

COMMON SENSE CONTRACTING

VOLUME 21, NUMBER 2

SUMMER 2007

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Prime Contractor's Right to Alter Schedule

561 Overview

Delay damages are a hot topic in discussions regarding construction contracts. In disputes involving project delays, the main issue for the parties to resolve is who is responsible for the costs associated with delays. Parties to a construction contract need to have a general understanding of delay damages in order to limit their exposure to liability and to prevent costly litigation. Liability for delay damages can result in significant additional costs for an owner or contractor who fails to complete its contractual obligations by the date or dates

Retired ASBCA Judge Steven L. Reed Joins Smith, Currie & Hancock

Smith, Currie & Hancock is pleased and honored to announce that Steven L. Reed has recently joined the firm as a partner subsequent to his retirement as a judge from the Armed Services Board of Contract Appeals and will concentrate his practice on federal government contracts.

Mr. Reed received both his undergraduate and law degrees from the University of Georgia. Following law school, he worked as an Assistant District Attorney in Gwinnett County, Georgia, prosecuting more than 75 felony cases before grand juries, trial juries, and bench trials before starting active Army service as a Judge Advocate officer. As a Judge Advocate, Steve tried more than 60 contested jury trials. Thereafter, he joined the U.S. Army Corps of Engineers as a contracts trial attorney, serving in the Pacific Islands, Korea, Japan, Western Europe, and Turkey where he was directly involved in the negotiation, settlement, or adjudication of hundreds of contract claims.

In 1988, Mr. Reed was assigned as a Hearing Examiner with the Corps of Engineers Board of Contract Appeals (ENG BCA) primarily to resolve disputes remaining under an agreement to build extensive military facilities in Saudi Arabia. He was appointed as an ENG BCA Judge in 1994. His docket at the ENG BCA included 225 appeals addressing matters related to locks, dams, navigation, flood prevention, construction of the Washington Metro light rail system, Panama Canal construction and procurement, Saudi military facilities, and foreign military sales transactions.

The ENG BCA was merged into the ASBCA in 2000. Until his retirement from the ASBCA in 2006, he mediated, assisted in the resolution of, or adjudicated 136 appeals involving all types of Department of Defense contracts, projects and facilities, as well as contractual matters arising out of contracts awarded by the U.S. Department of Health and Human Services, NASA, and other federal agencies.

Steve has also mediated or otherwise facilitated 50 alternative dispute resolution (ADR) conferences involving more than 220 separate disputed matters. Most of these matters involved appeals on his docket at the ENG BCA or ASBCA. After retirement from the ASBCA in 2006, he co-founded ImMediate LLC, an ADR services firm.

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contemplated by the contract.

Frequently, a “time is of the essence” clause operates to place the parties on notice that timely performance is a material provision of the contract. Contracts may also simply state a date for completion of job performance, represent that a job site will be ready for work to commence by setting forth a particular “start date” or contain a schedule reflecting the parties’ performance expectations.

However, owners and contractors should also be aware of clauses that attempt to limit or preclude recovery for delays such as “no-damages-for delay” clauses. Another potential cause of delay and increased costs could arise where a prime contractor or owner is able to unilaterally alter a schedule. While clauses allowing directed schedule changes are not unusual, that type of contract provision may not appear to directly address the recovery of damages for delays. In a recent New York State Court of Appeals case discussed below, the right to alter a schedule trumped any potential recovery for delay damages.

Right to Alter Schedule Precludes Delay Damages

The New York Supreme Court, Appellate Division, addressed a subcontractor’s right to recover delay damages in *Modern Mosaic Ltd. v. Sweet Associates, Inc.*, 806 N.Y.S. 2d 246 (2005) following a schedule change directed by the general contractor. In *Modern Mosaic*, the court held that a general contractor’s postponement of an installation start date did not constitute a breach of contract where the contract required the subcontractor to perform work “in accordance with the project schedule.” The court based its decision on the fact that the provision obligating the subcontractor to perform work “in accordance with the project schedule” allowed the general contractor to set the schedule and to postpone a subcontractor’s start date.

Sweet Associates, Inc., (“SAI”), the general contractor subcontracted with Modern Mosaic, Ltd. (“Modern Mosaic”) for fabrication and installation of approximately 500 precast concrete panels on the exterior of a building being constructed by the defendant. Modern Mosaic entered into a subcontract with Brownell Steel, Inc. to install the panels. The parties stipulated to the fact that the original start date for installation was May 1997. However, the start date was postponed until September 1997 and Modern Mosaic incurred costs for transportation and storage of the panels. The New York State Court of Appeals held that Modern Mosaic failed to establish a fixed start date for the installation of the precast panels and dismissed all claims for delay damages. The court held that Modern Mosaic was not entitled to recover those costs or delay damages incurred for transportation and storage of the panels because the subcontract agreement gave the general contractor the right to make such changes. Consequently, such changes (delays) were anticipated by the parties under the terms of the subcontract.

Under the terms of the subcontract, as interpreted by the court, SAI had the authority to set the schedule and nothing in the subcontract limited that authority. Modern

Mosaic failed to require any restrictions on changing the start date in the subcontract and never demanded a fixed start date, even though its president complained about the start date “slipping away” in August 1997. Also, the evidence demonstrated that the minutes of job site meetings listed a September 1997 date for the precast installation. Therefore, The New York Supreme Court, Appellate Division, upheld the trial court’s ruling that the postponement of the start date did not constitute a breach of the subcontract and that the subcontractor was not entitled to recover delay damages.

Comment

The *Modern Mosaic* decision should put contractors and owners on notice that a seemingly typical scheduling clause may substantially alter the risk associated with delay. A poorly drafted contract or an oversight by one of the parties can leave that party without any control over the timing of the contract work and also responsible to bear unanticipated costs associated with delays. In order to avoid this outcome, a contract should specify a start date and include a “time is of the essence” clause. These provisions may establish a framework for the interpretation of a perform in “accordance with the schedule” clause and alter the analysis of a party’s right to delay damages. In *Modern Mosaic*, the scheduling clause became a “stealth” no-damages-for-delay provision.

