



COMMON SENSE CONTRACTING

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Inside This Issue

- 636 Building Green with Confidence
- 637 Design Liability and Design Approval
- 638 Challenging a Liquidated Damages Provision
- 639 Exceptions to No-Damages-for-Delay Clauses
- 640 Implied Duties of Good Faith and Fair Dealing
- 641 Georgia's "Acceptance" Doctrine Survives
- 642 Federal Contracting Update

Building Green with Confidence

636 Concerns with global warming, environmental toxins, and high energy costs have mainstreamed the "green construction" movement. Green construction is now required for many state and federal projects and many private owners are choosing to build green for the anticipated long-term savings and positive public perception. Designers, contractors, subcontractors and even suppliers may be left behind if they ignore the green movement. However, green construction also entails the potential for additional costs, project delay, and liabilities which any contractor, design professional, or owner needs to consider when contracting to construct "green". This article provides an overview of some of these potential issues or pitfalls.

In 1998, the U.S. Green Building Council ("Green Building Council") developed the Leadership in Energy and Environmental Design (LEED) Green Building rating system. The LEED rating system is a point driven system organized into five environmental categories: Sustainable

Sites, Water Efficiency, Energy and Atmosphere, Materials and Resources, and Indoor Environmental Quality. An additional category, Innovation and Design Process, provides design teams the opportunity to be awarded points for exceptional performance. The Green Building Council uses the LEED rating system to certify a building depending on how many points the project is awarded. Projects may be certified as: LEED Certified, LEED Silver, LEED Gold, or LEED Platinum, with LEED Platinum being the highest rating.

Legal Considerations when Building Green

Owners have high expectations of green construction. When designers and builders fail – or the owner perceives they have failed – to deliver, there may be legal ramifications. The law concerning green construction and LEED certification is in its infancy, and courts have not addressed potential legal implications to designing and constructing a green project. However, given that the American legal system is based on past precedents, it is entirely possible that existing principles of contract law will be applied to these issues and liabilities.

Failure to Achieve a Specific LEED Classification?

When parties contract to design and build a LEED certified project, the possibility of failure may not be considered. What if the architect and contractor agree to complete a LEED Gold building, but the project only achieves a LEED Silver rating? Potential damages stemming from this failure can be great. The owner may lose tax benefits, government incentives, and leases from potential tenants. This is especially troubling since LEED certification is entirely dependent upon the decision of the USGBC. For this breach of contract, the owner could allege damages for the anticipated difference in energy cost savings between the Gold project and the Silver project over the life of the building. Both contractors and designers need to evaluate and address the risk of not achieving a specific LEED certification at the time of contracting.

The topics to be evaluated may include:

- Does the type of project present inherent difficulties in achieving a specific LEED level?

- What is the designer’s past experience in designing a LEED certified project?
- Has the contractor’s project team previously built a LEED certified project? This evaluation needs to encompass key subcontractors.
- Does the contract address the monetary liability for failing to achieve a specific LEED level? In that context, consider whether a limitation of liability provision should be negotiated.

Confusion between Performance Specifications and Design Specifications

In many construction projects, the owner provides plans and specifications to the contractor, and the contractor is required to build the project in accordance with them. “[I]f the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications.” *United States v. Spearin*, 248 U.S. 132 (1918). This proposition has become known as the “Spearin doctrine.” The doctrine, however, applies only to *design* specifications—specifications that provide the contractor clear instructions on how to perform the work and what materials to provide. It does not apply to *performance* specifications—specifications which simply set forth an objective or standard, but leave the means of attaining that end to the contractor.

Confusion between design and performance specifications can be challenging on a green project. For example, a design specification might direct the use of a specific adhesive and sealant or only one of the adhesives and sealants approved by the Green Seal Standard for Commercial Adhesives GS-36. If the contractor uses the specified products and it turns out that it fails to satisfy LEED requirements, the contractor may be able to invoke the Spearin doctrine and avoid responsibility for that failure. Conversely, a performance specification might direct the use of adhesives and sealants sufficient to obtain the credit for “Indoor Environmental Quality 4.1: Low-Emitting Materials - Adhesives and Sealants.” The contractor is free to select an appropriate adhesive and sealant to meet this goal. If, however, the adhesives and sealants utilized by the contractor do not achieve this LEED credit point, the contractor may bear that risk.

The resulting damages could be great. Using the incorrect sealant could not only impact IEQ Credit 4.1, but it could also negatively impact the indoor air quality and any ongoing construction. The required level of LEED certification may be impacted, resulting in, for example, increased design and construction costs and potential penalties on public projects. Thus, it is important on a green project for contracts to clearly specify, and for contractors to clearly understand, whether the contractor’s duties are driven by design or performance specifications.

The LEED Documentation Process

The LEED documentation process can be time consuming. The increased overhead spent in certifying

a project can be significant. The parties should agree who will bear the most substantial portion of this expense and coordinate the submission of documents to the USGBC.

The parties must also consider who is responsible for delays in reaching substantial completion because of the LEED certification process. If the project will not be deemed completed until the LEED process is completed, this can lead to delay costs if the LEED process is appealed or resubmittals are required. The contractor will be damaged as retainage is held pending final certification, and it cannot begin other jobs due to the work force assigned to the LEED project. The owner will be damaged, as it cannot open the project when scheduled. To remedy these potential problems, the parties should decide if the certification process will be expedited and who will pay for this service.

Green Performance Bonds

Performance bonds are being used to ensure compliance with green mandates in the District of Columbia. The District’s Green Building Act of 2006 requires that all new commercial buildings be LEED certified. For all privately-owned nonresidential projects of at least 50,000 square feet, the act requires that a performance bond be provided to the District along with the building permit application. D.C. Code § 6-1451-05(a) (2008).

This bond is tied to LEED certification. Bond amounts are capped at \$3 million and are set at a percentage of total building cost, ranging from 2-4%, based upon square footage. If LEED certification is not achieved within two years after the certificate of occupancy is issued for the project, all or part of the bond is forfeited to the District. D.C. Code § 6-1451-05(g)-(h) (2008).

