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OSHA Standards & Duty of Care

583 Overview

Congress created the Occupational Safety and Health Administration (OSHA) under the Occupational Safety and Health Act of 1970. The Act sets safety and health standards for workplace operations to prevent

work-related injuries, illnesses, and deaths. Although federal, state, and local government employers are exempt from OSHA standards, states may operate their own occupational and safety programs under plans approved by the U.S. Department of Labor. States with approved plans, such as Nevada, must cover state and local governmental workers in their programs.

Since its promulgation, courts have considered the evidentiary effect of OSHA standards and violations thereof in tort actions. Under a legal doctrine known as "negligence per se," a plaintiff can establish a presumption of the defendant's negligence by showing that the defendant violated a statute or regulation that was intended to protect against a certain type of harm. Under an OSHA context, in some jurisdictions, if a plaintiff demonstrates a violation of an applicable OSHA standard, the effect of the doctrine is to establish negligence, and it removes the issue of the reasonableness of the employer's conduct from the jury's determination. In the alternative, compliance with OSHA standards may serve as a defense where OSHA standards are accepted as a reasonable standard of conduct. Other courts have rejected this line of reasoning.

OSHA Standards and Negligence Claims

In a case before the Appellate Court of Illinois, First District, a widow of a decedent worker argued that the violation of OSHA standards by the contractor and own-

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er established negligence per se. In *Recio v. GR-MHA Corp.*, 851 N.E.2d 106 (Ill.App. 1 Dist. 2006), a worker, who was employed by a subcontractor, while carrying a bundle of shingles to the roof of a building on the owner's property, lost his balance, fell to the ground, and subsequently died from his injuries. The president of the contractor of the project, Great Lakes Roofing and Construction Company ("GLR"), testified that carrying shingles, up a ladder, is a commonly accepted practice. The owner's maintenance superintendent testified that carrying large quantities of shingles up a ladder was an "accident waiting to happen, ..."

Although GLR obtained a building permit for the project, the contractor's license for its subcontractor, DTM, had lapsed. The procurement of the building permit required GLR to agree that all work would be done in accordance with all ordinances, rules and regulations of Calumet City, Illinois. The plaintiff argued that by virtue of obtaining a building permit that Great Lakes also assumed a duty to ensure safety at the jobsite, including compliance with federal OSHA regulations regarding ladder safety. A subsequent OSHA investigation concluded that the incident did not arise from an OSHA violation. However, the plaintiff noted that under an applicable OSHA standard regarding the use of a ladder that, "[a]n employee shall not carry any object or load that could cause the employee to lose balance and fall." 29 C.F.R. 1926.1053(b)(2).

The court rejected the argument that the OSHA standard regarding ladder safety established a duty to ensure that employees did not carry bundles of shingles up a ladder. The court concluded that OSHA standards do not create a duty of care, but rather, such violations would be relevant to the determination of whether the defendant acted unreasonably. The court reasoned that the plaintiff's argument, in essence, had the effect of enlarging civil liability or creating a private right of action which is explicitly prohibited under OSHA. In its ruling, the court observed Congress's intent in section 653(b)(4) of the Act, that the standards not be a basis for modifying tort liability. The pertinent part of the Act states:

Nothing in this Act shall be construed to supersede or in any manner affect any workmen's compensation law or to enlarge or diminish or affect in any other manner the common law or statutory rights, duties, or liabilities of employers and employees under any law with respect to injuries, diseases, or death of employees arising out of, or in the course of, employment.

To date, no Nevada court has held that a violation of an OSHA standard establishes a presumption of negligence. Moreover, it appears that Nevada courts may also follow the logic of the *Recio* decision because the Nevada Supreme Court has held that section 653(b)(4) of the Act "does not create, either directly or impliedly a private civil remedy in favor of employees." See *Frith v. Harrah South Shore Corp.*, 92 Nev. 447, 552 P.2d 337 (Nev. 1976.) The Nevada Supreme Court also has observed that the intent and scope of Nevada's OSHA program, which is modeled

after the federal OSHA law, likewise, does not create an independent basis of civil liability. Given the uncertainty of the evidentiary effect of OSHA violations in Nevada, the *Recio* decision should put contractors and owners on notice that accepted industry practices, which fall short of compliance with state and federal OSHA standards, may provide the basis for an agreement that such practices may still be a basis for a claim of negligence.

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AIA A312 Bond Form Risks

584 Overview

Families of related construction forms, e.g., AIA, ConsensusDOCS, and EJCDC, are commonplace in the current construction environment. However, before adopting a particular form or family of forms, it is essential that a project's participants fully appreciate the risks and potential pitfalls related to the use of a particular form or related forms. The recent decision in *J.C. Gibson Plastering Co., Inc. v. XL Specialty Ins. Co.*, 521 F. Supp. 2d 1326 (M.D. Fla. 2007) interpreting a surety's obligations under the AIA A312 payment bond illustrates that point. This article provides an analysis of the most recent cases addressing this issue and further discusses the serious implications of that case in relation to sureties and principals alike.

The *Gibson Plastering* decision involved an unpaid subcontractor's claim against the surety on an AIA A312 payment and performance bond. The subcontractor initially provided the surety with notice of its intention to make a claim on the payment bond in accordance with Section 4 of that bond form. Upon receiving notice of a claim, Section 6 of the A312 bond form described the surety's obligation as follows:

§ 6 When the Claimant has satisfied the conditions of Section 4, the Surety shall promptly and at the Surety's expense take the following actions:

§ 6.1 Send an answer to the Claimant, with a copy to the Owner, within 45 days after receipt of the claim, stating the amounts that are undisputed and the basis for challenging any amounts that are disputed.

§ 6.2 Pay or arrange for payment of any undisputed amounts.

Shortly after having received the required notice, the surety requested copies of all records supporting the claim and notified the subcontractor that it would investigate the merits of its case. The subcontractor complied with the surety's request 26 days after it was received from the surety.