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Type I DSC Update

562 Federal government contractors encountering what appears to be a differing site condition on a construction project must satisfy certain well established prerequisites to entitlement to an equitable adjustment. The Federal Acquisition Regulation (“FAR”) and cases interpreting these regulations recognize two distinct categories of differing site conditions (“DSC”). The standard Differing Site Conditions clause, FAR § 52.236-2, addresses what is commonly referred to as a Type I Differing Site Conditions (“DSC”). In general, a government contractor claiming an equitable adjustment for a Type I DSC must establish that:

- i) the conditions indicated in the contract differed materially from those actually encountered during performance;
- ii) the conditions actually encountered were reasonably unforeseeable based upon all information available to the contractor at the time of bidding;
- iii) the contractor reasonably interpreted and relied upon that information and any contract related documents; and,
- iv) the contractor was damaged as a result of the material

variation between expected and encountered conditions.

Entitlement quite often turns upon a determination of the scope and extent to which the contractor evaluates and relies upon information made available by the government as part of the contractor's pre-bid investigation, and not necessarily just information set out in the four corners of the contract documents. Three recent cases, one from the General Services Board of Contract Appeals and two from the U.S. Court of Federal Claims, illustrate this point.

In *PCL Construction Services, Inc. v. GSA*, GSBCA No. 16588, 06-2 BCA ¶ 33,402, the contractor on a federal courthouse project submitted a Type I DSC claim contending that it had to perform deeper drilling than anticipated to reach bedrock and that it encountered more boulders than anticipated in its subsurface drilling. In preparing its bid, the contractor relied on test borings performed and evaluated by the government's geotechnical consultant ("boring logs"). The government's boring logs also contained a narrative detailing discontinuities in the subsurface soils, including the fact that these soils contained highly weathered rock and that there was considerable variation in depth to bedrock. The contractor hired its own geotechnical expert to evaluate the government's boring logs in anticipation of preparing its bid.

The board upheld the government's denial of the contractor's claim finding that the contractor had failed to show that actual conditions encountered differed materially from those indicated by the boring logs and that the conditions encountered were *not* reasonably unforeseeable. The board found that the contractor's reliance upon the boring logs was "selective" and, in that instance, unreasonable. In its ruling, the board emphasized that, while boring logs are the best indicators of subsurface conditions and bidders ought to rely heavily upon them, a reasonable contractor must evaluate that information in context. Such context would include: i) the number of borings; ii) spacing of boring locations; and, iii) consistency of results. The board further emphasized that a prudent bidder should also consider other available information such as the general site description and "other contract warnings" to determine whether subsurface data should be afforded more or less weight.

Likewise, in *Universal Construction, Inc. v. United States*, 71 Fed. Cl. 179 (2006), the contractor asserted a Type I DSC claim pertaining to the placement of fill materials on a road and parking lot construction project for the Federal Highway Administration. The contract required the contractor to obtain fill soil materials from two designated "borrow areas" provided by the government. The government provided the physical characteristics of the soils in these borrow areas in several documents referenced in the bid package. The contract required that the borrow area soils be placed as structural fill under the road and parking lot areas subject to specified moisture and compaction requirements.

During construction, the contractor encountered conditions in the borrow areas that made it much more difficult for the contractor to achieve the specified compaction of these soils. Ultimately, the contractor submitted a Type I DSC claim on the grounds that the borrow area soil conditions differed materially from those set forth in the contract. The contractor asserted that certain highway specifications incorporated into the contract by reference were controlling and that these specifications did not depict actual conditions. The government countered by relying upon a broader interpretation of this same specification, as well as other contract provisions. The government also relied upon the contract's "order of preference" clause in support of its argument that the contract indicated that differing soil types may be present in the borrow areas, including soil types that the contractor actually encountered. The court agreed with the government, reasoning that to adopt the contractor's narrow interpretation of the contract's depiction of the borrow areas would render significant sections of the contract meaningless, and would not be a reasonable interpretation of the contract when read as a whole.

Not all recent news on Type I differing site condition claims is unfavorable to the contractor. In *Ace Constructors, Inc. v. United States*, 70 Fed. Cl. 253 (2006), the contractor performing an airfield construction project established that it was entitled to an equitable adjustment for a Type I DSC. The contractor showed that it encountered lower site elevations at the project than those indicated in contract documents, which provided detailed cut and fill data points. The contractor bid the project as a "balanced" job (*i.e.* roughly same amount of cut and fill required). However, the actual site elevations encountered during construction required the contractor to place about double the amount of fill material than what was originally anticipated.

The government argued no entitlement on two grounds. First, the contractor failed to show that site conditions in the contract documents differed materially from those actually experienced. Second, the government contended that, even if actual conditions encountered did materially differ, the contractor failed to verify the data related to soil compaction and moisture content before starting cut and fill work, as required by the contract documents. The court rejected both of the government's arguments.

The court found that the lower site elevation was not a condition that a reasonable contractor would be expected to detect through visual observation on a site visit, which the contractor's representative did in fact make as part of the bid process. The court dismissed the government's "failure to verify" argument by finding that the evidence presented did not indicate any material difference in "actual" vs. "as bid" soil compaction criteria. The court further reasoned that soil compaction was not the issue; instead, it was a simpler issue that actual site elevation was much lower than indicated in the plan documents, thus requiring the contractor to place more fill soil than anticipated.

Comment

These recent cases illustrate several points that the construction professional should consider before proposing on a project in which differing site conditions may become an issue. First, before submitting a bid or proposal, read the entire contract including all documents included therein and incorporated by reference. Second, avoid making conclusions on site conditions based upon partial or incomplete interpretation of site information. This may require the contractor to retain a consultant to assist in evaluating such conditions; however, the consultant should look at all available data. Third, conduct and document, as necessary, a thorough site visit before bidding the work. Fourth, ask the government if it has possession of any other information on site conditions other than that contained in the bid documents. Finally, if such a situation arises, be prepared to document and articulate exactly how the changed condition has affected performance.

