



# STATE OF OHIO CONSTRUCTION LAW COMPENDIUM

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This compendium of Ohio construction law is intended only to provide the reader with a general outline of the Ohio law as of the date this compendium is published and should serve only as a resource for general information. Ohio law with regard to construction matters changes frequently as a result of the development of case law, and there have been some very recent Ohio Supreme Court decisions impacting the construction industry that have not yet been fully integrated into Ohio common law. Therefore, the reader should follow up with specific legal research once a topic of interest has been identified.

Ohio is also a modified comparative fault State for purposes of tort reform, and there have been some very recent legislative changes in the torts area that will have an indirect impact on tort claims involving the construction industry as well. Legislative changes and court decisions have recently modified and limited the collateral source rule and have significantly limited joint and several liability. The Ohio legislature has recently enacted reforms to separate economic and non-economic damages, and in certain cases, have implemented damage caps on bodily injury claims for non-economic damages, which have been upheld by the Ohio Supreme Court. Therefore, in those cases where the tort reforms are important, the reader is advised to consult with an attorney familiar with Ohio law on this topic for the most current information.

## **I. BREACH OF CONTRACT**

### **A. Statute Of Limitations & Choice Of Law**

Disputes concerning Ohio construction projects must be litigated in Ohio, subject to Ohio law, regardless of the choice of law provision or forum selection clause in the contract. O.R.C. §4113.62(D)(1) & (2). These statutory requirements cannot be waived. It may be possible to challenge such statutes when federal pre-emption is an issue, such as when the forum selection clause is part of an arbitration clause subject to the Federal Arbitration Act.

The statute of limitations for a contract claim will vary depending on the form of the contract. For example, the statute of limitations for a written contract is fifteen years, pursuant to O.R.C. §2305.06. A claim based on the breach of an oral contract has a six-year statute of limitations period. *See* O.R.C. §2305.07 Most breach of warranty claims have a four-year limitations period. *See* O.R.C. §2305.09. Claims that fall under the Ohio Consumer Sales Practices Act, as would a residential construction or home improvement contract must be brought within two years of the time the cause of action accrues. O.R.C §1345.02. Ohio follows a ten year statute of repose. *See*, O.R.C. §2305.131.

A cause of action for breach of contract accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. *See* O.R.C. §1302.98; *See also Midwest Specialties, Inc. v. Firestone Tire & Rubber Co.* (1988), 42 Ohio App.3d 6. Parties may contract to reduce the period of limitation to not less than one year. *See Hahn v. Jennings*, 10 Dist. App No. 04AP-24, 2004 -Ohio- 4789. Similarly tolling agreements are enforceable in Ohio. Tolling agreements are contractual agreements that extend the statute of limitations for pursuing a claim. An effective tolling agreement will identify (a) the parties to the dispute; (b) the applicable claims, damages, and defenses; and (c) a specification of the time period during which a lawsuit should be filed, or other means of dispute resolution sought.

## **B. Discovery Rule**

Typically, a cause of action accrues at the time the wrongful act was committed. *Collins v. Sotka* (1998), 81 Ohio St.3d 506, 507, citing *Kunz v. Buckeye Union Ins. Co.* (1982), 1 Ohio St.3d 79. However, Ohio's discovery rule provides an exception to this general rule, providing that for certain acts a cause of action for these acts accrues "at the time when the plaintiff discovers or, in the exercise of reasonable care, should have discovered the complained of injury. *Investors REIT One v. Jacobs* (1989), 46 Ohio St.3d 176, 179; *Cundall v. U.S. Bank* (2009), 122 Ohio St.3d 188. This is particularly important in the construction context where there may be latent defects in a project that are not immediately observable.

Accordingly, in Ohio, an action against a developer-vendor of real property for damage to the property accrues when it is first discovered, or through the exercise of reasonable diligence it should have been discovered, that there is damage to the property. *Harris v. Liston* (1999), 86 Ohio St.3d 203, 207 (where the discovery rule was applied to a negligence action). The question of what is reasonable is a factual determination to be determined by a judge or jury. *Crawford v. Wolfe*, 4th Dist. No. 01CA2811, 2002-Ohio-6163, at ¶ 21-22. The discovery rule typically will not apply in contract claims, because the statute of limitations for written contract breaches is so long this is rarely a concern. It will apply in tort claims, which are the preferred claims when the aggrieved party can not establish privity of contract with the target defendant. There are notable exceptions to this rule that do not recognize a discovery rule, particularly in breach of warranty claims. Please consult local counsel when in doubt on the applicability of the discovery rule.

## **C. Substantial Performance**

A party must substantially perform its obligations under a contract to recover for breach of contract. "[M]ere nominal, trifling or technical departures are not sufficient to constitute breach." *Hansel v. Creative Concrete & Masonry Constr. Co.* (2002), 148 Ohio App. 3d 53. A contractor does not breach a contract when the unperformed or wrongfully performed work does not destroy the value or purpose of the contract. *Id.* In order for a plaintiff's claim to be actionable, Ohio requires that a material contract breach occur, and courts will allow proof of substantial performance in most cases. *Enterprise Roofing & Sheet Metal Co. v. Howard Inv. Corp.* (1957), 105 Ohio App. 502, 504-505.

## **D. Cardinal Changes**

A cardinal change is a single change or group of changes that are so profound and have such a large impact on the project that it can be said that the original contract no longer exists. This is treated as a breach of contract. The cardinal change doctrine allows a prime contractor or subcontractor to recover damages for breach of contract when an owner makes changes to the specifications of the contract which are so significant, that they cannot be absorbed by the changes clause included in the original contract. The doctrine developed in the federal contract arena was to allow contractors a basis for equitable adjustments when necessary. However, states have not warmly embraced the doctrine. Ohio, in particular, does not recognize the cardinal change doctrine, and the federal courts in Ohio which have passed on this issue have

indicated that Ohio law will not recognize it in the future. *See, e.g. EBL v. Marous Brothers Const.*, 2002 WL 32818011 (N.D. Ohio 2002).

#### **E. Drug-Free Compliance**

Since 2007, Ohio law has required that all contractors and subcontractors enroll in a drug-free workplace program to be eligible to perform public construction work in Ohio. Failure to comply with this requirement is considered a breach of contract and may prevent a contractor from receiving a public contract for up to five years. O.R.C. §153.03.

#### **F. Third Party Beneficiaries And Privity Of Contract**

Generally, there must be privity of contract between parties in order to recover damages under a contract or negligence theory. *Thomas v. The Guarantee Title & Trust Company* (1910), 81 Ohio St. 432, 442. An “action for breach of contract by a third party can be brought only where the parties to a contract intended to benefit the third party.” *Hunter Building & Renovation v. Miller*, 8th Dist. App. No. 67131, 1996 WL 65811, at \*3.

Only a party to a contract or an intended third-party beneficiary of a contract may bring an action on a contract in Ohio. *Brewer v. H & R Concrete, Inc.* 2<sup>nd</sup> Dist. No. 17254, 1999 WL 49366, at \*2; *Mergenthal v. Star Banc Corp.*, 12th Dist. No. CA96-10-107, 122 Ohio App.3d 100, 103-104. A landowner can be a third-party beneficiary of a subcontractor's performance, but generally, landowners and subcontractors are not in privity of contract. *Brewer* at \*2. There must be evidence, on the part of the subcontractor, that he intended to directly benefit a third party, and not simply that some incidental benefit was conferred on an unrelated party by the promisee's actions under the contract. *Mergenthal* at 103-107.

Ohio does not permit a subcontractor to sue a design professional for errors and omissions in design drawings that caused the subcontractor delays or disruptions in performance unless the subcontractor and design professional are in privity on contract. *Floor Craft Coverings, Inc. v. Parma Community Hospital* 1990), 50 Ohio St.3d 1.

#### **G. Pay-If-Paid and Pay-When-Paid**

Ohio recognizes the difference between pay-if-paid and pay-when-paid clauses in construction contracts. The pay-when-paid clause represents an unconditional promise to pay a subcontractor within a reasonable time after the general contractor is paid by the owner. A pay-if-paid provision on the other hand, makes the general contractor's receipt of payment from the owner an absolute condition precedent to its obligation to pay the subcontractor. Under a pay-if-paid provision, the subcontractor assumes the risk of owner non-payment, whereas when a pay-when-paid provision, the general contractor assumes the risk of owner non-payment. *Chapman Excavating Co., Inc. v. Fortney & Weygandt, Inc.*, 2004 WL 1631118 (8<sup>th</sup> Dist. 2004). However, because pay-if-paid clauses could result in a forfeiture by the subcontractor in the event of owner non-payment, such clauses tend to be strictly construed, narrowly applied, and require some evidence that it is clear and unambiguous as to its true intent of imposing the risk of non-payment on the subcontractor. In the absence of the required clarity in the contract language,

Ohio courts typically will convert the clause to a pay-when-paid clause, and enforce it accordingly. In the event of owner non-payment under a pay-when-paid clause, the general contractor will still have an unconditional obligation to pay the subcontractor, and will be given a reasonable time within which to do so after it becomes clear that the owner will not or cannot make the required payments.

## **II. NEGLIGENCE WORKMANSHIP CLAIMS**

To assert a claim for negligent construction, one must demonstrate that the builder or designer breached the applicable standard of care. Builders who perform faulty construction projects can be held liable under Ohio tort law. Ohio law charges contractors with a common-law duty to perform construction work in a workmanlike manner. *Barton v. Ellis* (1986), 34 Ohio App.3d 251, 252-3. This standard requires a construction professional to act reasonably in exercising the degree of care which a member of the construction trade in good standing in the community would exercise under the same or similar circumstances. *Ohio Valley Bank v. Copley* (1997), 121 Ohio App.3d 197, 205.

Ohio law does not require expert testimony to establish a standard of care when the action involves conduct within the common knowledge and experience of jurors. This general rule also applies to construction and architectural projects. *Floyd v. United Home Imp. Ctr., Inc.*, (1997), 119 Ohio App.3d 716, 721 (applying rule to builder's alleged deviation from common standards of workmanship or failure to exercise ordinary care); *Simon v. Drake Constr. Co.* (1993), 87 Ohio App.3d 23, 26 (applying rule to architect's alleged deviation from standard of care).

A builder has a contractual duty to use proper materials and workmanlike skill and judgment when performing a project, taking into consideration the hazards of the lot and area and the risk of harm to the structure from those hazards. *Tibbs v. National Homes Const. Corp.* (1977), 52 Ohio App.2d 281, 292-3. However, privity of contract is not a necessary element of negligence actions by vendees against builder-vendors. Remote vendors can still file construction defect suits against builders, provided the claim is not barred by the statute of limitations or other legal defenses. Vendors are not strictly liable for building defects, and vendees are required to prove "traditional negligence elements." *McMillan v. Brune-Harpenau-Torbeck Builders, Inc* (1983), 8 Ohio St.3d 3, 3-4.

## **III. BREACH OF WARRANTY & STRICT LIABILITY CLAIMS**

The duty to perform in a workmanlike manner is imposed by common law upon builders and contractors, as well as by contract in most projects. A contract to perform work creates an implied warranty that the contractor will perform the work in a workmanlike manner. *Point East Condominium Owners' Assn. v. Cedar House Assoc.* (1995), 104 Ohio App.3d 704, 716. The duty to construct in a workmanlike manner extends to subsequent vendees not in privity with the builder-vendor. *Id.*, citing *McMillan v. Brune-Harpenau-Torbeck Builders, Inc.* (1983), 8 Ohio St.3d 3. However, a plaintiff cannot raise a claim of an implied warranty of workmanship and craftsmanship under a theory based upon breach of an implied warranty of fitness for a particular purpose. *Corporex Dev. & Const. Mgt. Inc. v. Shook, Inc.*, 2004 WL 557339 (10th Dist, 2004), 2004-Ohio-1408, judgment reversed and remanded on other grounds, 106 Ohio St.3d 412. These are two separate theories of liability which cannot be joined.

Ohio law sets express requirements for workmanship warranties on specific types of construction projects. For example, a condominium developer must provide a minimum two-year warranty covering the cost of labor and materials for any repairs to common service areas of the condominium property that may occur based on a defect in material or workmanship. Similarly, a condominium developer must provide a minimum one-year warranty to cover the cost of labor and materials for repairs individual units of a condominium resulting from defects in materials or workmanship. O.R.C. §5311.25(E)(1).