Believing that notice under the bond form was complete only after the subcontractor provided the requested records, the surety failed to provide an answer within 45 days of its receipt of the original notice letter. Thereafter, the

subcontractor filed suit against the surety to recover on the bond, at which point, the surety served written notification disputing the subcontractor's claim. The subcontractor moved for a summary judgment, contending that, as a result of the surety's failure to timely answer the written claim, the surety was barred from defending the action. The issues to be decided by the court were: 1) whether the surety had failed, as a matter of law, to comply with Section 6 of the bond, and 2) whether such failure worked to preclude the surety from disputing the claim. Both of these questions were resolved in favor of the subcontractor.

Surety's Obligation to Respond

The surety argued that the 45 day period of limitation contained in Section 6 ran from the date that the subcontractor provided the requested documents. The surety reasoned that a "proof of claim" was necessary to make a proper evaluation of its liabilities and that without such proof the surety could not provide a detailed answer to the claim. The surety further contended that, by virtue of the notice letter it sent only a few days after the expiration of the 45 day deadline, it had in fact *substantially complied* with Section 6 of the A312 form.

The court held that the deadline on the surety's duty to provide its answer ran from the date it received proper notice of the claim rather than the date that the subcontractor provided the requested records. The court noted that Section 6 of the A312 bond form merely requires that the notice state that a claim is being made under the bond and that it detail the amount of such claim. "That the notice did not contain enough information for [the surety] to verify the claim," the court held, "is immaterial because Section 4 did not require notices to contain such information.

The court further rejected the surety's contention that the correspondence provided to the subcontractor shortly after the expiration of the 45 day deadline substantially complied with the requirements of Section 6 of the bond form. Holding that the bond was to be strictly construed against the surety the court refused to consider the contents of the letter, stating: "forty-eight days may as well have been a hundred days."

Having concluded that the surety had failed to comply with Section 6 of the A312 bond form, the court addressed the consequences of that failure. The subcontractor contended that the only remedy for a surety's breach of its obligation under Section 6 was to render the claim against the bond undisputed. The surety argued that, regardless of its failure to comply with Section 6, under Florida law a party to a contract does not waive its benefits merely due to a failure to comply with a notice provision, unless the other party to the contract is prejudiced.

The court accepted the subcontractor's argument. In regard to Section 6, the court stated that the purpose of the 45 day deadline was to prevent "claimants from suffering extensive delays in the payment of their claim" and that in such cases, "the delay itself is the harm." A showing of prejudice was, therefore, unnecessary and the only

appropriate remedy, the court held, was to preclude the surety from defending against the suit.

The Effect of *Gibson Plastering*

Following the *Gibson Plastering* decision, most sureties have advised their bonding agents not to use an unaltered A312 form. In some cases, bonding agents have attached a rider to that bond form that purports to delete Section 6 of the A312 form without making physical change or notation to the original bond form. That approach involves some risk in the event that the rider is inadvertently not attached to the bond form. If there is discretion in the choice of a bond form, a safer course of action would be to use a bond form such as found in the ConsensusDOCS family, which does not impose a requirement on the surety similar to Section 6 of the AIA A312 form. In addition, if a public owner specifies the use of an unaltered A312 bond form in a set of bid documents, questions regarding changes to that form should be addressed prior to bid opening.

The fact remains, however, that a considerable number of A312 bonds executed before *Gibson Plastering* are currently in effect. Under generally applicable principals of surety law, a surety is permitted to assert the defenses of its principal against a party making a claim against a bond. *Cincinnati Ins. Co. v. Putnam*, 335 So.2d 855 (Fla. Dist Ct. App. 1972) (holding, that "the liability of the surety is ordinarily measured by the liability of the principal. . . and generally the surety is not liable if the principal is not liable."). The effect of *Gibson Plastering* is to preclude these type of defenses where the surety has failed to strictly comply with the 45 day deadline contained in Section 6 of the A312.

In relation to principals, however, the implications of *Gibson* are less clear. By virtue of indemnity agreements and common law indemnity rules, principals are generally required to reimburse sureties for claims that are paid out against a bond. But a surety's breach of its obligations under the bond may work to provide a principal with a valid defense against a surety's indemnity action. *See generally, Atlantic Contracting and Material Co., Inc. v. Ulico Cas. Co.*, 1844 A.2d 460 (Md. 2004) (holding that a surety's breach of the covenant good faith and fair dealing in paying out claims may preclude indemnification from principal). Accordingly, where the surety could have asserted the principal's defenses but for its failure to meet the requirements of Section 6 in the A312, a principal may be shielded from its obligation to indemnify the surety.

Going forward it will be important for sureties and principals who are party to an A312 bond to coordinate their efforts efficiently in order to circumvent the serious concerns that naturally derive from *Gibson*. Contractors using unaltered A312 bond forms should advise their sureties to implement protocols to deal with A312 bond claims and should stress the serious consequences of a failure to meet the requirements of Section 6.

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Prompt Payment Laws

585 A recent decision by a Pennsylvania appeals court demonstrates the extent to which one state will enforce its prompt payment statute and serves as an example of the importance of understanding the details of these laws in each state.

Forty-eight states have enacted prompt payment statutes that apply to all public projects. They generally require higher-tier contractors to pay their subcontractors promptly (with specific time limits) on government-funded construction projects. More than three dozen states have enacted, in addition, statutes similarly requiring prompt payment of subcontractors on private construction projects. The statutory requirements and judicial interpretations of these laws vary from state to state and between public and private construction. Understanding the practical effect of these variations is critical.

In *Pietrini Corp. v. Agate Construction Co.*, 901 A.2d 1050 (Pa. Super. 2006), the court decided that Pennsylvania's Prompt Pay Act required payment to a subcontractor of all amounts undisputedly due at the time for final payment, even in the face of clear non-compliance with a contractual provision obligating the subcontractor to provide a full and final release of all claims prior to final payment. Such a payment was not made in this case, further entitling the subcontractor to recover penalty interest and its attorney's fees associated.

