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Inside This Issue

629 Florida: Statutory Lien Rights and Arbitration

630 Releases: Anticipate the Consequences

631 North Carolina: Long-Term Warranty Rights

632 Nevada: Economic Loss Rule Applied

633 No License - No Recovery

634 The Value of an Additional Insured Status

635 Differing Site Condition Elements Applied

Florida: Statutory Lien Rights and Arbitration

629 Contractors rely on their statuory lien rights to protect themselves from the risk of non-payment. Additionally, many contractors negotiate the right to arbitrate disputes arising out of the performance of their contracts. Even if the underlying claims for entitlement are identical, the statutory lien right and contractual right to arbitration reflect different remedies. A contractor should exercise care when enforcing one of these rights in order to avoid losing its ability to enforce the other.

Compelling Arbitration Does NOT Preserve Your Lien Rights

Lien laws typically require that a contractor enforce its claim of lien within a set time period. A contractor will forfeit its lien rights forever unless it brings an action to enforce its lien in a court of law within the applicable time limitations. In Florida, demanding arbitration alone on a lien claim within that statutory time period will not preserve

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a contractor's lien rights. The recent case of *Brookshire v. GP Construction of Palm Beach, Inc.* demonstrates how a contractor can lose its lien rights by demanding arbitration instead of bringing an action to enforce its lien in court and thereafter seeking to compel arbitration. 993 So. 2d 179 (Fla. Dist. Ct. App. 2008).

In *Brookshire*, GP Construction ("GP") recorded a claim of lien against Brookshire's home for non-payment on a construction contract. Relying upon Section 713.21(4) of the Florida Statutes, Brookshire filed a complaint to show cause within 20 days why GP's lien should not be enforced by action or vacated and canceled of record. Instead of filing a counterclaim to enforce its lien, GP filed a motion within the twenty-day period to compel arbitration in accordance with the construction contract with Brookshire.

At the hearing on the motion to compel arbitration, Brookshire argued that the lien should be discharged because GP failed to comply with the order to show cause. GP argued that it was not required to comply with the order to show cause because the claims were subject to arbitration in accordance with the construction contract and that filing the motion to compel arbitration satisfied the requirements of the statute. The trial court agreed with GP and granted its motion to compel arbitration.

On appeal, the Third District Court of Appeal reversed and directed the trial court to discharge the lien. The Third District held that the twenty day period provided in section 713.21(4) does not allow for exceptions, such as extensions of time, nor does it allow the court to excuse a failure to comply for any reason — even where the contractor demands arbitration. Since GP did not file an action to enforce its claim of lien within the applicable time limitation, it forfeited its lien rights.

Enforcing Lien Rights Could Waive the Right to Arbitration

Where a contractor files suit to foreclose on its claim of lien without simultaneously requesting a stay and an order compelling arbitration, the contractor's active participation in the litigation may cause it to lose its right to arbitrate the dispute. In *Hough v. JKP Development, Inc.*, 654 So. 2d 1241 (Fla. Dist. Ct. App. 1995), JKP entered into a construction contract with Hough which contained an arbitration provision. JKP filed suit in circuit court against Hough to foreclose on its construction lien. The next day, JKP sent a letter to the American Arbitration Association requesting arbitration of its claim. JKP only moved to compel arbitration in the circuit court after: (a) Hough filed an answer, affirmative defenses and a counterclaim; and (b) JKP filed a reply to the affirmative defenses, a motion to dismiss the counterclaim, and a motion to strike Hough's request for attorneys' fees.

The Third District held that a "party's contractual right to arbitration may be waived by actively participating in a lawsuit or taking action inconsistent with that right." Initiating legal action or counterclaiming without seeking or raising the issue of arbitration waives the right to arbitrate. Since JKP instituted its lien action without simultaneously applying to the court for a stay and an order compelling arbitration, and because JKP actively litigated the case, the court found that JKP waived its contractual right to arbitration.

Practical Tip

These cases implicate not only lien law in Florida, but arbitration law as well. As seen by the *Hough* decision, courts have held that where a party actively participates in litigation, it waives its right to insist on arbitration. As a result, parties such as the contractor in *Brookshire* are reluctant to engage in any action that may waive their arbitration rights. The express wording of the Florida statute did not require that a counterclaim be filed, only that the lien claimant show cause as to why the lien should be enforced. Given the wording of the statute, an otherwise prudent contractor may have assumed that filing a motion to compel arbitration would be sufficient to show cause as to why the lien should not be discharged. The *Brookshire* case instructs otherwise.

The proper way to preserve your statutory lien rights and contractual arbitration rights in Florida is to: (1) timely file an action to foreclose on the claim of lien in a court of law; (2) simultaneously file a motion to stay the litigation in that court; and (3) simultaneously demand that the court compel arbitration. Taking these steps ensures that the claim of lien is timely filed in a court of law and that you

2010 Construction Industry Update Conference

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Further information on the program will be sent to you around December 15, 2009.

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have not taken any steps inconsistent with your contractual right to arbitrate the dispute.

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Releases: Anticipate the Consequences

630

Overview

Changes to construction projects are relatively common especially on public projects. Revised requirements and the availability of additional funds often prompt owners to modify a project while it is being constructed. Depending upon the scope, number, and timing of the modifications, the overall impact on a project can vary substantially. A single change, even a relatively significant one, may be evaluated, priced, and implemented without a major disruption to the overall project. In contrast, scores of changes can be very disruptive to the scheduling and the effective management of the work. While each proposed modification is typically priced on an individual basis, a contractor must attempt to anticipate whether that change will be a relatively isolated event on the project or one of scores or more changes to the project.

