



# COMMON SENSE CONTRACTING

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## Inside This Issue

- 643 Site Data Disclaimers
- 644 EPA's New Stormwater Effluent Limitation Rules
- 645 North Carolina's Public Project Funding Risks
- 646 Federal Bid Bond - Fatal Discrepancy
- 647 Contingent Payment Clause Enforcement
- 648 Mississippi: CGL Policies and Defective Workmanship
- 649 Unit Price Adjustments

## Site Data Disclaimers

### 643 Introduction

Owners commonly provide subsurface soil data and other site conditions reports as part of the bid documents provided to prospective bidders. Fearful of assuming liability for the accuracy of plans, borings, and other subsurface data provided to contractors, owners traditionally include exculpatory clauses that purport to shift the risk of inaccurate data away to the contractor. These clauses typically state that the data is provided for information only, the owner makes no warranties as to the accuracy of the data, and the contractor expressly assumes all risk that the conditions encountered differ from the conditions described in the reports.

When the proffered reports contain misrepresentations or withhold critical information, the efficacy of such clauses and owners' liability for the erroneous information are at issue. That is, may an owner escape liability for withholding pertinent information or for providing knowingly inaccurate information simply by disclaiming all responsibility for the data? Two recent cases, one set in Pennsylvania and the

other in Texas, highlight the differences in the approaches taken by the courts.

### **Pennsylvania: Exculpatory Clause Doesn't Excuse Fraud Representation of Balanced Sitework**

The first case, *Dep't of Gen. Servs. v. Pittsburgh Bldg. Co.*, 920 A.2d 973 (Pa. Commw. 2007), involved a contract to construct an armory building for the State of Pennsylvania. Pennsylvania's Department of General Services (DGS) provided bid documents stating that the project consisted of a balanced site, where soils from higher elevations could be borrowed to fill lower elevations without the necessity of using outside fill materials. The bidding documents also contained a geotechnical soil report that demonstrated adequate soil conditions. The soil report notably lacked any mention of clayey soils or subsurface springs, which would create compaction problems and make the soils unsuitable to be used as fill. When the winning bidder, Pittsburgh Building Company (PBC), later encountered large amounts of clayey soils and subsurface springs on the project site, it was unable to compact the soil and resorted to remedial measures that led to a lengthy project delay. PBC sued for the delay damages it suffered due to the unsuitable soils.

### **Key Information Withheld**

PBC subsequently discovered that DGS employees had, prior to the release of the bid documents, identified a significant presence of clayey soils on the site. This information was contained in an internal report that concluded with an assessment that the site was unsuitable

## WELCOME BACK!

Smith, Currie & Hancock LLP warmly welcomes the return of Rolly Chambers and Gene Rash as partners in our Charlotte, North Carolina office. Rolly and Gene rejoined the firm in January, 2010 focusing their practices in construction law, government contracting, and dispute resolution.

*Contact and biographical information for Rolly and Gene can be found on the back page of the newsletter.*

for earthwork when PBC was instructed to proceed. The existence of unsuitable soils effectively negated the concept that the site work would be “balanced,” meaning that soils would need to be imported from offsite locations. As DGS withheld this information and the report from the bid documents, PBC argued that DGS had engaged in constructive fraud and active interference with PBC’s performance.

DGS relied on the broad exculpatory clause contained within PBC’s contract. The contract required PBC to “assume all risk in excavating for this project” and stated that PBC “shall not be entitled to rely on any subsurface information” obtained from DGS. Thus, DGS argued that it had no responsibility for either the disclosed soil report indicating the presence of suitable soils on the site or the undisclosed internal report indicating unsuitable soils.

The Commonwealth Court of Pennsylvania disagreed with DGS. First, the court found that DGS committed fraud by affirmatively misrepresenting the site’s soil conditions. DGS knew of unsuitable soils on the site, yet it disclosed only bidding information that demonstrated adequate soil conditions. The court also found that these acts constituted active interference with PBC’s contractual duties as DGS directed PBC to commence work without

disclosing the unsuitable conditions, thereby preventing PBC from timely completing its work.

As a result of its fraud and active interference, DGS was unable to rely upon the exculpatory contract provisions. The court distinguished earlier cases in which broad exculpatory provisions were upheld, noting that in those cases, the party seeking exculpation lacked any prior knowledge of unfavorable conditions. As DGS had prior knowledge, the court would enforce the exculpatory provisions.

#### **Texas: Exculpatory Clause Enforced Against Contractor**

In a contrasting case, the U.S. Court of Appeals for the Fifth Circuit applied a series of broad exculpatory clauses to reverse a \$3 million jury verdict in favor of the contractor. *Interstate Contracting Corp. v. City of Dallas*, 407 F.3d 708 (5<sup>th</sup> Cir. 2005). This case arose out of a City of Dallas (“City”) contract with Interstate Contracting (“ICC”) to construct a levee around a water treatment facility. The contract also called for ICC to excavate two areas to create stormwater detention lakes. The excavated soil from the lakes, if suitable, could be used to create the levee, thereby reducing the costs of the work.

The City provided all bidders with contract documents

## **Federal Government Construction Contracts - Second Edition** *A Practical Guide for the Industry Professional*

In the spring of 2009 the Associated General Contractors of America (AGC) and John Wiley & Sons asked Smith, Currie & Hancock to prepare a Second Edition of its desk book on federal government construction contracting to be used by the AGC as its primary guide for contractors competing for and performing federal contracts. The American Recovery and Reinvestment Act, the adoption of new and challenging project delivery systems, and the numerous regulatory changes affecting contractors’ obligations and risks, made a Second Edition necessary.

Smith, Currie and the AGC contacted numerous contractors to obtain their advice and recommendations. This Advisory Council submitted comments on the organization and content in order to make this new book as useful as possible. The input of this Advisory Council was a key step in the development of this Second Edition. The new edition contains substantial revisions throughout the book plus approximately 150 pages of new materials, a specific chapter on the American Recovery and Reinvestment Act, as well as numerous checklists, tables of key clauses and statutes, sample federal government specifications on Building Information Modeling, and forms that can be adapted for any project. It is a truly comprehensive guide on federal government construction contracting for the industry professional.