This law does not specifically designate which party—the building owner, the contractor, or the architect—is to furnish the performance bond. To avoid disputes, the party responsible for posting the bond should be clearly spelled out in the contract documents. If the parties execute certain standard form contracts or are unaware of the bond requirement, some contractors may unknowingly agree to post the green performance bond. While the District of Columbia is currently the only known jurisdiction that requires a LEED performance bond, parties should be aware of the potential for such bonds in their respective jurisdictions.

Unexpected Increased Costs with LEED

Cost and availability of supplies may not be as stable with a green project as a non-green project. It is important to contract with suppliers to guarantee availability during construction and pass potential damages on to the supplier. For example, what if a contractor bids to construct a green building for a guaranteed maximum price based on the expected availability of specific green products during construction and those products later become unavailable? This unavailability could, at a minimum, affect the final cost to construct, and also affect the final LEED certification awarded the project.

How Can You Protect Yourself?

Education regarding LEED certification is paramount. It is important to have a working knowledge of the LEED points and how they interrelate. Any firm considering a LEED project should have a LEED Accredited Professional available to it or on its staff.

Do not treat a green project like a non-green project. Enter into contracts with others familiar with green practices. Have any contract or major subcontract reviewed by a professional who is well versed in the LEED certification process so as to not unknowingly assume liabilities.

Do not be deterred from designing or building green. The opportunities in this growing field of design and construction are limitless. As with any project, it is essential to identify and manage the risk. One can be aware of the risks —yet embrace the opportunities.

Maura K. Anderson
LEED Accredited Professional
954/769-5321
mkanderson@smithcurrie.com
Member of the State Bars of Florida, Georgia, and
South Carolina

Design Liability and Design Approval

637 Introduction

Construction contracts traditionally contain a provision stating that the approval of a shop drawing or a submittal does not constitute acceptance of a deviation from the plans and specifications unless certain other requirements are satisfied. Basically, the contractor assumes the burden of ascertaining all of the applicable requirements and specifically identifying deviations from those requirements. As design-build projects become more common, a potential question involves the effect of an owner's approval of the design documents on the design-builder's liability. A recent decision by the U.S. Court of Federal Claims in *Gee & Jenson Engineers, Architects, and Planners v. United States*, 2008 WL 4997488 (2008) illustrates both the extent of the design professional's obligation to ascertain the applicable design requirements and the possible effect of an owner's approval of the design documents.

The *Gee & Jenson* decision arose out of a project to design a building for the Navy, which was constructed under a separate construction contract, a classic design-bid-build scenario. After construction was completed, the building experienced leakage. After an investigation of the water infiltration, the Navy concluded that a contributing cause for the leaks was the absence of flashings under a concrete sill at the building's storefront and that these flashings should have been included in the design in accordance with various Navy guide specifications that were incorporated into the design contract by reference. Gee and Jenson asserted that it was obligated to design in accordance with the applicable building code and that the

building code did not require the use of flashing in the design, but made its use discretionary with the design professional. Finally, Gee & Jenson asserted that the Navy's approval of its design constituted a waiver of any requirement for flashing and shielded it from judgment. The court rejected all of the designer's assertions. For a contractor performing a design-build contract, this decision illustrates a different facet of its potential exposure in the event of a later design problem with the completed structure.

The Requirement for Flashing Was Not Ambiguous

Many of the details of the requirements for the design on this Navy project were, like most government contracts, incorporated by reference in the physical documents. Specifically, the contract referenced an "A-E Guide" and numerous Navy guide specifications. By reference to guide specifications, the Navy included detailed instructions for inclusion of flashings. In that context, the Court of Federal Claims stated that contractors who work with the government know well that the referenced design guides, performance manuals, rules and regulations are as binding and as much a part of the contract as if they were reproduced and actually in hand. Here the design engineer argued that since some provisions required flashing yet other guide specifications did not and the applicable building code gave the designer discretion to include flashings, the contract was ambiguous and any doubt should be resolved against the government. The court carefully studied all the guide specifications and the incorporated references in the contract documents, and held that the requirement for flashing, specifically at the concrete sill, was straightforward. The cases allowing the designer discretion did not apply to that requirement. The court concluded that simply because the design engineer disagreed with the government's guide specifications did not make the specifications ambiguous and did not relieve it of the requirement to follow the contract.

The Building Code Did Not Require Flashing

Consistent with its assertion that the guide specification did not expressly require that the design include flashing, the designer argued that it was justified in referring to the local building code which was also referenced in the contract. Since the standard building code which applied in Charleston, South Carolina at the time did not require flashing, then flashing was not required for the design.

The court studied the details of the building code and concluded, as did the designer, that the code did not require flashing. However, the court also concluded that the building code does not take precedence over the terms of the contract or the Navy's guide specifications incorporated into the contract. In the court's view, this was not a case where the government's guide specifications required a lesser standard of performance than the building code, but just the opposite. The court made it clear that when the government contract requires a higher standard of performance than the local building code, as in this case, the requirements of the contract control.

Approval of the Design by the Navy

Consistent with its interpretation of the contract, the guide specifications, and the building code, the design engineer omitted flashing under the concrete sill for the building's storefront. In the process of reviewing the building design, the Navy approved the design submitted by the engineer and the building was constructed according to that design. The engineer did not specifically request permission to omit flashing at the concrete sill and the approval by the Navy did not address the omission.

Rejecting this defense, the court noted that the contract clause at FAR §52.236-23, which was also incorporated by reference, provides that neither the government's review or approval, acceptance or payment operates as a waiver of any rights under the contract. While the Navy's approval of the overall design was an important milestone in design development, that approval did not function as a change in the contract requirements. The court explained that the contract's design requirement could be altered only by the designer specifically requesting authorization from the Navy's Engineer In Charge to omit the flashing and receiving specific authorization from the Engineer In Charge.