Factual Background

The case involved construction of a tower foundation to support a tram line spanning the Delaware River. The governmental owner of the tram-line project was the Delaware River Port Authority. The Authority's general contractor hired Agate Construction Co. to erect the tower foundation. Agate entered a subcontract with Pietrini Corp. to provide the labor and concrete materials for all permanent construction above the caisson cap on the tower.

During construction, Agate and Pietrini agreed that Pietrini would perform additional work caused by design modifications. Pietrini submitted change order requests seeking additional payment for the work necessitated by the design changes. Agate forwarded the change order requests to the general contractor. The general contractor approved some of the requests and rejected others.

After Agate's work on the project closed out, Agate advised Pietrini that it would make final payment under the original contract plus payment for the *approved* change orders. But Agate demanded that Pietrini sign a full release of all liens and claims before it would tender the payment. The subcontract between the parties required Pietrini to submit such a full and final release of all claims prior to final payment. Pietrini, contending all along that it was entitled to payment for its unapproved change order requests, refused to sign the release. Agate refused to pay any sum until the release was signed.

Pietrini consequently filed suit against Agate, seeking payment of its original contract balance plus payment for all of its change order requests. Pietrini also sought interest and attorney's fees under the prompt payment provisions of Pennsylvania's procurement statutes. Agate, admitting that it owed Pietrini the contract balance and the amounts of the approved change orders, nevertheless alleged that no payment was due because Pietrini failed to provide the release.

Competing Obligations and Payment

Pennsylvania's Prompt Pay Act generally requires a contractor, in the absence of sufficient reason otherwise, to pay a subcontractor within twenty days of receiving payment itself for the work performed by the subcontractor. The statute also provides that a court may award a subcontractor interest and attorney's fees if the court concludes that the contractor acted in an "arbitrary and vexatious" manner in withholding payment, meaning that the withholding was without sufficient ground in either law or fact, and served the sole purpose of causing annoyance.

The sole reason Agate withheld payment from Pietrini was Pietrini's failure to waive all other claims for payment. The court held that the prompt payment statute is intended to negate such harsh negotiating tactics on public projects, and it found that Agate's tactics constituted coercion rather than negotiation. The court also found that Agate intended to leverage or compel Pietrini into surrendering legitimate pursuit of its other claims by denying Pietrini money undisputedly due.

The court distinguished these circumstances from those where a contractor withholds payment because a good faith dispute exists over backcharges in an amount that would exceed an undisputedly due sum. Such a good faith reason justifies a refusal to pay a subcontractor and avoids liability under the Prompt Pay Act for interest penalties and attorney's fees on money withheld but subsequently paid. But where the validity of the debt owed is not the subject of a good faith dispute regarding the amount, withholding is not justified.

Agate never disputed that it owed a significant portion (approximately one-half) of the amount Pietrini claimed in its suit. There was no possibility that Agate would not eventually have to pay that sum. Agate did not assert counterclaims sufficient to negate its obligation to pay. Its sole defense was the contractual requirement that Pietrini submit the full and final release of all claims before final payment. Agate argued that this obligation should override the statutory prompt payment mandate. The court expressly disagreed. It interpreted the "clear intent" of the Pennsylvania Prompt Pay Act to be "to level the playing field between contractors and subcontractors when they are working on public projects." Contractors on public projects in that state must pay subcontractors for all items satisfactorily completed.

Comment

Agate sought a complete and final release of all claims

prior to making payment. It seems to remain an open question whether a good faith dispute would have existed to justify the withholding if it instead unsuccessfully sought a more limited release corresponding to claims for the work connected to the amounts not in dispute. However, it may be that the focus should be only on the arithmetic involved and that good faith disputes about contract obligations have no bearing on the propriety of withholding money that is duly owed.

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Federal False Claims: A New Meaning for CM “At Risk”

586 Introduction

Motivated by increased pressure to accomplish more with less funding, to get projects completed faster, and to eliminate as much risk as possible, state and local government entities are authorizing the use of alternative project delivery systems as a means of gaining efficiencies in the construction process. The traditional design-bid-build approach, while familiar, does not always provide the necessary flexibility to achieve the best project at the lowest price. The increasing use of alternative methods offers many advantages and opportunities, but may also expose industry participants to new risks and liabilities. For example, the Third Circuit’s decision in *United States v. Vitillo*, 490 F.3d 314 (3rd Cir. 2007) shows that a construction manager’s relationship with a local public agency and scope of authority was of critical importance in determining whether it was subject to federal criminal liability.

Factual Background

The Reading Regional Airport (“RRA”) – located in Berks County, Pennsylvania – was a small, regional airport that provided services to private and commuter aircraft. The RRA was managed by the Reading Regional Airport Authority (“Authority”). The Authority was a local government agency that received significant funding from the Federal Aviation Administration. Between 1997 and 2000, the Authority received approximately \$3 million from the federal government, half of which (approximately \$1.5 million) was set aside for its Terminal Expansion Project.

Because the RRA did not have a primary engineer on staff, the Authority, in 1997, appointed Mr. John Vitillo and Vitillo Engineering, Inc. (collectively referred to as Vitillo) to serve as the Authority’s “primary engineer and principal engineering consultant.” Vitillo worked for the Authority through the year 2000 and was paid by the hour at an agreed upon rate. During this time, Vitillo managed several projects at the RRA including the Terminal Expansion Project, which took over two years to complete.

The federal government became suspicious of Vitillo’s business practices and believed it was engaged in a massive

scheme to defraud the Authority. Specifically, the government suspected that Vitillo was submitting inflated invoices and charging for work not performed. In 2002, the FBI searched Vitillo’s offices seizing its time cards and billing records. A federal grand jury indicted Vitillo charging it with three counts of theft from an organization receiving federal funds, in violation of 18 U.S.C. §666 (entitled: “Theft or bribery concerning programs receiving Federal funds”), and one count of conspiracy. At trial the government presented substantial evidence of Vitillo’s methodical practice of preparing and submitting fraudulent invoices for work that was never actually performed at the RRA. The government showed that Vitillo defrauded the Authority of hundreds of thousands of dollars. The jury returned a verdict finding Vitillo guilty on all counts. Mr. Vitillo was sentenced to 36 months of imprisonment and two years of supervised release. The corporate entity was sentenced to 5 years probation. In addition, the defendants were ordered to pay \$317,760 (the approximate amount taken from the Authority) in restitution, jointly and severally.