In negotiating the price for each modification, any owner naturally seeks closure on the cost. That cost often includes the estimated direct cost (labor, materials, and equipment) for the revised work and for the added time necessary to perform that work. Typically, that pricing is premised upon certain anticipated conditions of performance, which can change dramatically, especially if the project is later subjected to more and more changes and modifications. This uncertainty can present a substantial risk for a contractor.

In that context, owners seek to obtain closure by having the contractor execute a release whenever there is an agreement on the price for a contract modification. For example, on federal government contracts, Section 43.204(c) of the Federal Acquisition Regulation instructs contracting officers that they *should seek* to obtain a release whenever there is agreement on the price for a modification. When presented with a request to execute a release, a contractor needs to carefully consider the wording of the release, and seek to anticipate the consequences of providing it. As illustrated by the 2009 decision by the United States Court of Appeals for the Federal Circuit in *Bell BCI Co. v. United States,* 570 F.3d 1337 (Fed. Cir. 2009) a change order release can have significant adverse consequences for a contractor.

Bell's Contract

The *Bell* decision arose in the context of a contract to construct a new five-story laboratory building for the National Institutes of Health (NIH). With a contract award date of March 26, 1998, the original project had a completion date of June 29, 2000. Approximately 8 months into the 29-month schedule, the project was on schedule. At that time, NIH discovered it had a budget surplus and decided to add another floor (a "new" fourth floor) to the building. Subsequently, the parties entered into a modification (Modification 93) on October 2, 2000 to compensate the contractor for the new floor and to provide a revised completion date. Modification 93 (Mod 93) contained two paragraphs (paragraphs 4 and 8) that ultimately controlled the decision at the Federal Circuit. Paragraph 4 read that Mod 93 would:

> [I]ncrease the contract amount by $2,296,963 . . . as full and equitable adjustment for the remaining direct and indirect costs of the Floor 4 fit-out . . . and full and equitable adjustment for all delays resulting from any and all Government changes transmitted to the contractor on or before August 31, 2000.

Paragraph 8 of that modification contained a release and read:

> The modification agreed to herein is a fair and equitable adjustment for the Contractor's direct and indirect costs. This modification provides full compensation for the changed work, including contract cost and contract time. The Contactor hereby releases the Government from **any and all further liability** under this contract for further equitable adjustment attributable to the modification. (Emphasis added)

Within one week of the execution of Mod 93 representatives of the contractor and NIH's construction manager jointly advised NIH in writing that NIH should refrain from making additional modifications to the project if the work was to meet the revised completion schedule. NIH did not heed that advice. Rather, it issued an additional 279 Extra Work Orders.

Of the 279 Extra Work Orders, 216 were incorporated into 113 contract modifications. NIH refused to pay for the other 58 Extra Work Orders, although Bell performed the work.

About 47 of the 113 further modifications contained the release language found in paragraph 8 of Mod 93. After realizing that the government was not controlling the number of changes to the project, Bell expressly reserved its rights under the balance of the modifications.

Bell's Claim for Delay and Impact

Bell ultimately completed the work on February 8, 2002 and submitted a claim for an equitable adjustment. In a

contracting officer's final decision, NIH, in addition to refusing to pay for the 58 Extra Work Orders, sought to recover liquidated damages, the value of credits, and the estimated costs for correction of alleged major deficiencies. Bell filed suit in the U.S. Court of Federal Claims (COFC). Following the trial, the COFC awarded Bell $6,200,672 including $2,058,456 for labor inefficiency due to the cumulative impact of the changes and $1,602,053 for delay.

NIH appealed the adverse decision to the Federal Circuit. While deferring to the COFC's decisions on the methodology for computing the contractor's damages, the Federal Circuit vacated the COFC's judgment based on the appellate court's reading of the "any and all liability" release language set forth in Mod 93 and in some 47 other modifications. In its interpretation of this release language, the Federal Circuit's decision acknowledged that Mod 93 was executed in the context of a request that NIH limit further changes, and further recognized that paragraph 4 of Mod 93 stated the express purpose of the monetary compensation in that modification. However, neither of those circumstances operated to limit the scope of the "any and all liability" phrase in Modification 93. That release language applied to a claim for the cumulative impact of all of NIH's EWOs and other directives issued to contractor.

According to the Federal Circuit, upon remand, the COFC could award inefficiency costs and delay costs for only those modifications, which did not contain the "any and all liability" release language. To the Federal Circuit that release language was unambiguous and it was not proper to interpret it in light of the circumstances surrounding the execution of Mod 93 or the specific compensation allowed in it. Even though Mod 93, as well as the other modifications containing that release language, do not appear to have expressly addressed cumulative impact, the "any and all liability" release language encompassed that type of claim and recovery. The practical effect of this ruling upon remand to the COFC could be substantial.

Points to Remember

Given that the Federal Circuit's interpretation of the "any and all liability" release language is binding on the boards of contract appeals, as well as the COFC, there are several key points to remember.

