER,
President Judge

⁷ The Liquidator produced no evidence in rebuttal challenging the reasonableness of the corrective measures or that corrections could have been effectively made at a lower cost.

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