This book was released on March 12, 2010. Enclosed with this newsletter is a flyer developed by the publisher, John Wiley & Sons, which provides more detail on the book and its contents. As you will see from the flyer, the list price for this book is \$110.00; however, the AGC of America has authorized us to advise our newsletter readers who are also AGC members of a discounted member price of **\$85.00** per copy for the next **60 days**. To place an order, call 800-242-1767 and reference discount code “**TK2010**.”

that required all fill material for the levee to be excavated from the lakes with one section of the plans designating several onsite borrow locations. Another section of plans referenced soil and subsurface reports available for review; however, the City disclaimed the subsurface data and encouraged bidders to examine the data and make their own investigation of the site prior to bidding on the project.

The contract between the City and ICC contained numerous exculpatory provisions. “All risks of differing subsurface conditions shall be borne solely by the CONTRACTOR.” ICC “shall bear all losses . . . because the conditions under which the work must be done are different from what were estimated or anticipated . . .”

The contract also stated that all bidders “shall rely exclusively upon their own estimates, investigations, tests and other data . . .”

When the lake excavation failed to yield sufficient quantities of suitable soil for construction of the levee, ICC brought suit against the City and won a \$3 million jury award at trial. ICC argued that the plans indicated that ICC would be able to extract sufficient levee fill material from onsite locations. This amounted to a misrepresentation by the City and stood as the basis for ICC’s recovery.

Upon appeal to the Fifth Circuit, the City argued that the exculpatory provisions of the contract relieved it of liability for ICC’s claims. The court agreed with the City, noting that the risks of the soil conditions had been clearly and expressly shifted to ICC. The court also found that the contract specifically disclaimed the adequacy of the plans and required ICC to rely exclusively upon its own site investigations. In the court’s view, ICC’s contract with the City relieved the City of liability for plan errors – it did not amount to a warranty of the plans by the City.

### Practical Note

These two cases highlight the subtle differences in facts that can lead courts to reach different outcomes. In the Pennsylvania case, the owner possessed information that contradicted the reports it provided to bidders. Providing knowingly inaccurate information was fraud, and this was a sufficient basis for disregarding the contract’s exculpatory provisions. In the Texas case, the owner-supplied information turned out to be incorrect, but there was no assertion that the City knew of the errors. Thus, the exculpatory provisions prevailed.

Contractors must be aware of the risks of unexpected site conditions. Who has the responsibility to explore the site conditions? Who bears the risk that the owner-furnished information might be inaccurate? Who bears the risk of unexpected site conditions? A contract that shifts the duty to investigate the site and all the risks of unexpected conditions onto the contractor should be carefully considered.

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## EPA’s New Stormwater Effluent Limitation Rules

**644** On December 1, 2009 the U.S. EPA issued a long-anticipated final stormwater rule, which impacts nearly every construction and development project in the United States. EPA promulgated the rule, titled “Effluent Limitations Guidelines and Standards for the Construction and Development Point Source Category”, pursuant to authority delegated it under the federal Clean Water Act. Now, for the first time, construction professionals are faced with an enforceable **numeric** limit on stormwater discharges from **large** construction sites, and must monitor stormwater discharge to ensure compliance with the numeric limit. The rule also requires nearly all construction sites to implement **non-numeric** erosion and sediment controls and pollution prevention measures. EPA was under a court ordered deadline to develop these Effluent Limitation Guidelines (“ELGs”), which took effect on February 1, 2010.

These requirements will be incorporated into the National Pollutant Discharge Elimination System (NPDES) construction general permit, presently required on all construction sites of one acre or more. *Non-numeric* effluent limitations remain in effect on every construction site exceeding one acre. The *numeric* limitation—and its associated monitoring requirements—will be phased in over four years. On August 1, 2011, construction sites disturbing **20 or more acres** at one time must comply with the numeric effluent limitations. Those same requirements will apply to construction sites disturbing **10 or more acres** as of February 2, 2014. The rule phases in the numeric effluent limitation over four years to allow permitting authorities adequate time to develop monitoring requirements and to allow the regulated community sufficient time to develop a full understanding of the new compliance processes.

The new rule loosely defines land disturbance to include clearing, grading, and excavation activities. It also includes any period during which affected land is generally exposed after removal of grass, rocks, pavement, and other protective ground covers. The acreage disturbed **at one time** triggers the numeric limitation requirement. For example, a construction site could ultimately disturb 10 or more acres, but so long as that site does not disturb 10 or more acres **at one time**, compliance with the numeric limitation is not required.

For many sites, the ELGs will require an additional layer of management practices and treatment above what most government programs currently require. Permitting authorities must incorporate the turbidity limitations into construction general permits, and permit holders must implement the control measures. EPA does not specify technologies to be used to meet the numeric limit. But EPA does specify the maximum daily turbidity level that may be present in a construction site’s stormwater discharges. Whether it is the owner, developer, general contractor, or sitework contractor, the party tasked with obtaining the construction permit may select the management practices

and technologies that are best suited to site-specific conditions.

EPA projects that these regulations will reduce the amount of sediment discharged from construction sites by approximately 4 billion pounds each year, at *an annual cost of about \$953 million*, once fully implemented.

### **Non-Numeric Effluent Requirements**

The non-numeric requirements apply to construction activities that will disturb one acre or more, and must be incorporated into permits issued after February 1, 2010. Many states already require such best management practices (or BMPs). The non-numeric effluent limitations include a range of erosion and sediment controls, soil stabilization requirements, and pollution prevention measures.

**Erosion and Sediment Controls.** Site-specific erosion and sediment control measures must be designed, installed, and maintained to control stormwater volume and velocity; minimize the amount of soil exposed, disturbed, and discharged during construction activity; provide and maintain natural buffers around surface waters; direct stormwater to vegetated areas; minimize soil compaction; and preserve topsoil.

**Soil Stabilization Requirements.** Permit holders must initiate soil stabilization measures immediately whenever any clearing, grading, excavating, or other earth disturbing activities have permanently ceased on any portion of the site, or if these activities temporarily cease on any portion of the site and will not resume for a period exceeding 14 calendar days. In arid, semiarid, and drought-stricken areas where initiating stabilization measures immediately may not be feasible, those measures must be initiated as soon as practical.