- Contractors need to anticipate that this language will become the government's standard release.
- Contractors need to consider as many of the potential future scenarios as possible when agreeing to this form of a release. Remember, Bell's anticipation of minimal future changes after the execution of Mod 93 did not occur.
- The FAR provision (Section 43.204(c)) setting forth the release does not require the contractor to sign a release. The suggested form release in the FAR can be modified. Consider the consequences if Bell had expressly qualified the release in Mod 93 on the condition that only a limited number of future changes would be issued or expressly reserved its right for a cumulative impact claim while agreeing on the value (price) of the specific scope of work in Modification 93.
- In an era of past performance evaluations, contractors may be urged to execute releases to demonstrate a cooperative spirit with the agency. While adamantly refusing to sign any release and invoking the Disputes process may not be desirable, contractors need to consider tailoring or limiting the release to the anticipated conditions and to seek professional advice, as needed, if the government sets forth a "take it or leave it" position on the wording of the release.

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North Carolina: Long Term Warranty Rights

631

Introduction

Many states have enacted statutes of repose related to claims arising out of construction projects. While the details vary from state to state, the basic concept of such statutes is to provide an absolute time limit on the assertion of claims related to that project. Typically, the period of time is measured from the date of beneficial occupancy, project acceptance, etc. That can present an obvious benefit for the builder. However, project specifications often set forth very long term warranties (twenty years, lifetime) on certain components or systems such as the roofing system. A basic question is the reconciliation of a very long-term warranty and a state statute of repose. The decision by the North Carolina Court of Appeals in *Roemer v. Preferred Roofing, Inc.*, 660 S.E. 2d 920 (N.C. App. 2008) illustrates a balancing of a long-term warranty and a relatively short statute of repose.

This case demonstrates that North Carolina's statute of repose does not necessarily set an outer limit for a claim to be made against a contractor, especially when a lifetime warranty is involved. This decision should be a cautionary tale to the unsuspecting North Carolina contractor who thinks it can close out its books based upon a statute of repose. At the same time, the *Preferred Roofing* decision illustrates that a party must be careful in asserting a claim on a long-term warranty to avoid having the claim barred by a statute of repose.

Preferred Roofing's Warranty

In *Preferred Roofing,* a homeowner ("Roemer") entered into a contract with a roofing company ("Contractor") in

1999 to remove an old roof and replace it with a new one. The contract contained an express lifetime warranty of the dependability and reliability of the installation of the roof. Several years later, Roemer noticed several alleged defects with the Contractor's work. In 2007, Roemer filed a complaint alleging several different claims against the Contractor, including a claim that the Contractor failed to comply with the express lifetime roof warranty.

In its complaint, Roemer only sought monetary damages and did not include a claim for specific performance of the lifetime warranty. Specific performance is an equitable remedy that requires one party to fulfill the terms of a contract when monetary damages are inadequate or inappropriate. Here, specific performance would have entitled Roemer to a new roof free from defects and damage. However, Roemer did not include specific performance as a potential claim for relief and therefore any judgment would have been limited to monetary damages.

In a pretrial motion, the trial court dismissed Roemer's complaint as a matter of law because all claims, including the claim for breach of warranty, were barred by North Carolina's statute of repose. North Carolina's statute of repose states, "[n]o action to recover damages based upon or arising out of the defective or unsafe condition of an improvement to real property shall be brought more than **six years** from the later of the specific act or omission of the defendant giving rise to the cause of action or substantial completion of the improvement." (emphasis added). N.C. Gen. Stat. § 1-50(a)(5)a. Therefore, North Carolina's statute of repose set forth a six-year limit to make a claim based upon an improvement to property. "Unlike an ordinary statute of limitations which begins running upon accrual of the claim, the period contained in the statute of repose begins when a specific event occurs, regardless of whether any injury has resulted." *Black v. Littlejohn*, 312 N.C. 626, 633, 325 S.E.2d 469, 474-475 (1985) (internal citations omitted).

Operation of Statute of Repose and Long-Term Warranty

A statute of repose operates to provide finality or closure on claims related to construction of a project A claim shall not be brought six years from the later of the date of substantial completion or from the specific act or omission of the defendant giving rise to the cause of action. The purpose of the statute of repose is to limit the number of years a contractor can be held liable for its work. If enforced, the statute of repose would operate to save Preferred Roofing from liability for damages.

Roemer appealed the trial court's dismissal and based its claim, in part, on the fact that the statute of repose could not invalidate a lifetime warranty on the contractor's work. However, the North Carolina Court of Appeals disagreed with Roemer's argument and held that the six-year statute of repose began to run after Preferred Roofing completed its installation of the new roof. The Court of Appeals noted that Roemer alleged in its complaint that the roofing project was completed in 2000, and that it had accepted the completed project. Therefore, Roemer admitted in the complaint that it was filing the action more than six years after substantial completion. This meant any monetary award would be barred by the North Carolina statute of repose.

However, the Appellate Court found a way to uphold both the statute of repose and the owner's potential rights based upon the contractor's lifetime warranty. It held that the statute of repose set an outer time limit as to monetary damages, but did not affect or limit an action for specific performance under a lifetime warranty. In that situation, the correct action would have been a suit seeking enforcement of the warranty - a replacement roof. Since that relief was not requested, the trial court's dismissal of the lawsuit was affirmed.

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Comment

This decision reflects one court's approach to balancing a long-term warranty obligation and enforcing a statute of repose. Contractors and owners should consider the following practical points:

- While many firms tailor their records retention policy to the applicable statute of repose, that retention policy may need modification to account for project records related to elements of the work with long-term warranties.
- If there is a claim arising out of a long-term warranty, that claim needs to be carefully asserted to avoid being barred by a statute of repose.