The Ohio Supreme Court recognizes strict liability claims involving implied warranties as to fitness for ordinary purposes with respect to materials incorporated into a real-property structure. In *Lonzrick v. Republic Steel Corp.* (1966) 6 Ohio St. 2d 227, the Ohio Supreme Court imposed strict liability upon the manufacturer of defective joists, finding that an implied warranty existed with respect to steel roof joists incorporated in a structure. Similarly, in *Iacono v. Anderson Concrete Corp., et al.* (1975), 42 Ohio St. 2d 88, the Ohio Supreme Court imposed strict liability with respect to concrete supplied to a contractor for use in an outdoor driveway where the concrete was not fit for that purpose causing pop-outs and damage to the driveway. In both of these cases, the Ohio Supreme Court imposed strict liability, without requiring privity, with respect to materials incorporated into a real-property structure.

#### **A. Warranty Of Plans And Specifications And The *Spearin* Doctrine**

Like many states, Ohio has adopted what is known as the *Spearin* Doctrine, which holds that “when a contractor follows an owner's plans, the owner impliedly warrants that the plans are accurate. If the construction is revealed to be defective [because the plans are inaccurate], the owner is the responsible party.” *Cent. Ohio Joint Vocational School Dist. Bd. of Education v. Peterson Construction*.(1998), 129 Ohio App.3d 58, 64, citing *United States v. Spearin* (1918), 248 U.S. 132, 136.

Under the *Spearin* doctrine, it is generally accepted that a public owner warrants the accuracy, completeness and suitability of the project plans and specifications. See *The Central Ohio Joint Vocational Dist. Bd. Of Ed. v. Peterson Construction Co.* (1998), 129 Ohio App.3d 58. An owner is required to furnish sufficient plans, specifications, and building site for the contractor to evaluate, price and bid the project and perform the work. If the owner provides the contractor with materials and equipment or specifies proprietary products for use on the project, then the owner impliedly warrants the suitability of the equipment or materials. *Jurgens Real Estate Co. v. Eastgate Development Partnership*(1995), 103 Ohio App. 3d 292; *Floor Craft Floor Coverings, Inc. v. Parma Community General Hospital* (1989), 1991 WL 95058, Case No. 56145 (Cuyahoga Ct. App.), *aff'd*, 50 Ohio St.3d 1 (1990); *Lathrop v. City of Toledo*, 5 Ohio St.2d 165 (1966).

The Ohio Supreme Court, however, has recently limited the scope of the *Spearin* Doctrine in Ohio. In *Dugan & Meyers Construction Co. Inc. v. Ohio Depart. of Admin. Svcs.* (2007), 113 Ohio St.3d 226, the court held that under Ohio law, the *Spearin* Doctrine only applies in cases where the damages flow from the owners “affirmative indications of job site conditions” and not to “cases involving delay due to plan changes.” *Id.* at 230-31. Furthermore, the court held that it will not impose an implied warranty regarding accuracy of plans to address delays if the contract

already has a provision in it to deal with that problem. *Id.* at 231. In this case, Dugan & Meyers Construction, the lead contractor on a project for The Ohio State University (“OSU”), signed a contract agreeing to give OSU notice and request an extension of time within 10 days of any event taking place on the project that Dugan & Meyers believed would impact the schedule. *Id.* When Dugan & Meyers failed to abide by this contract provision, the court would not allow them to use an implied warranty regarding the accuracy of plans under the *Spearin* doctrine to escape those consequences. *Id.* at 233. The court held that it would not elevate an implied warranty regarding plan accuracy over an express contract provision that was intended to address the effect of inaccurate plans. *Id.*

As a result of this ruling, contractors must strictly adhere to contract notice requirements regarding delays and other project impacts to avoid a waiver of such claims. Additionally, contractors can no longer take for granted that there is an implied warranty of accuracy of the plans and specifications issued by the owner. Although Ohio continues to recognize the *Spearin* Doctrine, it is important to know that Ohio courts will not imply an owner’s duties regarding plan requirements, but will look to the parties’ contract language to decide the consequences and remedies in the event of errors and omissions in the plan document. Therefore, it is very important that contracts are drafted to address this issue.

## **B. Implied Contract Duties**

Implied duties often form the basis of contract disputes when problems arise. Implied duties are those that are not expressly set forth in the contract documents but can be implied or deduced from what has been expressed in the contracts. The law certainly recognizes the validity of implied contract promises, but different rules apply as to when they can be argued.

Most contract documents contain integration clauses. These clauses are familiar because they form the boilerplate and generally state that the written contract is a complete expression of the parties’ agreement and that no party owes the other any obligation except as to what is set forth in the written agreement. The goal of this contract provision is to eliminate the risk and uncertainty that go along with implied promises. Therefore, in all cases of alleged breach of an implied promise, the first question is whether an implied promise is even enforceable if there is a valid integration clause as part of the contract documents. *See, e.g., Galmish v. Cicchini* (2000), 90 Ohio St.3d 22.

The other limitation in enforcement of implied duties surrounds the fact that most contracts go to great lengths to express the party’s contract duties. In those situations, if the contract sets forth an express promise dealing with a given issue, then a court will not enforce a contrary implied promise on that same issue. For example, in *Trucco Construction Co. v. Columbus*, Franklin App. No. 05AP-1134, 2006 -Ohio- 6984, there were numerous delays on the project due to a variety of causes. The contractor argued that it should receive compensation because the owner caused delays in awarding the contracts and dewatering the site. The contractor claimed the owner breached its implied duty not to hinder or interfere with the work and that the delay constituted a breach of this duty. The city argued that the contract contained an express condition that allowed the City to suspend work or delay certain phases without it being in breach, and therefore, the court could not imply a duty of cooperation that conflicted with that express provision. The Tenth District Court of Appeals held that imposing an implied duty not

to hinder or delay performance conflicted with the express contract right to delay work, and therefore, the court refused to imply such a duty into the contract. *Id.*

Understanding the limitations on enforcement of implied duties, Ohio courts remain willing to recognize such claims in appropriate circumstances. For example, “if a municipal corporation, by its own act, causes the work to be done by a contractor to be more expensive than it otherwise would have been according to the terms of the original contract, it is liable to him for the increased cost or extra work.” *Synergy Mechanical Contractors v. Kirk Williams Co.*, Franklin App. No. 98AP-431, 1998 WL 938592 at \*4, quoting *M.L. Ryder Bldg. Co. v. City of Albany* (1919), 176 N.Y.Supp. 456. “A contracting party impliedly obligates himself to cooperate in the performance of his contract and the law will not permit him to take advantage of an obstacle to performance which he has created or which lies within his power to remove.” *Id.* at \*5, quoting *Gulf, Mobile & Ohio Rd. Co., v. Illinois Cent. Railroad Co.* (1954), 128 F.Supp. 311, 324.

There may also be other implied duties in a contract that play into scheduling and delay issues. These include an owner’s duty to provide reasonable access to the project, *Avon Excavating Co. v. Parma*, 1980 WL 140377, perform reviews and make decisions on discretionary items in a timely manner so as not to delay the work, provide adequate plans and specifications *Central Ohio JVS v. Peterson* (1998), 129 Ohio App.3d 58 (12th Dist.), and coordinate separate contractors on multi-prime jobs *Norment Security Group, Inc. v. Ohio Dept. of Rehabilitation and Correction*, 2003 WL 22890088, Court of Claims App. No. 2001-11472, 2003 -Ohio- 6572.

Implied duties may also exist between a general contractor to a subcontractor. For example, in the absence of contract language to the contrary, a general contractor impliedly promises to provide its subcontractor with reasonable access to the project site, make reasonable efforts to coordinate the subcontractor’s work, and not interfere or hinder the subcontractor’s performance.

One of the perennial problems are delays associated with securing necessary government approvals or permits. This is a bigger problem in fast track projects or those where the design work is proceeding simultaneously with construction. If there is a problem with the drawings, a code compliance issue, or other concern by the entity performing the plan review, it can delay progress until the issue is resolved. In *Carrabine Construction Co. v. Chrysler Realty Corp.* (1986), 25 Ohio St.3d 222, the court found that the delays associated with the failure to obtain zoning approvals were the contractor’s responsibility because of how the obligations were allocated in the contract. The same principle holds true universally – if there is a delay associated with a design problem, or in obtaining government approvals, the entity who took responsibility for those tasks under the contract will face liability for any and all costs associated with the failure to fulfill that obligation.

#### **IV. FRAUD**

Fraud is defined as: (1) a representation or, where there is a duty to disclose, concealment of a fact; (2) which is material to the transaction at hand; (3) made falsely, with knowledge of its falsity, or with such utter disregard and recklessness as to whether it is true or false that knowledge may be inferred; (4) with the intent of misleading another into relying upon it; (5) justifiable reliance upon the representation or concealment; and (6) a resulting injury proximately

caused by the reliance. *Williams v. Aetna Fin. Co.* (1998), 83 Ohio St. 3d 464, 475. In order to establish a claim of fraud, it is necessary for the party to prove all of these elements.

A vendor has a duty to disclose material facts which are latent, not readily observable or discoverable through a purchaser's reasonable inspection. *Miles v. McSwegin* (1979), 58 Ohio St.2d 97. In cases where a vendor does not disclose these facts, O.R.C. § 2305.09 requires that a cause of action for fraud be brought within four years after the fraud was or should have been discovered. Ohio's discovery rule applies to cases of fraud, however "once sufficient indicia of fraud are shown, a party cannot rely on its unawareness or the efforts of the opposition to lull it into a false security to toll the statute." *Aluminum Line Products Co. v. Brad Smith Roofing Co., Inc.* (1996), 109 Ohio App.3d 246, 260.

*Caveat emptor* is a defense to fraud claims in failure to disclose cases. The doctrine of *caveat emptor* prevents a buyer from recovering for defects in the real property when (1) the defect [is] open to observation or discoverable on reasonable inspection, (2) the purchaser [had] an unimpeded opportunity to examine the property and (3) the vendor [has] not engage[d] in fraud." *Lapos Constr. Co. v. Leslie*, 9<sup>th</sup> Dist. App. No. 06CA008872, 2006 -Ohio- 5812, at ¶13, citing *Layman v. Binns* (1988), 35 Ohio St.3d 176, 177. The doctrine of *caveat emptor* is nullified by a fraudulent misrepresentation or fraudulent failure to disclose. *Dito v. Wozniak*, 9th Dist. No. 04CA008499, 2005-Ohio-7, at ¶13. However, a real estate purchaser cannot claim fraud if a seller's misstatements or misrepresentations are not significantly reprehensible in nature. *Id.*, citing *Traverse v. Long* (1956), 165 Ohio St. 249, 252.

A complaint in which a plaintiff is alleging fraudulent misrepresentation in a construction law context must state the circumstances constituting the fraud or mistake with particularity, including each statement or non-disclosure that is alleged to be fraudulent and the place, date, time, and content of each such statement or non-disclosure. See Ohio Civil Rule 9(B); *F&J Roofing v. McGinly & Sons, Inc.* (1987), 35 Ohio App.3d 16..

## V. INDEMNITY CLAIMS

Under Ohio law, indemnity arises from contract, either express or implied, and is the right of a person who has been compelled to pay what another should have paid to require complete reimbursement. *Wagner-Meinert, Inc. v. EDA Controls Corp.* (2006), 444 F. Supp. 2d 800 (N.D. Ohio). The right of indemnity may result from an express agreement or contractual provision when one party, who has been compelled to pay what the other party should have paid, reserves the right to require complete reimbursement. *Indiana Ins. Co. v. Barnes* (2005), 165 Ohio App. 3d 262, 267. An implied contract for indemnity exists only within the context of a relationship wherein one party is found to be vicariously liable for the acts of a tortfeasor. *Id.*

Ohio's anti-indemnity statute, ORC §2305.31, renders any construction contract provision that requires one to indemnify another for the other person's own negligence void and unenforceable as a violation of public policy. This rule applies regardless of whether the other person's negligence is sole or concurrent. *Kendall v. U.S. Dismantling* (1985), 20 Ohio St. 3d 61. The goal of the policy is to ensure that the risk of liability remains with the negligent party. For a discussion of the influence of this statute on additional endorsements and flowdown liability provisions in construction contracts, see Section XIV on Insurance Coverage.

