

CONSTRUCTION COUNSELING  
Pulling Together for a Winning Strategy

**CONSTRUCTION LAW PROGRAM FOR STATE AND LOCAL GOVERNMENT  
ATTORNEYS AND UNIVERSITY COUNSEL**

*Segment 2—Construction Risk Allocation*

Joel K. Gerber, Rubnitz, Gerber & Ziblut, P.C.  
Jack O'Neil, Western Construction Group, Inc.  
Aaron P. Silberman, Rogers Joseph O'Donnell, P.C.

- I. Issues of frequent concern arising between owner/contractor
  - A. Constructability of plans – *U.S. v. Spearin*, 248 U.S. 132 (1918)
    1. Owner warrants constructability of plans when it or its agent designer presents plans for construction
    2. Contractor not liable for design issues
    3. Owner's practical considerations in view of this obligation
  - B. Differing site conditions (DSC)
    1. What is a DSC? A risk-shifting device that places the burden of an unforeseen site condition on the owner. Intent is to discourage bidders from inflating bids and prevent disputes during the project.
    2. Examples are differing underground soil conditions, unanticipated ground water; rock formations and artificial subsurface conditions.
    3. In remedial construction, the unanticipated conditions are within the structure on which the work is being done, e.g. Inside the walls, under the topping slab or asphalt, the electrical conduit being in a place different than show on the plans, asbestos or other hazardous material being found where it was not expected.
    4. Types of DSC
      - a. Type I (the contract documents affirmatively show a specific subsurface condition, but construction reveals a different condition)

- b. Type II (the contract documents provide no information concerning the subsurface condition at issue and what the contractor encounters is materially different than what an experienced contractor familiar with conditions in the area would reasonably expect)
- c. *Foster Constr. v. U.S.*, 193 Ct. Cl. 587 (1970) (discussing types of DSC)
- d. Example DSC clauses
  - (1) FAR 52.236-2
  - (2) AIA A201-2007, ¶ 7.7.4
  - (3) FAR 52.236-3 (site investigation clause)
  - (4) FAR 52.236-4 (physical date clause)
- e. Qualification for remedial work. The question is what kind of inspection has the contractor been allowed to do? If the boilerplate says the contractor certifies it has inspected the site, was the opportunity to inspect meaningful?

C. Price/cost escalation

- 1. Price escalation clause (PEC) (material and labor)
  - a. What is a price escalation clause? What do they typically provide?
  - b. Is usually limited to specific labor or material. Recent common examples are PECs for steel and fuel/energy costs.
  - c. Without a PEC, contractors with fixed-price contracts are left with four potential legal alternatives to account for unforeseeable risks relating to prices increases:
    - (1) Force majeure clause
    - (2) Impossibility of performance
    - (3) Mutual mistake
    - (4) Commercial impracticability

2. Federal government – fixed-price contract with Economic Price Adjustment (EPA) – FAR 16-203-1 and 52-216-9, three types of EPAs (FAR 16.203-1)
    - a. Adjustments based on established prices
    - b. Adjustments based on actual costs of labor or material
    - c. Adjustments based on cost indexes of labor or material
  3. AIA does not provide a price escalation clause in its standard fixed-price contract
- D. Consequential damages
1. What are consequential damages?
  2. Types of owner consequential damages
  3. Types of contractor consequential damages
  4. Waiver of consequential damages
    - a. Why? *Perini Corp. v. Great Bay Hotel & Casino, Inc.*, 610 A.2d 364 (N.J. 1992)
    - b. Example clause – AIA A201-2007, ¶ 15.1.6
- E. Performance and payment bonds
1. What is a performance bond?
  2. What is a payment bond?
  3. Are they required on government projects?
    - a. Bond requirements on federal projects are governed by the Miller Act (40 U.S.C. § 3131 *et seq.*)
      - (1) Generally, federal projects in excess of \$100,000 require a performance bond (100% of the contract price unless CO determines a lesser amount is adequate for protection of the government). *See* FAR 28.102-1 and 28.102-2(a)-(b)(1).
      - (2) Generally, federal government projects in excess of \$100,000 require a payment bond; projects greater than

\$30,000 but less than \$100,000, there are other alternatives. *See* FAR 28.102-1.