**Pollution Prevention Measures.** Pollution prevention measures should be designed, installed, and maintained to: minimize discharge of pollutants from equipment and wash waters; prohibit discharge of fuels, oils, or other pollutants used in vehicle and equipment operation; minimize exposure of on-site building materials to precipitation and stormwater; minimize discharge of pollutants from spills and implement prevention and response procedures; and prohibit wastewater from washout of concrete, stucco, paint, form release oils, curing products, and other construction materials.

### **Numeric Effluent Requirements**

EPA's new rule sets a numeric effluent limitation for turbidity at 280 nephelometric turbidity units ("NTU") and requires monitoring to ensure that this limitation is met. EPA embraced this numeric approach by reasoning that turbidity is an "indicator pollutant" which will help control the discharge of other pollutants from construction sites, such as metals and nutrients. Moreover, EPA found that turbidity may be measured economically in the field using a readily available turbidimeter. The turbidity limitation applies only to construction sites disturbing land at any one time at or above a specified acreage. From August 1, 2011 until February 1, 2014 the numeric effluent requirements apply to construction sites that will disturb 20 or more acres at any one time. As of February 2, 2014, this threshold drops to construction sites that will disturb ten or more

acres at any one time.

The 280 NTU turbidity limit is expressed as a maximum daily limitation, meaning that the average daily sample may not exceed the maximum daily amount. This allows for temporary discharges of stormwater exceeding the turbidity requirement, such as discharges during an intense period of rainfall. Notably, the new rule exempts discharges resulting from a storm event that exceeds the local two-year, 24-hour storm level.

**Numeric Monitoring Requirements.** Each delegated state must determine its monitoring and compliance protocols, including the frequency, location, and duration of sampling in relation to storm events. EPA offered the following glimpse into its monitoring expectations:

- Collect a minimum of three samples per day at each discharge point while a discharge is occurring;
- Monitor any storm event or snowmelt that generates a discharge;
- Conduct, at a minimum, sampling during normal business hours;
- Use a properly calibrated turbidimeter;
- Reporting requirements are uncertain, but will likely include monthly discharge monitoring reports; and
- EPA has suggested that permitting authorities implement notification procedures as to when the 10-acre disturbance threshold has been exceeded.

**Technologies Available to Assist in Meeting the Numeric Limits.** Unlike previous rules in which EPA identified a "model" technology that had been demonstrated to meet the established limits, here EPA leaves the methodology determination to the permit holder. Nevertheless, EPA broadly recommends certain erosion and sediment control technologies to meet the numeric limits. Builders and developers may experience a trial and error period to determine which suite of control measures will achieve the required discharge limitation on a given project. In fact, EPA cites the need to adjust, modify, and revise the new control techniques as a primary factor for delaying numeric limits by 18 months.

Recommended erosion control technologies include: minimizing the extent of grading to reduce sediment yield; dissipating stormwater energy through diversion berms, conveyance channels, and slope drains to prevent high runoff velocities and concentrated erosive flows; vegetative stabilization; physical barriers, such as geotextiles, straw, rolled erosion control products, mulch and compost, and polymers and soil tackifiers; and periodic inspection. Typical sediment control technologies include: perimeter controls, such as filter fabric silt fences and compost filter berms; trapping devices, such as sediment traps and basins, inlet protectors, and check dams; and directing discharges from basins and channels or through silt fences or filter berms into vegetation or other buffers.

### **Can Builders and Developers Avoid the Numeric Limit?**

The 280 NTU limit only applies when the total amount of disturbed area on the project *at any one time* equals or exceeds the specified acreage threshold, first 20 or more, then ten or more, acres. So, by reducing the disturbed area

below the threshold (for example, 9.9 or 19.9 acres), the limit and its associated obligations may be avoided. This can be done throughout the entire project or during specific phases. For example, if a project initially disturbs ten or more acres, but after completion of clearing, grading, and infrastructure installation the site is stabilized before or during vertical construction, then the sampling requirements and turbidity limitations would cease to apply when the total disturbed land area falls below ten acres at one time. In all instances where the amount disturbed at any given time is greater than or equal to the specified threshold, however, the numeric limit will need to be met. EPA expects the states to determine recordkeeping and notification procedures that operators must follow to keep track of how much land is disturbed at any given time and when the limit applies.

### **Who Bears the Risk?**

It is estimated that EPA's new effluent limitation rule will affect more than 80,000 owners, developers, and contractors, performing both residential and commercial construction. Heavy and civil construction and engineering firms will also be impacted by the new rule. Consequently, construction professionals can expect to see increased stormwater discharge enforcement by federal, state, and local environmental regulators, including criminal and civil penalties for noncompliance, as well as more reporting and public oversight. The rule will also likely create time and cost impacts to projects in several ways, including: i) delays while permits are being obtained; ii) increased costs for monitoring equipment and enhanced erosion and sediment control and pollution prevention measures; and, iii) increased man-hours due to daily monitoring requirements. Much of the risk will fall to the project delivery team member responsible for obtaining the permit and ensuring compliance – particularly compliance with the new numeric limits. The current rule does not assign risk to any one entity. Prudent construction professionals should recognize these costs and consider how the risks associated with such monitoring should be allocated among the contracting parties, or how, through proper sequencing of work, they might be avoided.

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## **North Carolina: Public Project Funding Risks Local Government Defense to Payment**

**645** As governmental entities struggle with budget shortfalls, it is particularly important for contractors bidding on local public projects in North

Carolina to be aware of a little known, although decades old, statutory pitfall that could provide the public owner with a complete defense to contractor payment claims. North Carolina's Local Government Budget and Fiscal Control Act, found at N.C. Gen. Stat. §159-28, and its School Budget and Fiscal Control Act, found at N.C. Gen. Stat. §115C-441 (hereinafter referred to as "the Acts"), contain certain requirements that, if not satisfied, may bar a contractor from collecting payment for work performed under a contract with a local public entity. The North Carolina Court of Appeals recently acknowledged the applicability of this requirement to contracts with public school boards in *Transportation Services of North Carolina, Inc. v. Wake County Board of Education.*, 680 S.E.2d 223 (N.C. App. 2009).