Vitillo challenged the conviction by filing a motion for new trial. The primary argument raised in support of this motion is that Vitillo falls outside the scope of the federal statute under which it was convicted. Specifically, 18 U.S.C. §666 prohibits theft from programs, receiving federal funds, by *agents* of the organization which administer those funds. Vitillo argued that it was not an *agent* of the Authority and, thus, could not have violated the statute. The District Court rejected Vitillo’s argument and denied the motion. Vitillo appealed the ruling to the Third Circuit Court of Appeals.

Who is An “Agent”?

In analyzing the Vitillo’s argument, the Third Circuit stated that when “interpreting a federal criminal statute we must pay close heed to the language, legislative history, and purpose in order to strictly determine the scope of the forbidden conduct.” While recognizing that any ambiguity in the language of the statute must be resolved in favor of the defendant, the court noted that 18 U.S.C. §666 is extremely broad in scope. According to the court, Congress intended the terms of this statute to be construed broadly as this legislation “seeks to ensure the integrity of vast quantities of federal funds previously unprotected due to a serious gap in the law.”

Section 666 prohibits an “agent” of a local government agency that receives more than \$10,000 in federal funds from stealing, embezzling, or obtaining by fraud, from that agency property valued at more than \$5,000. Pursuant to §666(d)(1):

the term “agent” means a person authorized to act on behalf of another person or a government and, in the case of any organization or government, includes a servant or employee, and a partner, director, officer, manager, and representative.

In seeking to establish that it did not fall within the scope of the statutory definition of *agent*, Vitillo asserted two primary arguments. First, it contended that the

statutory definition of *agent* is limited to those qualifying persons or entities having “control over any federal funds.” As construction manager for the Terminal Expansion Project, Vitillo argued, it had no such control and, thus, did not fit the definition. Second, because it contracted with the Authority as an “independent contractor” – a term not listed in the definitional provision – Vitillo asserted that by the terms of that contract provision it was excluded from the statute’s coverage.

In rejecting the Vitillo’s first argument, the court stated that there is nothing to suggest that the statutory definition of *agent* was limited to “someone who necessarily controls federal funds...” To the contrary, the term is defined broadly as “a person with authority to act on behalf of the organization receiving federal funds and can include ... an employee, officer, manager or representative of that entity.” Because this language was clear, the court found no reason to “consult extrinsic sources”, as suggested by Vitillo, to further define *agent*. “To do so might result in the improper importation of extraneous language into the statutory text.” In short, the court found no basis to adopt Vitillo’s restrictive definition of an *agent*.

Vitillo’s second argument, which the court deemed “dubious”, was likewise rejected. Specifically, the court noted that by listing the terms “servant,” “employee,” “partner, director, officer, manager, and representative”, Congress did not intend to provide an all-inclusive list of entities within the scope of the definition. In fact, that Congress used the word “includes” to precede the list – by definition – shows it did not intend the list to be exhaustive. Accordingly, the court determined that an independent contractor who acts as a representative of an organization receiving federal funds is not excluded from the reach of the statute.

Comment

As state and local entities move away from the traditional project delivery system, contractors and other entities are placed in unfamiliar circumstances with new scopes of authority, responsibility, and risk. The changes in these variables directly impacts an entity’s potential liability on a given construction project. As illustrated in *Vitillo*, the construction manager’s relationship with the owner and its scope of authority was critical to the determination of whether the entity was subject to federal criminal liability. This decision is also instructive as it provides a general reminder that as traditional project “roles” evolve, industry participants – *before* entering into a contract—must consider whether its changing role implicates any requirements or obligations imposed by federal, state, or local regulations as that may alter the value and attractiveness of projects or the method in which the work is performed.

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Who Owns Unused Materials?

587 Introduction

It is no secret to those familiar with the construction industry that the costs of building materials have skyrocketed over the past few years. Construction budgets and project schedules are often confounded by the price and availability of concrete, steel and other raw materials that are essential to the ability of construction professionals to deliver a finished product to their customers. Construction materials that are not incorporated into one project can be a valuable commodity to an owner or a contractor on a subsequent project. So, who owns the “left-over” materials when the construction contract is silent on the matter? The question was recently addressed in *G&R Service Co., Inc. v. Department of Agriculture*, CBCA No. 121, 07-1 BCA ¶ 33,522, a case of “first impression” for the Civilian Board of Contract Appeals (“Board”).

Background

G&R Service Company, Inc. (“G&R”), entered into a fixed price construction contract with the Department of Agriculture Forest Service (“Forest Service” or “Government”) in the amount of \$128,560 to furnish “all necessary personnel, material, equipment, services, facilities, related site work and utilities to install new underground electrical system and replace eight existing water valves and valve boxes for the Big Biloxi Recreation Area.” The contract included the standard Federal Acquisition Regulation (FAR), clause entitled “Payments Under Fixed-Price Construction Contracts (SEPT 2000).” Under that clause, G&R was entitled to receive progress payments typically on a monthly basis. The contracting officer was to make payments based on estimates of “work accomplished” using, among other factors, *materials delivered to the project site* as a basis for such estimates. (Emphasis added) The contract provided that “at the time of [the progress] payment”, building materials covered by such payment would “become the sole property of the Government...” The contract did not address the delivery of building materials other than that which was to be included into the project.

G&R timely completed its work to the satisfaction of the Forest Service. At the conclusion of the project the Forest Service refused to release PVC conduit and other materials delivered to the project site by G&R, but not used during construction. G&R filed a claim with the contracting officer to recover the value of the building materials, plus other damages associated with the loss of use of the materials. The contracting officer denied G&R’s claim based on the provision in the contract that materials that were the subject of progress payments became “the sole property of the government at the time payment is made.” Thereafter, G&R appealed the final decision to the Board.