- b. Every state has a “Little Miller Act”
  - (1) Examples
    - (a) State of Georgia public works construction contracts are governed by O.C.G.A. §§ 13-10-1 *et seq.* and 13-10-60 *et seq.*
    - (b) Tennessee public works construction contracts are governed by T.C.A. § 12-4-201 *et seq.* (requires bond equivalent to 25 percent of the contract price on all contracts in excess of \$100,000, or other alternative security).
- 4. Performance bond – surety’s options in the event of a default
  - a. Tendering penal sum of bond
  - b. Takeover and completion
  - c. Tendering a new contractor
  - d. Financing the surety’s principal
  - e. Do nothing
- 5. Payment bond claims
  - a. For Miller Act bonds (federal):
    - (1) First and second tier subcontractors and suppliers are covered by the Miller Act (second tier subs and suppliers only covered if services provided to first tier sub, not supplier). 40 U.S.C. § 3133(b)(2).
    - (2) Subcontractors and suppliers below the second tier are not covered by the Miller Act. *See J.W. Bateson Co. v. U.S. ex rel. Bd. of Trs. Of the Nat’l Automatic Sprinkler Indus. Pension Fund*, 434 U.S. 586 (1978).
    - (3) Notice of claim must be provided within 90 days of last work performed or materials supplied. 40 U.S.C. § 3133(b)(2).

- (4) Suit must be filed within 1 year of the last day on which services were performed or on which materials supplied (but not within the first 90 days of the 1 year period). 40 U.S.C. § 3133(b)(1).
    - b. Little Miller Act bonds may vary.
  - 6. Payment and performance bond clause in AIA A201-2007, ¶ 11.4.
- F. Defective work identified before completion
- 1. Federal projects (Inspection of Construction clause – FAR 52.246-12)
    - a. If the work does not comply with the contract requirements, contractor is entitled to receive timely notice of the rejection that sets forth the reason therefor. FAR 46.407(g).
    - b. Contractor is entitled to have a reasonable period of time to correct the deficiency. *See Lionsgate Corp.*, ENG BCA No. 5809, 92-2 BCA ¶ 24,983.
    - c. Not obligated to correct deficiency if economically wasteful. *Granite Constr. Co. v. U.S.*, 962 F.2d 998 (Fed. Cir. 1992), *cert. denied*, 506 U.S. 1048 (1993).
  - 2. Contract clause example regarding contractor’s obligation to correct non-conforming work - AIA A201-2007, ¶ 12.2.1
- G. Indemnity and Insurance
- 1. General issues
    - a. Know what your state law is on how far indemnity can be enforced. Many states have statutes that deal specifically with construction projects.
    - b. Make sure indemnity and insurance issues are dealt with thoroughly in contract
    - c. Make sure that they relate to one another. Some things in indemnity are not covered by insurance so just saying give us insurance for everything in the indemnity may not work, or it may add significantly to the cost of the insurance.
  - 2. Indemnity
    - a. Personal injury

- (1) To persons working on the project (impact of worker's compensation laws)
  - (2) To visitors to the site or persons adjacent to the site
  - (3) To people who are working, or living in the building that is occupied while the project is underway
- b. Property damage
- (1) Property on or adjacent to the site
  - (2) Typically excludes damage to "the work" itself because damage to "the work" is usually protected by a "builder's risk" property insurance policy (see below)
- c. Patent or violation of other IP rights
- d. Safety violations at project site/regulatory liability
- e. Control as a factor in indemnity in remedial construction on occupied and functioning structures: indemnity needs to be in line with the amount of control that the contractor has over the site. Contractors may ask owners to take responsibility for the actions of their own employees. Also, the area of work at any particular time may be limited to a small area, and moved as the work is done.
- f. Hazardous materials
- (1) Known hazardous materials on site
  - (2) Unknown hazardous materials found in the course of construction activities
  - (3) Remedial construction: testing of existing older materials, such as paint (for lead) and caulking or mortar (for asbestos) should be done in the planning stages, not left to be found during the construction or restoration phase.
  - (4) Hazardous materials brought to the site

3. Insurance

- a. Make sure that the insurance program required of the contractor (and subs, etc.) provides the protection owner requires and dovetails with the indemnity requirements.

Many, though not all, of the items against which owner should require indemnity can be insured.

Additional Insured. Adding the Owner as an additional insured to the Contractors policy is very common, and can make the indemnification process easier.

Endorsements are generally used. BUT check that state anti-indemnification law to see if it also limits the scope of additional insured coverage.