Ohio's anti-indemnity statute has faced recent challenges. Many indemnity provisions include language different from that prohibited by the statute. Modern indemnity clauses proscribe a "duty to defend," while the statute only mentions "indemnity." Ohio courts have not ruled consistently on this issue. In *Moore*, the Second District Court of Appeals ruled that a "duty to defend" can require one to pay attorney's fees and expenses to defend a claim, even if the anti-indemnity statute precludes liability for personal injury or property damage. *Moore v. Dayton Power and Light*, 99 Ohio App.3d 138. Alternatively, in *Best*, the Ninth District ruled that any duty to defend is unenforceable if the underlying claim for loss is unenforceable. *Best v. Energized Substation* (1993) 88 Ohio App.3d 109.

## **VI. PROMPT PAY ACT**

Ohio's Prompt Pay Act is codified in section 4113.61 of the Revised Code. The act establishes clear deadlines during which subcontractors and materialmen must be paid. Contractors must pay subcontractors and materialmen within ten calendar days of receiving payment or retainage from an owner. *Id.* A contractor, subcontractor or material supplier who fails to pay a lower tier subcontractor or materialman within the statutory period is liable for interest payments at eighteen percent per annum, beginning on the eleventh day following the receipt of payment from the owner and ending on the date of full payment of the payment due plus interest to the subcontractor or material supplier. *Id.* If a prime contractor has not complied with the requirements of O.R.C. §4113.61 within thirty days, a subcontractor or material man may file suit to recover the original amount owed, in addition to interest and equitable attorneys' fees. O.R.C. §4113.61(B). The Prompt Pay Act does not apply to owners or cases involving the construction or improvement of single, two or three-family detached dwelling houses. O.R.C. §4113.61(C).

## **VII. PUBLIC PROJECTS**

### **A. Bidding**

#### **1. Public Project Delivery Methods**

Ohio law requires multi-prime bidding for public works contracts. This means that state agencies or political subdivisions ("public authorities") that award contracts for construction work have to take separate and distinct bids for furnishing materials for or doing certain classes of work. These classes of work include: (1) plumbing and gas fitting, (2) steam and hot-water heating, ventilating apparatus, and steam-power plant; and (3) electrical equipment. *See* O.R.C. §153.50.

When a public authority has to use multi-prime bidding, it cannot award a contract for an entire job or for work that is greater than the scope of one branch of work listed above unless "the separate bids do not cover all the work and materials required or the bids for the whole or for two or more kinds of work or materials are lower than the separate bids in the aggregate." O.R.C. §153.51(A).

When "any public authority of the state or any public institution" awards contracts for specific classes work, it is required to take the lowest responsive and responsible bidder. O.R.C. §153.52.

When a “county, municipal corporation, or school district,” awards such contracts on specific classes of work, it is required to take the lowest and best bidder for each class of work. O.R.C. §153.52.

These bidding regulations do not apply in every situation. When a project requires one of the branches of work or material listed in § 153.50(A), the public authority does not have to request separate bids for that branch of work if it costs less than \$5,000. O.R.C. §153.50(B). Similarly, Ohio Revised Code §153.52 states that none of these regulations apply “to the erections of buildings and other structures which cost less than fifty thousand dollars.” Furthermore, certain cities, known as charter cities, and one charter county can opt out of the multi-prime bidding requirements. *See, for example, Natl. Elec. Constr. Assn., Inc. v. Mentor* (1985), 108 Ohio App.3d 373 (holding that municipalities bidding provision requiring aggregate bidding for municipal public works contract superseded state regulation requiring multi-prime bidding). This is done by enacting a provision in the city’s charter to adopt an alternate standard for public contracting.

## **2. Bid Responsiveness And Bidder Responsibility For Public Projects**

Many of Ohio’s state agencies and political subdivisions are required to award a public works contract subject to competitive bidding to lowest responsive and responsible bidder. O.R.C. §9.312(A). In Ohio a bidder is deemed to be responsive “if the bidder's proposal responds to bid specifications in all material respects and contains no irregularities or deviations from the specifications which would affect the amount of the bid or otherwise give the bidder a competitive advantage.” *Id.* In interpreting this statute, courts have recognized that [i]n a bid for a construction project, not every variation from the instructions or specifications will destroy the competitive character of the bid. To have that effect, the variation from the instructions or specifications must be substantial, and to be substantial, it must affect the amount of the bid and must give the bidder an advantage or benefit not allowed to other bidders. *Wilson Bennett, Inc. v. Greater Cleveland Regional Transit Auth.* (1990), 67 Ohio App.3d 812, 819.

The key legal question in these cases is whether the deviation gives the conforming bidder a competitive advantage over the other bidders. To determine if a bidder is responsible, state agencies and political subdivisions can consider the following factors: “the experience of the bidder, the bidder's financial condition, conduct and performance on previous contracts, facilities, management skills, and ability to execute the contract properly.” Ohio courts have pointed out that this means that state agencies or political subdivisions are not limited to examining a bidder’s pecuniary ability to perform the contract when determining if it is responsible, but can examine characteristics such as: “its general ability and capacity to carry on the work, its equipment and facilities, its promptness, and the quality of work previously done by the bidder, its suitability to the particular task, and such other qualities as are found necessary to consider in order to determine whether or not, if awarded the contract, the bidder could perform it strictly in accordance with its terms.” *Steingass Mechanical Contracting, Inc. v. Warrensville Hts. Bd. of Edn.* (2003), 151 Ohio App.3d 321, 325. The biggest factor locally is whether the low bidder has a history of defaults or problems on prior projects. The biggest factor locally is whether the low bidder has a history of defaults or problems on prior projects.

If a court is asked to review a state agency or political subdivision's decision not to award a public works contract to the lowest bidder because that bidder is not responsive or responsible, the court should only overturn the decision if it finds that the state agency or political subdivision has abused its discretion. *Id.* Furthermore, a court will not find that a state agency or political subdivision has abused its discretion unless it finds that the public authority acted arbitrarily, capriciously, or unreasonably. *Id.* Although not impossible, it is extraordinarily difficult to succeed in overturning a public authority's decision in a bid award. Even if the court does overturn the award, Ohio courts will not direct the contract to the second lowest bidder. Instead, the project is simply re-bid and the process starts over again.

### **3. Bid Protests**

Under Ohio law, a state agency or political subdivision that is required to allow competitive bidding for public projects has the authority to pass an ordinance or resolution requiring that the state agency or political subdivision award its competitively bid contracts to the lowest responsible and responsive bidder. O.R.C. §9.312(C). If a state agency or political subdivision has adopted such an ordinance or resolution and chooses not to award a competitively bid contract to the lowest or lower bidders, the lower bidders, within five days of receiving notice that a higher bidder received the contract, can file a written protest with the state agency or political subdivision awarding the contract. O.R.C. §9.312(B). If such a protest is filed, the state agency or political subdivision is required to meet with the lowest bidder and not make final award until it has either affirmed or reversed its earlier determination. *Id.* This is often the only meaningful opportunity the unsuccessful low bidder has to change the public authority's mind.

The Ohio Supreme Court has found that a rejected low bidder may seek injunctive relief against a political subdivision to block the award of the contract.. *See, Cementech, Inc. v. City of Fairlawn* (2006), 109 Ohio St.3d 475. If the unsuccessful low bidder wins the injunction, then the public owner will be required to re-bid the project. Additionally, a rejected bidder may also sue to recover its bid preparation costs from a state agency or political subdivision. *Meccon, Inc. v. The University of Akron* (2009), 182 Ohio App.3d 85 (10th Dist.), currently on appeal, Ohio Supreme Court Case No. 2009-0950. A rejected low bidder is not legally permitted to recover its lost profits. *Cementech,*, 109 Ohio St.3d 475.

## **VIII. CHANGES AND DELAY**

### **A. Delay Damages**

There are two basic types of delay damages: direct and indirect. Direct damages are those costs that flow directly from the delay event, while indirect damages flow from other events as a result of the delay and not from the actual delay itself. Examples of direct damages are: labor and equipment costs, governmental fees to extend permits, additional supervision, material price increases, and increased fringe benefits, to name a few. Examples of indirect damages include extended field office overhead, lost/diminished bonding capacity, interest on money borrowed to finish work, and similar expenses. A landowner's direct damages might include lost revenue due to delayed operation of facility, additional project management expenses, or liquidated damages. Indirect expenses could include interest charges and fees to extend financing.

Ohio has adopted the rule that “a building or construction contractor has a right to recover damages resulting from a delay caused by the default of the contractee.” *Backus Associates, Inc. v. State of Ohio* (1976), 47 Ohio Misc. 11, 13. Owners also have the right to recover delay damages from a contractor’s failure to meet the contractual completion date. If a court finds that a delay was caused by an owner’s actions, it can award damages that cover the contractor and subcontractors’ costs associated with that delay. These costs include pay increases for workers and extended general condition costs such as: job supervision costs, insurance costs, lodging for employees, telephone bills and other office administration costs. However, if delay is caused by a prime contractor or subcontractor, a court may award damages to an owner including loss of use and revenues, liquidated damages, costs for additional project management and engineering, or other costs associated with an extension of the project. *Valentine Concrete, Inc. v. Ohio Depart. of Admin. Svcs.* (1991), 62 Ohio Misc.2d 591, 617. See also *Dugan & Meyers Construction Co. Inc. v. Ohio Depart. of Admin. Svcs.* (2007), 113 Ohio St.3d 226.

At one time owners could avoid liability for their delays under “no damage for delay” clauses, but in 1998 the Ohio legislature passed Ohio Revised Code §4113.62, which provides that contract provisions that waive or preclude damages or other remedies for delays that are the proximate result of the owner’s act or failure to act are “void and unenforceable as against public policy.” O.R.C. §4113.62(C)(1). This also applies to no damage for delay clauses in subcontract agreement where the delay was caused by the higher tier contractor’s act or failure to act.

It is also important to note that in a recent case, *Dugan & Meyers Construction Co. Inc. v. Ohio Depart. of Admin. Svcs.* (2007), 113 Ohio St.3d 226, the Ohio Supreme Court found that a contractor had completely waived its entire delay damage claim because of a failure to follow the contract’s notice requirement. *Id.* at 234. Therefore, even though “no damage for delay” clauses no longer protect owners from liability for delay caused by *their* actions, a contractor’s failure to perform other contractual provisions can bar it from collecting delay damages. In addition, “no damage for delay” clauses are still enforceable for non-owner/contractor caused delays, such as: Acts of God, materials shortages, and other factors.

Under Ohio law, no damages for delay clauses in construction contracts have traditionally been valid and enforceable, except “where the delay for which recovery is sought was not reasonably contemplated by the parties at the time of contracting.” *JWP/HYRE Electric Co. v. Mentor Village School District* (1996, 968 F.Supp. 356, 360 (N.D. Ohio), citing *Carabine Construction Co. v. Chrysler Realty Corp.* (1986), 25 Ohio St.3d 222.

Recently, however, Ohio has recognized several exceptions to this general rule. In *Daniel Terreri & Sons, Inc. v. Mahoning County Comm’rs* (2003), 152 Ohio App.3d 95 (Mahoning Co.), the court listed four notable exceptions to enforcement of no damage for delay clauses: 1) the delay was not contemplated by the parties at the time of contracting, 2) the delay resulted from fraud, misrepresentations or bad faith by the party seeking to enforce the clause, 3) the delay has extended the completion date so much that the party suffering the delay would have been justified in abandoning the contract, i.e., performance was made impossible, and 4) the delay is not within the scope of the damage of delay clause. *Id.* at 105.

If there is a “no damage for delay” clause and it is not nullified under O.R.C. §4113.62, to avoid the damage waiver, you must invoke one of the common law exceptions noted above. You must

also be able to demonstrate that you have followed all of the contract's notice requirements as well — such as timely requesting time extensions and/or change order for cost/schedule impacts. Most construction contracts have language instructing the contractors what to do in the event of a delay producing event. As a result of *Dugan & Meyers Construction Co. Inc. v. Ohio Depart. of Admin. Svcs.* (2007), 113 Ohio St.3d 226, if a contract fails to follow these requirements, there is a good chance the delay damage claim has been waived, or the “time extension as sole remedy” has been waived, thereby opening the door to liquidated damages if the project misses the completion date.

## **B. *Eichleay* Formula: Home Office Overhead Damages**

In Ohio, the *Eichleay* Formula is one of the approved methods used to calculate extended or “unabsorbed” home office overhead and general administrative expenses in instances where delays or disruptions of performance under a construction contract are excusable and compensable. *See, for example, Conti Corp. v. Ohio Department of Administrative Services* (1993), 90 Ohio App.3d 462. There must be an actual delay when the contractor is not able to work for the *Eichleay* Formula to apply. If the contractor is still working, but less efficiently, the damages must be pursued as a lost productivity claim.