Economic Loss Rule Applied

632 A judicially created doctrine, the Economic Loss Rule, shields a party from tort liability when damages are purely economic and without accompanying personal injury or property damage. The disparate judicial interpretation and application of the Economic Loss Rule in jurisdictions across the nation have created much uncertainty regarding the risk of parties conducting business. This tends to undermine the purpose of the rule in protecting the parties' contractual expectations in negotiated risk. The extension of this rule to construction cases operates to avoid a party's unfettered liability for tort damages. Recently, in a narrowly focused opinion, the Nevada Supreme Court answered a certified question from the U.S. District Court of Nevada and held that the Economic Loss Rule shields design professionals, who provide services in the commercial property development or improvement process, from negligence-based claims for

purely financial losses. *Terracon Consultants v. Mandalay Resort Group*, *et al*, 206 P.3d 81 (Nev. 2009).

Factual Background

In *Terracon,* Mandalay Bay sought $60 million dollars in damages from Terracon, its geotechnical engineer subcontractor, who prepared a geotechnical exploration report for the construction of the $1 billion dollar Mandalay Resort and Casino in Las Vegas, Nevada. Terracon was ultimately paid $29,180 to provide geotechnical engineering advice about the subsurface soil conditions and to recommend a foundation design for the hotel-casino.

During the construction of the tower of the project in 1998, Mandalay alleged that the soil settled approximately eighteen inches or over five times the amount than predicted in Terracon's engineering analysis, causing substantial damages to the structures and hotel rooms. Due to the imminent threat to the structural integrity of the project, the local jurisdictional authority required Mandalay to repair and reinforce the foundation before proceeding with the remaining work. In 2004, Mandalay sued Terracon in state court for damages; Terracon removed the case to federal court.

In seeking clarification of the scope of Nevada's Economic Loss Rule, the U.S. District Court submitted two certified questions to the Nevada Supreme Court:

(1) Does the economic loss doctrine apply to contractors who solely provide services in construction defect cases?

(2) Does the economic loss doctrine apply in construction defect cases to design professionals, such as engineers and architects, who solely provide services, regardless of whether the services are rendered before or during construction?

The Nevada Supreme Court accepted the referral of the certified two-part question but narrowly reframed it, acknowledging that the term "contractors" was not defined by the District Court and limiting its analysis to the legal issues presented by the pleadings of the parties:

> Does the economic loss doctrine apply to preclude negligence-based claims against design professionals, such as engineers and architects, who provide services in the commercial property development or improvement process, when the plaintiffs seek to recover purely economic losses?"

The Nevada Supreme Court responded that the economic loss rule applied to the owner's claims.

Purpose of the Rule

Acknowledging that the U.S. District Court had already decided that Mandalay's damages were purely economic, the Nevada Supreme Court discussed the Economic Loss Rule. The Economic Loss Rule, absent any exceptions, "bars unintentional tort actions when the plaintiff seeks to recover 'purely economic losses.'" The court reasoned that the rule's purpose, is "to shield defendants from unlimited liability for all of the economic consequences of a negligent act, particularly in a commercial or professional setting, and thus to keep the risk of liability reasonably calculable." The court further reasoned that "'[t]he economic loss doctrine marks the fundamental boundary between contract law, which is designed to enforce the expectancy interests of the parties, and tort law, which imposes a duty of reasonable care and thereby [generally] encourages citizens to avoid causing physical harm to others.'"

Exceptions to the Rule

In analyzing whether an exception to the rule should be applied, the court will assess the policies underlying the rule and any countervailing policy considerations that weigh against imposing liability. The policy considerations underlying the economic loss rule include: (1) balancing the desire to make injured plaintiffs whole with the need for useful commercial economic activity; (2) financial considerations in dispelling the fear of victim compensation costs that are unnecessarily high; and (3) balancing the disproportion between liability and fault.

To that end, the Nevada Supreme Court opined that "cutting off tort liability at the point where only economic loss is at stake without accompanying physical injury or property damage 'provides . . . incentives and disincentives to engage in economic activity or to make it safer.'" Imposing unfettered tort liability for pure financial harm could result in insurance premiums that are too expensive to afford by the average party.

Several examples of exceptions in other jurisdictions permitting recovery for purely economic losses against design professionals were cited by the Nevada Supreme Court. Those courts have reasoned that (1) the rule does not apply to negligently rendered services because the rule applies to the sale of goods; (2) recovery is permissible when design professionals owe duties beyond the terms of the contract such as a professional duty or a special relationship; or (3) claims that are foreseeable.

Specifically to Nevada, the court noted several exceptions in certain categories of cases, such as negligent misrepresentation and professional negligence actions against attorneys, accountants, real estate professionals, and insurance brokers. Nevada statutory law also creates a right to sue for losses related to construction defects in residential properties.

Mandalay's Negligence Claim

The court concluded that the claim against Terracon did not fall within the scope of any exception and also declined to create a new exception. The *Terracon* court held that the Economic Loss Rule barred Mandalay's negligence claim against design professionals, such as architects and engineers who have provided services in commercial property construction or development. The Nevada Supreme Court concluded that the rule applies to commercial

activity for which contract law is better suited to resolve professional negligence claims and stated that the "legal line between contract and tort liability promotes useful commercial economic activity, while still allowing tort recovery when personal injury or property damage are present."