- b. Make sure that the insurance program required of the contractor (and subs, etc.) is obtainable and provides the protection owner is seeking. For example, many forms of insurance requirements language required the contractor's insurer to provide 30 days written notice to owner before cancelation or material modification of insurance coverage. This is something that insurers almost uniformly now refuse to do.
- c. On smaller remedial projects, you may be presented with a blanket policy that the contractor uses to cover all the work they do.
- d. Make sure all parties, including owner, have proper insurance in place (insurance certificates and/or copies of policies from contractor before work commences).
- e. Typical insurance requirements

- (1) Contractor:

- (a) CGL ("Commercial General Liability") and Umbrella/Excess Coverage (often a less costly way to achieve limits, but be aware of whether the excess policy "follows form" or not). If it is a blanket policy does it have a per project aggregate?
- (b) Worker's compensation and employer's liability insurance
- (c) Builder's Risk

- i) Property insurance for project in process
  - ii) For remedial work on existing buildings, which presumably are already covered by some property insurance, this may be served by an “installation floater” for the limited work being done.
  - iii) Should cover interests of all project participants in the work under construction; materials/work in transit
  - iv) Can be purchased by owner or contractor
- (d) Other contractor coverages to consider:
- i) Contractor’s professional liability (performance specifications)
    - a) A routine requirement for Professional Liability insurance in smaller restoration projects may not be obtainable for many contractors. Many do not carry such coverage, and cannot just “go buy it.”
  - ii) Contractor’s pollution liability.
  - iii) Property coverage for Contractor’s tools, etc.

(2) Architect:

- (a) Professional liability/errors & omissions (E&O) coverage
- (b) Usually also required to carry insurance coverages similar to (but at lesser limits) that carried by contractor, if architect is going to be doing any work at the project site

(3) Wrap-Up insurance programs

- (a) OCIPs, CCIPs



## H. Changes

1. Contracts generally provide that no verbal changes are allowed and that the contractor must continue to work in the event of a dispute
  - a. Despite these provisions, federal law and that of many states recognize and allow contractor recovery for constructive changes, at least absent a government showing of prejudice (i.e., that it didn't know contractor considered something to be a compensable change, and, if it had, it would have done something else).
2. Standard change order definitions
  - a. FAR 52.243-4 (change order)
  - b. FAR 52.243-4(b) (constructive change order)
  - c. AIA A201-2007, ¶ 7.2.1
3. Bilateral change orders and construction change directives (CCD)
  - a. FAR 43.103(a)
  - b. AIA A201-2007, ¶ 7.3.1
4. Equitable adjustments in price and time
  - a. FAR 52.243-4(d) (there is no statutory definition of equitable adjustment)
    - (1) *Bruce Constr. Co. v. U.S.*, 324, F.2d 516 (Ct. Cl. 1963) – Court of Claims stating that the basic goal of an equitable adjustment is to “keep [a] contractor whole when the government modifies the contract”
  - b. AIA A201-2007, ¶¶ 7.2.1 (change orders), 7.3.3 -7.3.10 (CCD)
5. Must continue to work in the event of a dispute regarding a change relating to original scope work
  - a. FAR 52.249-10 (Default clause) and 52.233-1(i) (disputes clause)
  - b. AIA A201-2007, ¶ 15.1.3 (*but see* ¶ 9.7 regarding non-payment and ¶ regarding contractor's right to terminate)

- c. *B.C. Richter Contracting Co. v. Continental Cas.*, 230 Cal. App. 2d 491 (3d Dist. 1964) – rejecting a subcontractors attempt to rescind the contract because the contract contained a provision that required the subcontractor to continue work in the event of a dispute
- d. *Stoekert v. U.S.*, 391 F.2d 639 (Ct. Cl. 1968) – holding that the termination of contractor’s contract by the government was proper because the contractor refused to follow the contracting officer’s directive to perform certain work within the original scope of the contract

## I. Scheduling & Delays

### 1. Standard clauses

- a. FAR 52.211-13 and 52.249-10 (2010)
- b. AIA A201-2007, ¶ 4.3.7.2
- c. ConsensusDOCS 200 § 8.1.1

### 2. Need to decide and define scheduling responsibilities

- a. Who is responsible for creating and maintaining the schedule? When must it be created and updated? What must it contain?
- b. Scheduling for remedial projects in functioning structures needs to involve the people who are using the building, not just the engineers.
  - (1) What events are planned that might affect the work?
  - (2) How much space can be shut down at any one time? When will space(s) be available?
  - (3) Is exterior work going to impact building use?
  - (4) What limitations will be placed on how and when the contractor does its work (times of day, noise, dust, etc.)?

