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The matrix for each state or jurisdiction provides statutory citations and comments regarding these laws and is a module in AGC's DocuBuilder software package. On the next page is a sample page from the matrix for the State of Georgia. Since this project was completed in 2002, Smith, Currie has annually updated the matrix and has added new topics. Recent additions include topics such as: "Trust Fund" statutes applicable to payments to contractors or subcontractors; distinctions between construction management delivery vehicles, i.e., CM at Risk, CM Agency, and statutes addressing reverse bid auctions as a procurement technique for public construction projects. For the 2006 edition, we have added the following topics:

- Statutes Addressing Choice of Law Provisions in Subcontracts
- Statutes Addressing Forum Selection Provisions in Subcontracts
- Status of State OSHA Plans

In addition, each matrix includes information on legislative session calendars, links to state legislative search engines and free technical support through the AGC's DocuBuilder Help Desk. We are confident that each state's matrix can provide a basic resource tool for a firm contemplating work outside of its home state or seeking a checklist on construction law topics in its home state.

AGC'S STATE CONSTRUCTION LAW MATRIX: ANNUAL REVISION FOR 2006

Several years ago, the Associated General Contractors of America ("AGC") requested Smith, Currie & Hancock to design and develop a matrix of state laws affecting the construction process for each of the 50 states, the District of Columbia, and Puerto Rico. Utilizing a standard format, each matrix addressed legislation affecting the construction industry such as the following:

- Pre-Qualification Requirements
- Special Requirements for Out-of-State Contractors

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GEORGIA

Topic	Sub-topic	Yes/No	Statutory Requirements xxx Official Code of Ga. Annotated ("O.C.G.A.")	Notes/Comments
Pre-Qualification Requirements	1. Is there a State Licensing Requirement for: a. General Contractors	See comment.	O.C.G.A. §§ 43-14-1 et seq. (current) O.C.G.A. §§ 43-41-1 et seq (upon appropriation)	* While legislation has passed to require all persons engaging in the business of contracting to obtain a license, the law does not become operative until the effective date of an appropriation of funds expressed in a line item in an Appropriations Act enacted by the Georgia General Assembly.
	b. Construction Managers	See comment.	O.C.G.A. §§ 43-14-8.3, 43-14-8.4	* No person may be employed as a utility manager or foreman unless that person holds a current utility manager/foreman certificate. In addition, no utility system

A sample from the AGC State Construction Law Matrix for Georgia.

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Faulty Construction - CGL Coverage

515 Overview
During construction, faulty workmanship may not only require rework, but also may result in damage to

construction work performed by others. In a recent case, the work force of a contractor (Limbach Company) with a commercial general liability (CGL) policy improperly unpacked pipe which caused a leak in the steam pipe system and damaged other work. The contractor claimed that ripping out completed work performed by its subcontractors was covered under its CGL policy despite the defective workmanship exclusion that excluded coverage for property damage to "your work." The lower court's ruling that the damage was excluded was reversed by the United States Court of Appeals for the Fourth Circuit, which applied the law of Pennsylvania and held that the cost of repairing the resulting damage to construction work performed by others was covered as property damage under the CGL policy. *Limbach Company, LLC v. Zurich American Ins. Co.*, 396F.3d 358 (4th Cir. 2005).

Background

Limbach had a subcontract to perform the mechanical work that included installation of a prefabricated, insulated underground steamline. Limbach subcontracted the production of the steamline to one company and subcontracted the excavation and backfill of the trench where the line was to be installed to another company. After installation, a leak was discovered in the steam line, which damaged the insulation covering the pipe, the backfill which had been placed around the steam line, and the landscaping in the area surrounding the leak, including concrete walkways. The repair of the steamline also required the removal of concrete, which had been installed by a third party. Limbach filed a claim under its CGL policy for the cost of replacing the damaged steamline and included the cost of repairing the work damaged by the leak such as repairing the backfill, replacing the steam pipe, repairing

the landscaping, replacing the concrete, and the cost of a temporary steam boiler. The insurer agreed to cover the cost of the temporary steam boiler and part of the landscaping, but denied the other claims on the basis of CGL policy exclusions.

CGL Coverage: Exclusions and Exceptions

The CGL policy provided that the insurer would pay for those sums that the insured (Limbach) became legally obligated as property damage to which the policy applied. The policy included a “products – completed operations hazard” which was defined to include all property damage occurring away from premises owned or rented by the insured and arising out of “your work.” The term, “your work” was defined as “work or operations performed by you or on your behalf” and included “materials, parts or equipment furnished in connection with such work or operations.”

Exclusion (I) known as the “your work” exclusion excluded property damage to “your work” arising out of it or any part of it included in the products – completed operations hazard. However, an exception to the “your work” exclusion stated that the exclusion did not apply if the damaged work or the work out of which the damage arose was performed on the insured’s behalf by a subcontractor. Based on this exception to the “your work” exclusion, Limbach argued that the cost of repair or replacing damaged work performed by its subcontractors and/or third parties was covered.