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The “Value” of Verbal Agreements

563 A contractor recently discovered that a verbal agreement with a federal government contracting officer (“CO”) was unenforceable. The Armed Services Board of Contract Appeals (“ASBCA”) decided, based on

South Carolina – Federal Procurement Expo

On July 9, 2007, **Ron Robey and Matthew Cox** will be featured speakers at the South Carolina Congressional Federal Procurement Expo to be held in West Columbia, South Carolina. This all day program, which is organized by DESA, Inc., will review contracting opportunities and issues related to the \$1.5 billion in federal contracts awarded annually in South Carolina. For registration information, please e-mail SCCEXPO@desainc.com or call Diane Sumpter at 803/730-6466. Register online at <http://www.desainc.com> and click on the “South Carolina Congressional Expo” link.

a summary judgment motion submitted by the government (no factual hearing was conducted), that an alleged oral settlement agreement, which reflected a compromise on the liquidated damages assessed by the government, was of no effect because a written modification to the contract had not been executed to formalize the alleged settlement agreement. *Trawick Contractors, Inc.*, ASBCA No. 55097, 2007 WL 654226 (Feb. 23, 2007).

Decision

Trawick was awarded a construction contract by the Naval Facilities Engineering Command (NAVFAC). As is typical with federal government contracts, the contract terms specified a performance period and provided for liquidated damages (“LDs”) if the work was not completed or accepted by the specified completion date. During performance of the project, liquidated damages rates were bilaterally modified, in writing, by the parties. The project was not completed within the specified performance period, and the government eventually withheld LDs amounting to \$98,394.

Following completion, Trawick’s project manager communicated a settlement offer, via telephone, to the Navy’s administrative contracting officer (“ACO”) for the contract. The ACO who held a contracting officer’s warrant, had administered the contract terms related to LDs, and had signed 22 of the 27 modifications to the contract. Trawick’s project manager offered to allow the government to continue to withhold a portion of the LDs (\$25,000). According to Trawick’s project manager, the ACO declined the \$25,000 offer but indicated that he would discuss it with his supervisor and would speak with Trawick’s project manager again. In a later conversation, when Trawick’s project manager asked what it would take to settle, the ACO allegedly counter-offered at \$30,000. The project manager asserted in an affidavit that he accepted the counteroffer and asked the ACO to forward the “necessary close-out documents.” When Trawick’s representative and ACO spoke in a subsequent (third) conversation, the ACO advised the project manager that the Navy had rejected the settlement.

The ACO recalled only one conversation during which Trawick’s project manager had communicated a settlement offer. The ACO admitted that he had discussed the settlement offer with his supervisor and had e-mailed Navy counsel seeking advice. However, he asserted that his discussion with Trawick’s representative was not intended to be a final negotiation.

When the government would not honor the alleged agreement, Trawick submitted a CDA claim. Based on the alleged settlement agreement, the claim was for return of the balance of the LDs (that is, \$68,394 or \$98,394 in LDs withheld minus \$30,000 allegedly agreed by the parties as properly withheld). The administrative contracting officer denied the claim and signed a unilateral modification to the contract reducing the contract price by \$98,394, the full amount of the LDs being withheld by NAVFAC.

Trawick appealed the claim denial to the ASBCA. In a

summary judgment motion, the government argued that there was no verbal settlement agreement and that, even if there had been such an agreement, it could not be enforced absent a written, signed contract modification.

Decision

The board did not address credibility issues or other circumstantial evidence that would have been determinative of whether the parties, in fact, had made a settlement agreement. Instead, the ASBCA jumped straight to the issue of whether an alleged settlement agreement that changed the contract price could stand, as a matter of law, absent a written contract modification. According to the board, the single material fact was whether a modification to the contract had been written and signed to formalize the alleged settlement agreement. The board held that such a modification would have been necessary to reduce the contract price by the allegedly settled amount of LDs (\$30,000).

In the *Trawick* decision, the board relied on an earlier ASBCA decision, *Kato Corp.*, ASBCA No. 51462, 06-2 BCA ¶ 33,293. The board described *Kato* as involving “an alleged oral agreement to settle a contractor’s claim for \$85,000” and wrote that the settlement agreement in *Kato* “was held unenforceable because such agreement would change the contract price and there was no written contract modification to change the contract price, as required by the applicable FAR [Federal Acquisition Regulation] regulations.” The *Kato* decision contains a more extensive discussion and cites earlier court decisions, including *Mil-Spec Contractors, Inc. v. United States*, 835 F.2d 865 (Fed. Cir. 1987), previous board decisions, and FAR provisions. (The *Kato* decision is currently on appeal to the United States Court of Appeals for the Federal Circuit.)

While the *Trawick* decision did not turn on a question of the ACO’s authority, the board noted contract provisions that address the authority of the contracting officer and the administration of the contract by other “Government Representatives.” In the provision concerning contracting officer authority, the contract specified, in relevant part: “All such actions [including contract modifications] must be formalized by a proper contractual document executed by an appointed [CO].” Regarding government representatives other than the contracting officer, the contract provided, as pertinent here: “In no event . . . will any understanding or agreement, modification, change order, or any other matter deviating from the terms of the contract between the Contractor and any other person than the [CO] be effective or binding upon the Government, unless formalized by proper contractual documents executed by the [CO] . . .” Interestingly, in the *Mil-Spec* decision the Federal Circuit set forth three reasons for the non-enforceability of a verbal agreement, the first of which involved the authority of the government’s negotiator.

Practical Application

If you have been properly advised concerning the factual and legal implications of your actions and if you are confident that you are aware of the relevant facts in your case, then it is almost always better to resolve issues at the

lowest practicable level and as early in the process as is reasonable. However, in addition to knowing the authority of the person with whom you are dealing, the *Trawick* decision shows that any contractual agreement with the federal government should be reduced to writing, especially if the agreement modifies the contract’s terms. As Yogi Berra might have put it, “a verbal agreement is not worth the paper it’s not written on.”

The most conservative course is to negotiate directly with the contracting officer or a representative working with and appointed in writing by the contracting officer. If the person with whom you are dealing is an ACO or other representative of the contracting officer, examine the documentation issued in connection with the contract at issue to determine the limits of that person’s authority.