Extended home office overhead is one of the most common types of indirect damage claims. These damages are presumed to occur when the contractor is idle or not working due to delayed or suspended work, and is unable to perform other work because they are waiting to work on the delayed project. The theory is that when a contractor bids a job, they anticipate a certain amount of home office expense (overhead) will be absorbed by the anticipated amount of work (and income) derived from that project. When the project is delayed the argument is that the contractor can no longer absorb the home office expenses allocated to the project because of delays.

The formula is used to calculate home office overhead expenses in delay cases by following three steps. First, you multiply the total company billings for the actual contract period by the total home office overhead to get the Home Office Overhead Allocable to the Contract. Second, you divide the Home Office Overhead Allocable to the Contract by the actual days of contract performance to get the Daily Home Office Overhead Allocable to the Contract. Finally, you multiply the Daily Home Office Overhead by the number of days of delay to get the Total Compensable Home Office Overhead.

After proving that a delay was excusable and compensable, a contractor can use the *Eichleay* Formula if he can show two things. First, he must show that he mitigated damages or was unable to do so because it was unreasonable for him to obtain other jobs during the delay. Second, the contractor must show that it was impracticable to reduce the home office expenses during the delay. These preconditions are easily shown when the delay involved is sudden and of an indefinite duration. A contractor may also meet his burden of proof by showing that it was unsuccessful in bidding for replacement work. Ohio allows the owner to attack the *Eichleay* calculation by arguing that the contractor included expenses in the home office overhead calculation that serve no benefit to the owner. If the owner can prove that lack of benefit, the contractor cannot use those expenses as part of the *Eichleay* formula. This indirectly allows the owner to lower the contractor's delay damages.

An alternative to the *Eichleay* Formula is the direct cost method, which Ohio law recognizes. *Complete Gen. Constr. Co. v. Ohio Dept. of Transp.* (2002), 94 Ohio St.3d 54, 61. “The direct cost method compares the direct costs actually attributed to a project as a portion of all of the direct costs incurred by the business over a particular period. The result is a ratio by which the percentage of indirect costs can be calculated, including home office overhead applicable to a particular project.” *Id.*, citing *Royal Elec. Constr. Co. v. Ohio State Univ.*, 1993 WL 532013, at \*6, reversed on other grounds, 73 Ohio St.3d 110 (1995).

## **IX. ARBITRATION IN CONSTRUCTION AGREEMENTS**

### **A. Ohio Arbitration Act**

Ohio law compels arbitration when there is a written agreement to arbitrate. O.R.C. §2711.01. However, courts will not force parties to arbitrate their disputes absent an express agreement to arbitrate. *Al Barto v. Ben D. Imhoff, Inc.*, 9th Dist. No. 06CA0025, 2006-Ohio-6479.

Arbitration clauses in construction contracts are “valid, irrevocable, and enforceable” and are governed by the Ohio Arbitration Act (the “Act”) located at Ohio Revised Code §§2711.01-2711.24. When a complaint is filed, an opposing party can preserve his right to arbitrate by filing a motion with the trial court to stay the proceedings pending arbitration. To enforce an arbitration clause, an aggrieved party can petition the common pleas court for an order directing the parties to proceed to arbitration. O.R.C. §2711.03(A). If, after hearing from both parties, the common pleas court determines that “the making of the agreement for arbitration or the failure to comply with the agreement is not in issue,” the court will order that the parties go to arbitration. *Id.* If the court finds that these issues are disputed by the parties, the court will proceed to trial on the issues and, in all cases except those involving commercial construction contracts, either party can request a jury trial. O.R.C. §2711.03(B).

O.R.C. §2711 (A) defines a “commercial construction contract” as “any written contract or agreement for the construction of any improvement to real property, other than an improvement that is used or intended to be used as a single-family, two-family, or three-family detached dwelling house and accessory structures incidental to that use.”

If an action brought before the court involves an issue that is subject to an arbitration agreement, the court is required to stay the pending action until arbitration on the issue has been completed, unless the arbitration agreement has been waived by the party seeking enforcement. A court order that either grants or denies a stay of court proceedings pending arbitration is a final appealable order and can be appealed immediately. *Id.* If the court or jury does not find that an arbitration agreement exists or that there has not been a default under the terms of the arbitration agreement, the proceeding will be dismissed. *Id.* This type of court proceeding is reserved for those cases where the existence of an arbitration agreement itself is in dispute.

Arbitration clauses are also valid under federal law. The Federal Arbitration Act states that :

[a] written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction,... shall be valid, irrevocable, and

enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract. 9 U.S.C. §2.

A party to an arbitration agreement involving maritime transactions or interstate commerce can seek to enforce that agreement under federal law if the court finds that the parties agreed to arbitrate the dispute by applying the “federal substantive law of arbitrability.” *Weiss v. Voice/Fax Corp.* (1994), 94 Ohio App.3d 309. The Federal Arbitration Act can even apply if the claims being disputed are state law claims. *Id.*

Whether a party seeks to enforce a claim under the Federal Arbitration Act or the Ohio Arbitration Act may not be that important. The Ohio Arbitration Act is almost identical to the Federal Arbitration Act. If a case involves a conflict between the two laws, the Federal Arbitration Act supersedes the Ohio Arbitration Act. *See, Perry v. Thomas* (1987), 482 U.S. 483.

### **B. Determining Whether The Arbitration Clause Governs**

Generally, if there is a dispute over whether an arbitration clause applies to a certain situation, the courts, not the arbitrator, have jurisdiction to determine if the arbitration clause applies. *Divine Construction Co., Inc. v. Ohio-American Water Company* (1991), 75 Ohio App.3d 311. “The scope of an arbitration clause, that is whether a controversy is arbitrable under the provisions of the contract, is a question for the court to decide upon examination of the contract.” *Id.*, citing *Gibbons-Grable Co. v. Gilbane Building Co.* (1986), 34 Ohio App.3d 170. This rule also applies when the existence of the contract containing the arbitration clause is at issue. *Id.*, citing *Colegrove v. Handler* (1986), 34 Ohio App.3d 142.

The arbitrability of a dispute, however, “may itself be subject to arbitration if the parties so agree.” *Springfield Local Association of Classroom Teachers v. Springfield Local School District Board of Education* (1987), 37 Ohio App.3d 167). If the parties to a dispute have agreed that the question of arbitrability will be decided in arbitration, a court does not have the power to make an independent determination of the arbitrability of the dispute at issue. *Id.* at 169.

### **C. Defenses To Arbitration Clauses**

A party can avoid arbitration in several different ways. First, he can argue that the arbitration clause or the contract that it is a part of was procured by fraud. It is important how this argument is phrased, because a court will only have jurisdiction over a claim that an arbitration clause itself was procured by fraud. Whether or not the contract containing the arbitration agreement was procured by fraud is a determination that is to be made in arbitration. *See ABM Farms, Inc. v. Woods* (1998), 81 Ohio St.3d 498.

Second, a party seeking to avoid arbitration can claim that the arbitration clause is procedurally unconscionable and unenforceable. *Taylor Building Corporation of America v. Benfield* (2006), 168 Ohio App.3d 517, 523. “An arbitration clause is unconscionable when the clause is “so one-sided as to oppress or unfairly surprise [a] party.” *Id.* at 524. An arbitration clause is unconscionable only if it is both procedurally and substantively unconscionable. *Id.* To determine if an arbitration clause is procedurally unconscionable the courts consider: (1) the relative bargaining positions of the parties, (2) whether the terms of the provisions were explained to the weaker party, and (3) whether the party was represented by counsel at the time

the contract was executed. *Id.* A clause is substantively unconscionable if it is “unfair and commercially unreasonable.” This is determined by examining, among other things, the “fairness of the terms, the charge for the service rendered, the standard in the industry, and the ability to accurately predict the extent of future liability.” *Id.* If an arbitration clause is deemed to be unconscionable, it is unenforceable. *Id.* at 523.

A trial court may also refuse to enforce an arbitration clause if a party waives his contractual right to arbitrate a dispute. *Griffith v. Linton* (1998), 130 Ohio App.3d 746, 750. The right to arbitrate, like any other contractual right, may be waived. The waiver may be express or implied from conduct. However, because of the strong public policy favoring arbitration, evidence of an intent to waive the right to arbitrate must be clear. *Id.* A party asserting waiver has to prove two elements: that the party waiving the right knew of the existing right of arbitration, and that it acted inconsistently with that right. *Id.* The right to arbitrate is most frequently waived when a party files a complaint on an arbitrable issue. It may also be waived when a party participates in litigation without asserting its right to arbitrate, or commits other acts inconsistent with the right to proceed with arbitration, such as by answering the complaint without raising the arbitration clause, by filing a counterclaim, cross claim or third party claim or by participating in discovery. *Id.*

## **X. ECONOMIC LOSS DOCTRINE**

### **A. Economic Loss Rule**

The economic-loss rule prevents recovery in tort for damages based purely on economic loss, where there is no privity of contract between the parties. *Floor Craft Floor Covering, Inc. v. Parma Community General Hosp. Ass'n* (1990), 54 Ohio St.3d 1, 3 (as applied in a suit for negligent construction).

In Ohio, “[t]he economic-loss rule generally prevents recovery in tort of damages for purely economic loss,” because “a plaintiff who has suffered only economic loss due to another’s negligence has not been injured in a manner which is cognizable or compensable.” *Corporex Development & Construction Management, Inc. v. Shook, Inc.* (2005), 106 Ohio St.3d 412, 414,. Therefore, in the absence of a contract between two disputing parties, “[t]here is no duty to exercise reasonable care to avoid intangible economic loss or losses to others that do not arise from tangible physical harm to persons and tangible things.” *Floor Craft Floor Covering, Inc. v. Parma Community General Hospital Ass’n* (1990), 54 Ohio St.3d 1, 3,. This well-established general rule applies also in the negligence context, establishing that a plaintiff who has suffered only economic loss has not been injured in a manner which is legally cognizable or compensable. *Chemtrol Adhesives, Inc. v. Am. Mfrs. Mut. Ins. Co.* (1989), 42 Ohio St.3d 40, 44, quoting *Nebraska Innkeepers, Inc. v. Pittsburgh-Des Moines Corp.* (Iowa 1984), 345 N.W.2d 124, 126. A plaintiff must prove that the indirect economic damages arose from tangible physical injury to persons or from tangible property damage. Indirect economic damages that do not arise from tangible physical injury to persons or from tangible property damage may only be recovered in contract.” *Queen City Terminals, Inc. v. Gen. Am. Transp. Corp.* (1995), 73 Ohio St.3d 609.

### **B. Exception To Economic Loss Rule**

Ohio courts have created an exception to the economic loss rule where the plaintiff can prove it was an intended third party beneficiary of the contract from which the alleged duty arose, or if the defendant exercised a sufficient amount of control over the construction project that the control will be deemed a substitute for privity. *See, Clevecon, Inc. v. NE Ohio Regional Sewer Dist* (1993), 90 O.A.3d 215 (8th Dist.).

A similar exception is recognized where a sufficient nexus exists to create a substitute for privity. In *E. Ohio Gas Co. v. Kenmore Constr. Co.* an Ohio court found the *Queen City* rule inapplicable and stated that “where privity of contract or its substitute exist, purely economic losses may be recovered in a tort action.” *E. Ohio Gas Co. v. Kenmore Constr. Co.* (March 28, 2001), 9th Dist. Nos. 19567 and 19790, 2001 WL 302818., citing *Floor Craft Floor Covering, Inc. v. Parma Community Gen. Hosp. Assoc.* (1990), 54 Ohio St.3d 1, and *United Tel. Co. of Ohio v. Williams Excavating, Inc.* (1997), 125 Ohio App.3d 135.

The Economic Loss Doctrine is important in construction cases because it helps keep tort claims out of what really should be a contract dispute, and limits parties to suits against those with whom they are in privity. There are, however, exceptions that allow tort claims to proceed absent privity.

## **XI. DAMAGES**

### **A. Compensatory Damages**

In Ohio, the proper measure of damages for a construction defect claim is the reasonable cost of placing the building in the condition contemplated by the parties at the time they entered into the contract. *Jones v. Honchell* (1984), 14 Ohio App.3d 120, 470 N.E.2d 219, syllabus paragraph 3. This is the proper measure of damages unless the court finds that placing the building in the condition contemplated would create economic waste. In this situation, the court will use the fair market value test, which measures damages by taking the fair market value of the structure as it should have been constructed minus the value of the imperfect structure. *Stackhouse v. Logangate Property Management*, 2007 WL 1806074 at 10 (Ohio App. 7 Dist., 2007).

