The Interesting Tale of the *Greate Bay v. Perini Case* and its Impact on Construction Law Today

by Jeffrey B. Kozek

Call me Ishmael...[1]

While an expansion project at an Atlantic City casino started as a project to attract whales,[2] it ended up having a profound impact on construction law in New Jersey and changed the general conditions of a standard form document used on building projects throughout the U.S. This author was a participant in the fascinating case of *The Matter of Greate Bay Hotel and Casino v. Perini Corporation* and the associated litigation that followed, which involved the delayed completion of the (now) out-of-existence Sands Hotel & Casino in Atlantic City.

Why was this construction project so interesting? It contained all of the trademarks of a typical construction project gone bad—design issues, outstanding changes, delay, lack of clear communication between owner and contractor, among other things—and resulted in a case that started in arbitration and ended before the New Jersey Supreme Court, with many twists and turns along the way.

In the Beginning...[3]

The Sands Hotel & Casino, the first newly constructed hotel and casino in Atlantic City under the original name of the Brighton Hotel and Casino, ended up with the Sands moniker under a licensing agreement with its famous namesake in Las Vegas through a series of purchases of the property. The Sands was one of two properties along the ocean that were set back from the boardwalk. To attract more visitors and also to attract the aforementioned whales, the Sands decided to make improvements to the facility in three main areas: 1) the addition of a two-story escalator that would carry patrons up to the second floor casino space with expansion of the gaming area and the addition of a new food court; 2) the addition of a new floor to accommodate high-roller suites; and 3) the creation of a new entrance on the corner nearest the boardwalk that included a porte cochere and a glitzy glass façade running parallel with the boardwalk.

In 1983, Greate Bay (hereinafter referred to as the Sands) entered into a construction manager/general contractor (CM/GC) agreement with Perini Corporation, a well-known and established contractor out of Framingham, Massachusetts, to perform the expansion/renovation work. The cost reimbursement contract contained a guaranteed maximum price (GMP) of $16.8 million. In addition to a fee of $600,000, Perini was entitled to an additional four percent fee if costs (through approved change orders) exceeded $20 million. While some schedules showed the date of substantial completion as the end of May 1984, the Sands made it clear to Perini that the work needed to be accomplished by Memorial Day of 1984. This was a key date, since Memorial Day is the official kick-off of the summer Jersey shore season and the casinos generated more business during the summer season.

It Was the Best of Times, it Was the Worst of Times...[4]

As is not uncommon on many construction projects, the record keeping was not great. This was more the norm than the exception in 1984, when construction schedules were still being run on mainframe computers, as Primavera and MS Project scheduling software and PCs were just making their debut and not yet fully adopted by the construction industry along with all of the other project management supporting software available today. Typical of many owners who are infrequent construction builders, the construction schedule was a mystery, and the Sands indicated that Perini never took the time to explain what the schedule was showing. In fact, the Sands' general counsel related to this author that, when asked about the negative float in the schedule, he believed "negative float"[5] meant the work was ahead of schedule.

As the summer season approached in 1984, it became clear the work would not be accomplished by Memorial Day and, in fact, the project did not receive a temporary certificate of occupancy (TCO) until the middle of September, well after the end of the busy summer season. The very profitable year the Sands was

anticipating quickly disappeared. As the remaining work was proceeding that summer, the Sands retained the firm this author was employed by as its scheduling expert, and also retained an outside law firm to prepare a demand for arbitration.

All of this Happened, More or Less...[6]

While Perini still had its job trailer on site, the Sands literally took over the trailer in order to preserve the records on site. This led to a court hearing, with the judge ordering that both sides could have access to the trailer and its records. A security guard was posted at the trailer in order to maintain order and access.

During the latter part of 1984 and into 1985, both sides prepared for the arbitration hearings that were to commence in approximately Oct. 1985. Prior to the start of arbitration, the Sands reviewed outstanding change order requests, and certain issues relating to these claimed amounts were addressed and resolved. Although not all change order requests were resolved, this left the arbitration to deal primarily with the larger issue of delay and lost profits.

Arbitrators were selected (an attorney, an architect and an engineer) and the hearings began at the American Arbitration Association office in Somerset. Not long thereafter, while the hearings were proceeding, Perini's corporate office apparently forwarded documents to Perini in Atlantic City at the project site instead of Perini's new location that had been set up for its personnel after the 'taking' of the job trailer. The material mistakenly sent to the job trailer was given to the Sands' general counsel who, in turn, provided it to the Sands' outside counsel, who proceeded to use some of the material during the arbitration hearings. Included in the material were confidential Perini internal memoranda discussing the case, including privileged materials from its in-house counsel. Upon introduction of these materials during the arbitration, the hearings were halted while legal counsel for Perini sought protection from the court to bar introduction of the material in arbitration, since it was mistakenly sent to the wrong location. This occurred in late 1985. After a couple of years of contesting the use of this material up through the appellate level, the court confirmed the lower court's finding that not only were the documents tainted, but the law firm that introduced them was as well. As a result, Sands' outside legal counsel was disqualified, and the Sands was forced to retain new legal counsel.