On the backfill claim, the parties agreed that it was damaged by the leak and that the backfill work had been performed by another subcontractor. The insurance company’s position was that the “your work” exclusion precluded coverage for the damaged backfill because it was performed on the insured’s (Limbach’s) behalf. However, the court rejected this argument and held that the exclusion did not apply if the damaged work or the work which results in the damage was performed on the insured’s behalf by a subcontractor. The Fourth Circuit reviewed the history of the Insurance Services Office (ISO) exclusion on which this CGL policy was based and a Pennsylvania state court decision addressing the same exclusion where the Pennsylvania court noted that the subcontractor exception alters the definition of “your work” so as to except work performed by a subcontractor from the coverage exclusion. The Fourth Circuit concluded that since the backfill was performed on Limbach’s behalf by a subcontractor, the “your work” exclusion did not preclude coverage for the cost of repair to the damaged backfill. The court noted that to hold otherwise would be to ignore the clear terms of the exclusion’s exception for work performed by a subcontractor.

On the damaged pipe claim, Limbach argued that the damage was covered because the pipe was manufactured by a subcontractor. The lower court had determined that

the manufacturer was a materialman and not a subcontractor, and therefore excluded damage to the steam pipe from CGL coverage under the “your work” exclusion. The Fourth Circuit disagreed and found that the manufacturer’s role was distinguishable from that of an ordinary supplier because it had **custom manufactured** the steam pipe in accordance with shop drawings and project specifications for this particular project. In addition, the manufacturer’s representative had visited the site, reviewed the installation drawings with Limbach, and provided specific instructions regarding installation of the pipe. Consequently, under these facts a manufacturer of a custom product was deemed to be a subcontractor for the purposes of the CGL policy.

On the claims for replacing the concrete and repairing the damaged landscaping, the lower court applied the “your work” exclusion to preclude coverage, which was reversed when the appellate court held that the exclusion did not exclude coverage for damage to a third party’s work. Therefore, since the concrete and landscape work were performed by third parties, the “your work” exclusion did not preclude coverage for the costs of repairing and replacing the landscaping and concrete.

Comment

CGL insurance policies have many standard provisions, but coverage is determined by the state law applicable to the policy. In *Limbach*, the Fourth Circuit applied Pennsylvania law. A number of states have applied the exception to the “your work” exclusion and concluded that CGL policies with these ISO standard provisions provide coverage for damage resulting from work performed on behalf of the insured by a subcontractor.

Examples of other states’ decisions are as follows.

- *O’Shaughnessy v. Smuckler Corp.*, 543 N.W.2d 99 (Minn.Ct.App.1996) (recognizing that 1986 amendments to “your work” exclusion changed standard CGL policy so as to provide coverage for property damage to a contractor’s work when that damage is caused by a subcontractor’s defective work);
- *Kalchthaler v. Keller Constr. Co.*, 224 Wis.2d 387, 591 N.W.2d 169 (1999) (holding that CGL policy granted coverage for property damage to contractor’s completed work and that the exclusion for property damage to the insured’s work did not apply because an exception to the exclusion restored coverage if the work was performed by a subcontractor).
- *Fejes v. Alaska, Ins. Co., Inc.*, 984 P.2d 519 (Ak.1999) (holding that CGL policy covered claim by general contractor for damage to septic system caused by subcontractor’s faulty installation of curtain drain);
- *Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.*, 104 P.3d 997, 1003 (Kan.Ct.App.2005) (concluding that damage caused to structure of home as a result of

continuous exposure to moisture due to subcontractor's defective materials and work was an occurrence triggering indemnity provisions of CGL policy);

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Florida: Bonds Distinguished From Insurance

516 “Suretyship is not insurance.” *Pearlman v. Reliance Ins. Co.* 371 U.S. 132. In spite of this seemingly straightforward statement by the Supreme Court of the United States, uncertainty and confusion still surround suretyship. The distinction between insurance and suretyship is often blurred by owners, contractors, attorneys, and some courts. In Florida, ambiguity has led to the filing of statutory bad faith claims against sureties.

Effective June 14, 2005, Florida amended its civil insurance bad faith statute to alleviate some of the confusion surrounding claims on payment and performance bonds issued for the construction or maintenance of a building or roadway project. The civil insurance bad faith statute now specifically excludes the surety issuing these bonds from the definition of an “insurer” under this statute. Fla. Stat. § 624.155(9) (2005). The Florida legislature has spoken — these bonds are not insurance policies. This statutory amendment eliminates a cause of action many thought was previously available against a payment or performance bond surety and hopefully ends much of the confusion (at least in Florida) surrounding the applicability of statutory bad faith causes of action to surety bonds.

Florida's Bad Faith Insurance Statute

Section 624.155, Florida Statutes (2005) is the civil remedy statute of the Florida Insurance Code. This statute authorizes causes of action for bad faith against an insurer and provides the mechanism by which a person may bring a civil suit against an insurer who violates the insurance code. Any person who is damaged by an insurer's violation of the statutes incorporated within subsection 624.155(1)(a) or the acts enumerated in subsection 624.155(1)(b) may bring a bad faith action.