Have the settlement agreement written on the federal government form specifically designed for contract modifications, Standard Form (SF) 30, and make certain that the contracting officer signs and dates the form. Unless and until a negotiated resolution is reduced to writing on the proper form and signed and dated by the contracting officer, do not assume that the matter is concluded.

A more in-depth legal analysis reveals court and board decisions that call into question the straight-forward and straight-laced decision in *Trawick*. However, prudent business practice and proactive dispute avoidance techniques dictate a conservative course.

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Dispute Review Boards: Benefit or Burden?

564 The construction industry and owners have employed a variety of alternative dispute resolution procedures for over a century. While there is little documentation from the early part of the twentieth century reflecting the frequency and seriousness of disputes in the construction industry, broadly speaking, prior to the 1940s, the commonly utilized procedures on the job — informal negotiation, or a ruling by the architect or engineer — were generally sufficient to resolve most disputes at the job level. The AIA contract documents developed in the early 1900s codified this informal negotiation process and provided an express process for the escalation of disputes to the architect or engineer. Post World War II, competition and project complexity increased, as did claims and disputes. While owners increasingly utilized contract language to attempt to make the decision of the architect or engineer binding, courts recognized that the decision of the architect or engineer was not absolute and was subject to judicial review.

Alternative Dispute Resolution

Increasingly, owners and contractors turned to

alternative dispute resolution procedures to avoid litigation. While binding arbitration has been commonly used in the industry for years, arbitration typically does not occur while the job is ongoing. In the past decade, a new methodology for such resolution on the job has emerged, particularly in the public arena: the Dispute Review Board (“DRB”). In theory, a DRB is a relatively inexpensive and efficient method for resolving project disputes while the job progresses, rather than allowing disputes to fester and continue throughout a project and conclude with lengthy and costly arbitration/litigation. Generally speaking, a DRB utilizes a three member panel that will be involved from the outset of the project and will be charged with considering disputes submitted by either owner or contractor throughout the course of performance. While the DRB process has adherents in several state entities and has been utilized on multiple public projects in North America for the past ten years, it is not yet clear whether the DRB process actually provides real benefits to either the contractor or the owner. This article discusses the use, benefits, and burdens of Dispute Review Boards.

The Dispute Review Board Concept

The origins of the DRB process appear to have arisen in the 1970s within the underground contractors’ industry, and with sporadic use thereafter. In the 1990s, use of the method increased, in part due to promotion by The Dispute Resolution Board Foundation (“DRBF” or “Foundation”), established in 1996. The DRBF seeks to promote the use of the DRB process and “serve as a technical clearinghouse for owners, contractors, and Board members in order to improve the dispute resolution process.” (See www.drb.org) The Foundation counts as its users, among others, the California, Colorado, Florida, Massachusetts, Virginia, and Washington Departments of Transportation; the Cities of Atlanta, Copenhagen, and Columbus; various transportation authorities in Dallas, Orlando, Los Angeles, Seattle and Toronto; and international entities such as the the Hong Kong Airport Authority, the International Monetary Fund, and the World Bank. The Foundation asserts that DRBs are “exceptionally effective,” and that in North America, of all the DRB recommendations issued, “all but a handful have been adopted by the parties, thereby avoiding costly and time consuming arbitration and litigation.” The DRBF reports on its website that as of 2004, approximately 1237 contracts with contract values in excess of \$89 billion utilized the DRB process, and that 1418 disputes were settled through the DRB process.

The DRB process is set forth by contract, and generally requires the involvement of a three member impartial board. Typically, the agreement will provide for appointment of one member by the contractor, one member by the owner, and each of these appointees determining or approving a third member. While the majority of DRB provisions allow each party latitude in selection, most DRB provisions call for professionals experienced in the type of construction being performed and prohibit conflicts of interest. Most DRB provisions require that the parties to the contract agree on the selection of the third member, often designated

as the chairman following selection. Membership selection typically must be completed within a certain time frame following commencement of construction, and the DRB will meet monthly or periodically while the project is ongoing to keep up with the progress of the work.

DRB members are compensated for their services, generally by the owner at a daily rate ranging from \$800 to \$1200 per day. Most contracts requiring DRBs do not require specific skills or competence; however, DRB members are generally engineers, construction professionals, or attorneys. Some contracting parties may find it difficult to appoint a professional with the required level of competence at the rates paid under most DRB contracts, and often seek out retired or semi-retired appointees. One theory propounded by DRB advocates is that the decision or recommendation of a DRB should advise the parties of what their potential outcome may be if the matter is ultimately submitted to judge or jury. Although generally DRB members are atypical of the normal juror or judge, in that they have experience in the construction field, DRBs may provide some benefit in providing a view of how a judge or juror might view a claim or dispute. However, such a benefit would only exist if a party believed that the DRB was an impartial process.

Under a typical DRB provision, either party may submit a matter to the DRB for a non-binding recommendation. The parties provide written submissions and documentation and may provide presentations to the DRB. Although lawyers are permitted to attend, most DRB’s operating procedures provide that the presentation, if any, is made by the party representatives. A DRB panel may question the parties to promote a dialog, but each DRB may approach the procedural process differently. Following presentations, if any, the DRB will then provide a written, non-binding recommendation to the parties which the parties are free to accept or reject within a certain time following the recommendation.

Effect on Litigation/Arbitration

A typical contractual provision creating a DRB will require a dispute to be submitted to the DRB as a condition precedent to further litigation or arbitration proceedings. Courts have enforced such provisions and stayed cases brought by contractors when the DRB process has not been completed as to the claim being brought. *See, e.g., John Carlo, Inc. v. Greater Orlando Aviation Authority*, 2007 WL 430647 (M.D. Fla. 2007). DRB provisions may also attempt to direct that the DRB’s non-binding recommendation is admissible as evidence in future proceedings. While the enforceability of such provisions has not been determined by appellate courts, when considered in conjunction with provisions requiring the DRB process as a condition precedent to litigation, the potential admission of the DRB recommendation can have hidden cost implications for the parties. DRB process may have hidden costs. For example, if a contractor has a large dispute or multiple claims against an owner on a contract requiring a DRB process, it is likely that the contractor will expend considerable time and effort in preparing its case

to the DRB, particularly if the non-binding recommendation of that DRB may possibly be seen by a judge or jury.