Compensatory damages for construction tort claims, such as negligent workmanship and construction defects, can also be measured using the fair market value test if the injury done to the property is irreparable. *Id.* If the injury is susceptible to repair, the landowner may recover the reasonable cost of restoration plus the reasonable value of the loss of the use of the property. *Id.*, citing *Ohio Collieries Co. v. Cocke* (1923), 107 Ohio St. 238, 240. Finally, where restoration of the damaged building is practicable, damages should be the reasonable cost of restoration. *Id.*, citing *Northwestern Ohio Natural Gas v. First Congressional Church of Toledo* (1933), 126 Ohio St. 140, 150.

### **B. Punitive Damages**

Ohio will not award punitive damages for a breach of contract, but can award them for tortious actions that involve actual malice. *Tibbs v. National Homes Construction* (1997), 52 Ohio App.2d 281, 290 (1<sup>st</sup> Dist.). Actual malice, with regard to punitive damages, “can be placed in two general categories: first behavior characterized by hatred, ill, will, and a spirit of revenge,

and second, extremely reckless behavior revealing a conscious disregard for a great and obvious harm.” *Preston v. Murty* (1987), 32 Ohio St.3d 334, 335. A finding of fraud may also sustain, under appropriate circumstances, an award of punitive damages. *Tibbs*, 52 Ohio App.2d at 286. Punitive damages in construction cases can only be applied if the plaintiff can establish that the defendant committed an “independent tort.” This means a tort with the requisite degree of malice that is separate and distinct from conduct that would simply be a breach of the parties’ contract.

### **C. Liquidated Damages**

Liquidated damage clauses in Ohio are valid and enforceable in both public and private contracts. *Samson Sales, Inc. v. Honeywell, Inc.* (1984), 12 Ohio St. 3d 27. However, liquidated damages can only be applied in those situations where the true damages to the non-breaching party are difficult, unknown, or incapable of being calculated. *See Lakewood Creative Costumers v. Sharp* (1986), 31 Ohio App.3d 116, 117. Therefore, liquidated damages are usually tied to a contractor’s failure to complete the project by the substantial completion deadline, with other types of contract breaches excluded from the liquidated damage clause. For example, it is common for a contract to impose liquidated damages of a specified amount per day for all days beyond the contract completion date, but rare to see liquidated damages imposed for failure to perform in a good and workmanlike manner. In the case of delayed completion, the owner will be delayed in its use of the facility and suffer a consequent loss of use or revenue, the true dollar value of which will probably never be known. In the case of poor workmanship, the owner’s damages will be ascertainable by virtue of the simple cost to repair or replace the defective work, or by the diminution in value of the owner’s property.

Ohio courts will refuse to enforce liquidated damage clauses when the clause operates as a penalty rather than as a good faith estimate of the non-breaching party’s damages. *Schwartz v. Baker* (1950), N.E.2d 498, 500 (Ohio App. 2 Dist.). Courts judge the reasonableness of the liquidated damage clause *at the time the contract was signed* and not at the time the breach took place. In some cases, a party’s damages can be ascertained or proven, and in those cases, it may very well appear that the non-breaching party’s actual damages are far less than the liquidated damages. However, if the court is satisfied that *at the time the parties signed their contract*, the non-breaching party’s damages were: 1) probably going to be difficult to ascertain in the future should a breach occur, and 2) the liquidated amount is not grossly out of step with reality, then the clause will be enforced.

It is only when the liquidated damages are grossly out of proportion with reality that they can be considered punitive will enforcement be denied. In *Anderson v. U.S. Cable, Inc.*, 1995 WL 638567 (Ross Co. 1995), the court found a liquidated damage clause unenforceable as a penalty when it required forfeiture of the contractor’s retainage when the actual damages were slight. However, in *Security Fence Group, Inc. v. Cincinnati*, 2003 WL 22270179 (Hamilton Co. 2003), the court of appeals upheld the assessment of liquidated damages of \$600 per day for the failure to complete guardrail installation on time even though the street arguably could have been opened without the guardrails, and it appeared the city had not suffered any actual monetary losses as a result of not opening the street on time.

### **D. Loss Of Use Damages**

In Ohio, if a court determines that the appropriate measure of damages is the cost of repairing defects in real property, the damages can include “the reasonable value of the loss of the use of the property between the time of the injury and the restoration.” *Ohio Collieries Co. v. Cocks* (1923), 107 Ohio St. 238, 240. Damages can also include business interruption losses and lost profits under appropriate circumstances

### **E. Idle Equipment Damages**

Other types of recoverable damages include idle equipment expenses in delay cases. The difference between recoverable idle equipment expenses and extended general conditions is often in the accounting. If equipment is part of the contractor’s overhead on the general conditions, then it will be accounted for there. On the other hand, if it is production equipment that is charged a specific cost to a specific project, then it will be accounted for separately as idle equipment. In the case of leased equipment, the cost charge is easy to calculate by simply tallying up the rental fees for the period of delay. It gets a little more complicated for owned equipment, especially when that equipment has already been fully depreciated, because it is easy for the other side to argue there is no real cost to the contractor for downtime associated with owned and fully depreciated equipment.

Recovering idle equipment costs depends heavily on the contractor’s ability to document the downtime and cost associated with it. As with all damages, a contractor has a duty to mitigate its losses by moving unproductive equipment to other jobs during the downtime. Accurate time sheets show the total hours of downtime, and in the case of rented equipment, copies of the documentation to show expenses or evidence that the leased equipment could not have been returned for the duration of the downtime are all factors. The better the cost documentation, the more likely you are to recover the damages. In Ohio, a prerequisite for recovery of idle equipment damages is proof that the equipment was actually on the project site during the period of delay. *Complete General Construction Co.*(2002), 94 Ohio St.3d 54, 61.

### **F. Lost Productivity Claims**

Another item of potential damage concerns lost productivity claims. Everyone knows that a large number of factors can negatively affect worker productivity, and when they happen, it often results in slower or more costly completion. When it does, the affected contractor wants compensated for the lost productivity that it otherwise believes would not have occurred but for the impact. The question really then becomes whether the delay caused the lost productivity or the decreased productivity resulted in the delays.

Lost productivity claims are frequently rooted in situations where there have been a large number of unanticipated change orders, significant trade stacking, errors and omissions in specifications, poor supervision, site access problems, and out of sequence work, to name a few. These types of claims are associated with disruptions as often as they are with straight delays and sometimes indistinguishable. While many courts recognize that productivity suffers as a result of delays, and that when it can be proven, such damages are properly recoverable, the real problem in these cases is proving the value of the lost productivity.

The “Measured Mile” or “Measured Productivity” method is the most commonly used, and when appropriate, the most reliable. This formula uses an uninterrupted period of the project from which to establish a benchmark productivity, and then compares that to the productivity level during the impacted period to identify a difference, which then becomes the damages. The problems with this approach are many and typically surround criticisms associated with the selection of the benchmark period and whether it accurately represents the level of productivity that should be used for comparison, and the assumption that all productivity losses are due to the single event.

Some contractors simply try to prove lost productivity by taking the estimated, pre-construction labor costs and comparing them to the higher post-construction labor costs. Such an approach has logical appeal, but clearly fails to take into account the possibility that the contractor may have underestimated its productivity from the beginning. It also fails to take into account there may have been concurrent delays, or other disruptions to the work that were not chargeable to the party against whom recovery is sought.

#### **G. Acceleration Costs**

Ohio will recognize acceleration claims when the owner or higher tier contractor forced a contractor or subcontractor to accelerate performance to either meet a compressed schedule or to accommodate delays by another contractor to meet the substantial completion date. In cases of acceleration, courts or arbitrators will look to the contractors’ costs as proof of the damages, but may also allow recovery for lost profit, overhead and inefficiency on base contract work. *See, Sherman R. Smoot Co. v. Ohio Dept. of Admin. Svcs.* (2000), 136 Ohio App.3d 166.

#### **H. Escalation Costs**

When appropriate, contractors may also seek to recover escalation costs. These are the costs associated with rising prices for labor and materials. These can be part of a lost productivity claim, or stated separately depending upon the circumstances. If there has been a delay but no measurable loss in productivity, then a simple escalation claim may be the best approach.

A measured mile approach to prove the escalation in costs, or when available, one may use documents to support increased demands. For example, if a contractor suffered an increase in wages and fringes, or an increase in the price of steel, he could demonstrate the cause of the increase, the impacted period, and that he would not have otherwise incurred these added costs, but for the delay. Important proof here includes the collective bargaining agreements, supplier invoices before and after, and correspondence.

#### **I. Lost Profits**

Contractors may also look to recover profits lost due to delays. These can be profits lost on the project at issue and profits lost on other projects the contractor would have received but was prevented from bidding due to being tied up completing the subject project. In Ohio, lost profits are a recoverable element of damage provided they can be proven within a reasonable degree of certainty. This means the profit on a particular project or group of anticipated projects is not speculative or uncertain.

Proving profit lost on an impacted project can be made if the contractor's documentation is there and shows with convincing accuracy what the contractor's anticipated profit would have been on that job, and that the contractor would have earned that profit but for the delay. Be aware that if other elements of a contractor's claim already include compensation for overhead and profit on extra work or changed work, or are included in extended general conditions, then a court will not permit the contractor to double dip and recover lost profits twice on the same job.

Proving lost profits on work one was not able to bid is more problematic and very difficult to recover because he must show that he would have received the work but for his inability to bid it. It can be very hard to prove that a contractor would have been the lowest and best bidder on a public job for which he never submitted a bid. Similarly, proving that one would have been hired to perform a private project is challenging when a proposal is not submitted. In these cases, contractors typically look to a long history of annual performance and compare that to the year in which the impacted project occurred to show a decrease in profits. These types of claims are subject to the same attacks as all lost profit claims because they do not precisely account for other market factors unrelated to the project at issue that may have also accounted for lower profits during that year.

## **J. Lost Bonding Capacity**

Recovery for lost bonding capacity is based on the principle that a contractor is unable to bid on additional, profitable bonded work, because a significant portion of the bonding capacity is tied up in the project at issue due to delays. For example, if a contractor has \$1 million in bonding capacity, but \$750,000 is expended on a delayed project that extended into a successive construction season, the contractor can not bid on any additional bonded work in excess of \$250,000. If the contractor can prove that she would have bid on higher value work and received it, she may be able to recover the profits lost from that work due to the lost bonding capacity.

Ohio recognizes that both lost profit and lost bonding capacity damages are recoverable when proof is available to connect a certain loss to a specific project. In *Jeffrey B. Peterson & Assoc. v. Dayton Metropolitan Housing Authority*, 2<sup>nd</sup> Dist. App. No. 17306, 2000 WL 1006562, the Court of Appeals recognized that a lost profits claim in the construction context can include a claim based upon a loss of bonding capacity.

However, the case of *Daniel E. Terreri & Sons, Inc. v. Mahoning County Bd. of Comm'rs* (2003), 152 Ohio App.3d 95, is instructive on when a lost profit-lost bonding capacity claim will succeed or fail. In that case, the contractor used about \$2.2 million project of his \$3 million total bonding capacity on a county project. When the County delayed issuing notice to proceed for over three months, and later scrapped the project the contractor sued. Among other damages, the contractor sought recovery for lost profits as a result of its inability to bid other public work while it had over 2/3 of its bonding capacity tied up on the county project. The trial court awarded the contractor lost profit damages, but the court of appeals reversed, finding the contractor failed to meet its burden of proving there was an actual loss of profits. *Id.*

The court of appeals noted that it is not necessary for the contractor to prove it lost a specific contract, but the lack of proof regarding a lost contract is a relevant factor to consider whether the lost profits were proven with reasonable certainty. *Id.* The court found significant that the

contractor offered no evidence of specific contracts lost, the types of contracts they would have lost, or evidence of the contractor's ability to profitably complete the type of work they allegedly lost. *Id.* The court also considered that the contractor did not use up the \$800,000 in bonding capacity it did have to procure work during the same time period, when the owner presented evidence showing that there were 30 public projects offered for bid valued under \$800,000 during the same time period. *Id.* In light of the foregoing, the court believed the proof was not there that the contractor lost profitable work as a proximate result of the owner's failure to issue a timely notice to proceed.

