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Inside This Issue

- 508 **Concurrent Delay, It's Not as Easy to Prove as You Thought**
- 509 **Change Orders: Waiver of Contractual Procedures**
- 510 **Hiring Illegal Immigrants – Lawsuits by Legal Employees**
- 511 **Preserving Bond Coverage**
- 512 **Pay *When* Paid and Pay *If* Paid Clauses Distinguished**
- 513 **Notice Requirements May be Deadly**
- 514 **Reverse Auctions**

Concurrent Delay: It's Not As Easy To Prove As You Thought

508 Claims of concurrent delay are used as both a sword and a shield in fighting delay claims. A contractor may use concurrency to defend against a claim

for liquidated damages by an owner, while an owner may use it to ward off the contractor's pursuit of delay costs. The question of what is truly a concurrent delay, however, is facing heightened scrutiny. Not surprisingly, this grows out of the developing trend by courts and arbitration panels to require and rely upon more sophisticated delay analyses in order to prove or defend against delay claims. Recently, the United States Court of Federal Claims addressed the concept of concurrent delay in *R.P. Wallace, Inc. v. U.S.* 63 Fed. Cl. 402 (2004).

Factual Background

In *R.P. Wallace*, the Navy entered into a contract for Wallace to renovate a Naval Support Facility in New Orleans. As part of the contract, Wallace agreed to furnish and install specially designed windows consistent with the aesthetic characteristics of the existing facility, but sufficient to withstand winds of up to 160 miles per hour. The contractor was slow in starting its work, so that several months into the project, little progress had been made towards project completion. By that time, the contractor was substantially behind on its submittals and other activities, including its delivery of the window submittal.

When the window submittals were finally turned in, the contractor and the Navy determined that the design requirements for the windows could not be met and the

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 enelson@smithcurrie.com or any of the firm's attorneys.

design needed to be changed. The changes were implemented; but the project was delayed, partly because of the changes to the windows and partly because of the contractor's own lack of performance.

The contractor submitted a claim for release of the liquidated damages that were held against it. Wallace argued that even though it may have been responsible for certain delays, the government's change in the design was a concurrent delay to any contractor-caused delays, thus precluding the assessment of liquidated damages. In evaluating the claim, the court addressed the question of whether all of the delays in the project were excusable, even if they could be apportioned between the contractor and the government.

The court first noted that in order for a contractor to prove excusable delay, the contractor must prove that the excusable event proximately caused a delay to the overall completion of the contract, *i.e.*, the delay affected activities on the critical path. The court stated that the contractor was entitled to only so much of a time extension as the excusable cause actually delayed performance.

Delay Analysis by Court

The court then drew an important distinction between "concurrent delay" and "sequential delay." Concurrent delay occurs where the delay can be attributed simultaneously to the actions of both the government/owner and the contractor. Sequential delay, on the other hand, is based on delay events that do not occur simultaneously, but occur at distinct and intermittent periods. The court found that in the case of concurrent delay, the contractor's delayed performance is excused but the contractor is not entitled to an adjustment in the contract price; in other words, the contractor is entitled to a time extension, but is not entitled to additional money. With sequential delay, however, the delay is apportioned between the government/owner and the contractor.

In *R. P. Wallace*, the court rejected the contractor's concurrent delay argument and the delay claim conclusions offered by the contractor's expert witness. Instead, the court performed its own "windows analysis" by evaluating select periods in the project to determine who was responsible for the delay during each of those designated periods and how that delay affected the overall project completion. This typically requires a CPM schedule analysis to be able to allocate the delay appropriately among the various parties during each of the selected periods. Without such an analysis, it is often difficult to assign responsibility and therefore, the delay claim may be denied. Based on this analysis, the court was able to apportion delay between the government and Wallace in light of who it believed was responsible for the delay during the period of time evaluated.

Comment

The *Wallace* decision emphasizes the need for a contractor to develop a realistic baseline schedule and

maintain regular and accurate update schedules for each of its projects. The reason for doing this is to address delay events as they occur in an effort to avoid claims at the end of the project and to make necessary scheduling, sequencing and performance adjustments as early as possible during the course of work. Similarly, accurate and timely updates can assist in meeting the contractor's notice obligations. Moreover, in the event a delay claim arises, these schedules will be critical for proving any request for additional time or money relating to a delay event.