Decision on Appeal

The Board began its analysis of G&R’s appeal by

explaining that progress payments under federal contracts are based on either: (1) the costs incurred; or (2) completion of the work. John Cibinic, Jr. & Ralph C. Nash, Jr., *Administration of Government Contracts* (3d ed. 1995) 1138. For contracts with cost-based progress payments the FAR requires that the contract also include a payment provision located at FAR 52.232-16 which states that “[p]arts, materials, inventories, and work in process” to “vest in the Government” either “immediately upon the date of [the] contract, for property acquired or produced before that date” or “when the property is or should have been allocable or properly chargeable to [the] contract.” In essence, the transfer of title to building materials serves as a form of security for progress payments made to contractors to protect the Government against default or bankruptcy prior to the completion of the project. The Board noted, however, that the title transfer is not permanent. At the point of contract completion and the Government’s acceptance of the project, the “transfer of title” clause states that title to the building materials “not delivered to, and accepted by the Government” or “incorporated in supplies delivered to, and accepted by, the Government” is to revert back to the contractor. The Board explained that this temporary title transfer was logical because once a contract is completed and accepted, there is no need for the Government to secure its progress payments using building materials that are not consumed in the construction of the project.

The Board noted that fixed price construction contracts, like the one between G&R and the DOA, were typically geared to completion of the work, as opposed to the cost-based structure that required the FAR transfer of title clause. Under the completion of work structure, progress payments are made to a contractor as construction progresses based on estimates of the percentage of completion achieved, as measured against a schedule of values tied to the contract price. In its consideration of the G&R contract, the Board observed that the “Payments Under Fixed Price Construction Contracts” clause permitted the Government’s contracting officer to consider the amount of building materials delivered to the project site when estimating the percentage of work completed. In other words, a “completion of work” progress payment structure that takes into account materials delivered naturally requires a “cost-based” analysis. Accordingly, the Board determined that even if the transfer of title clause under FAR 52:232-16 is not present in a federal fixed price contract, the clause’s “transfer of title” treatment to building materials should be applied whenever the Government makes any progress payments on the basis of costs.

By applying the effect of transfer of title clause to the building materials withheld from G&R by the Forest Service, the Board overruled the decision of the contracting officer that the materials became the “sole property of the Government” at the conclusion of the project. The Board explained G&R’s contract required it to furnish “all

necessary personnel, material, equipment, services, facilities, related site work and utilities” to complete the project. Conversely, nothing in the contract indicated that G&R was expected to furnish for the Forest Service’s use extra conduit, wire, and other materials that were not needed for completion of the electrical and mechanical work on the project. The Board specifically rejected the Government’s argument that by tendering progress payments to G&R, it had effectively “paid” for the unused building materials. The only thing the Forest Service paid for under the fixed price contract, the Board explained, was the construction work that G&R completed and the Government accepted. In the Board’s view, permitting the Forest Service to retain the unused building materials would result in an “unjustified windfall” that would “unfairly deprive [G&R] of a substantial portion, if not all, of the profit earned” by successful completion of the project.

Comment

The Board concluded its decision in the *G&R Service Company* case by noting some discrepancies in the documents supporting G&R’s claim for damages arising out of the Government’s refusal to return the unused building materials. Consequently, while G&R was legally entitled to recover for whatever quantities of unused materials were kept by the Forest Service after contract completion, the Board held that G&R bore the burden of proving the dollar amount of all other damages it claimed were associated with the loss of use of the materials.

While seemingly minor at first glance, the Board’s requirement that G&R clearly establish its “periphery” claims was significant because the actual value of the building materials G&R sought to recover was only about \$13,000, or less than *half* of its total claim of \$30,901.¹² As we have done in past articles, we included this comment along with our discussion of the *G&R Service Company* decision to underscore the importance of maintaining thorough and accurate documentation of all damages asserted in this or any other type of construction claim.

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Insurance Coverage Developments

Editor’s Note: During the last decade, insurance coverage for the participants on a construction project has become a central feature of risk allocation and mitigation. The next two articles address two issues that have significant practical importance for any firm involved in a construction project. These are: (1) CGL policy coverage for damages resulting from defective work; and (2) the rights of an “additional insured” under a CGL policy.

Insurance Coverage for Construction Defects

588 Overview

Practically every construction-related business today has some form of Commercial General Liability (“CGL”) insurance. This insurance is typically purchased as part of a package of coverages which cover various aspects of the business enterprise, including automobiles and property. Broadly speaking, the CGL component covers the business’ exposure to third party claims for personal injury or property damage. In such a situation, CGL usually also requires the insurer to defend its insured in a related legal action. Accordingly, if a claim is “covered” by the CGL policy, it provides the third party with a source of recovery for the damage in addition to providing the insured with a defense and a source of funds to pay for the damages.

Like other forms of insurance, the CGL “policy” is almost always based on a common, industry-wide “form” policy that is updated and revised from time to time. By far, the most common CGL form is produced and maintained by Insurance Services Office, Inc. (“ISO”). As such, subject to various amendments, riders, and endorsements, a contractor’s CGL coverage is typically based on the same ISO form used by any other type of business that has purchased CGL coverage. Further, because CGL coverage is generally based on common form policies, a court’s decision concerning what is or is not covered under the CGL form will also usually apply to other insureds who have purchased coverage under the same CGL form.

What Is An Occurrence?

A significant feature of the CGL form is that it limits coverage of losses to those caused by an “occurrence.” While this term has been defined in innumerable ways, it is generally accepted to mean an “accident” or some other type of unexpected event or damage. Historically, many courts have held that a contractor’s CGL policy does not cover the risk that the contractor may be sued for property damage by an owner in relation to construction defects or faulty workmanship. Simply put, until recently, many courts have provided the contractor (and the owner) with no CGL coverage for typical construction-related claims. The courts’ basis for this holding is rooted in the notion that a defect in workmanship is not the type of “accident” or “occurrence” covered by the CGL form. Other courts have held that the risk of a construction defect claim is a “business risk” of the contractor and is not one covered by CGL.