The Omission of Flashing Did Not Cause the Leaks

If there had not been leaks through the walls of the building, the Navy may not have learned that the designer did not follow the guide specifications. During the investigation of the leaks, the government discovered the omission of the flashing by the contractor in accordance with the design documents. The investigation identified other causes of leaks and the contractor was instructed to perform remedial work that stopped the leaks. As the government explained, the case was not about the water damage from the leaks, but the damage to the government caused by the failure of the design engineer to comply with the contract. The government claimed damages for the cost of an investigation of the extent of the omission of flashing and costs for a contractor to perform mitigating remedial work since reconstruction in accordance with the guide specifications could not be accomplished without destroying the building. The court held that these damages are the kind of damages that can be recovered for breach of contract, to place the non-breaching party in the same position as if the contract had been faithfully performed.

Points to Remember

1. In any government contract, an incorporation by reference of guide specifications, standards and other performance requirements is as binding as if set forth in full in the contract document itself.
2. Local building codes are mandatory and binding standards of construction and are also evidence of the standard of care required for design professionals. However, any party can contract for performance that exceeds the local building code, so long as that performance does not also violate the building code.
3. Under contracts controlled by the Federal Acquisition

Regulation, the review, approval, acceptance or payment by the government for performance that is different from that required by the contract may not be a waiver of strict compliance with the contract. Any deviation should be specifically addressed, and specifically authorized, by a representative of the government vested with authority to make the change.

4. Damages may result from a failure to comply with contract requirements even though the design omission as in this case, did not directly cause water infiltration. The court's finding that the flashing was required for the adequate performance of the structure over its expected life was sufficient to authorize an investigation, remedial efforts by the government and was the basis for contractor liability for those damages.

Philip L. Fortune
404-582-8014

plfortune@smithcurrie.com
Member of the State Bar of Georgia

Challenging a Liquidated Damages Provision

638 Overview

More than a decade has passed since the movie *Jerry McGuire* introduced a simple, four-word phrase that cleverly captures the essence of many business transactions: "Show me the money!" In no other area of law is the essence of this phrase more applicable than in construction litigation. Construction disputes, by and large, arise because of money. A party in a construction dispute generally seeks to recover money in order to receive the benefit of its bargain, or it wants to limit its financial exposure resulting from an alleged failure to abide by the terms of the construction contract. Thus, it comes as no surprise that construction contracts oftentimes contain provisions that specifically deal with the issue of damages. One such provision is the liquidated damages ("LDs") provision.

A liquidated damages provision is basically an agreed-upon settlement of the anticipated actual damages arising from a future breach of contract, for example, late completion. Liquidated damages provisions allow contracting parties to protect themselves against the difficulty, uncertainty, and expense that necessarily follow the effort to prove actual damages. Although the concept behind LDs appears straight-forward, liquidated damages provisions are frequently challenged. Consequently, courts have adopted different guidelines, which vary from jurisdiction to jurisdiction, to determine the enforceability of such provisions.

Tests for Validity of LDs

Although the enforceability of a liquidated damages provision is a question of law for a court to determine, that analysis requires a close examination of the facts, including the contract, the language of the specific contract

provision, and the methods used to compute the liquidated damages rate. Courts have held that an enforceable liquidated damages provision cannot be a penalty. The distinction between a contractual penalty and valid liquidated damages provision is that a penalty, in effect, is a security for performance, while a provision for LDs requires a sum certain to be paid as compensation for a breach of contract. In determining whether a liquidated damages provision is a penalty, a court evaluates two main considerations: (1) the reasonableness of the dollar amount stipulated and (2) the difficulty of determining and proving actual damages in the event of the breach.

First, the court examines if the stipulated amount is conscionable. This means that the amount stipulated is reasonable in view of the contract's value and the probable or presumptive loss in case of breach. To determine whether the amount stipulated is reasonable, courts have developed two approaches. The prospective approach examines the reasonableness of the liquidated damages rate at the time the contract was executed. The retrospective approach uses hindsight to determine the reasonableness of the rate by comparing the actual damages sustained with the liquidated damages. If the discrepancy between the actual damages and the liquidated damages rate is very large, courts that apply the retrospective approach will find that the liquidated damages provision is a penalty, and will thus invalidate it. Some courts use both the prospective and the retrospective approach to determine whether a liquidated damages provision constitutes a penalty.

Second, the court examines the nature of the transaction to see whether the amount of damages resulting from the default would be easily and readily determinable. A liquidated damages provision is more likely to be upheld if it would be difficult to determine the amount of damages following a breach of contract.

Kansas: A Case Illustration

The analysis used by the courts to determine the enforceability of liquidated damages provisions is illustrated in *Carrothers Constr. Co., LLC v. City of South Hutchinson*, 207 P.3d 231 (KS. 2009), a recent Kansas Supreme Court case in which that court rejected the retrospective analysis for determining the enforceability of liquidated damages provisions.

Carrothers Construction ("Carrothers") entered into a contract with the City of South Hutchinson ("City") to construct a \$5,618,000 wastewater treatment facility to replace an existing plant. The contract contained multiple completion dates as well as a liquidated damages provision for delays in meeting the completion dates. Carrothers failed to complete the work by the contractually established completion dates.

The liquidated damages provision provided that time was of the essence, that it would be difficult to prove the actual loss suffered by the owner if the work were not completed on time, and specified LDs at \$850 per day for failure to achieve substantial completion and final

completion on time. To compute the LDs rate, the City hired an engineering firm that based the liquidated damages rate on several factors. These factors included the cost to monitor the project, additional labor costs, additional use of utilities, the cost of engaging another consultant, legal expenses, equipment rental, possible action by the Kansas Department of Health and Environment, and other unknowns in the event the project was not completed on time.

Carrothers was 170 days late in reaching substantial completion, and one day late in reaching final completion, bringing the total delay to 171 days. When the City withheld \$145,350 in liquidated damages (171 days x \$850/day), Carrothers challenged the validity of the liquidated damages provision, arguing that the specified rate was a penalty having no relation to the actual damages that the City had suffered. In effect, Carrothers used the retrospective approach. The court, however, rejected the retrospective approach in favor of a prospective analysis of the liquidated damages clause.