Additional costs may accrue on longer projects due to the on the job presence of the DRB. Most DRB provisions required the contractor's attendance at the periodic DRB meetings held throughout the course of the project. On larger projects, such provisions may require monthly DRB meetings, and the contractor must have appropriate project personnel present at such meetings to provide information about project progress and attend site visits. Some DRB provisions require provision of correspondence and other materials to the DRB, at the cost of the owner and/or contractor, depending on which party created the documents. In the event of a larger dispute, a DRB may require time to review documentation and prepare its recommendation, all at the daily rate established via contract.

Some DRB provisions make the DRB process not only mandatory, but also binding on the parties, much like an arbitration decision. *See, e.g., Massachusetts Highway Department v. Perini Corporation*, 14 Mass. L. Rptr. 452 (Sup. Ct. Mass. 2002) (treating a binding DRB provision similar to an arbitration decision, limiting judicial review of such decisions in the same manner as an arbitration decision, and enforcing the binding recommendation of the DRB). In such instances, the cost of a DRB to a contractor increases dramatically, as the DRB recommendation is no longer merely a recommendation, but rather a presumptively correct determination that can only be challenged judicially on certain limited grounds.

Decisions Interpreting DRB Requirements

Given the relative newness of the DRB process, there is limited case law interpreting DRB provisions and requirements. Of the limited court decisions available, a few themes have developed. Courts have a tendency to interpret DRB provisions like any other contractual term, by utilizing the plain meaning of the provision. Some courts have treated DRB provisions similar to agreements to arbitrate; however, courts have also concluded that the DRB process is unlike arbitration, and have declined to require non-signatories to participate in the DRB process.

With regard to subcontractors, the limited case law indicates that, in the absence of an express agreement by a subcontractor to submit its claims to a DRB, the subcontractor will not be obligated to do so as a condition precedent to further litigation. *See General Railway Signal Corp. v. L.K. Comstock & Co., Inc.*, 678 N.Y.S. 2d 208 (N.Y. App. Div. 1998) (subcontractor had not made express agreement to engage in the DRB procedures set forth in prime contract, therefore, subcontractor not obligated to submit its claim to DRB). This is contrary to the recent trend to expand the scope of an agreement to arbitrate to non-signatories. However, as noted by one California appellate court, when a DRB's membership is appointed by the contractor and the owner and the subcontractor's "interests are antithetical to those of the general contractor and the owner," the DRB process was

"presumptively biased and thus unenforceable as a condition precedent to pursuing litigation." *Sehulster Tunnels/Pre-Conv. Traylor Brothers, Inc./Obayashi Corp.*, 4 Cal. Rptr. 3d 655, 663 (Cal. Ct. App. 2003).

Other cases have addressed membership requirements and a party's right to dismiss its own DRB appointee. In *Los Angeles County Metropolitan Transportation Authority v. Shea-Kiewit-Kenny*, 69 Cal. Rptr. 2d 431 (Cal. Ct. App. 1997), a California appellate court concluded that the owner had the right to remove its own appointee from a DRB for "cause" despite contractor's objection. The owner cited its "loss of confidence" in its appointee based on its belief that its appointee had ex parte communications with the contractor and had prejudged certain issues to be presented to the DRB. The contractor argued that the standard for removal of a DRB member should be similar to that for recusal of a judge, and that the showing made by the owner was insufficient. The court disagreed, and ruled that the owner's loss of confidence, if verifiable by facts, were sufficient "cause" for the termination of the owner's appointee. This decision is an interesting commentary on the nature of a DRB. Although most DRB specifications urge that the appointee of a party is not an advocate for that party, clearly if there is a low standard for removal of the appointee, the appointee has incentive to side with the party that appointed him or her. Similarly, if the appointing party is free at any time to remove the appointee, the appointing party has an incentive to remove appointees that disagree with the appointing party's view.

In interpreting contractual DRB requirements, most courts have applied the plain language of the parties' agreement, sometimes with substantive ramifications. In *Excel Group, Inc. v. New York City Transit Authority*, 814 N.Y.S. 2d 220, 222 (N.Y. App. Div. 2006), the parties agreed to a binding DRB process for "any dispute" within 10 days of the Chief Engineer's decision as to a dispute. Only narrow judicial review was permitted, and was limited to whether the DRB decision was "arbitrary, capricious or [lacking] a rational basis." When the contractor was terminated for cause, the contractor did not seek redress in the DRB process, and instead filed suit. The trial court and the appellate court both determined that given the plain language of the contract, the contractor was required to pursue the DRB process for redress, notwithstanding the contractor's termination, and that because the contractor did not do so within the 10 days designated by the contract, the contractor "was foreclosed from pursuing that [DRB remedy] or any other remedy."

Conclusion Regarding DRB Utilization

If a public project contains a DRB provision, contractors need to determine the requirements and importance of the DRB early on in the Project. Careful appointment of the contractor's appointee and monitoring of the third member selection process may prove critical. Contract language should be carefully reviewed to determine the specific timing requirements for submittal of disputes to a DRB, as well as to determine whether the failure to utilize the DRB process will result in waiver of claims. If the contractor

wishes to require its subcontractors to engage in the DRB, specific language in the subcontracts is advisable. The contractor should also determine early on and even pre-bid the amount of effort and time it wishes to devote to the DRB process. On some projects, the DRB process is useful in achieving resolutions, particularly if the parties believe that the DRB members are knowledgeable and fair. If the DRB process is helpful in resolving disputes, or if the DRB decision is binding, appropriate resources should be expended on the DRB process, from selection of members to presentation of claims. However, if the DRB process becomes more of a burden than a benefit, and it is merely a non-binding recommendation that is not admissible in future proceedings, the devotion of limited resources may be sufficient.