In late 1987, the Sands retained new legal counsel, and the arbitration re-commenced in Feb. 1988. The locale of the arbitration hearing was changed. Now, the hearings would be held at the Seaview Hotel,[7] just outside of Atlantic City.

Fact and expert witness testimony was provided through most of 1988. Most of the testimony was provided by Sands' witnesses. Strangely, Perini did not provide testimony from its main project participants, including Perini's project manager. Perini's main fact witnesses were its electrical and mechanical subcontractors. A tactic used by Sands' legal counsel was to highlight the absence of testimony by Perini's project manager (the proverbial empty chair). Sands' counsel also proceeded to press Perini for the release of the personnel file of the project manager. This information was never released, and the non-appearance of the project manager and the non-production of his records appeared not to go over well with the arbitration panel.

The Sands' case concluded with its calculation of alleged damages. For this aspect of the case, the Sands' retained one of the 'Big 8' accounting firms (as known at that time) to determine the lost profits incurred due to the delayed completion of the work. The accounting firm prepared a schedule of lost profits with accompanying notes and exhibits to demonstrate the difference in operating income[8] between the claim period of May–Dec. 1984, and the subsequent same timeframe in 1985. The report noted that this difference—almost $13.5 million—was an appropriate measure of the profits lost due to the delayed construction. The report also noted that the improvement in operating income from 1984 to 1985 was not due to improved market conditions, since the Atlantic City casino industry, as a whole, had experienced negative growth from 1984 to 1985. Finally, it was noted that certain conditions and events that occurred during these two periods, notably the opening of the Trump Plaza and Trump Castle Hotel & Casinos during this period plus other negative factors (with regard to income generation) should have, in all likelihood, decreased operating profits in 1985 as compared to 1984, and thus represented the claimed damages amount as being on the conservative side. The exhibits that accompanied the report provided various comparisons between the Sands and the other hotel/casinos during the same timeframe, to highlight how the Sands' income deviated from the other establishments during the latter half of 1984.

For the damages portion of its case, Perini retained

another Big 8 accounting firm to counter the numbers and assumptions used by the Sands' accounting expert. Its position was, among some other more minor points, that failures to consider depreciation and interest expenses inflated lost profits by over $5 million.

The hearing was concluded prior to the end of 1988.

It Was Love at First Sight...[9]

The arbitration panel issued its decision in Jan. 1989. Not including the signature pages, the award consisted of nine brief paragraphs over two pages, which listed the gross amount awarded to the Sands; the gross amount awarded to Perini and its subcontractors for certain unpaid invoices; the apportionment of fees owed by the parties to the American Arbitration Association, the arbitrators and the Seaview (of which Perini was responsible for 75 percent and Sands the remaining 25 percent); and the statement that the award was a complete settlement of all claims and counterclaims associated with the arbitration. It was a split decision, with one of the three arbitrators dissenting. No explanation was provided as to how the amounts were reached or the basis for why the panel ruled as it did. There was also no explanation as to why one of the arbitrators (the attorney) did not agree on the award.

Justice? You Get Justice in the Next World, in This World you Have the Law ...[10]

Soon thereafter in 1989, judgment was entered by Judge L. Anthony Gibson in the Chancery Division confirming the awards.[11] Both sides appealed.[12] Perini contested the judgment based on four points: 1) an award of lost profits contravened the terms of the contract and was beyond the contemplation of the parties; 2) the award did not resolve all issues; 3) the award to the Sands was contradictory and inconsistent with the award to a subcontractor; and 4) the award would result in "manifest injustice" (a term cited in the arbitration statute) since the damages were grossly disproportionate to Perini's $600,000 fee under the contract.

In an unpublished opinion in May 1991, the Appellate Division affirmed Judge Gibson's confirmation of the award. The court noted that the evidence presented essentially came from Sands' fact and expert witnesses and not Perini witnesses, and demonstrated support for Judge Gibson's rejection of Perini's arguments regarding incompleteness of award and lack of liability. As to the substantial completion argument (that would have reduced the period for which damages were assessed), the court pointed to the testimony of senior Sands' management and Sands' scheduling expert as to the actual effect of the uncompleted outside work on the full beneficial use of the building. As to damages, the court pointed out that the damages experts were subject to exhaustive questioning by both sides, in addition to questions asked by the arbitrators.

In the end, the court stated that the credibility of the experts' testimony rested with the arbitrators. The court noted that the record suggested no absence of evidence or mistake of law sufficient to disturb the award on the ground that lost profits were not a reasonably certain consequence of the breach. In disregarding the manifest injustice argument, while stating that this argument is not one of the criteria for vacating an award, the court noted that even if it were to consider the argument, a $14.5 million award in comparison to a final $24 million contract value did not take on the enormity to make the award manifestly unjust.