Until this statutory change expressly excluding sureties from the definition of an insurer, sureties were arguably placed in a position of owing a duty of good faith to both the bonded contractor and the project owner. For example, if the bonded contractor and project owner were entitled to make a claim for bad faith related to the obligations on a performance bond, the surety would be required to acknowledge and act upon a default giving rise to its obligation under the bond while at the same time obligated

to not settle and contest the default. Owing a duty of good faith to entities with competing interests placed the surety in a position of being sued by one party or the other.

Bond vs. Insurance

No discussion about the importance of this legislative change is complete without an explanation of the basic difference between a contract of insurance and a surety bond.

Suretyship is a form of guaranty. In the context of a general contractor and an owner, the bond issued by a surety is a three-party instrument involving a surety, the contractor, and the project owner. (A similar analysis would apply to a performance bond on a subcontractor's work.) The bond requires the contractor to comply with all the terms and conditions of the project contract. In exchange for a premium, the surety lends its financial strength and credit to the contractor on the condition that, if the surety has to satisfy the contractor's debt or default, the contractor will indemnify the surety for its losses and expenses. Subject to the conditions set forth in the bond, the surety role is analogous to that of a guarantor of the contractor's ability to perform its obligations to the project owner.

If the contractor is unable to successfully perform the contract, the performance bond surety assumes the contractor's responsibilities to complete the project consistent with the provisions and limits of the bond. Similarly, a payment bond guarantees that persons who furnish labor, materials, equipment and/or supplies for use in the performance of the contract will receive payment. As with a performance bond, it is necessary to examine the terms of the payment bond, as well as any statute applicable to the bond, to determine who is entitled to payment and any conditions affecting the right to be paid.

Unlike suretyship, liability insurance is a contract between two parties consisting of the insurer and the insured. By that contract the insurer agrees to pay those obligations for which the insured legally may become liable by virtue of an act or negligence of the insured.

The Surety's and Insurer's Obligations Differ

By exempting surety bonds from the definition of insurance in the bad faith statute, the Florida legislature has noted that the surety's duty to the contractor (bond principal) who procured the bond or to the obligee; for example, the owner in the case of a prime contractor's performance bond is fundamentally different from an insurer's duty to an insured.

The difference between suretyship and insurance, reduced to its most basic ingredient, is the right to indemnification. Indemnification is the duty to reimburse after a loss or to pay compensation to somebody for damage, loss, or liability incurred. A surety is entitled under the common law, and usually pursuant to contract,

to indemnification from the bonded contractor. An insurer is not entitled to indemnification from its insured.

With insurance, losses are not only expected but are anticipated in setting premiums. For losses covered under the policy, the insurer has promised to defend and indemnify the insured from the loss for which the insured will be liable to the third party. A liability insurer has no right to indemnification from the party who purchased the insurance policy. In the insurance relationship, the insurer assumes primary responsibility for a risk of loss.

Suretyship, however, presumes there will be no loss. A surety does not underwrite a bond based upon some actuarial determination of the risk of loss. The bond premium is a “service fee” which is usually a percentage of the contract amount the contractor intends to bid upon.

Why Is this Relevant?

By specifically excluding sureties from the insurance bad faith statute the Florida legislature eliminated a potential remedy available to claimants on payment or performance bonds and an available shield to indemnity claim by a surety proceeding under a master indemnity agreement. Before the amendment, contractors could assert that a surety’s failure to pay a claim on a bond violated Florida’s good faith statute and gave use to a claim.

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CM Liability for Economic Losses

517 The Kentucky Supreme Court recently held that, despite the absence of a contract between them, a general contractor could sue a construction manager, acting as the owner’s agent, for purely economic damages on a theory of negligent misrepresentation and recover monetary damages. *Presnell Const. Managers, Inc. v. EH Construction, LLC*, 134 S.W. 3d 575 (Ky. 2004), (“*Presnell*”). This decision is significant because in certain other jurisdictions, recovery of such damages in the absence of a contract between two such parties has been barred by the “Economic Loss Rule”.

The “Economic Loss Rule”, in simple terms, holds that if another party’s negligence causes purely economic damages which does not result from injury to property or person—recovery from that person or entity for such purely economic losses via a negligence cause of action is not available. Under the Economic Loss Rule, typical damages for injury to property or persons are distinguished

from the economic damages or monetary losses. The rule was instituted so as to promote commerce and not hinder trade. According to the courts which created it, to promote commerce, providers of goods and services needed to be able to estimate the extent of their potential exposure for certain actions and account for it accordingly in the pricing for those goods and services.

In the construction world, this legal rule has arisen most often in the cases of defective design by an architect or engineer, or defective management by a construction manager. Negligence by either professional might cost a contractor substantial sums of money in delays during redesign or other factors. However, since the professional’s contract was in most cases only with the owner, and the contractor has suffered no personal injury or damage to property, then most often the contractor was left with an uphill battle with the owner for its economic damages, rather than a claim against the architect or construction manager.