#### **K. Emotional Distress Damages**

In 2001, Ohio courts joined the minority of courts that allow emotional distress damages in contract disputes between homeowners and builders. A plaintiff may now recover against a builder for non-economic, emotional damages, where the breach of contract has caused bodily harm or is "of such a kind that serious emotional distress was a particularly likely result." *Kishmarton v. William Bailey Constr., Inc.* (2001), 93 Ohio St.3d 226, 230. However, in *Kishmarton*, the Ohio Supreme Court did allow emotional damages for negligent construction of a home where the breach did not cause bodily injury and was not of a kind that would likely cause emotional disturbance. *Id.* The *Kishmarton* rule has been expressly limited to actions involving vendees and builder-vendors. *Brainard v. American Skandia Life Assurance Corp.*, 432 F.3d 655, 665 (6th Cir. 2005); *E.E.O.C. v. Honda of America, Mfg., Inc.* 2007 WL 1541364, at \*7 (S.D. Ohio, 2007), unreported.

#### **L. Stigma Damages/Diminution In Value/Economic Waste**

Under Ohio law, "stigma damages cannot be recovered unless there is actual, physical damage to a plaintiff's property. *Ramirez v. Akzo Nobel Coatings, Inc.* (2003), 153 Ohio App.3d 115, 117-18, citing *Chance v. BP Chemicals, Inc.* (1996), 77 Ohio St.3d 17. Where damage has been done to real property or such property has not been built as specified and the cost to repair such defect is "grossly disproportionate to the good attained," Ohio courts will award diminution of value damages instead of restoration damages in order to avoid economic waste. *Tru-Built Garage and Lumber Co., Inc. v. Mays*, 1993 WL 15664 at 4 (Ohio App. 2 Dist. 1993). Diminution value damages are calculated by finding "the difference in value of the structure contracted for [or before it has been harmed] and the structure received [or after it has been harmed]." *Id.* Thus, in a case where a construction company used roof rafters instead of storage trusses and the cost to replace the roof rafters with the storage trusses was more than the diminution of value caused by having the rafters instead of the trusses, the proper amount of damages was not the cost of replacing the rafters with trusses, but was the difference between the value of the house with the rafters and the value of the house with trusses. *Id.*

Some Ohio courts will require a plaintiff to put on evidence of both repair costs and diminution of value to prove which measure of damages is appropriate. Other courts will allow the plaintiff to elect its remedy and leave it to the defendant to prove the elected remedy is not the best measure of damages as a defense to the claim. This is an issue that depends upon which county and which appellate district you are in, and therefore, you will need to verify which rule applies.

## **XII. COSTS**

## A. Attorney Fees

Ohio follows the American Rule, which holds that a prevailing party generally cannot collect attorney fees. *Hagans v. Habitat Condominium Owners Ass'n* (2006), 166 Ohio App.3d 508, 517. Attorney fees can be awarded, however, if there is statutory authorization to award attorney fees, an enforceable contract provision provides for an award of attorney fees, *Id.*, or the losing party has conducted the case in bad faith or in a vexatious manner. *Wing Leasing, Inc. v. M & B Aviation, Inc.* (1998), 44 Ohio App.3d 178, 183, citing *Sorin v. Board of Education* (1976), 46 Ohio St.2d 177.

Although there are several statutes in Ohio that allow the prevailing party to seek attorney fees, Ohio Revised Code §§2743.19 and 2335.39 are particularly applicable to the construction industry. These sections provide, in pertinent part, that a party who successfully defends itself against a claim brought by the State in the Court of Claims is entitled to attorney fees if “the state's position in initiating the matter in controversy was not substantially justified.” O.R.C. §2743.19(A) (“The court of claims shall award compensation for fees to a prevailing party in an action under this chapter in accordance with section 2335.39 of the Revised Code.”) and O.R.C. §2335.39 (B)(1)(c) and (2). Thus, if the state brings a claim against a construction company that is not substantially justified, the construction company can collect attorney fees.

In a dispute between parties to a contract, the prevailing party may also be awarded attorney fees if they are provided by terms of the contract. Ohio courts will uphold contract provisions providing for attorney fees “absent a showing of grossly unequal bargaining positions between the parties, misunderstanding, deception or duress,” *Goldfarb v. Robb Report, Inc.* (1995), 101 Ohio App.3d 134, 147, and as long as “the fees awarded are fair, just, and reasonable.” *Northwood Condominium Owners' Association v. Arnold* (2002), 147 Ohio App.3d 343, 348.

Attorneys' fees may also be recoverable by statute in specific situations. For example, claims under the Prompt Pay Act, O.R.C. §4113.61, allow attorneys' fees to the prevailing party, which could include the general contractor if they successfully defend such a claim.

To determine if the amount of attorney fees award is reasonable, a court should look at a number of factors, the most important of which is how the fee allowed compares to the other damages awarded. *Wing Leasing, Inc.*, 44 Ohio App.3d at 184. “Apart from the amount recovered, the number of claims successfully litigated in relation to the total number of claims asserted, and the relation between the successful and unsuccessful claims should also have an important bearing on the reasonableness of the fees.” *Id.*, citing *Hensley v. Eckerhart* (1983), 461 U.S. 424,.

## B. Interest

Under Ohio Revised Code §1343.03(A), a person owed money payable on a contract or judgment is entitled to receive prejudgment interest at a rate per annum on the amount owed. Pursuant to Ohio Revised Code §5703.47, the interest rate is determined by adding three percent to the federal short-term rate as determined by the Ohio tax commissioner on October 15 of each year. This interest rate is used “unless a written contract provides a different rate of interest in relation to the money that becomes due and payable, in which case the creditor is entitled to interest at the rate provided in that contract.”

In a breach of contract claim brought by a contractor against an owner for failure to pay for construction costs, the court can award prejudgment interest to the contractor and that interest will begin to accrue from the time payment on the contract became due. *See, for example, Gordon Constr., Inc. v. Peterbilt of Cincinnati, Inc.*, 2003 WL 22227380, 2003 -Ohio- 5111 (Ohio App. 12 Dist. 2003). Such interest is also allowed for damages awarded as part of civil actions against the state “for the same period of time and at the same rate as allowed between private parties to a suit.” O.R.C. §2743.18(A)(1).

In cases where a court awards damages to a contractor for the delay caused by the state, the contractor is entitled to “prejudgment interest on all damages from the time of the accrual of the claim,” which is when the contractor, “had substantially completed its work on the project.” *Complete Gen. Constr. Co. v. Ohio Dept. of Transp.* (2002), 94 Ohio St.3d 54, 62.

### **XIII. INSURANCE COVERAGE FOR CONSTRUCTION CLAIMS**

Like the majority of states, commercial general liability insurance policies (“CGL” policies) in Ohio provide that insurance companies have a duty to defend and indemnify a policy holder when ever there is an occurrence, typically defined as an accident that causes property damage or bodily injury, that is not specifically excluded by the policy. The duty to defend is broader than the duty to indemnify, meaning that an insurance company may have to defend a claim that, in the end, its policy did not cover. In order to determine if an insurance company has a duty to defend, Ohio courts must apply four different tests. *Cole v. American Industries and Resources Corporation* (1998), 128 Ohio App.3d 546, 553. “If any one of the tests results in a determination that the duty to defend exists, then the insurance company is obligated to defend.” *Id.* These tests are:

- 1) The “Allegations Rule”, which provides that an insurance company is required to defend an insured when the “scope of the allegations contained in the complaint brings the action within the policy coverage.” *Id.* at 554.
- 2) The “Expanded Allegations Rule”, which provides that an insurance company is required to defend a claim even when the duty to defend is not apparent from the pleadings if “the allegations state a claim which is potentially or arguably within the policy coverage.” *Id.*
- 3) The “Groundless, False, or Fraudulent, Claims Test”, which provides that if an insurance company represent that it will cover a claim that appears to fall with the policy’s coverage even if it is factually unsupported, the insurer is required to provide coverage. *Id.*
- 4) The “True Fact Test”, which provides that an insurance company does not have to provide a defense “if there are not set of facts alleged in the complaint against an insured which, if proven true, would result in the insurance company’s duty to pay damages.” *Id.*

Although these tests seem to require an insurance company to defend almost any claim brought against its insured, Ohio courts have found that certain types of claims against construction companies are clearly not covered by a CGL policy. For example, Ohio courts have held that

claims for defective workmanship of a contractor or its subcontractor do not fall within the definition of “occurrence” under a CGL policy unless the claim alleges that the defective workmanship has caused collateral or consequential damage to other property. *See, Heile v. Herrmann* (1999), 136 Ohio App.3d 351, 354 (holding that insurance company did not have duty to defend because the only harm alleged by plaintiff’s claim was the insured’s defective workmanship) and *Erie Insurance Exchange v. Colony Development Corporation* (2000), 136 Ohio App.3d 419 (holding that insurance company had a duty to defend because plaintiff claimed that defective workmanship caused harm to other parts of plaintiff’s property).

#### **XIV. MECHANIC’S LIENS**

Contractors and material suppliers may use mechanic’s liens a method of obtaining payment from owners. Mechanic’s liens are creatures of statute and are considered in derogation of the common law. Thus, Ohio courts will strictly construe the statutory requirements regarding when and whether a lien arises and substantial compliance with these requirements is not sufficient to secure the lien. However, once the lien has been established, substantial compliance is all that is required to succeed on the lien claim.

A mechanic’s lien will be strictly construed when a question arises as to whether there has been proper perfection. The rule of liberal construction only applies to post-attachment matters, once there has been a determination that all the procedural requirements for perfection have been followed. *See* O.R.C. §1311.22.

Ohio provides mechanic’s lien rights to all laborers, subcontractors and material suppliers who perform work or provide materials used to improve real property, regardless of their contractual relationships on the project. Ohio’s mechanic’s liens law is codified and can be reviewed at O.R.C. §1311.01, *et seq.*

##### **A. Private Improvement Liens**

###### **1. Liens On Real Property**

Ohio law treats residential project liens a little differently than non-residential liens. If the work is being done on a residential project as defined in O.R.C. §1311.01, then certain defenses can apply to a lien claim that benefit owners that do not apply in non-residential situations. The idea is to protect homeowners from having to pay twice for the same work or materials. No such protection benefits owners on non-residential projects.

In addition to mechanic’s lien rights on traditional construction projects, the Ohio lien law also permits mechanic’s liens on oil and gas wells subject to limitations as to whose interest can be liened. Lien rights can also accrue on work done to improve streets, turnpikes, roads, sidewalks, rights of way, drains, ditches and sewers as described in O.R.C. §1311.03.

###### **2. Notice Of Commencement**

Ohio lien law requires all commercial project and public owners to record a Notice of Commencement prior to beginning any construction activities. The purpose of the Notice of

Commencement is to put all subcontractors and material suppliers who are not in direct privity of contract with the owner on notice that work is about to begin to improve real property and to provide these parties with the information that they need to perfect mechanic's liens to the extent of the improvements they construct. Because Ohio law allows subcontractors and material suppliers who are not in privity of contract with either the owner or the general contractor to have lien rights, the Notice of Commencement provides these individuals with the specific information that they will need to secure their liens in the event of non-payment, and also shifts the risk of providing inaccurate information in this regard to the project owner by making the project owner responsible for any inaccuracies in the Notice of Commencement that would impair lien rights of downstream contractors and suppliers. If a project owner fails to file a Notice of Commencement, then subcontractors and suppliers who are not in privity of contract with the owner or general contractor will not have to provide any type of notification to the owner that these individuals are providing labor or materials to the project in order to keep their rights to a lien.

The Notice of Commencement is intended to provide a ready source of information to lien claimants regarding the nature of the improvement and the identities and interests of the parties to the project. In addition, the filing of the Notice of Commencement serves as a precondition to the obligations of various lien claimants to serve a Notice of Furnishing in order to preserve their lien rights on the project.

The lien statute provides that the Notice of Commencement must contain very specific information. *See* O.R.C. §1311.04(B). The contents of the Notice of Commencement must be verified in affidavit form by the owner, part owner, lessee or the agent completing the form. *Id.*

### **3. Time For And Manner Of Filing**

The Notice of Commencement must be filed for all projects except: (a) Home purchase, construction or improvement contracts (b) projects relating to oil and gas wells, or (c) projects where utility companies are owners, part owners or lessees. *See* O.R.C. §§1311.011, 1311.021 and 1311.04(Q). The Notice must be filed with the office of the county recorder in the county where the property subject to the improvement is situated prior to performance or any labor or work or the furnishing of any material for the improvement. *See* O.R.C. §1311.04(A)(1).