In the Land of the Blind, the One-eyed Man is King...[13]

The Appellate Division decision was appealed to the New Jersey Supreme Court. In a decision handed down in Aug. 1992,[14] the Court addressed the following issues: 1) whether the asserted mistake of law was reviewable by the courts; 2) the continued validity of the principle that mistakes of law are the equivalent of "undue means" (another term used in the arbitration statute); and 3) the disproportionality of the arbitration award as compared to the amount of the contract and the amount of Perini's fee.[15]

The two principal errors of law asserted were that the arbitrators failed to follow principled settled areas of law by awarding damages: 1) that were not in the contemplation of the parties at the time of contract; and 2) that should not have been awarded for the period after the project was considered substantially complete. A majority found "that the asserted errors of law were not so gross, unmistakable, or in manifest disregard of the applicable law as to warrant judicial invalidation of the award."[16] Specifically addressing the two perceived mistakes of law, the Court found that as to foreseeability of the extent of the damages, the arbitrators had more than enough evidence to conclude that Perini was aware that its failure to complete the project in a timely fashion could lead to a significant loss of income.[17] After a lengthy discussion on the meaning and use of the term "substantial completion" in the context of construction contracts, the Court agreed

that delay damages cannot be awarded after substantial completion of the contract. However, the Court, citing the testimony elicited during the arbitration concerning the appearance of the building after the issuance of the TCO in mid-September of 1984, noted that the arbitrators could have considered it fair to award damages based on the uncompleted conditions that still existed subsequent to the issuance of the TCO.[18] The Court also noted that the public's perception of the building during the summer months could have had a significant impact on operations that could have had a carryover effect on lagging profits into the fall season.[19]

As to Perini's argument that the award was highly disproportionate to the fee received, the Court noted that Perini was not a novice when it came to casino construction in Atlantic City. In addition, Perini could have bargained for a no damages for delay clause or a liquidated damages clause in the contract.[20]

In a lengthy concurring opinion, Chief Justice Robert Wilentz stated that arbitration decisions should be final and not subject to judicial review, absent fraud, corruption or similar wrongdoing on the part of the arbitrators;[21] and that unless the parties state otherwise in the arbitration agreement, mistakes of law do not serve as a valid basis for judicial review.[22]

Two years later, in *Tretina Printing, Inc. v. Fitzpatrick & Associates*,[23] the plurality adopted as a rule governing judicial review of private contract arbitration awards the standard set forth in Chief Justice Wilentz's concurring opinion in the *Perini v. Greate Bay* decision. The plurality ruling in the *Perini* case was that the arbitrators must have clearly intended to decide according to the law, must have clearly mistaken the legal rule, and that mistake must appear on the face of the award. In addition, the error, to be fatal, must result in a failure of intent or be so gross as to suggest fraud or misconduct.[24] That standard was superseded in *Tretina,* and is now as follows:

> Basically, arbitration awards may be vacated only for fraud, corruption, or similar wrongdoing on the part of the arbitrators. [They] can be corrected or modified only for very specifically defined mistakes as set forth in [*N.J.S.A.* 2A:24-9]. If the arbitrators decide a matter not even submitted to them, that matter can be excluded from the award...[25]

The Past is a Foreign Country; They Do Things Differently There...[26]

Based on the number of articles and commentaries that have been published, the *Perini* decision sent shockwaves through the contracting community given the focus on a contractor being assessed damages 24 times in excess of its fee. As an apparent result, when the American Institute of Architects (AIA) updated its set of general conditions (Standard Form A201) in 1997, a "mutual" waiver of consequential damages clause appeared. The waiver language[27] included:

> 1. damages incurred by the Owner for rental expenses, for losses of use, income, profit, financing, business and reputation, and for loss of management or employee productivity or of the service of such persons; and
> 2. damages incurred by the Contractor for principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit except anticipated profit arising directly from the Work.

The provision went on to state that it did not preclude the inclusion and award of liquidated damages in accordance with the requirements of the contract documents.