After rejecting the retrospective approach, the court compared the liquidated damages amount of \$145,350 to the total contract price of \$5,168,000, and found the amount of liquidated damages to be reasonably in proportion to the contract price. The court also compared the \$850 per day rate to all foreseeable costs at the time the contract was entered into, both for the substantial completion and final completion stages of work, and found the liquidated damages estimates for both to be reasonable.

Carrothers also argued that the City waived its right to further liquidated damages when it occupied a partially completed facility. The court disagreed. To dispose of this issue, the court examined the language of the entire contract, as well as the language of the liquidated damages provision. Neither the contract nor the liquidated damages provision provided that liquidated damages would be waived if the City moved into the partially completed building; instead, the contract and the liquidated damages provision held that substantial and final completion had to be done by a certain date, and that any subsequent delays thereafter would cost Carrothers \$850 per day. In other words, the court simply enforced the contract and the liquidated damages provision as written.

Practical Tips

For those engaging in construction projects in any jurisdiction, the first and most important lesson from *Carrothers* is an appreciation of the different approaches for determining the enforceability of LDs provisions. For example, in Kansas, the reasonableness of the liquidated damages estimate is determined by applying only the prospective approach. The rejection of the retrospective approach increases the chances that a court will uphold a LDs provision because the breaching party cannot use actual damages to show that the liquidated damages estimate is unreasonable. This, however, may not be the law in all states. Therefore, be sure to check the law of the state where the project is located.

When drafting a liquidated damages provision, ensure that the provision is not a penalty, or a security for performance. Avoid using the word “penalty” in a liquidated damages provision. The language of the liquidated damages provision should also clearly explain that actual damages would be difficult to ascertain, and that therefore the parties choose to use the liquidated damages in case of breach rather than requiring proof of actual damages. Use reasonable factors to accurately compute the damage estimate. Good factors to base LDs estimates on include the additional costs of labor, additional costs to monitor the project, additional utilities use, costs of engaging other consultants, legal expenses, and equipment rentals. Consider hiring a professional engineering firm or other business entities that specialize in forecasting construction costs when trying to come up with an estimate. In addition, make sure that the LDs estimate is a reasonable percentage of the total cost of the project.

Taking these steps will decrease the chance of a court viewing the liquidated damages provision as a penalty, which will in turn result in the creation of an enforceable penalty provision.

Goran Musinovic
(404) 582-8123

gmusinovic@smithcurrie.com

Member of the State Bars of Georgia and Tennessee

Exceptions to No-Damages-For-Delay Clauses

639 Two recent decisions demonstrate how courts are willing to recognize exceptions to no-damages-for-delay clauses. One of these decisions, however, illustrates the practical difficulty of proving the circumstances that trigger the exceptions.

Traditional Statement of Exceptions

The first case, *United States ex rel. Gurtz Electric Co. v. Gilbane Building Co.*, No. 07CV4430 (N.D. Ill. October 10, 2008), arose out of a federal government project in Chicago and involved the application of exceptions to a no-damages-for-delay clause under Illinois law. This case is notable because the clause in question was not a classic no-damages-for-delay clause. Instead, the clause, labeled a “Limitations Clause” allowed delay damages under limited circumstances. The Limitations Clause excluded the owner, the architect, and the construction manager from liability to trade contractors for damages caused by delay, hindrance or interference with the performance of the work with two exceptions. First, the trade contractor could recover damages for active interference of the owner or one of its representatives. Second, delays resulting from defective plans and specifications could result in the trade contractor’s recovery of delay damages.

The trade contractor sued the construction manager

and its Miller Act payment bond surety. The complaint alleged that the construction manager caused delay by furnishing defective plans and specifications; by demanding that the trade contractor perform work different from, or in addition to, the work required under the subcontract; by interfering with the trade contractor’s access to the project; and by failing to cooperate with the trade contractor and to properly schedule and coordinate other subcontractors or suppliers in a manner that would allow the trade contractor to complete its work timely. These allegations were contained within three legal theories: (1) a bond claim under the Miller Act; (2) a breach of contract claim against the construction manager; and (3) a claim for *quantum meruit*.

The construction manager and surety moved to dismiss and to have the court strike the allegations that sought to hold the construction manager and the surety liable for delay claims beyond the scope of the Limitations Clause. The trade contractor countered that Illinois law recognized exceptions to no-damages-for-delay clauses and that its allegations were within these exceptions.

The Illinois exceptions are: (1) delays not within the contemplation of the parties; (2) delay of an unreasonable duration; and (3) delay attributable to inexcusable ignorance or incompetence of the party attempting to enforce. The construction manager and its surety argued that these exceptions did not apply because the clause was not a true no-damages-for-delay clause. Rather, it was a limitation of liability clause. The court rejected the construction manager’s and surety’s arguments because, under Illinois law, the recognized exceptions to no-damages-for-delay clauses may be extended to other exculpatory clauses that limit but do not completely prohibit recovery of damages. Thus the court expanded the trade contractor’s ability to recover for delay damages in addition to those listed in the Limitations Clause. The court allowed the trade contractor to proceed with its claims for delays due to the construction manager’s failure to cooperate with the trade contractor and failure to coordinate the other subcontractors, presumably an allegation consistent with the third Illinois exception. In the end the trade contractor in Illinois had an opportunity to seek delay damages beyond the contractual limitations, if there are facts to support an application of the recognized exceptions to no-damages-for-delay clauses in Illinois.

Proving the Exceptions

The second case illustrates the difficulties of establishing an exception to the enforcement of a no-damages-for-delay clause. In *Mafco Elec. Contractors, Inc. v. Turner Constr. Co.*, 2009 WL 807469 (W.D. Conn. March 26, 2009), an electrical subcontractor brought a breach of contract case against the general contractor seeking damages for its unpaid contract balance and an equitable adjustment to its contract of nearly \$900,000 because of delays experienced on the project. The general contractor moved for partial summary judgment on the equitable adjustment claim, arguing that the no-damages-

for-delay clause prevented recovery. The no-damages-for-delay clause prohibited the subcontractor from recovering damages for delay, obstruction, hindrances, or interferences with its work unless the general contractor actually recovered corresponding costs from the owner. The subcontract also gave the general contractor the right, in its sole discretion, to refuse to pursue a subcontractor claim with the owner, if the general contractor deemed the claim to lack merit in whole or in part.