In support of its conclusion, the court recognized that the work provided by construction contractors or the services rendered by design professionals in the commercial building process are "both integral to the building process and impact the quality of building projects. Therefore, when the quality is deemed defective, resulting in economic loss, remedies are properly addressed through contract law." The Nevada Supreme Court did not find a distinction between design professionals rendering advice in the commercial development process and contractors and subcontractors involved in physically constructing improvements to real property. In the commercial property development and improvement process, only the contract prescribes the duties of a design professional. Indeed, the court stated that the parties had addressed economic losses in their contract. The specific nature of those contract provisions was not set forth in the opinion.

Comment

It is important to recognize that *Terracon* is an isolated decision. The Nevada Supreme Court noted that Mandalay had alleged that Terracon's negligence caused damage to the resort structure itself but that this aspect of Mandalay's claim was not considered because the federal district court had only asked whether tort recovery is permitted assuming the losses are purely economic. Thus, had personal injury or property damage been a part of the court's consideration, the rule would not have barred Mandalay's negligence claim against Terracon.

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No License - No Recovery

633 Many states, including Georgia, require those desiring to engage in construction-related activities to obtain a license or to associate with a licensed individual. Failing to comply with the state's licensing requirements can negatively affect a contractor's ability to enforce a contract or recover costs for any work performed. For example, in *JR Construction/Electric, LLC v. Ordner Construction Co.*, 669 S.E.2d 224 (Ga. App. 2008), the court held that the subcontract for electrical work between a contractor and a subcontractor was void as against public policy and unenforceable because the subcontractor was unable to show that it had conformed to the state's licensing requirements.

Georgia's Licensing Requirement

JR Construction/Electric, LLC ("JR"), a Wisconsin company, entered into an agreement with Ordner Construction Company ("Ordner") to install electrical systems. At the time of contracting, JR was not directly associated with a Georgia licensed electrician. Georgia statute O.C.G.A. § 43-14-8(a), states that "[n]o person shall engage in the electrical contracting business as an electrical contractor unless such person has a valid license from the Division of Electrical Contractors." Under section 43-14-8(f), the statute further provides that "[n]o partnership, limited liability company, or corporation shall have the right to engage in the business of electrical contracting unless there is **regularly connected** with such partnership, limited liability company, or corporation a person or persons actually engaged in the performance of such business on a full-time basis who have valid licenses issued to them" from the Division of Electrical Contractors.

In an effort to comply with the statute's licensing requirement, JR entered into a joint venture agreement with Moore Electric Company ("Moore"). Moore had one licensed electrician, whose role, as project manager, was to supervise and monitor each Moore project and insure that all work was in accordance with the plans, codes and specifications. After performing the work outlined in the Ordner subcontract, JR filed a claim against Ordner for breach of contract, unjust enrichment and expenses of litigation. Ordner moved for summary judgment asserting that JR was not licensed to perform work in Georgia. The trial court granted Ordner's motion for summary judgment. On appeal, JR asserted that it complied with the state's licensing statute through the creation of a joint venture with Moore. JR claimed that Moore's project manager supervised and monitored the work performed under the Ordner subcontract. However, no evidence was produced to show that Moore's project manager did more than present his electrical license to obtain permits for the work.

The court determined that Moore's project manager's involvement with the project was too remote to comply with the Georgia licensing statute. JR failed to produce any additional evidence that it complied with the "being **regularly connected** to a Georgia-licensed electrician" requirement of the statute. Because JR failed to show compliance with the statute, the court held that it was unable to enforce the subcontract agreement against Ordner.

Additionally, JR was prohibited from recovering the value of its services under the theories of unjust enrichment or quantum meruit. In the decision, the court stated that where "an express agreement is unenforceable because it violates public policy, the agreement cannot be made legal and binding as an implied contract, by merely praying for a recovery on quantum meruit of a portion of the amount expressly agreed upon." In other words, JR's failure to produce evidence that it complied with Georgia's licensing requirements voided the Ordner subcontract as against

public policy and any implied promises to pay for services were also void when made.

New York's Licensing Requirement

Similarly, licensing requirements in other states have prevented unlicensed contractors from enforcing mechanic's liens or recovering payments under contract or in quantum meruit. In *Vanguard Construction & Development Co., Inc.*, 879 N.Y.2d 300 (N.Y. 2009), the New York court held that although the homeowner was aware that the contractor was unlicensed and planned to take advantage of such fact, the contractor could not recover any further payments under the contract or in quantum meruit. New York's public policy prohibits an unlicensed contractor from recovering for breach of contract or in quantum meruit and renders the underlying **contract unenforceable by the contractor**. However, the statute does not prevent the homeowner from recovering damages for breach of contract from the unlicensed contractor. Thus, while a contractor was unable to pursue damages arising from an express or implied contract, nor could it foreclose on a mechanic's lien, the homeowner was entitled to enforce the contract and recover damages for breach of contract.

New Mexico's Licensing Requirement

Likewise, in *Romero v. Parker*, 207 P.3d 350 (N.M. Ct. App. 2009), the New Mexico court held that public policy prevented an unlicensed subcontractor from bringing suit to recover payment for work performed on five different projects. Further, an unlicensed contractor risks having to repay payments already made to it. The court stated that "an **unlicensed contractor may not retain payments** made pursuant to a contract which requires him to perform in violation of the statute" and entitles a "landowner a full refund." The general contractor that hired the unlicensed subcontractor filed a counterclaim seeking recovery of payments made to the subcontractor. However, the court denied the general contractor's counterclaim because the general contractor failed "to furnish and maintain evidence of responsibility." New Mexico statute § 60-13-1.1(c) requires that "contractors be required to furnish and maintain evidence of responsibility." There was no indication that the subcontractor withheld information from the general contractor or that the general contractor made any attempt to obtain information concerning the subcontractor's licensure. Therefore, the court concluded that New Mexico's statute barred "both an unlicensed subcontractor from recovering compensation from a general contractor and a general contractor who did not act responsibly in hiring an unlicensed subcontractor from recovering compensation already paid to the unlicensed subcontractor."