North Carolina's school boards and local governmental entities, for contracts under which the government entity incurs a payment obligation, must provide a "pre-audit certificate" stating that the entity has complied with its statutory obligations in regard to the appropriations necessary for the contract. The Acts require the pre-audit certificate to be executed by the local entity's authorized finance officer and the certificate must be included *on the face* of any contract to be entered into with the local entity.

### **Contractors Risk Unenforceable Contracts**

Under North Carolina law a party dealing with a public entity is presumed to know all limitations to the government's authority, and that contracting party assumes the risk of those limitations. Because of this presumption, the contractor must determine whether the government has complied with the applicable statutory requirements. Otherwise, the contractor risks not being paid for work performed since a public owner may rightfully refuse to make payment on a void contract.

The pre-audit certificate is required for a local governmental entity to enter into a valid contract under which it incurs a financial obligation within that fiscal year. Absent a pre-audit certificate, there is no waiver of the public entity's sovereign immunity. Consequently, the contract is void and unenforceable and the local public entity is immune from liability. The fact that a pre-audit confirmation of funding contemplated by the Acts may have been conducted by a local entity is insufficient to render a contract enforceable if the pre-audit certificate is not included with the contract. North Carolina courts have ruled that attempting to address the Acts' requirements through a contractual provision, or rider is not acceptable as a substitute for a properly executed and attached pre-audit certificate.

### **How Far Does the Risk Extend?**

The risk to the contractor that is associated with North Carolina's pre-audit certification requirement is substantial - a local public entity may rightfully refuse to remit payment for work performed in the absence of a proper pre-audit certificate attached to the face of the contract. This risk also extends to settlement agreements entered into by local public entities without a proper pre-audit certificate. It is yet unclear whether the contractor's risk of non-payment would extend to contract change orders that

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increase a local government entity's financial obligation. If, however, North Carolina courts interpret an additive change order to be an agreement evidencing a financial obligation undertaken by the public entity that is within the scope of the Acts, then the lack of a pre-audit certificate attached to the face of a change order may provide the local public owner a defense to making payment for that work.

### **Eliminating the Risk**

The budget shortfalls being experienced by many local governmental entities in North Carolina may cause an increase in the number of construction contracts entered into by those entities without a proper pre-audit certificate. As a result, contractors face an increased risk of not receiving payment where cash-strapped local entities can assert the lack of a proper pre-audit certificate as a defense. The prudent contractor should ensure that the local government entity has strictly complied with the applicable Act before signing any local government construction contract. To do this, the contractor should confirm that the pre-audit certificate has been: (1) executed by the government entity's authorized finance officer; and (2) attached to the face of the contract. The burden falls on the contractor to ensure that the representative executing the certification has proper authority under the Acts. That authority is vested *only* in the local public entity's finance officer or authorized deputy finance officer.

When working with a local entity, the prudent contractor should also request that the local government entity prepare, properly execute, and attach a pre-audit certificate to all change orders that substantially increase the contract sum. This is recommended since it is currently unclear as to how North Carolina courts will view additive change orders under the Acts. If a contractor finds itself having already completed work on a contract that lacks a pre-audit certificate, the contractor should seek advice of counsel as to how to minimize the potential loss it may incur if the local entity were to invoke the absence of the certificate as a defense to an otherwise legitimate payment claim. At a minimum, a contractor in such a situation should consider quickly stopping work if the public entity falls behind in making payment.

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## **Federal Bid Bond – Fatal Discrepancy**

**646** In the current economy many contractors seek new business opportunities and a primary target is federal government construction contracting. Upon closer inspection, contractors quickly learn that competing in the government contracting arena can prove difficult as many projects require a commitment of resources and surety bonding capacity that exceeds the capability of a single firm. As such, contractors have sought avenues such as teaming agreements or joint ventures to pool

resources to increase their opportunities. But, as evidenced by a decision from the Government Accountability Office (“GAO”) in *BW JVI, LLC*, B-401841 (2009 CPD ¶ 249), contractors who team up to bid work must ensure that their bid strictly complies with the requirements set forth in the applicable procurement regulations, the Federal Acquisition Regulation (“FAR”). Lack of attention to detail may cost the bid team a substantial business opportunity.

### **Factual Background**

The Department of Veterans Affairs (“VA”) issued an invitation for bids (“IFB”) for renovations at the Clement J. Zablocki VA Medical Center in Milwaukee. The IFB required bidders to submit their bids along with a bid guarantee or bid bond. BW JV1 was identified as the bidder on the apparent low bid with a business address in New Berlin, Wisconsin. The BW JV1 joint venture was comprised of two separate companies – BW Contracting Services (“BW”) and KPH Construction Corp. (“KPH”). BW JV1's bid was signed by two individuals, identified as the President and Project Director.

The accompanying bid bond listed the principal on the bond as “BW JVI” with a Milwaukee, Wisconsin address. The bid bond appeared to be signed by the same two persons who had signed off on the joint venture's bid. “BW JVI” was identified as a “joint venture” under the “Type of Organization” section of the bid bond. A notarized Acknowledgement of Principal was attached to the bid bond identifying the principal that executed the bid bond as “KPH.” The Acknowledgement of Principal was signed by KPH's President.

The VA's contracting officer asked the bidder to explain the discrepancy between the principal listed in the bid and the principal listed in the bid bond. In response, the bidder provided the VA with a copy of the joint venture agreement showing that BW JV1 was a joint venture between BW, with a New Berlin, Wisconsin business address, and KPH, with a Milwaukee, Wisconsin business address. The joint venture agreement specifically provided that neither venture member could execute a security agreement or bond on behalf of, or in the name of, the joint venture except by written authorization of both BW and KPH.

The VA rejected the BW JV1 bid as nonresponsive. The VA concluded that the varying names, addresses, and signatories on the bid and bid bond created an ambiguity as to whether the principal in the bid and bid bond were the same legal entity. The joint venture then filed a protest with the GAO challenging the VA's rejection of its bid.