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Resolving Potential Contract Ambiguities

565 Whether on a private project or a federal government contract, construction contracts containing extensive specification documents or standards incorporated by reference, and multiple drawings can be quite complicated. That complication introduces the potential for conflict or ambiguity. Many techniques have been utilized by the courts and the drafters of contracts in an effort to eliminate conflicts and ambiguities. For example, one legal principle, which is often invoked, states that a contract will be construed to give effect to every provision of a contract to avoid rendering any provision meaningless. If an ambiguity is obvious or patent, case law has imposed the obligation on the party, who did not draft the documents (typically the contractor) to advise the other party of the ambiguity. Whether in federal government contracts or private contracts, this is seen as a means to obviate unnecessary disputes. See *S.O.G. of Arkansas v. United States*, 546 F.2d 367 (Ct. Cl. 1976). Contractors that fail to make pre-bid inquiries run the risk that the other party's (government or private owner) interpretation will become binding.

Numerous standard contract clauses also address the resolution of possible conflicts and ambiguities. When drawings and specifications are not perfectly harmonized, the federal government's SPECIFICATIONS AND DRAWINGS FOR CONSTRUCTION clause (FAR § 52.236-21) (colloquially known as the "like effect" clause) gives priority to specification requirements in the event of a conflict with drawings, and provides that items included in the drawings but not the specifications – or vice versa – are deemed to be included in both. The "like effect" provision states as follows:

Anything mentioned in the specifications and not shown on the drawings, or shown on the drawings and not mentioned in the specifications, shall be of *like effect* as

if shown or mentioned in both. In case of difference between drawings and specifications, the specifications shall govern. (emphasis added).

In many contracts, the specifications may set forth or describe more than one material or component, each of which appears to be acceptable. At the same time, the drawings may depict only one. This situation sets the stage for a future contract interpretation dispute. The question often becomes: Which controls? A recent decision by the United States Court of Appeals for the Federal Circuit used the "like effect" clause to reject the government's argument that drawings depicting only one specified item narrowed (one might say eliminated) a contractor's ability to choose between competing specification requirements. *Medlin Construction Group, Ltd. v. Harvey*, 449 F.3d 1195 (Fed. Cir. 2006).

In *Medlin*, the Federal Circuit addressed whether the "like effect" provision in conjunction with contract specifications gave the contractor the option to use either of two specified materials (pre-cast concrete or polystyrene) as concrete void retainers. Both were described and sized in the specifications. However, the contract drawings contained notes describing in detail and sizing only a pre-cast concrete retainer for use as a void retainer.

The contractor planned and bid the job based on using the less expensive polystyrene void retainer. The government insisted that the drawings operated to narrow the contractor's choices to the pre-cast concrete retainer. In *Medlin Constr. Group, Ltd.*, ASBCA No. 54772, 05-1 BCA ¶ 32,939, the Armed Services Board of Contract Appeals agreed with the government's interpretation and denied the contractor's claim for \$56,140.38 in additional costs associated with use of the pre-cast retainers.

The Federal Circuit reversed the board's decision. The court invoked the "like effect" language of the SPECIFICATIONS AND DRAWINGS FOR CONSTRUCTION clause to hold that the drawings, which depicted only a pre-cast concrete void retainer, operated to provide specific information on the pre-cast product – information that was only applicable *if* the contractor elected to use the pre-cast material. The drawings did not eliminate the choices set forth in the specifications and nothing in the drawings stated that polystyrene could not be used. As stated by the court "[t]he like effect provision does not apply in only one direction, i.e., reading the drawing details into the specifications; rather, it applies in the other direction as well, reading details from the specifications into the drawings." Under this rationale, the drawings were deemed to reference both pre-cast and polystyrene retainers. The contractor was entitled to use either product and, ultimately, was granted an equitable adjustment for the cost differential.

Points to Consider:

- Provisions similar to the Specifications and Drawings for Construction clause are not confined to federal government contracts.

- Specifications may set forth optional materials while the designer's drawings depict one material. "Like effect" provisions can be used to resolve interpretation conflicts and allow a contractor to maintain the benefit of its competitive pricing.
- If the contract documents allow options in the selection of materials, the contractor needs to be prepared to document the basis of its price at the time of bid or proposal.

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Limited Funds – Expanded Risk

566 Traditionally contractors performing military construction projects for the Department of Defense ("DOD") have been awarded contracts that were funded to the 100% of the contract price. In contrast, certain federal government civil works projects (dams, flood control works, etc.) are often labeled "continuing contracts" and are funded incrementally. Incrementally funded civil works projects present scheduling and payment challenges for both the government agencies and the contractors performing the work.

Recently, contractors awarded DOD military construction projects face new risks as incremental funding is becoming a more common practice on these projects. The challenges and risks facing contractors flow from the Department of Defense FAR Supplement Clause, LIMITATION OF GOVERNMENT'S OBLIGATION (May 2006), (hereinafter "LOGO" clause) contained in these partially funded, fixed price contracts. It is not unusual to receive a RFP for a "design-build" project that contains an anticipated funding schedule with the allotted funds for the first increment of time (up to 12 months) limited to an amount as low as 15% of the total contract price. The RFP may also provide that the contractor is to fully complete the project design within that increment of funding.

The LOGO clause, found at DFARS § 252.232-7007, expressly details the contractor's obligations related to the incremental funding and purports to limit the government's liability in the event that the project is not fully funded. To an extent, the contractor's rights and obligations under the LOGO clause are similar to the clauses traditionally found in incrementally funded government civil works contracts. However, there are some significant differences, which materially change the contractor's risks. These include the following:

- Agreement by the contractor to perform up to a point at which the total amount payable by the government *including* reimbursement in the event of a termination for convenience "approximates" the amount of funds allotted to the contract.

- Requires the contractor to advise the government 90 days prior to the date, in the contractor's best judgment, that the total amount payable by the government, including any cost for a termination for convenience will *approximate* 85% of the total amount of monies that allotted to the contract.
- Expressly states that the contractor *is not authorized* to continue working on the project beyond that funding allotment. This is a major change in direction and reflects the Congressional mandate to put the full risk of non-payment on the contractor if it performs "in advance" of the funding stream.
- Expressly states that the government is *not obligated* to reimburse the contractor in excess of the amount of funds allotted to the contract regardless of anything to the contrary in the standard Termination for Convenience clause. This provision creates a major risk related to controlling subcontract and purchase order commitments and the comparable activities by the lower tier subcontractors.
- Expressly states the **total amount** payable to the contractor includes all estimated termination settlement expenses and costs. Again, this is an effort to place a hard ceiling on the government's liability.