### 3. Who caused the delay?

- a. Contractor
- b. Government

- c. Others (third parties, force majeure, etc.)
  - d. Concurrent delay
4. Contractor-caused delays to completion
- a. Government duty to notify
  - b. Contractor duty to accelerate
  - c. Excusable delays
  - d. Government remedies
  - e. Liquidated damages
    - (1) FAR 11.501, 11.503 and 52.211-12
    - (2) *Winship Constr., Inc. v. City of Portland*, 2008 Tex. App. LEXIS 6354, 2008 WL 3867849 (Tex. App. Corpus Christi 2008)
  - f. Actual damages
    - (1) Direct damages
    - (2) Consequential damages, see AIA A201-2007, ¶ 4.3.10, ConsensusDOCS 200 § 6.6
5. Government-caused delays to completion
- a. Contractor duty to notify
    - (1) FAR 52.249-10(b)(2)
    - (2) AIA A201-2007, ¶ 15.1.2
    - (3) ConsensusDOCS 200 § 6.3.3
  - b. Government duty to grant time extension
    - (1) FAR 11.503 and 52.211-13
  - c. Contractor ability to accelerate (and recover)
  - d. Contractor remedies
    - (1) Time extension

- (2) Damages
- (3) “No damages for delay” clauses
  - (a) Allowed?
    - i) General rule re enforceability
      - a) Federal: *Harper/Neilsen-Dillingham Builders, Inc. v. United States*, 81 Fed. Cl. 667 (2008)
      - b) Texas: *Green Int’l v. Solis*, 951 S.W.2d 384, 386 (Tex. 1997); *City of Houston v. R.F. Ball Constr. Co., Inc.*, 570 S.W.2d 75 (Tex.Civ.App.-Houston [14th Dist.] 1978, writ ref’d)
      - c) North Dakota: *Markwed Excavating v. City of Mandan*, 791 N.W. 2d 22 (North Dakota, 2010)
    - ii) Not allowed
      - a) California: Public Contract Code § 7102; *Howard Contracting, Inc. v. G.A. MacDonald Construction Co., Inc.*, 71 Cal. App. 4th 38 (1999)
      - b) Virginia: 2010 Va. Code § 2.2-4335
- (4) Liquidated damages – not commonly used for contractor recovery for Government delays
- (5) Actual damages
  - (a) Direct damages
    - i) FAR 52.243-1 – Changes – Fixed-Price (Aug 1987), subparagraph (b)
  - (b) Overhead expenses

- i) *Eichleay Corporation*, ASBCA No. 5183, 60-2 BCA 2688, *aff'd on recon.*, 61-1 BCA 2894
- ii) *Wickam Contracting Co. v. Fischer*, 12 F.3d 1574 (Fed. Cir. 1994)
- iii) *Fairfax County Redevelopment & Housing Auth. v. Worcester Bros. Co., Inc.*, No. 980731, 1999 Va. LEXIS 48, 1999 WL 107422 (Va. Feb. 26, 1999)
- iv) *Chilton Insurance Co. v. Pate & Pate Enterprises*, 930 S.W.2d 877, 21 CC 75 (Tex. App. 1996)
- v) *Conti Corp. v. Ohio Dept. of Administrative Services*, 90 Ohio App. 3d 462, 629 N.E.2d 1073 (Ohio Ct. App. 1993)

(c) Consequential damages

J. Terminations

1. Termination for default

a. Standard clauses

- (1) FAR 52.249-10 (2010)
- (2) AIA Document A201-2007, ¶ 14.2
- (3) ConsensusDOCS 200 § 11.3 (2007)

b. Cure notice

- (1) *Fru-Con Constr. Corp. v. Sacramento Mun. Util. Dist.*, 2007 WL 1791699 (E.D. Cal. June 15, 2007)

c. Government damages/contractor recovery

- (1) *San Francisco Bay Area Rapid Transit v. GE Transportation Systems Global Signaling LLC*, 2010 WL 2179769 (N.D. Cal. May 27, 2010)