### **GAO Decision**

FAR §§ 14.404-2(a) and 28.101-4(a) require the rejection of bids that fail to conform to the essential requirements of the IFB or where the bidder fails to furnish a bid guarantee in accordance with the requirements of the IFB. The protestor argued that the bid and the bid bond were submitted by the same entity because BW JV1 was a joint venture and representatives for both members of the venture signed the bid and bid bond. The protestor pointed to the fact that the different addresses were

mutually agreed upon offices as specified in the joint venture agreement. The protestor also relied upon applicable FAR provisions to argue that any discrepancy between the names was an insignificant typographical error which the agency should have waived as an informality or minor irregularity. The protestor also argued that the Acknowledgement of Principal should not affect the validity of the bid bond because this document was not required by the IFB. Finally, the protestor provided a letter from its surety confirming that the surety company stood behind the validity of the bond.

In reviewing the protest, the GAO explained that bid bonds are required for the protection of the government. The GAO noted that a surety does not incur liability to pay the debts of another unless it expressly agrees to be bound. As a result, the GAO *rigidly* applies the rule that the principal listed on the bid bond must be the same as the nominal bidder. The GAO noted prior decisions holding that if the bid bond names a principal different from the nominal bidder, it is deficient and may not be corrected after bid opening as a minor informality. Conversely, the GAO has previously ruled if the entity that submitted the bid and that is identified as the bid bond principal are exactly the same, any discrepancy between the bidder's bond and bid bond principal's names is a matter of form that does not require rejection of the bid.

In this case, the GAO noted that at first glance the different spellings of "BW JV1" and "BW JVI" (Number "1" vs. Roman Numeral "I") appeared to be a discrepancy that is a mere matter of form. The more significant issue involved the discrepancy between identification of a corporation as the entity that executed the bid bond compared to the bidder's identification as a joint venture. As such, this presented a question as to the bid bond surety's liability if the joint venture refused to execute the underlying contract. The GAO relied on the Acknowledgement of Principal and the fact that it stated that the person executing the bid bond was the president of KPH, only one of the joint venture members, and that was "the corporation described in the foregoing instrument" (i.e. the bid bond). But, the principal on the face of the bid bond was the joint venture. Additionally, although KPH was one of the two joint venture members, the joint venture agreement required the bid bond to be executed by both joint venture members.

The GAO rejected the protestor's argument that the Acknowledgement of Principal should not be considered because it was not required under the IFB. The GAO noted prior decisions holding that where bidders include unsolicited or extraneous materials in their bid submission, those materials are considered part of the bid and can render the bid nonresponsive. The GAO also gave no weight to the surety's post-bid letter, reasoning that a nonresponsive bid cannot be made responsive after bid opening through explanation of what the bidder or surety intended.

Under these facts, the GAO ruled that the bid bond was unclear as to whether the nominal bidder executed the bid

bond, which cast doubt on whether the surety would be liable to the government if the joint venture failed to execute the contract after bid acceptance. Based on the foregoing, the GAO upheld the VA's decision to reject the protestor's bid as nonresponsive.

### **Comment**

The bidder in this case lost out on a multi-million dollar business opportunity simply because it failed to pay attention to detail. The GAO's decision reinforces the importance of having qualified personnel and counsel with federal government contracting experience reviewing a bid before and advising the prospective bidder before it is submitted to a government agency. Government agencies will hold bidders and contractors to the requirements of the FAR, so an informed construction professional must know these regulations thoroughly. Failure to know and understand these requirements can render an otherwise competitive bid nonresponsive.

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## **Contingent Payment Clause Enforcement**

### **647 Introduction**

One frequent dilemma in construction contracting involves who should share in the financial risk when the owner fails to pay. Since the project owner provides the basic financing for the work, many general contractors believe that this financial risk should be shared by all of the contracting entities (prime and subcontractor). As a result, the contingent payment clause was born. Subcontractors and suppliers assert that such clauses are not reasonable as they look to their general contractor for payment and that it is the general contractor's obligation to ascertain the owner's financial capability. Many states will enforce contingent payment clauses, variously known as "pay-if-paid" or sometimes "pay-when-paid" clauses. Not only does the wording of these clauses vary from contract to contract, enforceability and validity of the clauses vary from jurisdiction to jurisdiction. Some courts adopt strict interpretation rules in determining the validity of contingent payment clauses, and recognize a distinction between these conditional payment clauses.

In a recent case out of the United States District Court for the Eastern District of Pennsylvania, the court recognized the distinction between "pay-if-paid," where a contractor does not have a duty to pay a lower tier subcontractor until the contractor is paid by the owner, and a "pay-when-paid" clause, where a contractor has a reasonable time to pay its lower tier subcontractor, regardless of whether the owner has actually paid the contractor. According to that court, the distinction lies in the wording of the clause itself, and there must exist a very strongly worded provision conditioning payment before

the risk of owner non-payment will shift to the subcontractor. In a period of severe, adverse financial conditions, these distinctions can be extremely important.

### **Pennsylvania Interpretation**

In *Sloan Co. v. Liberty Mutual Insurance Co.*, 2009 WL 2616715 (E.D. Pa. 2009) a subcontractor, Sloan, sued the general contractor's payment bond surety after the general contractor failed to pay Sloan. The owner had not paid the general contractor, and Sloan's subcontract with the general contractor contained a contingent payment clause. The surety argued that it was entitled to raise any and all defenses of the general contractor. Since the subcontract contained a clause conditioning the general contractor's payment to Sloan on the general contractor's receipt of payment from the owner, and the owner had not paid the general contractor, the surety argued it was not liable under the bond.

The key issue was whether the payment clause in the subcontract was a "pay-if-paid" clause which does not require a contractor to pay a subcontractor until the contractor receives payment or a "pay-when-paid" clause which "merely creates a timing mechanism for a contractor's payments to a subcontractor and do not condition payments" based upon receipt of payment from an owner. The relevant clause in Sloan's subcontract stated: "Final payment [to the Subcontractor] shall be made within thirty (30) days after the last of the following to occur, the occurrence of all of which shall be conditions precedent to such a final payment: . . . (6) Contractor shall have received final payment from the Owner for the Subcontractor's Work."