The subcontractor admitted the applicability of the no-damages-for-delay clause, but contended that one of the several exceptions to enforcement, under Connecticut or New York law, should apply. The court held that the law of Connecticut and New York recognized four exceptions to enforcement of no-damages-for-delay clauses: (1) delays caused by the enforcing party's bad faith or willful, malicious, or grossly negligent conduct; (2) unanticipated delays; (3) delays so unreasonable that they constitute an intentional abandonment of the contract; and (4) delays resulting from the enforcing party's breach of a fundamental obligation of the contract.

The electrical subcontractor argued that the general contractor's conduct fell into the first, second, and fourth exceptions. The court disagreed and held that, as a matter of law, the no-damages-for-delay clause was enforceable under the facts of this case.

The electrical subcontractor attempted to prove that the general contractor was grossly negligent in causing its delays. The general contractor responded that these allegations, even if true, amounted to ordinary negligence so that the no-damages-for-delay clause applied. The court agreed with the general contractor. The court found the electrical subcontractor's allegations of gross negligence to be conclusory and vague. The only persuasive fact cited by the electrical subcontractor to support its gross negligence claim was an owner's representative's statement that the general contractor's supervision was the "worst ever seen" in his twenty years in the construction industry. Upon closer examination, however, that statement was made with respect to the general contractor's supervision of other trades, not the electrical work at issue in this case. To sum it up, vague and conclusory assertions of delay, mismanagement, and failure of coordination do not constitute gross negligence or willful or malicious conduct.

The court also agreed that there was no evidence for a jury to consider on the exception of unanticipated delays. The legal standard here is whether the delays experienced are reasonably foreseeable. In this case, the electrical subcontractor received an extension to its substantial completion date. At the end of the contract, even by the electrical subcontractor's own expert's opinion, the delay to substantial completion was at most seven months. Such a delay, the court ruled as a matter of law, could not be a delay that was not contemplated by the parties. The court characterized a delay that could

support this exception as one that is, in essence, an abandonment of the contract. That court ruled, as a matter of law, that a seven-month delay is not an abandonment of the contract. This reasoning appears to collapse the second and third exceptions into a single category.

Finally, the electrical subcontractor argued that the delays constituted a breach of a fundamental obligation of the subcontract. The court also rejected this position. The electrical subcontractor based its argument for this exception on the general contractor's failure to provide timely materials and purchasing and delivery information for the installation of certain light fixtures. The court noted that the record was undisputed that the electrical subcontractor did eventually receive the materials and completed its work, except for punchlist items, seven months beyond the substantial completion date at the latest. Such breaches of contract are not a complete failure of a condition precedent to performance. In reaching this conclusion the court relied on a decision where an owner failed to obtain a wetlands permit necessary to begin construction and a second case in which a two-year delay caused by faulty subsurface exploration, plan changes and the invasion of protesters onto the job site prevented a contractor from making progress. As the court noted, "the fundamental breach must completely frustrate the performance of one of the parties, not merely delay it for a time."

The court also rejected the electrical subcontractor's argument that the general contractor's failure to present its delay claim to the owner constituted a fundamental breach of contract. The court relied upon the contractual provision noted above that gave the general contractor discretion to refrain from presenting such a claim if it deemed it without merit.

Practical Points

The exceptions to no-damages-for-delay clauses vary from jurisdiction to jurisdiction. Some jurisdictions may provide exceptions that are more easily proven than others. Nevertheless, all parties to construction contracts should be reminded that court-made exceptions to no-damages-for-delay clauses and other liability limitations clauses require proof that is beyond the "garden variety" delay. It is also significant that the Illinois and Connecticut cases were in very different stages of litigation. The construction manager's and surety's motion in the Illinois case was directed at the complaint's allegations, while the Connecticut case was a partial summary judgment hearing on a more fully-developed record after discovery. At the summary judgment stage, a party seeking to apply one of the exceptions to the application of a no-damages-for-delay clause must be able to show particular facts for a jury to consider that support those exceptions. Conclusory allegations simply will not do.

William L. Baggett, Jr.

404-582-8056

wlbaggett@smithcurrie.com

Member of the State Bars of Georgia and Tennessee

The Implied Duties of Good Faith and Fair Dealing

640 Overview

Every contract includes an implied covenant of good faith and fair dealing, which means that neither party shall do anything that has the effect of destroying, injuring, or hindering the rights of the other party from receiving the full benefits of the contract. The courts will read an implied covenant of good faith and fair dealing into a contract, especially when the contract gives one party discretionary authority to interpret or apply a contract term. Under the covenant of good faith and fair dealing, a party exercising discretion must refrain from activities that frustrate the right of the other party.

The implied covenant of good faith and fair dealing may not be used to create new, independent rights or duties beyond those agreed to by the parties. Rather, the implied covenant must arise from the language used or be indispensable to effectuate the intention of the contract, the parties' conduct, and their course of dealing. As illustrated by the decision in *City of Gillette v. Hladky Construction, Inc.*, 196 P.3d 184 (WY. 2008), this implied covenant simply requires that a party to a contract not act in a manner that would frustrate the rights of the other party to receive the benefit of the agreement. In the *City of Gillette* case, the contractor, Hladky, brought an action against the city alleging it breached the covenant of good faith and fair dealing by allowing its representative to modify specifications regarding concrete panels and failing to act on the contractor's change order request regarding such panels in a timely manner.

Background – City's Failure to Cooperate

When the City of Gillette opted to remodel and expand city hall, it hired Schutz Foss Architects (SFA) as the project architect. SFA assigned one of its employees to act as the on-site project manager during construction. The project specifications required installation of precast concrete exterior panels and provided that the precast concrete manufacturing plant be certified by the Precast/Prestressed Concrete Institute, Plant Certification Program, *prior to the start of production*. The language requiring that the certification take place *prior to the start of production* was added to a standard American Institute of Architects contract by SFA. This language was thought necessary to promote competitive bids as there was only one certified precast concrete manufacturing plant at bid time, Gage Brothers Concrete Productions, Inc., ("Gage").