Contractors reviewing this type of clause and the prospect of a firm fixed-price contract with a stated duration of several years need to consider the following issues.

- Award of subcontracts and management of the actions taken by subcontractors in awarding lower tier purchase orders and sub-subcontractors.
- Terms and conditions of subcontracts and purchase orders that flow down the same obligations and limits of liability. Consider limiting the liability of the contractor and the Miller Act surety to both direct subcontractors and suppliers to the available funds.
- Fixing prices for work, materials and equipment during periods of possible sharp price escalation within the funds allotted at the time of award while also limiting liability in the event of a termination for convenience.
- Risk of price escalation if key subcontracts and purchase orders are not fully priced and executed at the time of award of the initial contract by the government.
- Risk of exposure to Miller Act claims by lower tier suppliers and sub-subcontractors. A prospective waiver of a firm's Miller Act rights is void under 40 U.S.C. § 3133(c).

Due to the long-term nature of multiyear contracts, FAR § 17.109(b) provides that contracting officers are authorized to include an economic price adjustment clause in fixed-price contracts. Such clauses often refer to official labor and material indices to be used as the basis for any price adjustment. However, it is very rare to see economic price adjustment clauses used in domestic fixed-price military construction projects. If that type of clause is absent from a fixed-price contract, the contractor *normally* bears the

risk of unexpected price escalation. *See Spindler Construction Corp.*, ASBCA No. 55007, 06-2 BCA ¶33,376.

All of these issues reflect risks that are implicit in the LOGO clause, incrementally funded fixed-price contracts, and the management of the subcontracting process. As one person recently commented after seeing this clause, it is a “Brave New World out there”.

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Arbitration Update

567 As evidenced by past articles in our newsletter, enforcing arbitration provisions, or working around them, continues to be an ever-present issue in the construction industry. Recent cases emphasize the importance of memorializing arbitration prerequisites in not only the parties’ contract, but in each subsequent modification of that contract. The cases also reflect the continuing vitality of the federal policy in favor of arbitration. Three such cases are discussed below.

Who Determines If Prerequisites for Arbitration Have Been Met

In *O’Keefe Architects, Inc. v. CED Construction Partners, Ltd.*, 944 So. 2d 181 (Fla. 2006), the property owners filed arbitration demands against an architect arising from alleged design defects on two projects. The arbitration clauses were broad and required arbitration of all issues related to the parties’ contracts. The architect objected to arbitration, arguing that the demands were too late. The architect relied on the provision in the arbitration clause which stated that demands for arbitration had to be made before the expiration of the period set forth in the applicable statute of limitations for the claims at issue. A statute of limitations is a law that sets the deadline for a plaintiff to initiate a particular legal proceeding.

The trial court ruled that the issue of whether it was too late for the owners to demand arbitration was a matter to be determined by the arbitrator. The architect appealed, seeking to have a court determine the timeliness of the demands for arbitration, rather than the arbitrator who had already ruled against him. The architect argued that under Florida law, the courts, not arbitrators, determine whether parties have agreed to a valid arbitration provision, and whether a particular issue is arbitrable under that provision. The architect claimed that determining whether the statute of limitations barred the owner’s claims was a prerequisite to arbitration. Therefore, the issue was one of arbitrability under the parties’ arbitration clause, which must be determined by the court.

The Florida Supreme Court held that where there is a valid and broad agreement to arbitrate all issues related to the parties’ contract, and the dispute in question falls within the scope of that agreement, alleged defenses to

arbitration such as unreasonable delay or the statute of limitations are not issues of arbitrability. Therefore, **unless the parties agree otherwise**, an arbitrator—not a court—must determine the applicability of such defenses, even if they are framed as prerequisites for demanding arbitration.

The lesson conveyed by this case is simple. If you want to ensure that a court—and not an arbitrator—determines whether prerequisites to arbitration have been satisfied, be sure the requirement is set forth in your agreement.

Drafting Shortcuts Can Be Costly

In *Twin Oaks at Southwood, LLC v. Summit Contractors, Inc.*, 941 So. 2d 1263 (Fla. 1st DCA 2006), one can find another lesson on the importance of expressly stating arbitration requirements in writing. In that case, the contractor and the owner entered into a contract for the construction of a multi-family development. The contract included the AIA-201 “General Conditions of the Contract for Construction,” which defined the “Contract Documents” as including modifications of the contract issued after execution of the contract. The AIA General Conditions also included a broad arbitration provision.

Three months after the intended completion date, the parties entered into a project completion agreement (the “PCA”). In the PCA, the owner acknowledged the amount due to the contractor, accepted change orders, and acknowledged that substantial delays had been caused by the owner’s architect. The PCA incorporated the terms and conditions of the underlying contract, but did not expressly include an arbitration provision.

The contractor eventually sued the owner for amounts due under the PCA. The owner countersued for liquidated damages and defective work. The contractor moved to dismiss the owner’s counterclaims, arguing that while the contractor’s claims arose from the PCA, an agreement separate from the original contract that did not require arbitration, the owner’s counterclaims arose from the original contract, which did require arbitration.

The trial court agreed with the contractor and dismissed the owner’s counterclaims. The trial court noted that “[i]f the intent of the parties was to arbitrate claims arising out of or related to a breach of the Project Completion Agreement then they should have included an arbitration provision in the agreement.” The First District Court of Appeal found that the trial court was wrong. The appellate court held that the PCA was not a separate agreement from the original contract, but a modification of the original contract. However, the contractor waived its right to arbitrate the owner’s counterclaims by filing the lawsuit.

Although the appellate court ultimately held that the arbitration provision in the original contract applied to the PCA as a subsequent modification of the original contract, as a practical matter, the owner was required to expend significant time and money getting there. Again, the simple lesson is write it down. Memorialize your intention to require arbitration in not only original contracts, but in subsequent modifications. Merely incorporating the terms of prior agreements may be quicker and easier in the short

term, but such shortcuts can result in additional costs in the long term.