Unfortunately, this line of holdings has confounded the expectations of contractors and owners faced with construction defect claims. Owners are often surprised to learn that their “insured” contractor actually has no coverage for damage it or its subcontractors may cause by its defective work. Further, contractors are often left without an insurer-provided defense to construction defect claims and must come out of pocket for what were believed to be covered claims. Moreover, while other risk-shifting

tools, such as the performance bond, provide a more limited form of recovery from the surety for the owner, the contractor typically remains liable to reimburse its surety under the terms of a master indemnity agreement.

Recovery of Damages Related to Defective Work

In light of these concerns and dashed expectations, several key cases have re-visited the issue of whether a construction defect claim against a contractor may be covered under CGL. Notably, many of these cases have come from Southern states and it can now be said that these cases appear to be part of a growing “trend” favoring CGL coverage for construction defect claims.

The first such case is the Tennessee Supreme Court decision of *Travelers Indem. Co. of America v. Moore & Associates, Inc.*, 216 S.W.3d 302 (Tenn. 2007). In this matter, the court was presented with a claim against a contractor for the faulty construction and installation of windows on a project by its subcontractor, which caused water-intrusion and related damage. Relying on older decisions, the contractor’s CGL insurer claimed there was no coverage under the CGL policy for this type of damage. In review, the court rejected the insurer’s argument. In so doing, the court declined to find, as a matter of law, that construction defects cannot constitute an “occurrence” under the CGL policy. Instead, the court held that as long as the damage caused by the defective work was not “foreseeable” from the insured contractor’s standpoint, the claim could potentially be covered.

The next case in this emerging trend favoring CGL coverage is the Texas Supreme Court decision in *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007). In this case, the insured contractor was faced with an owner claim for foundation defects. Again, the insurer argued that the CGL policy simply does not cover defective construction as an “occurrence” or “accident” as defined by the policy. In rejecting this argument, the *Lamar Homes* court found that unintended construction defects could very well give rise to an occurrence under the CGL policy and that the resulting damage was “property damage” under the policy.

A third case illustrating this trend is *U.S. Fire Ins. Co. v. J.S.U.B., Inc.*, 2007 WL 4440232 (Fla. 2007), decided by the Florida Supreme Court in December 2007. *J.S.U.B.* involved a claim against the contractor for poor soil and compaction by a subcontractor, which resulted in property damage. As in the other cases highlighted herein, the insurer made numerous arguments to the court as to why a claim for defective work cannot be covered under the CGL policy – these arguments generally relate to the insurer’s contention that such defective work cannot be an “occurrence” or “accident.” However, like the courts noted above, the Florida Supreme Court rejected any argument that would automatically bar such claims from coverage. Accordingly, the court held that “faulty workmanship that is neither intended nor expected from the standpoint of the contractor can constitute an ‘accident’ and, thus, an ‘occurrence’ under a post-1986 CGL policy.”

Summary

As such, these three cases, along with others from Wisconsin and Minnesota, illustrate a growing acceptance by courts that a construction defect claim may very well be covered by a contractor's CGL policy. These cases provide insured's under the current ISO CGL form with a potential additional layer of security when faced with a construction defect claim. It is further important to note, however, that these cases merely "open the door" to the possibility of coverage. In reviewing whether or not insurance coverage exists, courts first review the "insuring agreement," and then move on to review "exclusions," and then the "exceptions to the exclusions." The three cases noted above provide a strong argument that the "insuring agreement" does not foreclose CGL coverage for construction defects. Aside from this issue, the insurer may still have many defenses to coverage. Accordingly, even if a court finds that a construction defect may constitute an "occurrence," there may very well be an exclusion elsewhere in the policy that could serve to invalidate coverage.

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Duty to Defend Additional Insureds

589 Insurance policies serve an important role in managing risk in the construction industry. A Commercial General Liability (CGL) policy generally covers liability for bodily injury and property damage due to an accident. If the damages sustained are within the scope of the policy's coverage, the insurance company (insurer) will pay up to the limits of the policy. The policyholder (insured), however, is responsible for first paying up to the amount of the policy's deductible.

A CGL policy also requires the insurer to defend the insured against injured parties seeking damages due to bodily injury or property damage, subject to the limitations of the policy. The insurer's duty to defend is triggered by the filing of a lawsuit, arbitration proceeding, or a mediation hearing. If the insurer has a duty to defend the insured, the insurer must pay the associated attorneys' fees and related expenses.

Additional Insureds

Construction contracts often require contractors and subcontractors to purchase CGL policies to guard against the financial risks of loss. It is not uncommon for the project owner to require contractors and subcontractors to purchase a policy that names the owner as an "additional insured." This provides coverage for the owner for bodily injuries and property damages arising out of the work of the owner's contractors and subcontractors. Requiring "additional insured" protection is not limited to owners – contractors and subcontractors at any level may impose

similar requirements. As a result, owners, prime contractors, and subcontractors may often have potential coverage under their own policies, as the insured, as well as under another policy, as an additional insured.

The significance of coverage as an insured rather than as an additional insured is important for several reasons. First, the impacts of a pay out for damages and defense costs eventually can lead to higher insurance premiums for the insured. As the additional insured is covered under the insured's policy, it is the insured, and not the additional insured, that typically bears this burden. Second, only the insured, in general, pays the deductible as long as the insured's policy (ordinarily defined as the primary policy) will be sufficient to cover the total amount of loss. If a contractor is an additional insured under a subcontractor's policy, the contractor may not have to pay a deductible; that is the responsibility of the subcontractor. If the subcontractor's primary policy limit is not sufficient to cover the damages, then the contractor's policy may take effect as excess coverage.