Hladky initially submitted a bid identifying Gage as its supplier of precast panels. However, on the day that bids were accepted by the City, Hladky changed its bid to name another precast panel manufacturer, Winfrey Architectural Concrete, Inc. (Winfrey), a firm that Hladky incorrectly believed was a certified precast manufacturer. Winfrey indicated that it could produce the panels for almost \$70,000 less than Gage. The City awarded the project to Hladky.

Approximately one week after signing the contract, Hladky met with the City, and SFA and was informed by SFA's representative that it needed to produce Winfrey's certification *before ordering* the precast panels. This condition ignored the specification that required the manufacturer to have its certification prior to the start of panel production. This new requirement presented a problem for Hladky because it needed to place the order for the precast panels to avoid a disruption in the project schedule and could not wait for Winfrey to obtain certification before placing the order.

After the meeting, Hladky advised Winfrey that the order for the precast panels could not be placed until Winfrey was certified. Hladky also requested that the City and SFA withdraw the requirement that certification take place before the precasts were ordered. Hladky also submitted a request for a change order to allow it to substitute Gage for Winfrey as its precast supplier for an additional cost but SFA did not respond to the request.

Hladky again met with the City and SFA seeking approval for its change order request. The City responded by stating that it could not grant authorization to approve the request and that Hladky should focus on Winfrey's certification process. Approximately four weeks later, Hladky submitted a second change order request proposing to remove the precast panels from its bid and have the City negotiate with certified suppliers for production of the panels "in an effort to minimize the cost of delays, litigation, etc." Hladky also included a letter stating that "[d]ue to the ambiguous specifications there is potential for a major impact on the schedule causing loss of productivity and increased costs." SFA denied the request.

A few weeks later, Hladky sent another letter restating that the City's actions and inactions resulted in delay and additional costs. After another two weeks elapsed, the City approved a change order to allow Hladky to substitute Gage for Winfrey. Unfortunately, Gage's plant was unavailable due to work on another project and could not begin work on the precast panels for several weeks. Hladky informed the City that it would reschedule subcontractors as necessary to complete the project as efficiently as possible and that it would document the costs associated with the delays caused by the City. Roughly one year after the project was scheduled to be completed, Hladky completed the work.

Subsequently, Hladky submitted a claim for approximately \$1.3 million dollars allegedly caused by changes in the project specifications and subsequent delays. After an unsuccessful attempt at mediation, Hladky filed a complaint claiming that the City breached the contract and the implied covenant of good faith and fair dealing when it refused to allow Hladky to order the precast panels from Winfrey until Winfrey, contrary to the express contract provision requiring certification prior to the start of production, obtained the required certification. Hladky also claimed that the City breached the contract and the

implied covenant when it failed to approve Hladky's change order requests in time for Hladky to obtain the precast panels from Gage.

After a jury trial, the jury returned a verdict finding that the City had not breached the express terms of the contract but had breached the implied covenant of good faith and fair dealing. The jury awarded Hladky damages in the amount of \$1.125 million dollars. On appeal, the City argued that because the jury had found that it did not breach express terms of the contract, Hladky could not recover for breach of the implied covenant of good faith and fair dealing. The City rested its assertion on the fact that language in the contract unambiguously provided that SFA did not have the authority to bind the City and that any modifications to the contract must be in writing. The City argued that SFA's statements had no effect on the contract, did not bind the City, and did not prevent Hladky from ordering precast panels from Winfrey.

Hladky contended that a breach of the implied covenant of good faith and fair dealing could exist without breaching the express terms of the contract. It argued that an implied covenant to cooperate and not interfere with contract performance existed in every contract separate and apart from the express terms. Hladky asserted that the City breached the implied covenant when it refused to allow Winfrey to order precast panels until Winfrey was certified and when it did not act on Hladky's change order request to substitute Gage Brothers as the precast supplier until it was too late for Hladky to meet the scheduled completion date.

Independent Implied Duty to Cooperate

The court, applying Wyoming law, stated that "the implied covenant requires that neither party to a commercial contract act in a manner that would injure the rights of the other party to receive the benefit of the agreement." Further, the implied covenant "requires the parties to act in accordance with their agreed common purpose and each other's justified expectations. A breach of the implied covenant occurs when a party interferes or fails to cooperate in the other party's performance."

In the court's view, an implied covenant of good faith and fair dealing "must arise from the language used or be indispensable to effectuate the intention of the parties as determined by the contract language" and not used to create new or independent rights or duties. The question of whether the implied covenant of good faith and fair dealing was breached is ordinarily one of fact, focusing on the conduct alleged as constituting the breach within the context of the contract language, the parties' course of conduct and industry standards.

The contract identified the City as the owner and stated that SFA did not have authority to bind the owner without an express written modification of the contract. There was no written modification of the contract specification requiring certification prior to the start of production. Therefore, the City contended that it did not breach the

implied covenant when SFA orally modified the contract specification requiring certification prior to ordering the precast panels.

The court rejected that argument and stated that the evidence "created" a reasonable inference that, rather than conforming to the agreed common purpose and [Hladky's] justified expectations, the City instead interfered and failed to cooperate with [Hladky's] ability to perform." The evidence showed that, despite the contract provisions, the City went along with SFA's modification of the contract specification and failed to dispute SFA's statements and position. In addition, the evidence also permitted a reasonable inference that the City breached the covenant when it did not act on Hladky's change order request to substitute Gage as the precast supplier.

There was no question that the City knew the precast panels needed to be ordered to avoid delays to the project. Because the City took no action to allow Hladky to order the precast panels from Winfrey or, alternatively, to substitute Gage as the supplier, the City breached the implied covenant of good faith and fair dealing by interfering or failing to cooperate with Hladky's ability to perform.