The *Sloan* court acknowledged that other courts have found phrases such as "condition precedent," "if and only if," and "unless and until" to be sufficient to establish that the agreement shifted the risk of non-payment to the subcontractor, and established a pay-if-paid defense for the contractor and its surety. The *Sloan* court, however, ruled that the presence of a single word or phrase such as "condition precedent" was insufficient to determine whether a provision was pay-if-paid or pay-when-paid. The court stressed the necessity of examining the contract as a whole to determine whether the intent of the parties was to shift the risk of non-payment to the subcontractor, and required *strong evidence* of such intent in order to find that a clause was a true pay-if-paid clause. The *Sloan* court ultimately held that the contingent payment clause ("condition precedent" language) in the subcontract did not clearly show an intent to shift the risk of the owner's non-payment to the subcontractor, and was thus a pay-when-paid clause. Consequently, the subcontractor could recover from the surety the amount the subcontractor was owed.

### **Comment**

The court in *Sloan* is not the only court to find that a clause thought to be a pay-if-paid is really a pay-when-paid, based on the wording of the clause in question. Many jurisdictions, such as Florida, recognize the distinction. Other jurisdictions, such as Georgia, do not distinguish between pay-if-paid and pay-when-paid. In

Georgia, there are no half measures - if a clause makes payment to a subcontractor conditional to payment by the owner that is the end of the analysis.

*Sloan* is not novel in its distinction between types of contingent payment clauses. The case is noteworthy, however, for the higher standard it places on contractors (and sureties) attempting to use the pay-if-paid defense. In *Sloan* the court looked for strong and clear language to demonstrate that the parties intended to shift the risk of owner non-payment to the subcontractor. The clause the court in *Sloan* found to be the most illustrative of a valid pay-if-paid clause stated "Subcontractor agrees that Contractor shall never be obligated to pay Subcontractor under any circumstances, unless and until funds are in hand received by Contractor . . . [t]his is a condition precedent to any obligation of Contractor, and shall not be construed as a time of payment clause." Similarly, the *Sloan* court noted that the use of the phrase "final payment" rather than "full payment" was indicative of a provision addressing the timing of a payment.

One key point for contractors, sureties, and subcontractors is that contractors wishing to include contingent payment clauses in their subcontracts should err on the side of forceful language such as the clause the *Sloan* court cited approvingly. Using the phrases "shall never be obligated," "condition precedent" and "shall not be construed as a time payment clause" apparently would be sufficient for a valid pay-if-paid defense in Pennsylvania, which is one of the jurisdictions imposing a higher standard on pay-if-paid defenses. By adopting the higher standard used in the *Sloan* case, contractors in jurisdictions such as Georgia should be amply protected.

Contractors using industry form contracts must also determine whether the contingent payment clause in the form contract contains strong enough conditional language, such as that mentioned in this article, or whether it contains weaker language that a court in a jurisdiction such as Pennsylvania might find insufficient to support a pay-if-paid defense. If the form contract's contingent payment clause does not contain the strong conditional wording the *Sloan* court illustrated, the contractor may wish to substitute its own language.

One point made clear by the *Sloan* decision is that the law surrounding pay-if-paid provisions varies across jurisdictions. Any contractor or surety wishing to rely on a contingent payment provision and avoid bearing the full risk of owner non-payment must make sure the provision is drafted in such a way as to provide full protection. Alternatively, for subcontractors wishing to pierce the pay-if-paid defense of a nonpaying general contractor, the *Sloan* case potentially provides some ammunition for arguing that the clause in question does not establish that the general contractor and subcontractor agreed to shift the entire risk of owner non-payment to the subcontractor.

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## Mississippi CGL Policies and Defective Workmanship

### 648 Overview

Virtually every construction project requires the general contractor, and other members of the project delivery team to obtain and maintain specified insurance coverage. This requirement includes what is commonly referred to as commercial general liability (or CGL) coverage. Most CGL policies are issued on standard forms drafted by the Insurance Services Office (ISO). These ISO forms typically start out by broadly defining what events are covered by the policy. This broad **coverage** is then narrowed through the use of **exclusions** to the policy. Then, the insurer may write back in some level of coverage through the use of **exceptions** to the exclusions. Finally, the insurer may alter any portion of the policy by adding **endorsements**.

The standard CGL policy language is, without question, very difficult to follow. First, the reader must conduct a four-prong analysis: i) do I have basic coverage; or, ii) does an exclusion apply; and, iii) if an exclusion applies is there an exception to the exclusion; and finally, iv) must I start the analysis over because an endorsement alters the policy language? Second, the policy reader must parse the meaning of multiple words and phrases such as “occurrence”, “accident”, “property damage”, “bodily injury”, “your work” and “expected or intended from the standpoint of the insured.” These efforts can be frustrating and time consuming. Insurance policy providers and underwriters, and, yes, even lawyers, can sometimes add to the confusion - - not much help to the construction professional.

### Defective Workmanship Coverage

One issue that has frequently arisen is to what extent these CGL policies issued in favor of the general contractor require the insurer to cover property damage claims when that damage is caused by the work of a subcontractor. Although the CGL policy provisions regarding property damage caused by defective workmanship are fairly standard, courts across the country are split on their interpretation. Many courts have found that property damage claims for defective subcontractor work are not even covered by CGL policies because the underlying event is excluded from the definition as to what constitutes an “occurrence” under the policy. Still, other courts have held that defective subcontractor work should constitute an occurrence under a standard CGL policy. An occurrence is typically defined by the CGL policy as “an **accident**, including continuous or repeated exposure to substantially the same general harmful conditions.”

For many years, these court decisions have relied upon underlying policy justifications, a main one being whether a CGL policy is the proper tool for mitigating the risk a general contractor faces when it **intentionally hires** a subcontractor who performs defective work. Recently, the Mississippi Supreme Court, faced with this same dilemma, took a different approach. Instead of evaluating whether such coverage existed based on policy justifications, it

embarked upon “a return to the basics” and conducted its analysis by focusing upon the plain language of the CGL policy. In ruling that coverage for such conduct may exist under a standard CGL policy, the court provided a different approach to resolving this problem.

### Mississippi Ruling

In *Architex Ass’n, Inc. v. Scottsdale Insurance Co.*, 2010 WL 457236 (Miss., 2010), the court was asked to determine whether the intentional act of hiring a subcontractor to perform work, precluded, as a matter of law, the possibility of coverage under a standard CGL policy. In *Architex* the owner of a hotel sued the general contractor, Architex, claiming, among other things, that Architex had failed to remedy defective work. The alleged defective work involved insufficient amounts of reinforcing steel in the building foundation. During construction, this work was performed by a subcontractor to Architex.