The Kentucky Supreme Court has therefore changed construction litigation approaches in Kentucky with its decision in *Presnell*. The facts in *Presnell* were typical. Delor Design Group, Inc. (“Delor”) owned a building it wished to have renovated (“the Project”). It hired Presnell Construction Managers, Inc. (“PCM”) as its Construction Manager. Delor hired EH Construction, LLC (“EH”) as its contractor.

Problems ensued on the Project that EH attributed to the failure of performance and negligence of PCM in its management of the project. EH, however, had no contract with PCM and therefore had no cause of action against PCM except for purely negligence theories—namely negligent misrepresentation and negligent supervision. EH suffered damages but only of the economic variety. After EH filed its lawsuit, PCM raised the lack of a duty to EH and the Economic Loss Rule as a bar to EH’s claims. The trial court agreed and entered judgment in favor of PCM. EH appealed and the Kentucky Court of Appeals reversed and remanded. PCM then moved for discretionary review.

The Kentucky Supreme Court first examined whether or not privity must exist between the parties before EH could maintain an action for negligent misrepresentation and recover pecuniary damages. In doing so, the court essentially was determining whether or not to follow other jurisdictions such as Tennessee in adopting the Restatement (Second) of Torts §552, which outlines the elements of negligent misrepresentation. Section 552 expressly allows for the recovery of such pecuniary damages when someone supplies false information for the guidance of others “while failing to exercise reasonable care or competence in obtaining or communicating the information.”

Determining that the adoption of §552 was appropriate

in keeping with the current state of the law, and noting that federal courts in Kentucky had already predicted they would adopt it, the court stated expressly that the Restatement's view of negligent misrepresentation was now Kentucky law. The court then concurred with the appeals court that EH's complaint could not be dismissed for failure to state a claim and could therefore proceed to determine if the underlying facts could provide a basis for a negligent misrepresentation claim against Presnell.

Conclusion:

While this decision allowed a claim against a construction manager to go forward, the Economic Loss Rule was abandoned in only one fairly specific instance, and the likelihood that claimants can regularly prevail against a construction manager on this theory is still in doubt. Significantly, the claimant must show that the defendant "supplied false information" and failed to exercise "reasonable care or competence in obtaining or communicating the information". As such, stating that a construction manager was simply negligent in their management of the project, or simply made poor decisions, would probably not satisfy these requirements. The construction manager would actually have to make false statements or provide some other sort of false information.

Although they were not involved in the *Presnell* facts, what the decision may truly open up are claims by contractors against *design professionals*. If an architect or engineer produces plans that contain false information—such as in a changed conditions situation or a gross design error—then the *Presnell* decision may enable Kentucky contractors to sue the design professional directly as well as the owner for breach of any implied warranties of the accuracy of the plans.

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Georgia Reverse Bid Auction Invalid

518 Overview

In the fall 2005 issue of *Common Sense Contracting* we provided an update on the status of the use of reverse bid auctions by the federal government. Basically, at the federal government level that technique for awarding contracts has been held not to violate federal procurement laws and regulations even though some federal agencies question the inherent value of using the reverse bid auction. (See Article No. 514.)

Georgia Decision

In a recent decision, *Georgia Branch, Associated General Contractors of America, Inc.; Georgia Utility Contractors, Inc.; and ABC of Georgia, Inc. v. City of Statesboro, Georgia* (November 15, 2005) ("*Statesboro*" decision), Smith, Currie & Hancock successfully led a challenge to a reverse bid auction procurement of a construction project by the City of Statesboro ("City").

In the *Statesboro* decision, the City asserted that a "Reverse Bid Auction Event" was a permissible technique as a form of sealed bidding under Georgia law in accordance with O.C.G.A. § 36-91-21(b) which is part of the Georgia Local Procurement Public Works Construction Law. A key portion of that statute requires the public body to receive sealed bids, open them publicly, and evaluate such bids without discussion with the bidders. There is no provision allowing bidders to reduce their prices subsequent to disclosure of the relative order of the bids or disclosure of certain pricing information. The Superior Court of Bulloch County, Georgia, found that a "Reverse Bid Auction Event" was inconsistent with that statute's intent.

At the state level, Georgia law has a nearly identical definition of a "sealed bid" under O.C.G.A. § 50-5-67. In addition, the Georgia Legislature had expressly prohibited the use of revised bid auction technique by the state government to procure construction. Since the Georgia Legislature used identical descriptions of "sealed bidding", it was successfully argued before the court that the legislature could not have intended that a political subdivision of the State of Georgia was implicitly authorized to use the reverse bid auction technique to procure construction when the Georgia Legislature had prohibited its use by the State Government.

For more information on this development and the status of reverse bid auctions, please contact Jason McLarry at Smith Currie. His direct line is (404)582-8047 and his e-mail address is jdmclarry@smithcurrie.com. Jason had the lead role in developing the arguments and addressing them to the Bulloch County Superior Court.