Practical Notes

A breach of the implied covenant occurs when a party interferes or fails to cooperate in the other party's performance. To determine whether a party has breached the implied covenant of good faith and fair dealing, the courts will focus on the conduct alleged as causing the breach within the context of the contract language, the parties' course of conduct, and the applicable industry standards. If the actions of the offending party run contrary to the clear contract language and the evidence establishes a material dispute as to whether a party's conduct went beyond the exercise of contract rights and amounted to self-dealing or a violation of community standards of decency, fairness or reasonableness, the issue is one for determination by the fact-finder.

To avoid breaching the implied covenant of good faith and fair dealing, ensure that all actions and conduct fall within the context of the contract language. Where a contract authorizes one party discretionary authority to determine a contract term, it is important that the party exercising that right refrain from doing anything that will have the effect of frustrating the rights of the other party.

Ian C. Clarke

(404) 582-8049

icclarke@smithcurrie.com

Member of the State Bar of Georgia

Georgia's "Acceptance" Doctrine Survives

641 The Acceptance Doctrine's History

Since 1905, Georgia courts and contractors have followed the judicially created "acceptance doctrine."

The current statement of this doctrine provides that where a contractor does not hold itself out as a design expert on a particular project, performs its work without negligence, and such work is accepted by the owner, then the contractor is not liable for any injuries resulting from that work.

The acceptance doctrine was once followed universally, but has recently come under increased scrutiny. In the past few years, more than 40 states have considered the continued viability of the acceptance doctrine, and 75% of those states decided they would no longer follow that doctrine. These states now follow a “foreseeability doctrine,” which holds a contractor liable for those injuries arising from its work which could have been foreseen at the time of the construction – whether or not the owner accepted that work.

The *Bragg v. Oxford* Decision

In 2009, Georgia became the latest state to reevaluate the acceptance doctrine when the Georgia Supreme Court considered *Bragg v. Oxford Construction Co.* (“Oxford”), 258 Ga. 98 (2009). In that case, Ken and Francesca Bragg sued Oxford Construction for damages sustained in a one-car auto accident. Dougherty County (“County”) had hired Oxford to repave and overlay asphalt patches on a county road. The County had also retained its own engineer, which in turn directed Oxford’s work. Specifically, the County’s engineer ordered Oxford to install an overlay patch on the very piece of roadway where the Braggs’ accident occurred. The court took great care to state that Oxford did not make design decisions, but instead followed the engineer’s instructions. After it completed construction, Oxford found what it thought was an error with the finished product. It requested the County’s permission to correct the error, but the County denied that request. Thereafter, the County approved and accepted Oxford’s work.

Just seven months after Oxford completed its work, the Braggs were injured in an automobile accident on the same stretch of road. The Braggs sued Oxford for their injuries, alleging “negligent construction.” The Braggs’ expert found nothing negligent in the means and methods of Oxford’s construction, but nevertheless alleged the accident was caused by the road surface on which Oxford had worked.

The trial court found the acceptance doctrine provided Oxford with a complete defense and dismissed the Braggs’ suit. The Braggs appealed, urging the Georgia Supreme Court to overturn the acceptance doctrine. The Georgia Supreme Court denied that request. Although the court described its ruling as an approval of the acceptance doctrine, it did so only on the facts of that case.

Ironically, the language in the *Bragg* opinion indicates the court ruled more out of concern for fairness and responsibility, and relied very little on the County’s actual acceptance of Oxford’s work. According to the court, the facts of the *Bragg* matter clearly placed liability for the couple’s injuries on the designers, and not the contractor. “Under such circumstances, liability, if any, should rest

with the entity that hired Oxford, ordered it to patch the road, and accepted Oxford’s completed work.”

Practical Impact of *Bragg* & the Acceptance Doctrine

The Georgia Supreme Court was much more concerned with the underlying facts of the *Bragg* case than it was with acceptance, or the viability of the acceptance doctrine. For this reason, contractors are better served analyzing those facts than they are with a detailed analysis of the legal doctrine. After reviewing the facts, the *Bragg* opinion teaches contractors to avoid liability for future injuries by concentrating upon (1) avoiding negligent work, and (2) following the owner-provided plans and specifications.

(1) Avoid Non-Negligent Work

The majority’s opinion noted on several occasions that there were no defects in the construction work Oxford performed. Oxford also went the “extra mile” to alert the County to potential problems. This action shielded Oxford from liability. The court noted that if there had been any allegation Oxford performed its work negligently, then its opinion would have been different — even if the County still accepted Oxford’s work. “If Oxford had somehow been negligent . . . it could still have been subjected to liability under Georgia law regardless of whether or not the County accepted its work.” The *Bragg* opinion reinforces what contractors already know – avoiding trouble and liability starts with competent performance.

(2) Follow the Owner’s Plans and Specifications

The other fact which impressed the Georgia court and allowed Oxford to avoid liability was Oxford’s strict compliance with the County’s plans and specifications. The court would not allow Oxford to be held liable for merely following the instructions given to it by the County and County’s engineer. As the *Bragg* court noted, “If it appears the contractor has followed the plans and specifications of his employer and injury has resulted, the employer, and not the contractor, is to be held liable.” In this situation, “Oxford followed the specific instructions given to it in performing its work and performed its work to the satisfaction of the County . . . Oxford just did what it was instructed to do by the County . . .” According to the court, Oxford should not be held liable for simply following instructions.

It is likely that the result might have been different if Oxford deviated from the plans and specifications, if it had participated in the design of roadway, or if it had held itself out as a design expert. The real result of the *Bragg* decision is that the Georgia Supreme Court used the acceptance doctrine to place liability on the party responsible for the faulty design: Dougherty County. The court would not allow Oxford to bear the liability for the County’s design errors. “Because Oxford performed the requested work according to the specifications given to it by the County, and because there is no evidence that Oxford performed the assigned work in a negligent matter, [Oxford] cannot be held liable for injuries resulting from its

employer's allegedly defective design of the work."

The *Bragg* opinion does discuss acceptance, and does continue to approve the acceptance doctrine – but only under certain fact patterns. The real underlying question for contractors on future projects may not be whether the owner accepted a contractor's work or if the acceptance doctrine remains valid. Instead, the most important question will be whether the contractor avoided negligent or defective construction work, and whether the contractor followed the plans and specifications. If it did so, that contractor should avoid liability.