Practical Note

Each state has its own contractor licensing requirements. Before performing work in a particular state, a contractor should ensure that it has complied with and understands that state's licensing requirements. A failure to fully comply may leave a contractor with an unenforceable contract and no rights to file a lien, enforce a lien, make a claim on a bond, or to receive any payments.

Unenforceable contracts are contracts that have no remedy in damages or specific performance because they arise out of illegal bargains, which are void at their inception. If one takes the risk and performs work without a license, in violation of a state statute, not only is the contract unenforceable, the contractor opens itself up to a plethora of other claims. Some states require that the contractor reimburse the property owner any amount paid for work performed without a license. Additionally, the contractor may be held liable to the property owners, general contractors, subcontractors, insurance companies, and bonding companies for damages for breach of contract, fraud, and indemnification.

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The Value of an "Additionally Insured" Status

634

Introduction

An Owner typically seeks to be protected from liability arising out of the work of its contractor. Contractors also seek protection from the subcontractors they hire. "Additional Insured" status provides extra coverage to the owner or contractor in the event an insurance claim is made. To receive this extra coverage, an owner (contractor) often requires its contractor (subcontractors) to provide "additional insured" status under a commercial general liability (CGL) policy. "Additional insured" status provides a defense and indemnity to the additional insured. Unfortunately, an owner or a contractor may accept a certificate of insurance as evidence of additional insured coverage only to find out after a claim is made that the certificate of insurance naming it as an additional insured is worthless.

The Certificate of Insurance

The certificate of insurance is a form usually prepared by the named insured's broker. The certificate of insurance identifies the type and amount of insurance coverage provided to the named insured. It generally does not provide specifics as to what is covered under the policy. Some forms may contain a disclaimer that the recipient of the certificate has no rights under the policy. Although certificates of insurance are frequently used, they should not be relied upon to establish coverage or the presence or absence of an endorsement. Failure to be aware of the accuracy of the certificate of insurance and to understand how it operates can leave one relying on it exposed. This is illustrated in the case of *United Stationers Supply Co.*

v. Zurich American Ins. Co., 896 N.E. 425 (Ill. App. 2008)

The Intended Coverage

United Stationers Supply Company (United Stationers) entered into a contract with D.C. Taylor Company (Taylor) for a roof replacement. The contract provided, in addition to an indemnification provision, that Taylor would present to United Stationers a Certificate of Insurance demonstrating full compliance with the insurance and indemnity provisions of the general conditions of the contract. The contract listed four types of insurance to be obtained by Taylor including: Workers Compensation, Contractual Liability, Automobile Liability and Hazardous Materials Liability Policy Endorsement.

The contract required Taylor to obtain certificates of insurance signed by an authorized representative of the insurance company and stating in pertinent part that "such Certificate(s) shall name [United Stationers] as an additional insured on a primary and non-contributory basis." The contract did not specify any type of insurance to which United Stationers was required to be named as an additional insured.

The CGL Policy

Zurich American Insurance Company (Zurich) issued a policy to Taylor which contained an endorsement Form U-GU-614-A CE (10/02) which amended the CGL policy as follows:

> "FORM U-GL-1175-A CW 09/03 ADDITIONAL INSURED AUTOMATIC-OWNERS, LESSEES OR CONTRACTORS- BROAD FORM IS ADDED TO THIS POLICY PER THE ATTACHED."

The "Broad Form" defined an "insured" as:

> any person or organization whom you are required to add as an additional insured on this policy under a written contract or written agreement." It further provided that "the insurance provided to additional insured applies only to 'bodily injury', 'property damage' or 'personal and advertising injury'...

Finally, the policy stated that throughout this policy the words 'you' and 'your' refer to the Named Insured shown in the Declarations, and any other person or organization qualifying as a Named Insured under this policy." The declaration only named Taylor as the named insured and no other person or organization was listed within the policy.

United Stationers was not listed as an additional insured in the CGL policy. However, the certificate of insurance listed it as the certificate holder for the CGL policy. The certificate of insurance stated that the "Certificate Holder is an Additional Insured on the General Liability policy on a primary & non-contributory basis with respect to the operations of the insured." The certificate of insurance also stated: " it is issued as a matter of information only and confers no rights upon the certificate holder. This certificate does not amend, extend or alter the coverage afforded by the policies below." The certificate of insurance indentified the policies as the CGL policy, an automobile liability policy, an excess liability policy, and a contractors/ pollution liability policy.

An employee of United Stationers was injured during the roofing project and filed suit against Taylor. In response Taylor filed a third party complaint for contribution against United Stationers alleging that the employee sought damages for injuries sustained during the scope of his employment with United Stationers. United Stationers tendered coverage to Zurich based upon the Certificate of Insurance. Before Zurich made a decision as to coverage, United Stationers filed a declaratory action requesting an order declaring that Zurich was obligated to defend and indemnify. Zurich contended that United Stationers did not qualify as an additional insured and even if it did, it was excluded from coverage by the CGL policy's employer liability exclusion.