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Warrantless OSHA Inspections

519 In *Lakeland Enterprises of Rhineland, Inc. v. Chao*, 402 F.3d 739 (7th Cir. 2005), a sewer and water contractor (Lakeland) in northern Wisconsin was performing excavation work at an industrial park when an

OSHA inspector, driving by on the public street, decided to stop and perform an impromptu inspection. After walking past traffic cones that were blocking street traffic from the project site, the inspector observed a Lakeland employee excavating a trench with a backhoe while another employee worked at the bottom of the trench. The trench was approximately eighteen feet deep and six feet wide at the bottom and did not contain a ladder or trench box.

When the contractor's project superintendent began conversing with the OSHA inspector, the worker in the trench climbed up one of the walls to exit, which resulted in loose dirt falling back into the trench. The employee performing the excavation work admitted that he knew that the other worker was not supposed to be working in the trench and that he failed to remove him.

OSHA issued three citations and assessed a \$49,000 civil penalty against the contractor, including a willful violation for permitting an employee to work in an unprotected trench (in violation of 29 CFR § 1926.652(a)(1)). During the evidentiary hearing, the contractor moved to suppress the evidence obtained from the inspection on the basis that the OSHA inspector's warrantless search of the excavation site violated the Fourth Amendment. The administrative law judge denied the motion, finding that the contractor had no right of privacy at the excavation site because the land was located on a public road. In addition, the administrative law judge concluded that any Fourth Amendment claim was waived because the contractor failed to object to the inspection or ask for a warrant at the site.

On appeal, the contractor was unsuccessful with the argument that the warrantless OSHA inspection violated the Fourth Amendment. The excavation in question occurred on a public street, not private property, and there was no reasonable expectation of privacy in an open trench dug on a public roadway. The Seventh Circuit cited the following similar rulings from other federal appellate courts: *L.R. Wilson & Sons, Inc. v. OSHRC*, 134 F.3d 1235, 1238-39 (4th Cir. 1998) (no reasonable expectation of privacy on construction jobsite easily observable by passersby); *Donovan v. A.A. Beiro Construction Co., Inc.*, 746 F.2d 894 (D.C. Cir. 1984) (no expectation of privacy in construction areas open to plain view by the public); *Marshall v. Western Waterproofing Co., Inc.*, 560 F.2d 947, 951 (8th Cir. 1977) (no reasonable expectation of privacy in construction site scaffolding readily observable by public); *Accu-Namic, Inc. v. OSHRC*, 515 F.2d 828, 833 (5th Cir. 1975) (no violation of contractor's Fourth Amendment rights because trench inspection occurred on public street).

The appellate court affirmed the administrative law judge's conclusion that any Fourth Amendment objection

had been waived because the contractor did not object to the OSHA inspection and request a warrant at the scene. In addition, the willful citation assessed against the contractor was supported by the fact that the contractor's supervisors were aware of the employee working in the trench without adequate protection from a cave-in, yet did nothing to eliminate the danger or remove the employee from the trench. Such conduct, itself, represented "plain indifference" to OSHA's requirements and regulations, particularly given the contractor's history of OSHA violations, which included a prior trenching violation that resulted in a fatality.

Practical Pointers

- Understand that no advance notice of a worksite inspection will be given—unannounced inspections are an important tool in OSHA's mission to promote safe and healthful working conditions at all times.

- Remember that if your construction worksite is located on premises open to the public and readily observable by the public, it is unlikely that any reasonable expectation of privacy exists that would support a Fourth Amendment right against a warrantless inspection. An inspector's ability to observe what is open to public view does not constitute a search.

- An OSHA inspector's failure to advise of the right to insist on a warrant does not render the consent unknowing or involuntary. If asked, however, an inspector should indicate that there is a right to refuse a warrantless inspection.

- Valid consent to a worksite inspection operates as a waiver of the Fourth Amendment right against unreasonable search and seizure. Consent to an OSHA inspection need not be express—the failure to object to a known search constitutes consent (i.e., consent existed when project superintendent accompanied an OSHA inspector on a walkaround without protest).

- Exigent (emergency) circumstances may also eliminate the warrant requirement because the urgent need for an immediate search outweighs the right to privacy.

- An employer and employee representative should be given an opportunity to accompany the OSHA inspection tour for the purpose of aiding the inspection.

- During the inspection, the OSHA inspector may question privately any employer, owner, operator, agent, or employee.

- A closing conference should occur after the inspection in order to review the findings of the inspection with the employer and employee representatives.

- Contact the OSHA Area Office immediately within eight (8) hours after the death of any employee from a work-

related incident or the in-patient hospitalization of three or more employees as a result of a work-related incident.

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No License – Free Ride?

520 For nearly 70 years, California has embraced a statutory licensing scheme for contractors. The Contractors’ State License Law, Ca. Bus & Prof. Code § 7000, *et seq.* (the “CSLL”) significantly punishes a contractor for failure to maintain proper licensure while performing construction services in that state. This punishment extends into the California courts as well. Within the CSLL, Code Section 7031 includes a general rule that regardless of the merits of the claim, “no contractor may bring or maintain any action, or recover in law or equity in any action, in any court of this state for the collection of compensation for the performance of any act or contract where a license is required . . . without alleging that he or she was duly licensed at all times during the performance of that act or contract. . . .” CA BUS & PROF § 7031(a).