David C. King
404-582-8036

dcking@smithcurrie.com
Member of the State Bar of Georgia

Federal Contracting Update

642 As reported in the November 9, 2009 issue of *Engineering News Record*, federal government military construction contracting may be one of the few segments of the construction market offering substantial opportunities for new work. Within the federal government, contracts awarded by the Corps of Engineers, the Naval Facilities Engineering Command, and the Air Force (hereinafter "DOD construction projects") comprise a substantial percentage of these opportunities. Contractors considering new DOD construction projects need to be aware that Congress passed legislation in late 2008 imposing additional performance and compliance requirements on contractors performing DOD contracts. The purpose of this article is to provide a summary update on these requirements that became effective in 2009.

Buy American Act – Steel Products

The basic Buy American Act requirements are found in Subpart 25.2 of the Federal Acquisition Regulation. While those provisions express a strong policy preference for the use of domestic construction materials on construction projects performed in the United States, FAR § 25.202 allows for exceptions to this policy. However, in Section 108 of the Military Construction and Veterans Affairs Appropriation Act (Pub. L. 110-329, Division E) Congress prohibited the procurement of steel for any military construction project funded by that Act for which American steel producers, fabricators, or manufacturers are denied the opportunity to compete. Reflecting that mandate, the Department of Defense adopted a new regulation (DFARS § 236.274) and clause (DFARS § 252.236-7013), which apply to new military construction projects using funds appropriated by Title I of the Military Construction and Veterans Affairs Appropriations Act, 2009. This new policy and clause require the contractor to:

- Provide "American" steel producers, fabricators, and manufacturers the "opportunity" to compete when acquiring steel as a construction material (e.g., steel beams, rods, cables, plates).

- Include the substance of the clause at DFARS § 252.236-7013 including a further flow down requirement in any subcontract that involves the acquisition of steel as a construction material.

Some Possible Questions

The regulation and clause leave several questions open to interpretation. For example, there is no definition in the FAR or DFARS of an "American" steel producer or fabricator. Is a fabrication facility in the United States which is a wholly owned subsidiary of a foreign steel company considered to be "American?" The concept of an "opportunity to compete" is not defined in the new regulation. How does a contractor demonstrate compliance or determine that a lower tier subcontractor has done so?

Even if this new regulation is somewhat vague, it would be a mistake to conclude that it will have no effect on contractors. For example, it is entirely possible that a firm may file a bid protest asserting that another contractor failed to comply with this requirement. In addition, in 2009 Congress appropriated substantial sums for additional audits and inspector general reviews of contractor compliance. These individuals will most certainly examine a contractor's files to determine if the contractor can prove that it made a good faith effort to adhere to this policy.

The entire subject of compliance with the Buy American Act has become more complicated in the last year. The American Recovery and Reinvestment Act has special Buy American requirements that can add to the complexity of a contractor's compliance obligations. As a service to its clients, Smith Currie has developed a *Buy American – White Paper*, which is available upon request. Simply e-mail Doug Tabelaing at dtabelaing@smithcurrie.com or call him at 404-582-8058.

False Claims – Whistle Blower Protections

During the final years of the second Bush Administration, Congress and the Administration considered various proposals to strengthen the federal False Claims Act, 31 U.S.C. §§ 3729-3733, as part of a comprehensive business ethics and compliance program. One element of this program provides encouragement for contractor's employees to report suspected wrongdoing to the federal government. Generally, this is known as a "whistleblower's program." Federal agency Hotline posters with 800 numbers are used to provide an easy mechanism to "blow the whistle."

Congress and the agencies also seek to redress any retaliatory action by a contractor against a whistle blowing employee. Since 1995, the FAR has contained provisions prohibiting reprisals against employees for disclosing a substantial violation of law. See FAR Subpart 3.9, 10 U.S.C. § 2409, and 41 U.S.C. § 251 *et seq.*

However, in 2008 Congress enacted legislation in Section 846 of the National Defense Authorization Act for Fiscal Year 2008 and in Section 842 of the National Defense Authorization Act for Fiscal Year 2009 mandating that DOD adopt regulations that differ from the current whistle

blower protection requirements in the FAR and 41 U.S.C. § 251 *et seq.* This new legislation operates to expand the protections available to employees, the types of protected disclosures, and the categories of government officials to whom information may be disclosed without reprisal. In addition, these new regulations impose affirmative obligations on a contractor to inform its employees of their “whistleblower rights.” These requirements have been implemented in DFARS Subpart 203.9 and in a new mandatory clause for DOD contracts at DFARS § 252.203-7002.

Contractors performing contracts for DOD need to anticipate agency inspector generals reviewing contractor activities to inform employees of their rights. In addition, contractors should consider actions and practices that can help establish that no reprisals or retaliatory actions occurred. Again, Smith, Currie has developed a **Federal Whistleblower – White Paper** which is available upon request. Simply e-mail Tom Kelleher at tjkelleher@smithcurrie.com or call him at 404-582-8016.

Thomas J. Kelleher, Jr.
404-582-8016
tjkelleher@smithcurrie.com
Member of the State Bars of
Georgia and Virginia

Supervisory Editors: Thomas J. Kelleher, Jr., and Charles W. Surasky.



2700 Marquis One Tower
245 Peachtree Center Avenue, N.E.
Atlanta, Georgia 30303-1227
404/521-3800

Upcoming Seminars

Georgia Lien Law Update, Georgia Branch AGC, February 10, 2010, Atlanta, GA. *S. Gregory Joy.*

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

Legal Issues and Contract Clauses, Construction Project Manager Course, AGC of America, February 21-26, 2010, Indianapolis, IN. *Philip E. Beck.*

Federal Government Construction Contracting, 2010 National Convention, AGC of America, March 17-20, 2010, Orlando, FL. *Phillip E. Beck, Robert C. Chambers, Thomas J. Kelleher, Jr. and Joseph C. Staak.*

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