Bankruptcy and Arbitration

A federal court recently held that a contractor can enforce its right to arbitrate claims asserted against it by a subcontractor, even when the subcontractor is in bankruptcy. *Whiting-Turner Contracting Co. v. Electric Machinery Enterprises, Inc.*, (In re Elec. Mach. Enter., Inc.) 479 F.3d 791 (11th Cir. 2007) In *Whiting-Turner Contracting Co.*, a general contractor and its electrical subcontractor entered into a subcontract on a theme park improvements project. Both the contractor and the subcontractor incurred additional costs due to delays.

The contractor submitted a claim to the owner for the additional costs, including amounts claimed by the subcontractor. To provide the contractor with time to pursue its claims against the owner, the contractor and the subcontractor entered into a tolling agreement. The tolling agreement halted the application of the statute of limitations to the subcontractor's claims against the contractor. The tolling agreement also included an arbitration clause that required the parties to arbitrate any issues, claims or defenses between them. Ultimately, the owner settled with the contractor, but the contractor did not pay the subcontractor any portion of the settlement amount.

The subcontractor filed for bankruptcy and sued the contractor in bankruptcy court for the subcontractor's share of the settlement amount. The contractor responded by moving to compel arbitration of the dispute pursuant to the terms of the tolling agreement. The subcontractor did not deny that the tolling agreement contained a valid arbitration provision, but argued that the contractor could not enforce the arbitration provision because the subcontractor was in bankruptcy. A determination of that dispute, the subcontractor argued, was reserved to the bankruptcy court. The bankruptcy court agreed with the subcontractor and denied the contractor's request to compel arbitration.

On appeal, the Eleventh Circuit stated that the Federal Arbitration Act ("FAA") established a federal policy in favor of arbitration. It is widely accepted that, consistent with the FAA, a bankruptcy court must enforce arbitration agreements that are related to "non-core" bankruptcy proceedings. A "core" proceeding in bankruptcy is an action to resolve disputes involving rights created by federal bankruptcy law or disputes that could only arise in a bankruptcy case. For example, a claim by a creditor against funds held by a debtor in bankruptcy, and any modification of that creditor's rights pursuant to the Bankruptcy Code, is a core proceeding. A "non-core" proceeding is an action that relates to the bankruptcy case, but is not based on rights created by federal bankruptcy law and could be brought against a party outside of a bankruptcy case.

The Eleventh Circuit noted that in *Whiting-Turner Contracting Co.*, the dispute did not pertain to the claim of a creditor against a debtor in bankruptcy, but was a

breach of contract action brought by the subcontractor against the contractor for amounts owed. The subcontractor could have sued the contractor for the subcontractor's portion of the settlement amount regardless of whether the subcontractor was in bankruptcy. Therefore, the claim was a "non-core" proceeding and the bankruptcy court was required to compel arbitration of the dispute. The Eleventh Circuit also noted, for the sake of discussion, that if the subcontractor's claim was a "core" proceeding, it would still be subject to arbitration because there was no evidence that arbitrating the breach of contract claim would inherently conflict with the underlying purposes of the Bankruptcy Code—a requirement to override the FAA mandate, absent express statutory language in support of such an override.

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UPCOMING SEMINARS

Owner's Perspective and Rights on Construction Projects, July 17-19, 2007, Masters Institute on Construction Law, Federal Publications, Las Vegas, Nevada. *James F. Butler.*

AIA A201 - To Endorse or Not to Endorse, July 18, 2007, Georgia Branch, Associated General Contractors of America, Atlanta, Georgia. *Philip E. Beck.*

Legal Issues & Strategies, July 24, 2007, Construction Industry Executive Forum Conference, Denver, Colorado. *Philip E. Beck.*

2007 SCH Carolinas Update Conference, presented in conjunction with the Carolinas AGC, September 26, 2007, The Palisades Country Club, Charlotte, North Carolina. *Robert J. Greene.*

General Considerations in Construction Insurance Law, September 27-29, 2007, 26th Annual Insurance Law Institute. St. Simons, Georgia. *Ronald G. Robey and David C. King.*

Successful Contracting Course, November 6-7, 2007, Georgia Branch, Associated General Contractors of America, Atlanta, Georgia. *Philip E. Beck.*

AIA Contracts, November 13, 2007, Lorman Education Services, Jacksonville, Florida. *S. Elysha Luken.*

Notice to Florida Licensed Contractors

For many contractors, 2007 is the deadline for obtaining your mandatory fourteen (14) hours of continuing education ("CE") credits to maintain your Florida contractor's license. These requirements include one hour of workplace safety, one hour of worker's compensation, one hour of business practice, one hour of advanced code, and ten hours of general topics. Smith, Currie & Hancock LLP is an approved course sponsor (Provider No. 0000998) by the Florida Construction Industry Licensing Board (FCILB).

The absolute deadline for completion of these hours for many licensed contractors is August 31, 2007.

To assist FCILB licensed contractors to

obtain many of these CE credits, we have scheduled four opportunities to attend FCILB courses in August of 2007. These courses are as follows:

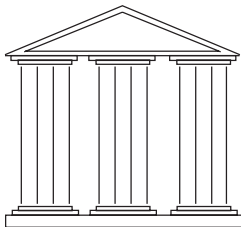
August 2-3, 2007 – Atlanta, Georgia
August 16-17, 2007 – Birmingham, Alabama
August 21-22, 2007 – Ft. Lauderdale, Florida
August 23-24, 2007 – Orlando, Florida

Flyers with course details and registration forms will be mailed out in the near future using address data provided by the FCILB. However, if you wish to update your mailing address, have the information faxed to you, or have any questions, please contact Tom Kelleher at 404/582-8016 or via e-mail at tjkelleher@smithcurrie.com.

Address Change? To ensure you continue receiving our newsletter, please call or e-mail your address changes to 404/582-8092 or sivey@smithcurrie.com.

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

This newsletter is intended to be a source of general information on new or current topics on construction law, government contracts and commercial law. It is not intended to render legal advice on specific problems. In assessing specific problems, advice and counsel should be sought from experienced professionals.



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