There may be confusion, however, as to whether the insurance company is obligated to defend the additional insured. As it is the one paying the costs of the defense, the insurance company generally will seek to share the financial burden of the defense and potential liability by asserting that the additional insured's other policies provide primary coverage. In this respect, the insurer may deny or delay a decision on whether it has a duty to defend an additional insured, waiting until ultimate liability for the accident is first determined. Thus, additional insureds may wonder when they are entitled to a defense against claims arising out of their subcontractors' work.

Potential Coverage is Sufficient

A recent New York case addressed the issue of an insurer's duty to defend an additional insured. *BP Air Conditioning Corp. v. One Beacon Ins. Group*, 8 N.Y.3d 708, (N.Y. 2007). In that case, BP Air Conditioning Corp., an HVAC subcontractor working on a renovation of the World Trade Center, subcontracted pipe fitting work to a lower tier subcontractor, Alpha Piping Corp. BP was named as an additional insured on Alpha's CGL policy. When a construction worker was injured on the project and sued the general contractor, the general contractor brought a suit against BP and its subcontractor Alpha, seeking indemnification as the accident allegedly occurred as a result of the HVAC work. BP tendered its defense to its subcontractor's insurer as an additional insured.

The insurer refused to defend BP as an additional insured on the basis that the duty to defend did not cover the additional insured until it had been proven at trial that the injury was due to the insured's work at the site. The insurer did, however, agree to defend the insured. Thus, the insurance company was arguing that the duty to defend was judged by different standards; one standard for the insured and another for the additional insured. The insurer acknowledged that it had a duty to defend the insured against the potential liability defined by the allegations, but argued that the additional insured's

defense was not owed until the allegations had been proven and liability had been determined.

The New York Court of Appeals disagreed. The duty to defend is “exceedingly broad.” The insurer’s duty to defend is triggered by the allegations made in the lawsuit. If the allegations create the potential for coverage under the policy, the insurer must defend. What’s more, the underlying merits of the claim are irrelevant. The insured is entitled to a defense even if the claims are groundless, false or fraudulent. This standard for determining whether a duty to defend the insured exists is the same as that used to determine whether the additional insured is entitled to a defense. The court based its decision on the reasonable expectations of the additional insured. That is, when BP required its subcontractor Alpha to name it as an additional insured, BP reasonably expected that it would gain protection against lawsuits arising out of its subcontractor’s work. Thus, BP was entitled to a defense.

Which Policy Is Primary?

The question of which policy provides primary (initial) coverage for a claim or defense costs often arises when a contractor or subcontractor is named as an additional insured under one of the policies and that firm also carries similar insurance. In the *BP Air Conditioning* decision, an appellate court had held that BP’s coverage under its own policy was “excess” coverage. The Court of Appeals of New York overturned that ruling on the basis that none of the other policies had been introduced in the trial court. Lacking an ability to review all of the potentially applicable insurance policies, the court declined to determine which policy was primary.

Practical Considerations

There are many potential benefits of being named as an additional insured on a CGL policy. Avoiding deductible payments and protecting against potential future policy price increases are just two examples. As with a primary policy, however, owners and contractors named as additional insureds must meet certain conditions to trigger an insurer’s duty to defend. Additional insureds should carefully read the insuring agreement and any additional endorsements to determine the scope of coverage and the responsibilities that first must be met to trigger coverage. Notice provisions, for example, require the insured to promptly notify the insurance company of potential claims. An owner or contractor that is sued for an accident that causes bodily injury or property damage allegedly caused by a company it hired for a project should notify both its own insurance company as well as the lower-tiered company’s insurer. Providing notice to the carrier of the policy on which it is listed as an additional insured triggers the duty to defend. Finally, in order to resolve the question of which policy is primary, all of the potentially applicable policies should be before the court.

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Proving Acceleration

590 Overview

Acceleration and delay are often considered opposite sides of the same coin. They are also frequently and inappropriately confused. Delays generally occur when there is a slowdown in the work. During an acceleration, the contractor performs at a faster rate than required by the original contract. Acceleration is normally achieved by working overtime or working double shifts—resulting in extra labor costs and loss of efficiency. Acceleration damages can also include the costs of additional tools, equipment, and overhead. Acceleration claims arise when a contractor experiences excusable delay, is denied a time extension, required to meet the original construction schedule, and incurs additional costs in doing so.

Acceleration claims can be for actual or constructive acceleration. The necessary elements of proof depend on which type of acceleration claim is brought. Actual acceleration requires a directive to finish the work according to the non-extended schedule. As articulated in *Granite Constr. Co. v. United States*, 24 Cl. Ct. 735 (1991), a contractor bringing a claim for actual acceleration typically must prove:

- * The owner issued an oral or, if required by contract, a written change order;
- * The contractor reasonably attempted to accelerate;
- * Actual acceleration occurred;
- * The contractor incurred acceleration costs.

In *Fraser Const. Co. v. United States*, 384 F.3d 1354 (Fed. Cir. 2000), the court identified the elements of a constructive acceleration. These are:

- * Contractor encountered excusable delay entitling it to a time extension;
- * Contractor made timely and sufficient request for time extension;
- * Request for time denied or postponed;
- * Conduct that is reasonably construed as an order to complete within the non-extended performance period;
- * Contractor accelerated and incurred additional costs as a result.

Constructive acceleration is simply a form of constructive change. Even though acceleration and delay are different, excusable delay is an element of constructive acceleration. A recent decision of the United States Court of Appeals for the Seventh Circuit, *Murdock & Sons Constr., Inc. v. Goheen General Constr., Inc.*, 461 F.3d 837 (2006), illustrates the importance of providing actual evidence of what caused the contractor’s delay when asserting a claim for constructive acceleration.

Factual Background

Indiana sought bids for a new maximum security prison

to be built near Terre Haute. Goheen General Construction submitted the low bid of \$6.97 million. Murdock & Sons Construction, at the state's suggestion, gave Goheen a bid for the masonry work. Goheen received three bids on the masonry. Murdock's bid of \$1.63 million was more than \$845,000 lower than the next lowest bid. Goheen awarded the masonry subcontract to Murdock.

