A MARYLAND FEDERAL COURT EVALUATES WHO REALLY BEARS THE RISK OF A WILDLY INACCURATE GMP

By: Shoshana E. Rothman

This past summer, a Maryland federal court took the opportunity to address the risks inherent in a guaranteed maximum price (GMP) contract and whether the general contractor can be liable for breach when the GMP was exceeded by $20 million. Although Maryland courts usually are not known for strictly interpreting parties' contract terms and conditions like courts in neighboring states, in this decision, the federal court suggested that, to protect the parties' interests when project costs double, all likely scenarios should be contemplated and addressed in the contract.

In *J.E. Dunn Construction Co. v. S.R.P. Development Limited Partnership*,[1] a dispute arose following the construction of a mega church in Upper Marlboro, Maryland. To construct the church, the Metropolitan Baptist Church ("Owner") entered into separate development and design-build contracts with S.R.P. Development Limited Partnership, The Smoot Corporation, and Robuck Investment, Inc. (collectively, "SRP"), to provide the Owner with project management services. As part of those services, SRP solicited contracts from general contractors, and entered into a GMP contract with J.E. Dunn Construction Co., whereby J.E. Dunn agreed to serve as the project's general contractor and provided a preliminary GMP of $31 million. The parties also executed a contract amendment stating that the parties would agree to a GMP after final plans and specifications were developed. No further action was taken to modify the contract and finalize the GMP.

Problems ensued after construction started, and when the project was only 55% complete, J.E. Dunn had approached the limits of its GMP. After being notified of the fact that costs would exceed the GMP, the Owner terminated its contract with SRP, which in turn caused SRP to terminate the GMP contract. The Owner then contracted directly with J.E. Dunn to complete the project, to the ire of SRP, which believed that J.E. Dunn had independently and secretly schemed with the Owner to oust SRP, thereby permitting the Owner to redirect project management fees toward construction costs.

Construction costs ultimately exceeded the GMP by $20 million. Following completion, J.E. Dunn filed suit against SRP on the ground that SRP refused to accept J.E. Dunn's GMP change order proposals, but had directed J.E. Dunn to proceed with the work while the price and scope of the project continually increased. In its complaint, J.E. Dunn sought breach of contract damages of $3.5 million for amounts unpaid to it, and quantum meruit and unjust enrichment damages of $7.3 million, pleading that SRP received a benefit from J.E. Dunn without paying for that value. J.E. Dunn later amended its complaint and asserted similar damages against the Owner for its unpaid contract balance of $3.6 million.

SRP counterclaimed against J.E. Dunn for J.E. Dunn's alleged breach of its contract with SRP on two grounds: (1) that J.E. Dunn surreptitiously negotiated with the Owner for the Owner to terminate SRP, which would then free up J.E. Dunn and the Owner to contract directly, and thereby save the Owner from having to pay SRP's fee; and (2) that J.E. Dunn was liable for a breach of contract by failing to complete the project within the GMP. J.E. Dunn moved to strike or dismiss SRP's counterclaim, which brought the issue of the contract risk of a GMP before the court.

On J.E. Dunn's motion, the court considered and rejected SRP's two grounds for breach of the contract. As to SRP's first argument, the court ruled that SRP could not point to any provision in its contract with J.E. Dunn that prohibited J.E. Dunn from engaging in negotiations with the Owner. Absent any such contractual prohibition, the court was left to question whether J.E. Dunn's conduct constituted a violation of the duty of good faith. Although the duty of good faith is impliedly contemplated within all Maryland contracts, it is not recognized as a separate, stand-alone cause of action. Absent the allegation of breach of a specific contractual term, the court therefore was left without any means to remedy the first breach of contract allegation raised by SRP.

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1 Civil Action No. DKC 11-1948, 2014 WL 3865993 (D. Md. Aug. 5, 2014).

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The court also rejected SRP's second theory of breach, explaining that the purpose of a GMP contract is to transfer the risk of exceeding the project's cost estimate to the contractor. Since SRP did not allege that J.E. Dunn refused to perform or that J.E. Dunn demanded payment for costs in excess of the GMP before SRP terminated the contract, the fact that J.E. Dunn later exceeded its GMP, even by $20 million, did not support a cause of action for breach of contract, and again left SRP without a mechanism for recovery.

In its briefing, SRP raised anticipatory repudiation as a third theory of recovery against J.E. Dunn for breach of contract. According to SRP, J.E. Dunn's underestimation of the GMP by $20 million made J.E. Dunn's inability to perform either inevitable, or so much in doubt, that it constituted an anticipatory repudiation of the contract. Similar to SRP's other theories of recovery, however, that argument failed as well, because SRP did not allege that J.E. Dunn actually failed or refused to perform.