Architex notified its insurance carrier after it was told of the owner’s defective work claim, and sought indemnification and defense of the owner’s claims from the insurer. Architex’s insurer refused to accept this tender of defense and indemnification, contending that there had been no “occurrence” which would trigger “coverage” under the policy. Architex then sued its insurer, but the trial court dismissed Architex’s claim, agreeing with the insurer that there had been no “occurrence.” Architex then appealed this ruling to the Mississippi Supreme Court.

The *Architex* court overturned the lower court’s ruling by concluding that the CGL policy could not be construed as a matter of law to “preclude coverage for **unexpected or unintended** property damage resulting from work performed on Architex’s behalf by a subcontractor.” The court determined that such an analysis had to be conducted in order to determine whether there was an “occurrence” triggering the policy. The court reached this conclusion by expressly limiting its analysis to the policy language.

The *Architex* court recognized the need to look at the policy as a whole, following a common rule of contract interpretation. In doing so, the court first noted that the main insuring agreement covers “property damage” caused by an “occurrence.” The term “occurrence” is defined by the CGL policy as meaning “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.” The court rejected any threshold conclusion that subcontractor work is not even a covered event. To do so, the court found, would overlook “the plain language and purpose” of the coverage provisions in CGL policies. Instead, the court reasoned, that, in order to be excluded, an event first had to be included. Only in that way could the exclusionary language function “as a meaningful limitation or restriction on the insuring clause.”

### The “Your Work” Exclusion and the “Subcontractor” Exception

The *Architex* court recognized the need to analyze the stated exclusions and relevant exceptions to the exclusions as part of a thorough analysis of the underlying policy. Standard ISO form CGL policies contain, as did the one in *Architex*, what is commonly referred to as a “your work”

exclusion. This exclusion is typically construed so as to eliminate coverage for losses arising from the contractor's poor workmanship on a construction project, and is often construed to extend to losses caused by poor workmanship of the insured's subcontractors.

But the "your work" exclusion contains an exception, which was incorporated into the ISO form CGL policy in 1986. This exception provides that the exclusion "does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor." The court primarily focused upon this exclusion, and the so-called "subcontractor exception", which it then viewed within the broad coverage provisions of the CGL policy.

### Comment

Ultimately, relying upon an analysis of CGL policy language similar to that analyzed by the *Architex* court, one cannot say that there will or will not always be coverage for defective subcontractor work. And, under such analysis, coverage would extend only where the facts show that the defective workmanship was accidental. Yet, the *Architex* decision may set a precedent as to how courts analyze whether defective workmanship claims are covered by CGL policies. Contractors and owners seeking coverage for claims related to defective workmanship need to appreciate that there is a wide disparity in rulings from state to state. This lack of uniformity requires that the contracting parties obtain professional review of the specific language of any CGL policy (coverage, definitions, exclusions, exceptions, and endorsements), under the law of the state which is applicable to the project. Coverage questions need to be addressed at the inception of the project so that the risk of surprises at the end of the project is minimized.

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## Unit Price Adjustments

### 649 Introduction

Contracts based on unit prices typically contain provisions for adjustment of those prices if actual quantities differ substantially from those estimated. These so-called "variations in quantities" clauses afford some measure of protection to both the contractor and the owner if quantity estimates are off and the actual costs incurred are either higher or lower than anticipated. It is important that the parties to the contract understand and follow the procedures set forth in such provisions or they may not be able to enjoy that protection. *Pavers, Inc. v. Board of Regents of the University of Nebraska*, 276 Neb. 559, 755 N.W.2d 400 (2008), provides a cautionary tale of what can happen if such a contractual procedure is not followed.

### Factual Background

Pavers, Inc. ("Pavers") contracted with the University of Nebraska (the "University") to perform earthwork for a

student housing project. The contract divided the work into several separate activities all of them paid on a unit price basis. The University's bid form for the project had specified an estimated quantity for each separate activity and Pavers bid the project based on those estimated quantities.

Substantial overruns on the project were experienced for three of the activities: soil removal, seepage water removal, and seepage water disposal. Pavers notified the University of the overruns. The University was also independently aware of the overruns. Nevertheless, the University instructed Pavers to proceed with the work without first requiring a change order or issuing a construction change directive.

After the project was completed, Pavers sought payment for the actual quantities of work performed based on the unit prices in the contract. The University contended that, because of the overruns, the unit prices should be equitably adjusted. The University then unilaterally adjusted these unit prices and paid Pavers an amount it claimed was fair and equitable for the work performed. But the amount the University paid to Pavers for activities that experienced the overruns was not only far less than the amount Pavers contended it was entitled to based on the unit prices, it was also far less than the actual costs incurred by Pavers in performing that work. So, Pavers filed suit alleging breach of contract.

The trial court concluded that neither awarding Pavers its full unit price nor requiring Pavers to bear the increased costs of the work would be equitable. The court did not determine what would have been an equitable adjustment to the unit prices because it found both that the University had failed to meet its burden for the equitable adjustment it sought and that Pavers' exact losses and increased expenses were difficult to determine "because expenses were not tracked on a per work unit basis." Instead, the trial court reasoned that a total cost method should be applied and awarded Pavers its total costs incurred on the project less the amount paid by the University. Both parties appealed.

### Opinion of the Supreme Court of Nebraska

The Supreme Court of Nebraska stated that the issue was whether the unit prices should be reduced because of the large increases in the quantities. The University argued that the applicable section of the contract's general conditions required an equitable adjustment to the unit prices. The specific contract provision stated:

If unit prices are stated in the Contract Documents or subsequently agreed upon, and if quantities originally contemplated are so changed in a proposed Change Order or Construction Change Directive that application of such unit prices to quantities of Work proposed will cause substantial inequity to the Owner or Contractor, the applicable unit prices shall be equitably adjusted.