Only one Notice of Commencement must be filed for each project. If more than one Notice is filed for the same project, then they are deemed to be amendments to the original Notice. The effective date of an amendment to the original Notice of Commencement relates back to the original filing. *See* O.R.C. §1311.04(A)(2).

### **4. Effect Of Owner's, Part Owner's Or Lessee's Failure To File Notice Of Commencement**

A failure to file the Notice of Commencement has several adverse consequences for the owner, part owner or lessee. First, it suspends the requirement that all subtrades and materialmen must serve a Notice of Furnishing, thereby increasing the risk of "hidden liens." *See* O.R.C. §1311.04(I). Second, it affects the determination of priorities of mechanic's lien on the project.

*See* O.R.C. §1311.13. Third, it renders the owner, part owner or lessee potentially liable to lien claimants for actual costs and expenses incurred in gathering the information necessary to perfect a mechanic's lien claim on the project. *See* O.R.C. §1311.04(K). Fourth, the owner, part owner or lessee may be liable for the costs and expenses incurred by an Original Contractor and lender who exercise their statutory right to file a Notice of Commencement. Fifth, the owner, part owner or lessee is liable to an Original Contractor for all expenses relating to a mechanic's lien claim that otherwise could have been avoided if the Notice of Commencement had been filed. *See* O.R.C. §§1311.04(M)(1) and 1311.04(N)(1).

**a. Right of Original Contractor To File Notice of Commencement**

Section 1311.04 of the Ohio Revised Code gives the Original Contractor the right to serve a written demand on the owner, part owner or lessee demanding the filing and posting of the Notice of Commencement for the project. The Original Contractor may prepare and file the Notice on behalf of the owner, part owner or lessee ten (10) days after the commencement of construction, or three (3) days after demand, whichever is later. *See* O.R.C. §1311.04(N)(1). If the owner, part owner or lessee fails to respond to the written demand or otherwise fails to post the Notice, then the owner, part owner or lessee will be liable to the Original Contractor for all damages, costs and expenses resulting from the filing of a mechanic's lien that could have been avoided by the filing of the Notice. *See* O.R.C. §1311.04(M)(1). The owner, part owner or lessee also will be liable for all expenses incurred by the Original Contractor in obtaining the information and filing the Notice of Commencement. *See* O.R.C. §1311.04(N)(2).

If the Notice of Commencement is filed by an Original Contractor, then the Notice must reflect on its face the fact that the Notice was prepared by the Original Contractor. *See* O.R.C. §1311.04(N)(4). The Original Contractor will not be liable for any errors in the Notice, unless the Original Contractor was required by contract to file the Notice on behalf of the owner, part owner or lessee. *See* O.R.C. §1311.04(N)(3).

**b. Right of Lender To File Notice of Commencement**

Ohio Revised Code Section 1311.04 also gives the mortgagee the right to prepare and file the Notice of Commencement if the owner, part owner or lessee fails to file before commencement of visible construction on the project. The owner, part owner or lessee also will be liable for all expenses incurred by the mortgagee to obtain the information and prepare and file the Notice. *See* O.R.C. §1311.04(N) (2).

The lender will not be liable for any errors in the Notice, unless the lender was required to prepare the Notice on behalf of the owner, part owner or lessee. *See* O.R.C. §1311.04(N)(3). The lender must indicate in the Notice the fact that the lender prepared and filed the Notice. *See* O.R.C. §1311.04(N)(4).

**5. Posting The Notice Of Commencement**

The owner, part owner or lessee must post and maintain a copy of the Notice of Commencement in a conspicuous place on the project throughout the entire period of physical construction or improvement. *See* O.R.C. §1311.04(G). If the owner fails to post the Notice, then the Original Contractor has the right to make a written demand for posting. A failure to comply with the Original Contractor's demand within ten (10) days creates liability for all damages, costs and expenses relating to the filing of mechanic's liens which otherwise could have been avoided. *See* O.R.C. §1311.04(M)(1).

An owner, part owner or lessee that fails to post the Notice also remains potentially liable to any lien claimant for all actual expenses incurred by the lien claimant to gather the information. *See* O.R.C. §1311.04(K).

## **6. Effect Of Errors In Notice Of Commencement**

An owner, part owner or lessee that includes incorrect information in the Notice of Commencement is liable to claimants for any resulting loss of lien rights or the actual expenses of preserving those rights, including attorneys' fees. This remedy only is available, however, if the claimant's loss resulted exclusively from the claimant's reliance on the incorrect information. *See* O.R.C. §1311.04(C). Mechanic's lien claimants may amend their Affidavit for Mechanic's Lien if the amendment is necessary to correct an Affidavit which, based on errors in the Notice of Commencement, contains incorrect information.

## **7. Amending The Notice Of Commencement**

Owners, part owners and lessees may amend a previously filed Notice of Commencement in order to correct or add information. In addition, the owner, part owner or lessee has a duty to amend the Notice to reflect the names of new lenders, sureties, and Original Contractors. The amendment relates back to the time the original Notice of Commencement was filed. *See* O.R.C. §1311.04(A)(Z).

## **8. Service And Distribution Of The Notice Of Commencement**

### **a. Service By The Owner, Part Owner Or Lessee**

The owner, part owner or lessee must serve a copy of the Notice of Commencement on all Original Contractors for the project. *See* O.R.C. §1311.04(H). The owner, part owner or lessee also must serve a copy of the Notice on all subtrades and materialmen that serve a written demand for a copy of the Notice within ten (10) days of receipt of the demand. *See* O.R.C. §1311.04(J). The subtrade's or materialman's request should be made by certified mail, return receipt requested. *See* O.R.C. §1311.04(B).

The owner's, part owner's or lessee's failure to serve the Original Contractor with a copy of the Notice will create liability to the Original Contractor for the actual cost incurred by the Original Contractor to obtain the information that should have been in the Notice. *See* O.R.C. §1311.04(H). The owner's, part owner's or lessee's failure to timely respond to a subtrade's or materialman's written request for a copy of the Notice will create liability for all actual expenses

incurred by the requesting party to obtain the information that otherwise would have been provided in the Notice. The failure to respond to the request also suspends the subcontractor's or materialman's obligation to serve a Notice of Furnishing. *See* O.R.C. §1311.04(J).

**b. Service By Original Contractors And Subcontractors**

A Subcontractor may serve a written request for a copy of the Notice of Commencement on the Original Contractor or owner, part-owner or lessee. Furthermore, lower-tier subcontractors and materialmen may serve a written request on the Subcontractor with whom they are in privity of contract. An Original Contractor or Subcontractor that receives such a written request must respond within ten (10) days of receiving the request. *See* O.R.C. §1311.04(E)-(F). If the Original Contractor or Subcontractor fails to respond to the request in a timely manner, then the Original Contractor or Subcontractor will be liable to the requesting party for the actual expenses incurred as a result of having to obtain the information. *See* O.R.C. §1311.04(L).

**9. Process For Perfection -- The "Notice Of Furnishing"**

**a. Notice of Furnishing -- Step One**

The first major step for perfecting a mechanic's lien requires the lien claimant to prepare and serve a "Notice of Furnishing," pursuant to O.R.C. §1311.05. This step applies only if (a) the lien claimant is a materialman, subcontractor, or lower-tier subcontractor; and (b) a Notice of Commencement has been filed for a project.

The Notice of Furnishing is intended to put the owner and the Original Contractor on notice of a subcontractor's, materialman's or lower-tier subcontractor's involvement in the project, thus eliminating "hidden" liens. It is a mandatory provision that subcontractors, materialmen and lower-tiers must strictly follow in order to preserve their lien rights on projects.

As noted above, Original Contractors and laborers do not have to prepare and serve a Notice of Furnishing to preserve their lien rights on a project. The definition of Original Contractor includes any person or entity that contributes to a project pursuant to a direct contract with the owner. Therefore, the term "Original Contractor" necessarily includes general contractors, principal trade contractors and construction managers and other lien claimants who are in privity of contract directly with the owner.

As with the Notice of Commencement, Ohio's lien statute requires that the Notice of Furnishing must contain very specific information as well. *See* O.R.C. §1311.05 The Notice of Furnishing need not be in the form of a sworn affidavit. However, it must substantially comply with the statutory form set forth in O.R.C. §1311.05(B). The party supplying the Notice of Furnishing may rely on the information contained in the Notice of Commencement for the project when completing the statutory form.

**b. Time For Service of Notice of Furnishing -- 21 Day Relation Back Rule**

The duty for a subcontractor, materialman or lower-tier to serve a Notice of Furnishing under O.R.C. §1311.05, and the corresponding time period within which service is to be made, is directly dependent on the filing of the Notice of Commencement for the project. In fact, the filing of the Notice of Commencement is an absolute condition precedent to the duty to serve the Notice of Furnishing. Therefore, subtrades and materialmen need not serve a Notice of Furnishing if no Notice of Commencement has been filed. *See* O.R.C. §§1311.04(I) and 1311.05(A).

If the Notice of Commencement is filed prior to commencement of construction on the project, then the subtrades and materialmen must serve their individual Notice of Furnishing either before they actually commence work or furnish materials for the project or within twenty-one (21) days after commencement in order to preserve their lien rights for the entire value of their work and material.

A subtrade or materialman may serve a Notice of Furnishing more than twenty-one (21) days after they first begin work or furnish materials. In such a case, the Notice of Furnishing will relate back twenty-one (21) days from the date of service (the “Relation Back Period”). The Notice of Furnishing will preserve the lien claim only for the value of work and materials provided during the Relation Back Period and prospectively from the date of service. The subtrade or materialman will have waived its lien rights for the value of labor or material supplied more than twenty-one (21) days prior to service.

If the Notice of Commencement is filed after construction operations commence, then subtrades and materialmen can preserve their entire lien claim by serving their Notices of Furnishing within twenty-one (21) days after the Notice of Commencement is filed with the county recorder. Again, a Notice of Furnishing may be filed after the twenty-one (21) day period expires, subject to the limitations on claimant’s lien set forth in the preceding paragraph.

### **c. Service of Notice of Furnishing**

Once a Notice for Commencement has been filed, all subtrades and materialmen must serve a copy of their Notice of Furnishing on the first named owner or the owner’s designee at the address contained in the Notice of Commencement. Furthermore, if the subtrade or materialman serving the Notice of Furnishing is not in direct privity of contract with the Original Contractor, then the subtrade or materialman also must serve a copy of the Notice on the Original Contractor or the Original Contractor’s designee at the address listed in the Notice of Commencement. Ohio law does not require subtrades and materialmen to serve notices of furnishing on a lender, however, it is always a good practice to do so. Generally, if a designee is named in the Notice of Commencement, then it is best to serve the designee, the first named owner, the Original Contractor and the Original Contractor’s designee. Furthermore, prudence dictates that the claimant serve the Construction Manager on the project if one exists.

Section 1311.19(A) of the Ohio Revised Code provides for personal service by the sheriff of the county in which the person to be served resides or maintains his or its principal place of business. Furthermore, this section authorizes service by certified or registered mail, overnight delivery, hand delivery, or any other method that includes “written evidence of receipt.” *See* O.R.C.

§1311.19 (A)(2). The Notice of Service may be served on the statutory agent of a corporation, pursuant to Section 1701.07 of the Ohio Revised Code. *See* O.R.C. §1311.19(A)(3). Most subcontractors and suppliers serve their Notice of Furnishing by certified mail.

Service is complete when it is received by the party being served. If the Notice of Furnishing is sent to an address listed in the Notice of Commencement, but it is subsequently returned unclaimed, refused or returned for any other reason not the fault of the party serving the notice, then service will be deemed completed upon initial mailing. *See* O.R.C. §1311.19(B).

## **10. Contents Of The Mechanic's Lien Affidavit**

Ohio Revised Code §1311.06 sets forth the legal requirements for the mechanic's lien affidavit along with the time periods within which the lien affidavit must be recorded in the office of the county recorder for the county in which the project is located. If the lien arises in connection with a residential project, including certain aspects of condominium projects, the lien must be filed within sixty (60) days from the date on which the last labor or work was performed or material was furnished by the person claiming the lien. If the lien arises in connection with improvements to gas and oil wells, then the lien must be recorded within one-hundred twenty (120) days from the date on which the last labor or work was performed or material provided. For all other projects, the lien must be recorded within seventy-five (75) days from the date upon which the last of the labor or work was performed or material provided. If the lien is not recorded within the proper time frame, it will be deemed legally invalid. This aspect of the Ohio lien law is strictly construed against the person claiming the lien, therefore, it is of critical importance to the success of any lien claim that the lien affidavit be recorded in a timely manner.