On July 14, 2005, the California Supreme Court, in *MW Erectors, Inc. v. Niederhauser Ornamental & Metal Works Co., Inc.*, 36 Cal. 4th 412, 115 P. 3d 41 (2005) (“*MW Erectors*”) ruled on several issues regarding the applicability of this code section. The case stems from two lower tier subcontracts to perform structural and ornamental steel erection on a privately owned hotel construction project. When MW Erectors signed both of these subcontracts, it did not hold a California contractor’s license under the applicable contractor designation. (California’s contractor licensing scheme has 62 differing classifications. See <http://www.cslb.gov>.) Ultimately, MW Erectors obtained its California contractor’s license for steel erection work; however, this license did not become effective until roughly **three weeks after** it started performing work on the steel erection subcontract. MW Erectors had the license in place when it began the ornamental steel erection subcontract work.

Ultimately, MW Erectors sued Niederhauser for over \$1.3 million due on the two subcontracts. It was not disputed that MW Erectors performed the work under these subcontracts. However, Niederhauser sought full dismissal of MW Erectors lawsuit on grounds that CSLL section 7031(a) expressly prohibited recovery because MW Erectors was not a licensed California contractor at all

times during its performance of the subcontracts. Arguing against dismissal, MW Erectors contended that, while it was not licensed when it signed the subcontracts or when it started performing the steel erection subcontract, it had nevertheless substantially complied with the state’s license requirements. MW Erectors also asserted that Niederhauser was judicially estopped from raising this defense where, in separate litigation, it had implicitly acknowledged MW Erectors’ proper licensure in claims against the general contractor. The trial court granted Niederhauser’s motion for summary judgment and dismissed MW Erectors’ case, from which it appealed.

The California Court of Appeal reversed the trial court’s ruling in part when it held that MW Erectors could proceed to trial and seek recovery for money owed on work performed during the subcontract performance periods when it had its contractor’s license. As such, except for the relatively short three week time period at the beginning of the steel erection subcontract, the Court of Appeal held that MW Erectors could proceed with its claims on the balance of the work performed under the steel erection subcontract. The California Supreme Court granted Niederhauser’s appeal and, in a lengthy opinion, reached several significant conclusions. Three of these conclusions pertain to a contractor’s ability (or lack thereof) to recover money for work performed if it was unlicensed during all or some portion of the performance period. These are:

- (1) Where applicable, section 7031(a) bars a person from suing to recover compensation for *any* work he or she did under an agreement for services requiring a contractor’s license unless proper licensure was in place *at all times* during such contractual performance.
- (2) Section 7031(a) does not allow a contractor who was unlicensed at any time during contractual performance nonetheless to recover compensation for individual acts performed while he or she was duly licensed.
- (3) The statutory exception for substantial compliance is not available to a contractor who had not been duly licensed at some time *before beginning* contractual performance under the contract.

MW Erectors, 36 Cal.4th at 419
(emphasis in original)

In reaching these conclusions, the California Supreme Court relied heavily on what it termed the CCSL’s “stiff all-or-nothing penalty for unlicensed work by specifying that a contractor is barred from all recovery for such an ‘act or contract’ if unlicensed *at any time* while performing it. *Id.* at 426. (emphasis in original). The court further reasoned that this legislative intent is “directly at odds with the premise that contractors with lapses in licensure may

nonetheless recover partial compensation by narrowly segmenting the licensed and unlicensed portions of their performance.” Moreover, the *MW Erectors* court eviscerated a previously recognized “substantial compliance” exception to the strict pleading and proof requirements of Section 7031(a). Further, according to this court, an unlicensed contractor will not be afforded any equitable relief in California either, even where an upper tier contractor has become unjustly enriched by recovering monies for work that the unlicensed contractor performed.

This portion of the ruling by the *MW Erectors* Court should serve as **clear notice** to contractors performing construction services in California that if you perform work there without a license, you run a **substantial and likely risk** of performing such work at your sole cost and expense. In light of this decision, California courts will not provide redress for recovery of any monies owed for work performed by an unlicensed contractor. An unlicensed contractor, even if unlicensed for a relatively minor period of time during its performance, can only rely upon the good graces of its contracting partner. Contractors throughout the country can only hope that the old adage “As California Goes, So Goes The Nation” does not hold true in this instance, unless, of course, they enjoy giving free rides to their customers.

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Georgia Lien Law Narrowly Interpreted

521 Background

In *Trench Shoring Services of Atlanta, Inc. v. Westchester Fire Insurance Company, Inc.*, 274 Ga. App. 850 (2005), the Georgia Court of Appeals recently demonstrated the narrow reading given to lien laws in borderline fact situations. The *Trench Shoring* case certainly involved a borderline situation. Trench Shoring Services provided equipment to the contractor building a private, residential subdivision. The contractor used the equipment to connect the subdivision’s sewer system to the public sewer main. All of the work done with Trench Shoring Services’ equipment was performed in the public right-of-way.