The court rejected the University's argument. Instead, the court held that *before* the work was completed the University could have sought relief under the contract by change order or construction change directive once it

determined that it had greatly underestimated the quantities, and *before* the additional quantities of work were performed. The court noted, the contract specifically allowed the University to seek an equitable adjustment while the work was being performed. If the parties could not agree on the unit price to be charged, the contract allowed the University to issue "Construction Change Directives" to change the work and propose a basis for adjustment of the contract sum. In this regard, the contract stated:

The Owner may by Construction Change Directive, without invalidating the Contract, order changes in the Work within the general scope of the Contract consisting of additions, deletions or other revisions, the Contract Sum and Contract Time being adjusted accordingly.

A Construction Change Directive shall be used in the absence of total agreement on the terms of a Change Order.

If the Contractor does not respond promptly or disagrees with the method for adjustment in the Contract Sum, the method and the adjustment shall be determined by the Architect on the basis of reasonable expenditures ... including, in case of an increase in the Contract Sum, a reasonable allowance for overhead and profit.

The contract did not, however, permit the University "to unilaterally reduce the unit prices in the contract *after* the work had been performed." The court thus held that Pavers should be paid for quantities of work performed based upon the contract unit prices.

The court concluded its opinion by stating that it was not the province of the trial court to rewrite the contract or adjust it based upon what the court considered to be fair. Instead, it was required to enforce the contract between the parties. Under the contract at issue in this case, the Supreme Court of Nebraska found that, it was "incumbent upon the University to seek an adjustment of the unit prices before the work was completed or sustain its burden of proof regarding an equitable adjustment to the unit prices." The University failed to do either and thus there was no basis to award Pavers anything other than the unit prices.

#### **Comment**

This case illustrates the importance of understanding contract provisions covering extra work, quantity changes, and payment, and the dangers of deviating from them. In this case, the University knew large quantity overruns were being encountered and apparently (based upon testimony given at trial by its project manager) anticipated that the unit prices would be adjusted after the project was over. The contract expressly permitted adjustment of those unit prices; however, it did so by means of a specific procedure. The University failed to follow that procedure. As a result, the University was unable to obtain a unit price adjustment to which it may well have been entitled had it simply followed its contract.

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## **Upcoming Seminars**

**A Look at ConsensusDOCS**, Construction Specifications Institute, April 13, 2010, Harrisburg, PA. *Dirk D. Haire.*

**Dispute Review Boards and Partnering in Public Works Contracts**, ABA Public Contract Law Section, ADR Committee, Webinar, April 13, 2010. *Hubert J. Bell, Jr.*

**Federal Government Construction Contracts – Appreciating the Critical Differences (FCILB Approved Course)**, Georgia Branch of the AGC, April 14, 2010, Atlanta, GA. *Thomas J. Kelleher, Jr., Joseph C. Staak, and John M. Mastin, Jr.*

**Making the Business Case for Diversity in the Practice of Construction Law**, ABA Forum on the Construction Industry, 2010 Annual Meeting, April 22-24, 2010, Austin, TX. *Lisa Colon Heron.*

**AGC 2010 Federal Contractors Conference**, AGC of America, April 26-29, 2010, Washington, DC. *Dirk D. Haire, Reginald M. Jones, Thomas J. Kelleher, Jr., and Steven L. Reed.*

**What's Really Covered in General Liability Coverage?** 2010 Insurance in the Construction Industry Conference, The Seminar Group, May 6, 2010, Atlanta, GA. *Kirk D. Johnston.*

**Mid-Atlantic Florida Contractors Licensing Program**, AGC of DC, May 18, 2010, Washington, DC. *Dirk D. Haire and Thomas J. Kelleher, Jr.*

**The Hidden Legal Risks of Green Building**, GA AGC 2010 Annual Convention and Fall Leadership Conference, June 6-9, 2010, Hilton Head, SC. *James K. Bidgood, Jr., Eugene J. Heady, and Douglas L. Tabeling.*

**Georgia Lien Law Update**, Georgia Branch of the AGC, June 16, 2010, Atlanta, GA. *S. Gregory Joy.*

## Gene Rash and Rolly L. Chambers Rejoin Smith, Currie & Hancock

**GENE RASH** has rejoined Smith, Currie & Hancock. Gene received his undergraduate education in civil engineering (construction option), graduating from North Carolina State University in 1985. While at NC State, Gene also worked as a post-tensioned concrete inspector for a major engineering and testing company, and he performed quantity surveys for a local contractor. Following graduation, Gene was a project engineer, and later, a project manager for a regional general contractor. In 1990, Gene obtained North Carolina registration as a professional engineer and also became the general contractor license qualifier for a small commercial contractor in North Carolina. In 1992, Gene was awarded the Brown Scholarship to attend Wake Forest University School of Law. He obtained his law degree from Wake Forest in 1995, and was shortly thereafter admitted to the bars of North and South Carolina. Gene joined Smith, Currie & Hancock in 1999 and became a partner in the firm in 2002. Gene left the firm in 2004 to form Taylor, Penry, Rash & Riemann, PLLC. Gene rejoined Smith Currie on January 1, 2010 and is based in the firm's Charlotte office. Gene can be reached at 704/335-5019 or at gfrasch@smithcurrie.com.

**ROLLY L. CHAMBERS** has rejoined the Charlotte, North Carolina office of Smith, Currie & Hancock LLP. Rolly previously was a partner in the firm from 1999 until 2006. He received his J.D. degree in 1984 from the Marshall-Wythe School of Law of the College of William & Mary in Williamsburg, Virginia where he was a member of the *William & Mary Law Review*. He received a B.A. degree in English (with Honors) and Psychology in 1975 from the University of North Carolina at Chapel Hill where he was a Morehead Scholar. From 1976 to 1981 he served on active duty as an officer in the U.S. Navy Reserve. Rolly has been a member of the North Carolina Bar and the Bars of the federal courts in North Carolina since 1984. He is a member of the American Bar Association, the North Carolina Bar Association, and the Mecklenburg County Bar and of various committees and sections within those professional organizations. Rolly also is a North Carolina Dispute Resolution Commission Certified Mediator for Superior Court and Estates & Guardianship matters and has mediated numerous commercial and construction cases. Rolly can be reached at 704/335-5018 or at rlchambers@smithcurrie.com.

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