Murdock's bid was based on its estimate that a mason should lay 150 blocks a day on this project. While Murdock considered 200 blocks a day as "normal" production, Murdock reduced that figure because of the strict masonry specifications for the prison. Murdock was required to use union masons and entered an agreement with the local union in Terre Haute. Even though Murdock had worked on previous projects in the area, it had never dealt directly with the local union.

Murdock began work in January 1992 and encountered serious productivity problems. Murdock's union masons were laying only 50 blocks a day—one-third of what Murdock had estimated. Murdock tried several things to speed up production. It fired slow workers, provided additional equipment, tweaked the construction process, and increased crew sizes. All of Murdock's efforts to increase productivity ultimately failed. Murdock suffered delays and cost overruns and fell behind schedule. Goheen and the state were aware that Murdock was behind schedule. They first requested, and then later demanded, that Murdock pick up the pace to meet the construction deadline.

Murdock notified Goheen that it wanted a change order for more time and more money. Goheen forwarded Murdock's request to the state and it was denied. Murdock stopped work and walked off the job. Goheen eventually finished the project 180 days late. Murdock sued Goheen and the state, claiming it was entitled to a time extension under the contract. Murdock brought a constructive acceleration claim arguing that its project delays were due to either a labor dispute or a cause beyond its control.

Court's Analysis—Where's the Proof?

The court acknowledged there were no Indiana cases recognizing constructive acceleration claims, but noted that many other jurisdictions recognized this type of claim, and held that such a claim was viable. The court pointed out that a claim for constructive acceleration normally arises when an owner requires a contractor to meet the original construction schedule even though the contractor is entitled to a time extension due to excusable delay. The court spelled out the five elements, as summarized above, that make up a constructive acceleration claim. The first element requires an excusable delay. Excusable delay is generally a delay to the critical path outside of the control of the contracting parties. Murdock never got passed the first element.

Murdock was entitled to a time extension under the contract if it was delayed by labor disputes or any causes beyond its control. Murdock argued that its delay—the masons' slow pace—was due to either a labor dispute or

a cause beyond its control. Murdock's argument failed, however, because it did not offer sufficient evidence to show that the slower-than-anticipated masonry work was due to either a labor dispute or a cause beyond its control.

Murdock offered the testimony of three witnesses at trial. Mr. Murdock himself testified that he believed there was a labor dispute because he did not receive a fair day's work from the union masons in return for a fair day's pay. There was also witness testimony indicating there was an organized work slowdown by the masons. None of Murdock's witnesses could, however, point to a specific reason or underlying cause of the slow production. This proved fatal to Murdock's claim.

The court ruled the testimony was nothing more than pure speculation or guesswork and did not prove the existence of a labor dispute. Murdock argued that even if the delay in the progress of its work was not due to a labor dispute it was due to a cause beyond its control. Murdock contended that the slow progress was outside its control because it tried everything it could to speed up the masons' work and all its efforts failed. The court rejected this argument, reasoning that Murdock did not try everything because it never offered cash bonuses to the masons for completing their work faster or on time. The court also noted that when Murdock added more masons productivity did increase for a short period of time.

An unsympathetic court held that Murdock grossly underestimated the time and effort required to perform the masonry work in accordance with the stringent specifications for a maximum security prison, and that unexpected difficulties in the performance of a construction contract are risks that the contractor must accept. Murdock failed to prove that the masons' lack of productivity was an excusable delay, it was therefore not entitled to a time extension, and its constructive acceleration claim was denied.

Comment

Acceleration claims can often be avoided if the contracting parties communicate on a regular basis. An accurate and properly adjusted schedule can be a critical component to a successful construction project. If the owner actually needs to have performance completed earlier than the updated schedule, the contractor should be ordered to accelerate, and the owner should pay the acceleration costs plus a reasonable profit. When an excusable delay occurs, a prudent contractor requests a time extension. If a dispute arises, and an acceleration claim is made, the parties must recognize the difference between actual and constructive acceleration and the elements needed to establish each claim. The parties must also recognize that speculation or guesswork will rarely prove a claim. Evidence of the specific cause of an excusable delay is the first step in proving a constructive acceleration claim.

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UPCOMING SEMINARS

ConsensusDOCS, Carolinas AGC, April 10, 2008, Raleigh, North Carolina. *Philip E. Beck.*

Mediation, National Contract Management Association, 2008 World Congress, April 14, 2008, Cincinnati, Ohio. *Hubert J. Bell, Jr., Steven L. Reed.*

ConsensusDOCS, ABC of Florida, April 23, 2008, West Palm Beach, Florida. *Philip E. Beck, Leonard N. Ortiz.*

Construction Law Update, ABC of Alabama, April 23, 2008, Birmingham, Alabama. *Thomas J. Kelleher, Jr., Eric L. Nelson, Kirk D. Johnston.*

Common Sense Construction Law, ABC of Georgia, May 6, 2008, Atlanta, Georgia. *Philip E. Beck, Thomas J. Kelleher, Jr., G. Scott Walters.*

Update on Construction Law, ABC National Conference, May 7, 2008, Las Vegas, Nevada. *Eric L. Nelson.*

The Hidden Risks of Green Buildings: Why Building Failures Are Likely and How to Avoid Them, Lorman Education Services, May 14, 2008, Miami, Florida. *James K. Bidgood, Jr., Eugene J. Heady.*

ConsensusDOCS, Carolinas AGC, May 22, 2008, Greenville, South Carolina. *Philip E. Beck*

Avoiding and Winning Construction Claims and Disputes, ABC of Georgia, June 26, 2008, Atlanta, Georgia. *Philip E. Beck, G. Scott Walters.*

What to Do When Construction Projects Go Bad, Lorman Education Services, July 16, 2008, Jacksonville, Florida. *S. Elysha Luken.*

Resolving Problems & Disputes on Construction Projects, National Business Institute, August 7, 2008, Atlanta, Georgia. *Philip E. Beck, James K. Bidgood, Jr.*

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