No Additional Insured Coverage

United Stationers argued it was an additional insured on two grounds. First, it argued that the certificate of insurance specifically named it as an additional insured under the CGL policy. Second, it argued that the construction contract required Taylor to provide insurance for bodily injury although it admitted that the contract was silent on the precise type of liability policy. Zurich countered that United Stationers did not establish that it qualified as an additional insured under the CGL policy. Zurich also pointed out that there was no written contract requiring Taylor to name United Stationers as an additional insured on the CGL policy. Zurich pointed out that the only provision in the contract that required United Stationers to be named as an additional insured was silent as to which policy it was to be added. Zurich further added that the certificate of insurance did not modify the terms of the CGL policy and did not create additional insured coverage.

Concluding that the certificate of insurance did not confer coverage of additional insured status to United Stationers, the court analyzed two lines of cases. The first is where the certificate of insurance did not refer to the policy and the terms of the certificate conflicted with the terms of the policy. In those cases, the courts found the certificate language should govern the extent and terms of coverage. The other line of cases is where the certificate refers to the policy and expressly disclaims any coverage other than that contained in the policy. In those cases, the courts found that the policy should govern the extent and terms of coverage.

Finding this case was in line with the latter, the court held that United Stationers was not an additional insured under the CGL policy because: 1) United Stationers was not listed as an additional insured under the CGL policy; 2) the contract did not require Taylor to purchase a commercial general liability policy; 3) there was no evidence

of intent by the parties that United Stationers was to be made an additional insured; and 4) the certificate of insurance had a disclaimer which put United Stationers on notice that the CGL policy controlled coverage of additional insured.

Comment

United Stationers is a reminder that the certificate of insurance should not be relied upon as evidence of coverage. An owner or contractor seeking additional insured status should insist on obtaining a copy of the policy endorsement listing the names of the additional insured. The terms of the endorsement should be carefully reviewed to determine the type of coverage provided. The Insurance Service Office (ISO) developed a series of standard endorsement forms that can be identified by a form number and date. The additional insured form is the ISO 20 10 form. Some policies may have a broad form endorsement which will apply to insured contracts with the named insured. A review of the contract should be made to ensure that you are named as an additional insured on the appropriate polices.

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Differing Site Condition Elements Applied

635

Introduction

Under the Federal Acquisition Regulation, the Differing Site Conditions clause at FAR § 52.236-2 is a mandatory clause in most fixed-price federal government contracts. This provision operates to shift the risk of certain unforeseen physical conditions to the government. As discussed in Chapter 7 of Smith Currie's *Federal Government Construction Contracts* (John Wiley & Sons, 2008), the basic tests to establish entitlement to relief under that clause are well established.

A "differing site condition"—or "changed condition," as it is sometimes called—is a physical condition encountered in performing the work that was not visible and not known to exist at the time of bidding and that is materially different from the condition reasonably believed to exist at the time of pricing the contract. Differing site conditions are classified as either Type I, involving subsurface or latent physical conditions that differ materially from those indicated in the contract documents, or Type II, which involve unusual physical conditions that differ materially from those ordinarily encountered in similar work.

In general, if these conditions are satisfied, the existence of a differing site condition ("DSC") triggers entitlement to an adjustment in the contract price or time without having to establish fault by one of the parties to the contract. Given that background, what happens if the contract does not contain a DSC clause and an unforeseen condition is encountered? Is any remedy available given the basic concept that a contractor bears the risk of site conditions in the absence of a DSC provision? *Simpson v. United States,* 172 U.S. 372 (1899). As illustrated by the decision of the United States Federal Circuit Court of Appeals in *International Technology Corp. v. Winter,* 523 F.3d 1341 (Fed. Cir. 2008), a basis for relief may be available and the basic elements of a DSC claim may be used to evaluate the contractor's entitlement.

International Technology - No DSC Clause

In *International Technology* the Federal Circuit evaluated a prime contractor's breach of contract claim against the U.S. Navy using the same factors that are considered for Type I differing site conditions claims even though the parties' contract did not contain a DSC clause. The case originated after the Navy awarded the prime contractor, International Technology Corporation ("ITC"), a cost-plus-fixed-fee contract to remove pesticides and related chemicals, including DDT, from soil located at the Naval Communication Station in Stockton, California. Thereafter, ITC subcontracted with Terra Kleen Response Group, Inc. ("TK"), to use a solvent extraction technology to remove contaminants from the soil at the project site. TK previously demonstrated the special extraction technology to the government during a pilot program; a fact that would ultimately be important in the outcome of the case.

Unfortunately, the effectiveness of TK's solvent extraction technology was limited by high clay concentrations in the soil which the contractors asserted were discovered at the site after the remediation project began. Specifically, the solvent took much longer to dissolve into soil with high clay concentrations, a condition known as "reduced soil permeability", thereby greatly increasing treatment time and costs. At the conclusion of the project, ITC filed a breach of contract claim against the government for additional soil remediation expenses incurred by TK as a result of the unexpected clay concentrations.

According to ITC, the government misrepresented the soil composition at the site in one of two reports that were referenced by the contract documents. The two reports, entitled the "Solvent Technology Report" and the "Feasibility Study", were prepared by a third party contractor for purposes other than the soil remediation project. ITC argued that the contract documents required the prime contractor to "examine" both reports. Included in the Solvent Technology Report was a table that listed soil characteristics for samples taken during the pilot program, including the clay content percentages that ranged between 6% and 11%. Conversely, the Feasibility Study indicated that some of the contaminated soil treated by TK during the pilot program had higher concentrations of clay than what was shown in the Solvent Technology Report tables.