d. If the contractor contests the termination

- (1) *United States fbo Arrow Equipment & Services v. Travelers Casualty & Surety Co.*, 2010 WL 1005161(E.D. Va., March 16, 2010)
  - (2) *Elcon Const., Inc v. Eastern Washington University*, 151 Wash. App. 1062 (2009)
  - (3) *R&J Construction Corporation v. E.W. Howell Co., Inc.*, 2008 NY Slip Op 31660U; 2008 N.Y. Misc. LEXIS 9430; 239 N.Y.L.J. 123 (Sup. Ct. June 12, 2008); *see also Marine Constr. & Dredging, Inc.*, ASBCA No. 38412, *et al.*, 95-1 BCA ¶ 27,286
  - (4) *United States ex rel. Quality Trust, Inc. v. Cajun Contrs., Inc.*, 486 F. Supp 2d 1255 (D. Kan. 2007)
- e. Strategic considerations
2. Termination for convenience
- a. Standard clauses
    - (1) FAR 52.249-2, Alt. I
    - (2) AIA Document A201-2007, ¶ 14.4.2
    - (3) ConsensusDOCS 200 § 11.4 (2007)
  - b. Limits on ability to terminate for convenience
    - (1) *IMS Engineers-Architects, P.C.*, 87 Fed. Cl. 541 (2009)
  - c. Contractor recovery
    - (1) Typically limited to contract price for completed and accepted work and costs incurred for work in progress plus a reasonable profit (or loss) on that work
      - (a) *Symbion Ozdil Joint Venture*, ASBCA 56713, 10-1 BCA ¶34,367
      - (b) *Washington Health Care Ass'n v. Arnold-Williams*, 601 F. Supp. 2d 1224 (W.D. Wash. 2009)
      - (c) *Myers v. Dept of Soc. & Health Servs.*, 218 P.3d 241 (Wash. App. 2009)

(d) *Encon Utah, LLC v. Fluor Ames Kraemer, LLC*, 210 P. 3d 263 (Utah. Sup. Ct. 2009)

(2) On any construction site, there is more to shutting down after a termination for convenience than getting in the truck and going home. Allow for demobilization costs, and costs incurred to make the site safe.

## K. Disputes

### 1. Contractor claims

#### a. Administrative requirements

##### (1) General

(a) Federal Contract Disputes Act, 41 U.S.C. §§ 601-613, and Disputes Clause, FAR 52.233-1

(b) California Government Code § 910

##### (2) Notice of claim

(a) FAR 52.243-4(b), (d)-(f) (notice)

i) If formal change in writing, then contractor must submit a written notice to the CO within 30 days of receipt of the change order if it intends to assert a claim for costs incurred as a result of the change. *See* FAR 52.243-4(e).

ii) If the directive is a constructive change (written or oral directives from the CO that are not formal change orders), then the notice requirements under FAR 52.243-4(b) and (e) apply.

iii) Notice requirements may be avoided:

a) If the CO in fact knew of the circumstances that form the basis for the alleged change.

b) If the CO considered the associated equitable adjustment claim on its merits without objecting to the

contractor's non-compliance with the notice provisions. *See Fox Valley Eng'g, Inc. v. U.S.*, 151 Ct. Cl. 228 (1960).

c) If the failure to notify does not prejudice the government. *See Eggers & Higgins*, VACAB No. 537, 66-1 BCA ¶ 5525, at 25,876 – stating that prejudice “occurs when one of the parties loses a valuable right or suffers a detrimental change in position as a result of the unjustified act, delay or omission of another.”

iv) Contract requirements (sample provisions)

a) AIA A201-2007, ¶ 7.3.5 (notice to architect)

b) AIA A201-2007, ¶ 7.3.9 (claim if contractor not satisfied with architect's determination of change cost or time)

b. Court remedies

c. Subcontractor pass-through claims

(1) Some jurisdictions allow, *e.g.*, N.C.: N.C. Gen. Stat. § 143-134.2

(2) Others do not, *e.g.*, Tenn.: *Kay and Kay Contracting, LLC v. Tennessee Dep't of Transportation*, 2010 Tenn. App. LEXIS 405 (June 25, 2010)

(3) Severin doctrine: *Severin v. U.S.*, 99 Ct. Cl. 435 (1943); *Dep't of the Navy v. Floor-Pro, Inc.*, 570 F.3d 1367 (Fed. Cir. 2009)

2. Government claims

a. Backcharges and withholding retention

b. Acceptance, effect of



(1) FAR 52.246-12(i)

3. Venue

- a. While not often an issue in Government construction projects, distant venues are often found in generic service contracts and really make no sense in the construction or renovation context.
- b. In most cases the most efficient venue is the location of the project. Possible exception is work in a very remote area.