Trench Shoring Services filed a lien against the subdivision when the contractor did not pay the amount Trench Shoring Services charged for the use of its equipment. The owner of the subdivision arranged for a surety to post a bond that assured payment of any amount

found to be due on the lien. Trench Shoring Services sued the contractor and obtained a judgment, but was unable to collect on that judgment. The land owner that had obtained the bond later filed for bankruptcy. As a result, Trench Shoring Services pursued the bond posted by the surety.

Trench Shoring Services filed a lawsuit to establish the lien amount that the surety was liable to pay on its bond. The surety, however, moved to dismiss Trench Shoring Service’s lawsuit. The judge granted a summary judgment to the surety, holding that Trench Shoring Service’s lien claim was invalid because the lien was against the subdivision property, but the equipment supplied by Trench Shoring Services was used only in the public right-of-way. Trench Shoring Services appealed.

Work on Public Property – No Lien Rights

On appeal the critical question was whether a contractor, subcontractor or supplier of material, who furnished materials for the benefit of a private owner of private property, could have a lien on the property if all of the materials were used off site, on the adjoining public right-of-way? The answer to that question would almost certainly apply not only to a supplier of materials, but also to any subcontractor or contractor supplying labor services or equipment in similar circumstances.

Trench Shoring Services argued on appeal that its equipment was used for the improvement of the private subdivision, even if the use actually occurred in the public right-of-way. The wording of Georgia’s lien law would seem to lend some weight to that argument, as it permits contractors and subcontractors to “have a special lien on the real estate...for which they furnish labor services or materials.” O.C.G.A. § 44-14-361 (emphasis added). The equipment used to connect the sewer lines on the private development to the public sanitary system certainly could be interpreted as equipment furnished for the private development. Trench Shoring Services argued that the Georgia Legislature intended to cover such off-site work under the lien laws. Nonetheless, the Georgia Court of Appeals held that a lien could not attach to the private property under the facts of this case.

The reasoning of the Court of Appeals was simple and concise in the *Trench Shoring* case. First, the lien law gave lien rights to contractors who would not otherwise have such rights, and therefore the lien laws are read strictly to give contractors only those rights that the lien law clearly stated. Second, Georgia courts had held that an improvement to real estate means “something that goes into and becomes a part of the finished structure...”. See, *Amador v. Thomas*, 259 Ga. App. 835, 578 S.E.2nd 537 (2003). Third, the Court of Appeals noted that its job was to read the statute as written, without adding to it or taking away

from it. Trench Shoring Services' arguments might make sense taken alone, but: they were not based on the wording of the lien law itself; they were contrary to decided cases; and, despite those cases, the Georgia Legislature had not acted to broaden the lien law to include off-site work, as argued by Trench Shoring Services. Therefore, a lien could not be filed for equipment used entirely in the public right-of-way.

Comment

The decision in *Trench Shoring* repeats a message that contractors and subcontractors are wise to take to heart. The lien laws protect those working on private property, but those protections are read strictly based upon the wording of the laws. Rather than assuming that they are covered by the lien laws, contractors and others improving property should check carefully, with an attorney if necessary, to understand and perfect their rights under Georgia law. However, a note of caution should be added concerning the *Trench Shoring* case: an appeal of the Georgia Court of Appeals' decision has been filed to the Supreme Court of Georgia. Therefore, it is possible we have not heard the last word on this issue.

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Contractor Quality Control Plans

522 CQC Staffing

In 2005 the ASBCA issued a decision regarding its interpretation of the typical Contractor Quality Control (CQC) provisions found in a COE contract, which could have some expensive consequences for those performing under these COE Contractor Quality Control ("CQC") requirements or similar provisions used by other federal government agencies. *M.A. Mortenson Co.*, ASBCA No. 53349, 05-2 BCA ¶33,014.

The contract in *Mortenson* involved the construction of a \$120 million hospital project for the USAF and the Department of Veterans Affairs. The contract was awarded and administered by the Corps of Engineers ("Corps"). The Contractor Quality Control specifications required the contractor (Mortenson) to name an individual within its organization who was responsible for the overall management of the contractor's quality control program ("CQC System Manager"). That person was to be on site at all times. The CQC specification used by the Corps expressly stated that the CQC System Manager "shall be

employed by the Contractor. . ."

The CQC staffing specifications also required that a registered mechanical engineer and a registered electrical engineer be on site on a full time basis from the date that the respective discipline's submittals were available for review until the respective discipline's work was completed. Unlike the specification applicable to the CQC System Manager, there was **no** requirement that either the mechanical or electrical engineer be employed by the "Contractor". After performance began, Mortenson introduced one of the mechanical subcontractor's employees as its mechanical engineer on the quality control staff.

The Corps' Administrative Contracting Officer ("ACO") required that both the mechanical engineer and the electrical engineer be employees of Mortenson, not its subcontractors. Following an exchange of letters, which addressed Mortenson's opinion that the COE's interpretation was a change to the contract, the Corps' ACO wrote Mortenson and stated:

. . . Upon further review, I agree that the contract did not specifically require the mechanical and electrical quality control personnel to be directly employed by the prime contract; consequently, I agree that my previous directive was a change to the contract requirements.