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Change Orders: Waiver of Contractual Procedures

509 One of the very few certainties on a construction project is that there will be changes to the scope of work. Most construction contracts, in fact, expressly acknowledge the potential for changes and anticipate how to deal with those changes that arise during a construction project. A "changes" clause provides a mechanism for modifying the original contract, and typically provides that a change order is valid only if it is in writing and is signed by both parties.

Clearly, such a provision is the best way to manage and control changes to a construction project; however, it is often not what happens in real life. Many times, multiple changes occur throughout the construction project and, even though the contract may express how to address such changes, the clause is not strictly followed. Whether the contractor can ultimately recover additional compensation for such changes will depend on many factors, including whether the owner is a public or private entity. Two state court decisions offer some insight into this dichotomy.

Change Order Requirement Waived

In *Flooring Systems, Inc. v. Staat Construction Co.*, 100 S.W.3d 835 (Mo. Ct. App. 2003), Staat Construction Company ("Staat") contracted with a private owner to build a commercial office building. Staat agreed to construct this office building for a fixed price, based on a defined scope of work. The contract contained a changes clause which provided that any change to the original scope of work should be made as a written change order, submitted to the project architect and signed by both owner and contractor. During the course of the project, the parties met frequently and discussed changes to the original scope which included such items as stormwater runoff and detention, site grading, and exterior and interior building finishes. The parties did not execute any written change orders during the project. At the end of the project,

however, Staat asserted a claim for “extras”, which the owner refused to pay.

The trial court awarded Staat all of the money that it sought for the extra work, even though there were no written change orders to the contract. In affirming this portion of the trial court’s ruling, the Missouri Court of Appeals held that, even though there were no written change orders, the parties’ actions showed a willingness to acknowledge multiple scope changes. Specifically, the court recognized a limited exception to the strict written change order provisions where the parties, by their conduct, waived the requirement. The Court of Appeals stated: “[W]aiver of a written change order may be accomplished by either habitual acceptance of work completed on oral change orders or by presenting evidence that the parties agreed to the changes and the changes were accepted.” This ruling appears understandable in light of the underlying facts; that is, even though the parties failed to comply with the strict formal written change order requirements, they acknowledged changes to the scope of work and the contractor performed the extra work.

No Waiver of Requirement

Contrast this holding to a similar Indiana dispute. In *Town of New Ross v. Ferretti*, 815 N.E.2d 162 (Ind. Ct. App. 2004), Scott Ferretti, d/b/a Ferretti Construction (“Ferretti”) contracted with the Town of New Ross, Indiana (the “Town”) to build a new volunteer fire department for a fixed price. The contract documents allowed for some adjustments to this price if Ferretti incurred additional costs for complying with plans that subsequently had to meet certain state approvals as well as additional work necessitated by “state codes and requirements.” Ferretti incurred additional costs to comply with these state imposed requirements, as well as for extra work that the Town’s building committee verbally asked him to perform. No written change orders were issued during the fire station construction. After project completion, Ferretti submitted an invoice for additional work, which the Town refused to pay. Ferretti sued the Town and the trial court awarded him his entire claim amount.

The Indiana Court of Appeals reversed a portion of the trial court’s decision relating to Ferretti’s claim for changes verbally requested by the building committee. In this portion of its ruling, the court held that Ferretti could not recover for those changes for two reasons. First, because there was a valid express written contract which stated that any changes to the cost must be made in writing, Ferretti could not prevail on his equitable theory of unjust enrichment for recovering these amounts. The court reasoned that, instead, Ferretti should have obtained written change orders for the work or refused to perform the additional work that he was under no obligation to perform. Second, the court concluded that it would violate Indiana public policy for a contractor to recover for changes that were not included in the agreement and not properly

approved by the Town. Specifically, it held that: “to allow recovery under an unjust enrichment theory . . . would lead to an undermining of the protection that the competitive bidding process provides to taxpayers.” *Ferretti*, 815 N.E.2d at 169. In the court’s opinion, allowing unwritten or improperly authorized changes to a public works project would circumvent this process and the public would not be safeguarded against “fraud, favoritism, graft, extravagance, improvidence and corruption [and would not be assured that] the best work is done at the lowest reasonable cost.” This ruling may reflect a higher level of scrutiny when a court is requested to recognize any exceptions to the written change order requirements on public works projects.