This language remained relatively intact in the A201 2007 and 2017 updates.[28] The inclusion of this provision was somewhat controversial, since owner groups believed their potential losses due to consequential damages[29] dwarfed the amount the contractor was giving up, and thus the waiver was not equitable or truly mutual. The AIA, however, decided to include the provision so the parties could plan accordingly and avoid such claims in the future.[30] Another commentator's take was that in a 1988 Missouri case,[31] wherein the engineer was found liable in a pedestrian bridge collapse where it was held that the engineer failed to review a shop drawing that was found to be in error, that decision caused havoc in the design professional community. Thus, the inclusion of the waiver of consequential damages provision served to protect both contractors and design professionals.[32]

As can be deduced from the above, the Sands case was rather unique. The use of arbitration did not convey some of the supposed benefits of this alternative dispute resolution process (*i.e.*, a shorter period of time for reso-

lution (there were over 60 days of hearings; information was introduced during the arbitration whose admittance needed to be addressed by the courts, which suspended the arbitration for over two years; and the parties saw the inside of a courtroom again at the end when the arbitration panel's decision was appealed)). The case led to new law in New Jersey regarding the grounds for appeal of an arbitration decision, and it appears to have been the impetus for changing the way consequential damages are addressed in the AIA's Standard Form A201 General Conditions. As for the Sands itself, it is only a memory, as it was imploded in 2007. ■

Jeffrey B. Kozek is a founding member and principal of Resolution Management Consultants, Inc., a professional consulting firm headquartered in Marlton, providing project/construction management support services and construction claims/dispute resolution/litigation support services to owners and contractors both domestically and internationally. Assistance in writing this article (and memory) was provided by William J. Taylor, who was part of the two-attorney team that replaced the ousted law firm, and whose firm represented Greate Bay through the Supreme Court decision.

Endnotes

1. Opening line of *Moby-Dick* by Herman Melville (1851).
2. The term given to gambling high rollers.
3. Even Bill Maher knows where this opening line came from.
4. Opening line of *A Tale of Two Cities* by Charles Dickens (1859).
5. In critical path method scheduling, negative float generally refers to the number of days work is projected to finish beyond the current contract completion date.
6. Opening line of *Slaughterhouse Five* by Kurt Vonnegut (1969).
7. The Seaview is a historic 100+-year-old hotel that once hosted Warren G. Harding, Dwight D. Eisenhower, The Rolling Stones, Bob Dylan and Grace Kelly—not all at the same time.
8. The excess of net revenues over operating expenses as explained on page 2 of the report.
9. Opening line of *Catch 22* by Joseph Heller (1961).
10. Opening line of *A Frolic of His Own* by William Gaddis (1994).
11. Judge L. Anthony Gibson, J.S.C. (ret.) handled this matter as well as the prior issues in the Sands matter that came before the Court.
12. Greate Bay's cross-appeal was limited to Judge Gibson's refusal to fashion a net award such that Perini should have had to pay its subcontractor, which would then have reduced the amount due Greate Bay by Perini.
13. Proverb from *Adagia* by Desiderius Erasmus (1500).
14. *Perini Corporation v. Greate Bay Hotel & Casino, Inc.*, 129 N.J. 479 (1992).
15. *Id.* at *489.
16. *Id.* at *484.
17. *Id.* at *499.
18. *Id.* at *507.
19. *Id.* at *508.
20. *Id.* at *515. It should be noted that a no damages provision is typically incorporated into a contract to protect the owner, and not the contractor, by granting a time extension but no compensation. Why the court indicated that a no damages provision could have protected Perini from damages claimed by the Sands is unknown.
21. *Id. at *519* (Wilentz, C. J., concurring).
22. *Id. at *525* (Wilentz, C. J., concurring).
23. 135 N.J. 349 (1994).
24. *Supra* at *494.
25. *Id.* at *358; 129 N.J. at *548-49. The court then noted that either under the *Perini* plurality standard or the standard expressed in C.J. Wilentz' concurring opinion now adopted in *Tretina*, the result would have been the same.
26. Opening line in *The Go-Between* by L.P. Hartley (1953).
27. AIA Document A201, General Conditions of the Contract for Construction (1997).
28. The major change was a re-numbering of the applicable paragraph from §4.3.10 (in the 1997 edition) to §15.1.6 (in the 2007 edition) to §15.1.17 (in the 2017 edition) and the removal of the word "direct" when referring to liquidated damages.

29. For a discussion on the distinction between direct and consequential damages, *see* Benton T. Wheatley and Randy A. Canche, Navigating the Labyrinth of Consequential Damages in the Construction Industry: A History of and Legal Approaches to Living with Them, *The Construction Lawyer* (Vol. 33, Number 3, Summer 2013);and John H. Dannecker, Jason W. Hill, John E. Kofron and Dale B. Rycraft, Recovering and Avoiding Consequential Damages in the Current Economic Climate, *The Construction Lawyer* (Vol. 30, Number 4, Fall 2010).
30. S.H. Harness, K.W. Cobleigh, M.B. Bomba and H.G. Goldberg, 2007 Revisions to AIA Contract Documents, *The Construction Lawyer* (Spring 2008).
31. D*uncan v. Missouri Board for Architects*, 744 S.W.2d 525, 541 (M0. App. 1988).
32. Ty D. Laurie and Jessica Manning, AIA A201's "Mutual Waiver of Consequential Damages, *Construction Law Corner eNewsletter* (Fall 2015).