This section of the Revised Code also sets forth a form affidavit for mechanic's lien that should be followed with rare exceptions. A legal description of the project is required in the lien affidavit to permit the county recorder to attach the lien properly. If the project is one upon which a Notice of Commencement has been recorded by the owner, or other vested party, then the lien claimant is permitted to rely upon the information set forth in the Notice of Commencement when preparing the lien affidavit, and the project owner at that point assumes the risk of inaccuracies in the information that is used. However, if the project is one for which a Notice of Commencement has not been recorded, then the lien claimant bears responsibility for the accuracy of the information used to prepare the affidavit including the accuracy of the legal description to the property upon which the lien attaches, and this is also a requirement that will be strictly construed against the person claiming the lien. Therefore, in cases where there is no Notice of Commencement, it is generally advisable to have a title search done on the property to verify the correct legal description.

## **11. Material Supplier Liens**

The rules are slightly different for material and equipment suppliers than they are for subcontractors and laborers. A materialman has a lien only when the materials are furnished with the intention that the materials are going to be used to improve a particular project. This must be evidenced either by a contract, a delivery order, a physical delivery to the jobsite by the lien claimant, or some other evidence to prove that the materials were destined for a specific

project, and then the materials need to be actually incorporated into or consumed in the course of making improvements to a specific project. The only exception is for specialty fabricated materials which cannot be resold on the open market, if not actually used in the project. However, even specially fabricated materials must have been originally intended for a specific project before a lien will arise on that particular project. Materialman liens also include liens for tools or machinery used in the course of improvements.

The physical delivery of materials or equipment to a project site creates a conclusive presumption under the lien law that the materials were used in the course of the improvement and incorporated into the improvement for purposes of satisfying the statutory requirements. It is custom and practice in Ohio that material suppliers who deliver products directly to a jobsite are able to claim a mechanic's lien to the extent of products supplied to that project site provided they have served a proper Notice of Furnishing. To the extent that a material supplier has sold materials on an open account, and is unable to trace specific products to a specific project, then that material man will not be able to properly perfect a mechanic's lien based upon that open account.

## **12. Notice To Lienholder To Commence Suit**

The only way to challenge the sufficiency of a mechanic's lien in Ohio is to serve the lien claimant with a statutory notice commence suit under O.R.C. §1311.11. The notice may be given by the property owner, or by an original contractor or subcontractor if they have provided a bond in order to discharge the mechanic's lien, which is also permitted under the statute. The Notice to Commence Suit must be served by the procedure set forth under the statute, and an affidavit of service properly recorded with the county recorder. The lienholder then has sixty (60) days from the date of service within which to file a lawsuit to enforce the lien, or the lien is declared automatically void and the property is discharged. The failure of the lienholder to commence suit does not result in a waiver of the underlying claim for providing the labor or materials, but it will result in the automatic loss of lien rights.

A general contractor or a subcontractor may post a surety bond or cash deposit in order to discharge the real property from a mechanic's lien filed by one of their downstream contractors or suppliers. O.R.C. §1311.11 sets forth the procedure to be followed to bond off a mechanic's lien and court approval is required. A petition must be filed in the court of common pleas in the county in which the real property subject to lien is situated, and provided the surety bond meets the statutory requirements, the court is obligated to accept the bond and discharge the property from the mechanic's lien. This procedure is frequently utilized by contractors and subcontractors to avoid breaches of the standard no lien clauses in their contracts because it still allows the entity posting the bond to challenge the sufficiency and adequacy of the lien as well as the underlying claim, but freeze the real estate from the lien itself in any possible foreclosure action.

## **13. Proceeding On A Mechanic's Lien**

A person holding a lien may proceed to enforce the lien by filing a foreclosure action in the common pleas court in the county in which the real estate subject to lien is situated. The Plaintiff must join all entities who have or may have an interest in the subject real estate in the

action, and most local rules require the plaintiff to also provide and file at the time of the complaint a preliminary judicial report for the subject property consisting of a full title history and identifying all interested parties. When multiple mechanic's liens are perfected on a single property, and thereafter joined in a single action, if a judgment is obtained in favor of the lien claimants, the court may award attorneys' fees to the party that successfully enforced the mechanic's liens out of the fund realized to pay all lien claimants. Otherwise, attorneys' fees are not permitted for mechanic's lien litigation unless provided for separately by a contract between the interested parties.

#### **14. Notice Of Intent To Lien**

The Ohio lien law does not require a party to serve a notice of intention to claim a lien prior to lien rights accruing except when a Notice of Furnishing is required. The Notice of Furnishing in effect puts the project owner and upstream contractors on notice that the individual may file a mechanic's lien if not paid. However, Ohio law does permit an individual to serve a pre-lien notice, in those situations when the individual is providing labor or materials to a project, but payment is not yet due, and there is ongoing or threatened litigation by actual lien claimants that could impair this individual's ability to collect monies when they do become due and payable. In those situations, the claimant can serve a pre-lien notice and thereby join in any litigation to enforce existing liens. The only time this would become an issue, is when an owner has been sued by a lien claimant while work is still progressing and these contractors are concerned their payment rights may be impaired based upon the underlying mechanic's lien claims.

#### **15. Damages For Failure To Release Mechanic's Liens**

Ohio law does recognize claims for slander of title when invalid or improper mechanic's liens have been claimed on real property. In the event an improper mechanic's lien is recorded against real estate and clouds the title, and the property owner subsequently proves the lien was invalid and has sustained damages as a result of the cloud on the title, the property owner is permitted to recover those damages from the individual who improperly filed the mechanic's lien. The claim is considered an intentional tort in Ohio, and requires the tortfeasor to have acted with malice toward the property owner as an essential element of the claim. Therefore, the mere negligent filing of an improper mechanic's lien will not sustain a slander of title claim.

The mechanic's lien statute, O.R.C. §1311.20, provides a right of action in favor of a property owner against the lien claimant if the lien amount has been satisfied or a court has determined it to be invalid and the lien is not released within thirty (30) days thereof. In such cases, the lienholder is liable to the property owner for all damages arising out of the failure to release the lien in an amount not to exceed the amount of the lien plus court costs.

#### **B. Public Improvement Liens**

Ohio's law on public improvement liens are proscribed by sections 1311.25 through 1311.33 of the Ohio Revised Code, and are interpreted differently from private improvement liens. Public liens are available to any subcontractor, material supplier, and/or laborer who not only performs specified services for a public entity, but also to those who furnish materials in furtherance of a public improvement project. O.R.C. §1311.251. These materials must be furnished with the

intent to be used in the course of the public improvement. Courts may also require the materials are actually incorporated in and/or consumed during the course of the project. *Id.* The delivery of materials to the site of the public improvement creates a conclusive presumption that the materials were used in the course of the public improvement or were incorporated into the public improvement. *Id.* All deliveries and/ or sales of materials, tools and machinery constitute a single claim for the unpaid portion of goods, pursuant to O.R.C. §1311.251.

### **1. Notice of Commencement**

A public authority must prepare a notice of commencement before any work is performed. The public notice of commencement serves a function similar to that of those existing in the context of private projects. The rights of a claimant under O.R.C. §1311.252 are not negatively impacted if the notice of commencement is not produced in a timely manner or if it contains incorrect information which the claimant relies upon to his detriment.

O.R.C. §1311.252 requires that the notice incorporate very specific information including: (1) the name, location, and a number, if any, used by the public authority to identify the public improvement sufficient to permit the public improvement to be identified; (2) the name and address of the public authority; (3) the name, address, and trade of all principal contractors; (4) the date the public authority first executed a contract with a principal contractor for the public improvement; (5) the name and address of the sureties for all principal contractors; and (6) the name and address of the representative of the public authority upon whom service shall be made for the purposes of serving an affidavit. A claimant's statement of amount and value of labor materials cannot merely list charges and payments received without further elaboration. The statement should set forth in some detail the separate instances in which labor was performed and list the material or machinery furnished. *Crock Constr. Co. v. Stanley Miller Const. Co.* (1993), 66 Ohio St.3d 588.

Another important aspect of Ohio mechanic's lien law is that unlike liens upon privately owned property, mechanic's liens with respect to work done on Ohio public projects attach not to the property, but to a public fund set aside for the payment of subcontracts. O.R.C. §1311.26. *See also Poenisch v. Kingsley-Dunbar, Inc.* (1990), 64 Ohio App.3d 699, 582; *Talco Capital Corp. v. State Underground Parking Comm'n* (1974), 41 Ohio App.2d 171 (lien against public works only attaches to fund since law forbids execution against public property). A materialman who is owed money by the principal contractor may only retain a lien upon payments that the public authority owes to the principal contractor. The lien does not attach to the funds held by the public authority until those funds are due to the principal contractor. *Intercargo Ins. Co. v. Mun. Pipe Contrs., Inc.* (2003) 127 Ohio Misc.2d 48.

In order to obtain a lien a claimant must first provide the public authority named on the notice of commencement with an affidavit stating the amount due and unpaid for the labor and work performed and material furnished. O.R.C. §1311.26. The affidavit must also include the mailing address of the claimant, as well as, the times at which the last of the labor or work was performed, and when the last of the material was furnished, including all credits and setoffs. *Id.* This affidavit must be served within one hundred twenty days of time the work was finished or the materials were last furnished. *Id.* One affidavit may include the claims of more than one

laborer as long as each claim is separately identified according to each laborer. *Id.* The affidavit may also be filed and served by an agent of one or more laborers. *Id.*

## 2. Notice of Furnishing

In order to obtain a lien, a subcontractor or materialman who has performed work or furnished materials to a public authority must serve a notice of furnishing. O.R.C. §1311.261. The notice of furnishing must be served on the principal contractor within 21 days after the date the subcontractor or materialman first performed labor or work of furnished materials on the site. *Id.*

It must also contain the name and address of the principal contractor, the subcontractor or material supplier; a description of the work to be done and/or materials that will be used, a description or address of the property where the work will be completed or the materials delivered, and the name of the individual ordering the labor or goods. *Id.* The notice must also contain the date that the work or materials were first performed /furnished or a future date that the labor will be performed or the materials furnished. *Id.* However, subcontractors or materialmen who are in direct privity of contract with the principal contractor are not required provide to provide this notice. O.R.C. §1311.261(A)(1).

“The filing of the affidavit immediately imposes a duty to withhold all subsequent payments from the principal contractor.” *B.F. Sturtevant Co. v. Board of Education of City School Dist. of Cincinnati* (1935), 51 Ohio App. 348, 352. When a public authority receives a lien affidavit it is required to detain funds from the principal contractor or from the balance of the funds remaining in the contract with the principal contractor. However, the amount detained cannot exceed the amount claimed by the lien, nor the balance remaining in the contract. O.R.C. §1311.28. A subcontractor’s lien generally applies only to funds the public authority pays to a general contractor *after* the lien is filed, and not those the authority has already paid. *L.E. Myers Co., High Voltage Systems Div. v. Jordano Elec. Co.* (1988), 47 Ohio App.3d 132, 135.

A public authority cannot detain any funds unless the claimant files a sworn statement averring the date the notice of furnishing was served to the principal contractor. The authority will then place all detained funds in an escrow account as provided for under section 153.63 of the Ohio Revised Code.

A claimant who serves an affidavit must also file a copy with the county recorder in the county where the public improvement is situated, or with the county recorder of each of the counties where the public improvement is situated if the public improvement is situated in more than one county. O.R.C. §1311.29. Filing the affidavit with the county recorders gives a claimant preference over other claims not filed with the county recorder. O.R.C. §1311.29. Filing with the county recorder does not grant a claimant a priority on distribution of detained funds. *Id.* Payments to multiple claimants are in prorated amounts, based on the value of each of valid claim. *Id.*

Section 1311.31 of the Ohio Revised Code further requires that a public authority or the claimant, (or appropriate agent) serve the principal contractor with a copy of the claimant’s affidavit within five days of the time it is filed. The authority must also inform the principal that

he must provide notice of any intention to dispute the claim within twenty days. Failure to dispute the claim within the proscribed time period constitutes assent to the correctness of the claim, and the authority will use detained funds to pay the amount claimed.

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