The ACO and Mortenson could not agree that any compensation was actually due for this "change." Ultimately, the Corps issued a unilateral modification which altered the CQC specification to expressly require that both engineers be "employed directly by the Contractor". On appeal, Mortenson sought in excess of \$750,000 on behalf of itself and the two affected subcontractors due to this changed requirement. The ASBCA denied the appeal on all bases.

Analysis of CQC Requirements

The ASBCA rejected the argument that it should defer to the "admissions" (statement of agreement) by the Corps' ACOs (actually two different individuals) that the directives to Mortenson that it employ the mechanical and electrical engineers were changes. Simply ignoring the principle that some weight should be afforded to the parties' mutual or pre-dispute interpretation, the ASBCA stated that what the two Corps' employees admitted was "inconsequential" and that the Board found "no value in 'admissions' regarding how [it] should interpret the contract."

Relying on the Federal Circuit's decision in *England v. Sherman R. Smoot Corp.*, 388 F.3d 844, 856 (Fed. Cir. 2004), the Board gave no weight to the unilateral modification. Under the *Smoot* decision, an interim decision such as the

unilateral modification does not bind the government on appeal. In this case, it was given no evidentiary weight.

The ASBCA then addressed the merits of Mortenson's interpretation argument. In the Board's opinion, the absence of the requirement that either the mechanical or electrical engineers be employees of the prime contractor was not material. The Board noted that the contract required Mortenson to ensure that the work of the subcontractors complied with the contract documents. In the ASBCA's view, allowing the subcontractors to "police themselves" when the contract placed that responsibility on Mortenson frustrated the very purpose of requiring Mortenson to establish an effective quality control staff. (Actually the contractor has to "police itself", but this was not discussed by the ASBCA either.) The Board offered no explanation for the purpose of the express requirement in the specifications that the CQL System Manager be employed by the contractor. In effect, under the Board's analysis that requirement simply became a group of surplus words.

Comments

- In federal government contracting in the 21st century, unilateral modifications may have little value or

weight upon appeal to a board or the Court of Federal Claims. This is a change from the customary expectation that the boards would not, in general, undo the benefit of an unilateral modification.

- Do not anticipate that the traditional principles of contract interpretation will be followed if a board finds an overriding policy purpose for a particular requirement. In the ASBCA's view, Mortenson's interpretation produced "a weird and whimsical result" and it was rejected on that basis.
- If you are about to bid or submit a proposal on a federal government contract, review the CQC staffing specification included in the proposed contract documents.

The Corps has a very effective internal system for distributing "helpful" information. We are accustomed to seeing references to *Mortenson* if the topic is field overhead. Now *Mortenson* will be cited for CQC staff requirements.

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UPCOMING SEMINARS

Construction Contracting and Lien Enforcement in Georgia: Building a Foundation for Payment. January 11, 2006, National Business Institute, Inc. Atlanta, GA. *Philip E. Beck.*

Practical Construction Law for Florida Contractors, January 12-13, 2006, AGC Offices, Marietta, GA. *Philip E. Beck, S. Gregory Joy, Thomas J. Kelleher, Jr., and Joseph C. Staak.* This course, approved by the Florida Construction Industry Licensing Board, provides 14 hours CE credit including one hour each of Workplace Safety, Worker's Compensation and Business Practice.

Minimizing Design-Build Risk, January 26, 2006, DBIA Design-Build in Water/

Wastewater Conference, Albuquerque, New Mexico. *James F. Butler, III.*

Building a Foundation for Managing Complex Construction Law Issues in Georgia, February 6, 2006, National Business Institute, Inc., Atlanta, GA. *Philip E. Beck.*

The Strategy Development Symposium – Developing a Winning Formula for the Construction Industry, February 14-15, 2006, Business Development & Strategic Leadership Journal, Miami, Florida. *Philip E. Beck and Catherine M. Hobart.*

2006 Annual Update Seminar, March 2-3, 2006, Hyatt Regency Atlanta, Atlanta, Georgia.

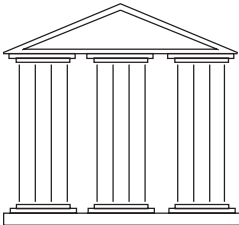
2006 Construction Industry Update

Mark your calendars and plan on attending **Smith, Currie & Hancock's 2006 Update for the Construction Industry** to be held on March 2-3, 2006 at the Hyatt Regency Hotel in Atlanta. Avoiding costly claims and disputes is a priority for everyone (contractors, subcontractors, owners, designers, etc.) working in the construction industry. One of the best ways to avoid problems and cost overruns is to obtain current information regarding project delivery systems, the "best value" and "reverse bid" auction selection processes, construction defect claims and defenses, recovery of extended overhead and lost productivity costs, as well as recent construction and employment law rulings that affect your rights, obligations, and bottom line.

Hold these dates for our **Atlanta** program. Shortly after the first of the year, you will receive more detailed information on the program. In the meantime, if there are topics you would like to see us address in the program, please feel free to contact **Eric Nelson**, (404)582-8061 or elnelson@smithcurrie.com or any of the firm's attorneys.

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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