Decision on Misrepresentation Claim

Both the contracting officer and the Armed Services Board of Contract Appeals denied ITC's claim for the additional soil treatment expenses and the case was appealed to the Federal Circuit. That court analyzed ITC's claim of misrepresentation in the contract documents using the same four factors that are considered in a Type I Differing Site Condition. To recover increased costs due to a Type I DSC, a contractor must prove:

1. That a reasonable contractor reading the contract documents as a whole would interpret them as making a representation as to the site conditions;
2. That actual site conditions were not reasonably foreseeable to the contractor with the information available outside of the contract documents (i.e., the contractor "relied" on the representations);
3. The contractor actually relied on the contract representation; and
4. Conditions differed materially from those represented and that the contractor suffered damages as a result.

The first element relies on the principle that there cannot be a differing site condition unless the contract indicated what that condition would be. With that principle in mind, the court stated that ITC could not prove that the contract documents and specifically, the clay composition levels listed in the Solvent Technology Report tables, represented the clay content of the contaminated soil at the project site. The court observed that the contract documents did not reference the soil composition analysis in the report and merely suggested that a review of both reports would assist the prime contractor in preparing a construction work plan, a quality control plan, and a site specific health and safety plan. Further, the court noted that the soil composition data contained in the Feasibility Study reflected the presence of clay content that substantially exceeded the percentages listed in the Solvent Technology Report and specifically warned that soil composed primarily of silt and clay might not be suitable for the solvent extraction process. As a result of these considerations, the court determined that a reasonable contractor could not have interpreted the contract as representing that the soil would contain less than 11% clay composition based on the soil samples contained in the Solvent Technology Report.

The court further held that even if it were able to conclude that the Solvent Technology Report represented the clay content of the soil at the project site, ITC would not prevail because it could not establish the second element – site conditions encountered were not reasonably foreseeable in light of all information available. Interestingly, the court's analysis of the second element focused on the knowledge of TK, and not ITC. Based on the evidence presented at trial, the court explained that it was unreasonable for TK to rely on the soil composition levels contained in the Solvent Technology Report because

UPCOMING EVENTS

Construction Delay, Acceleration and Inefficiency Claims, Federal Publications, October 20-21, 2009, Washington, D.C. *Steven L. Reed, Reginald M. Jones.*

What's Different About Federal Contracts?, Carolinas AGC, October 20, 2009, Fayetteville, North Carolina. *Philip L. Fortune, Robert J. Greene, and Thomas J. Kelleher, Jr.*

Know the State Laws that Impact Your Construction Contracts, National AGC, Webinar 1:00-2:30 p.m. EDT, October 21, 2009. *Philip E. Beck, James K. Bidgood, and Thomas J. Kelleher, Jr.*

Tapping into the Stimulus Money: The American Recovery and Reinvestment Act of 2009, National ABC Webinar 11:00 a.m.-12:15 p.m. EDT, October 26, 2009. *Reginald M. Jones and Steven L. Reed, panelists.*

Fundamentals of Construction Law: Learn the Basics from the Pros, American Bar Association, November 5, 2009, Fort Lauderdale, Florida. *Lisa Colon Heron.*

Managing and Mitigating Risk on the "Shovel Ready" Design-Build Project, Design Build Institute of America Annual Meeting, November 5-7, 2009, Washington, D.C. *James F. Butler III.*

Contract Traps & Pitfalls, Georgia AGC, November 10, 2009, Atlanta, GA. *Philip E. Beck.*

New Restrictions on Federal Construction Contractors, American Bar Association, November 13, 2009, Orlando, FL. *Eric L. Nelson, panelist.*

Smith, Currie & Hancock's 2010 Construction Law Update Seminar, Hyatt Regency Atlanta, February 11-12, 2010, Atlanta, Georgia.

of its awareness of flaws in the testing performed during the pilot program. Testimony from TK's president revealed that the company was aware that samples used for the Solvent Technology Report were only collected from the perimeter of a large soil stockpile and did not include sampling from deeper portions of that stockpile. This fact was important because of TK's acknowledgment that clay is not often evenly distributed through subterranean soil and is often found in concentrated layers, known as lens. In other words, there was no basis for TK to infer that the pilot program samples would be representative of conditions throughout the site. Further, the court noted that TK used a completely different sampling methodology, one that included random, deep soil borings, when it evaluated clay content during its work under the ITC subcontract. Because of known flaws in the sampling methodology underlying the clay composition levels in the Solvent Technology Report, the court determined that TK could not have reasonably relied on any representations in the report.

Comment

This decision has several practical implications for contractors and subcontractors. Obviously, the absence of a DSC clause may not leave the contractors without any remedy and the reference to the elements for a Type I DSC provides some degree of certainty to the analysis. More importantly, the prime contractor was able to rely on its trade subcontractor's knowledge and evaluation of the conditions in seeking to establish entitlement to relief. The Federal Circuit did not impose a requirement that the prime contractor's employees have direct personal involvement in order to establish reliance.

One topic was not resolved. That is, is it necessary to show some degree of fault or culpability when asserting a claim for misrepresentation? While noting that the board had identified proof of culpability as a necessary element for recovery, the court indicated that such might not be necessary if the representation was material. Unfortunately, the court declined to make a definitive ruling on that potential issue.

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