For SRP to recover under a theory of repudiation, the court explained that "repudiation must take the form of a positive statement or act," and there must be a "definite, specific, positive, and unconditional repudiation of the contract by one of the parties to the contract."[2] The court also stated: "the expression of a doubt as to whether the ability to perform in accordance with the contract will exist when the time comes, is not a repudiation."[3] Since SRP only alleged that J.E. Dunn's repudiation could be *inferred* from its "wildly off base GMP," there was no "positive statement or act" that J.E. Dunn would not perform or that J.E. Dunn expected SRP or the Owner to pay the additional costs of exceeding the GMP that could rise to the level necessary to constitute an anticipatory breach.[4] Absent any express statement by J.E. Dunn, the court rejected SRP's repudiation theory.

Finally, the court considered and rejected SRP's second proposed cause of action against J.E. Dunn for J.E. Dunn's allegedly precontractual negligent representation that it could perform the contract for the GMP. The court noted that, to the extent SRP attempted to assert that J.E. Dunn breached the contract by misrepresenting the GMP or by negligently failing to investigate costs in preparing the GMP and that SRP relied upon the GMP to its detriment, SRP's reliance was unreasonable because the parties never formalized a final GMP after the final plans and specifications were developed. In addition, where the risk of exceeding the GMP falls on the contractor, SRP did not adequately plead how any allegedly false statement by J.E. Dunn that it could perform within the GMP would have caused SRP injury. The court therefore denied that theory of recovery as well.

The *J.E. Dunn* opinion represents a shift from traditional Maryland contract cases that place more emphasis on equities to requiring a stricter contractual interpretation. The court also disregarded the traditional chain of command in contractual privity, essentially finding that common law notions of tortious interference with contracts do not apply in the context of a construction project, and potentially encouraging parties to actively work to subvert privity for financial gain. Had SRP included a clause in its contract with J.E. Dunn prohibiting any interference with the Owner, the opinion suggests that SRP would have an avenue of recovery for what SRP believed to be a conspiracy between J.E. Dunn and the Owner. Similarly, had the GMP contract reinforced that SRP relied upon the GMP contractor to develop a reasonable price for which the project could be constructed and spelled out the consequences for a truly out-of-line GMP, SRP might have had purchase to pursue its counterclaim against J.E. Dunn.

The J.E. Dunn case highlights the risks involved with utilizing a GMP contract. Because the framework for a typical GMP contract places the risk on the contractor, most contracts leave room for upward modification of the GMP in the event of scope changes. Thus, there are few cases where an owner has successfully held a contractor liable for exceeding the GMP. In those few instances, the scenario often involves a contractor seeking recovery for change order work that is outside the work specified in the GMP. Courts then apply a typical breach of contract and change order analysis to determine whether, and in what amount, the contractor is owed for the extra work.

Although the GMP contracting vehicle is frequently employed by parties wanting to control costs, contracting parties still should be cognizant of including language that could transform an intended GMP into a contract in which the owner retains the risk of costs in excess

2 *Id.* at *5-6.

3 *Id.* at *6 (citing C.W. Blomquist & Co., v. Capital Area Realty Investors Corp., 311 A.2d 787 (Md. 1973), which quoted from 4 Corbin on Contracts § 974 (1951)).

4 *Id.*

of the proposed GMP. For example, in *Professional Service Industries, Inc. v. J.P. Construction, Inc.*,[5] the Nebraska Supreme Court examined a subcontract for quality control testing services to be provided on a road paving project, wherein the prime contractor intended to bind its subcontractor to a GMP. The key language in the agreement turned on the phrase "Total Subcontract (estimated) $44,000.00", and whether the use of the term "estimated", even in parentheses, destroyed what the prime contractor intended to be a GMP.

At trial, the lower court in *J.P. Construction* agreed with the prime contractor that the use of the term "estimated" demonstrated the parties' intent to hold close to that amount. However, the trial court was reversed on appeal, where the Nebraska Supreme Court concluded that "there is no language in the entire document to indicate that the estimate is either a guaranteed maximum or minimum figure. There is nothing to manifest that the $44,000 figure is anything more than [what] it states it is: an estimate."[6] As the Nebraska Supreme Court recognized, "when an estimated figure is a guaranteed maximum or minimum, or when the parties expressly provide otherwise, only then may the court treat the estimate as a fixed amount to which the parties are contractually bound."[7] The particular language employed in the *J.P. Construction* contract was insufficient to express an intent that the contract price was a fixed maximum limit. The Nebraska Supreme Court remanded the case to enter judgment in favor of the subcontractor for the total of its billings, which the prime contractor had refused to pay in excess of $44,000.

These cases demonstrate the attention to detail that must be given when memorializing contractual negotiations, and that all contracting parties should not only review their contracts prior to execution, but understand how the contract's terms will govern the outcome of their projects. As was the case in Nebraska, the very success of a project hinged on a single word. When conducting the contract review, additional GMP terms that contractors should consider include how price escalations, material shortages, and change orders that occur after the contract is signed are addressed, which construction documents are incorporated in the GMP, and the specific components and scope included in the GMP price. The contractor should also be aware of any time and notice requirements associated with those terms. While a contract may look lucrative now, one can only imagine the heartburn later when a contractor has to eat millions of dollars of excess costs merely because all scenarios were not considered and addressed at the contracting stage.

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5 491 N.W.2d 351 (Neb. 1992).

6 *Id.* at 354.

7 *Id.* at 355.