Comment

Contractors can avoid such inconsistencies evinced by these different rulings by complying at all times with the written change order provisions. Further, contractors should be even more attuned to complying with the change order requirements in public works projects, particularly with towns, cities and municipalities. A “gentlemen’s agreement” for such changes may not be sufficient where public policy strongly favors strict adherence to contract terms and conditions, even at the expense of viable equitable grounds for recovering on such changes.

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Hiring Illegal Immigrants – Lawsuits by Legal Employees

510 Background

The U.S. Citizenship and Immigration Service (C.I.S.), formerly known as the U.S. Immigration and Naturalization Service (I.N.S.), requires employers to complete Form I-9 for each individual they hire for employment within three working days of the new employee’s employment. On the form, the employer must verify the individual’s employment eligibility by identifying documents presented by the employee and recording the document information on the Form I-9. Acceptable documents for this purpose are listed on the back of the Form I-9 and at the end of this article. (See Tables A-C for a listing of these documents.)

In completing this task, employers may not question a new employee’s citizenship. They may only ask whether the individual is legally eligible to work in the United States. An individual who provides the appropriate paperwork, as listed on the Form I-9, is presumed to be eligible to work in the United States. Nonetheless, it has become apparent, especially in the construction industry, that a growing percentage of workers who are hired by contractors, have presented forged documents or have

taken on someone else's identity.

With the sophisticated technology available today, it is difficult for employers to determine whether or not the paperwork they are given by new employees to verify their eligibility to work in the United States, is authentic. Many employers receive notices from the Social Security Administration (SSA) informing them that the social security numbers, which they have provided for employees do not match with the information maintained by the SSA. Still, the employers are warned not to take adverse action against these employees, but to only verify that the information they have provided to the SSA is accurate based upon information obtained from the employee. As a result, unless the employer has evidence to the contrary, it must assume that the paperwork is valid.

For the most part, construction employers are satisfied with the process they are required to perform to verify employment eligibility. They have little or no resources to investigate whether paperwork is authentic or fake. Some may believe that an illegal immigrant will work harder and will avoid filing worker's compensation claims than an employee legally in the United States.

Actions Against Employers

Employees who are legally eligible to work in the United States ("legal employees"), and who work side by side with illegal immigrants, resent the employment of illegal immigrant workers. Indeed, they have begun to fight back. In a series of recent lawsuits, employees have sued their employers claiming that the employers knowingly hired illegal immigrants in order to keep wages low and unions out of the workplace.

In *Mendoza v. Zirkle Fruit Co.*, 301 F.3d 1163 (9th Cir. 2002), a class of legal employees alleged that two employers and their labor recruiter artificially deflated wages by means of a racketeering scheme to hire illegal workers at very low wages. Specifically, the legal employees claimed that these employers knowingly hired illegal immigrants in violation of immigration law, and that they were direct victims of the alleged illegal conduct with resulting damages by way of lower wages. The Ninth Circuit disagreed with the trial court's finding that the alleged damages to the workers were indirect and too speculative. Rather, the Ninth Circuit ruled that the legal employees could show they were direct victims of the alleged illegal conduct and that the alleged damages were plausible enough to survive a motion to dismiss. Back at the trial court level, this case has now been certified as a class action.

Similar allegations have also been made by legal employees in *Trollingerv. Tyson Foods Inc.*, 370 F.3d 602 (6th Cir. 2004) and *Williams v. Mohawk Industries Inc.*, 411 F.3d 1252 (11th Cir. 2005). Each of these cases have withstood motions to dismiss in the Sixth Circuit (reversing trial court's dismissal of case) and Eleventh Circuit (affirming trial court's decision denying dismissal of case), respectively. Both the Sixth and Eleventh Circuits

specifically found that the legal employees alleged direct damages related to the hiring of illegal immigrants.

Only one case, to date, has dismissed similar allegations on the basis that the damages are too speculative and the harm to the legal employees was indirect. In *Baker v. IBP Inc.*, 357 F.3d 685 (7th Cir. 2004), legal employees alleged that their employer and a labor recruiter operated a "scheme" to hire illegal workers who presented false documents. Unlike other cases noted above, the Seventh Circuit dismissed this case on several grounds. The grounds for dismissal included that the union, which bargained with the employer about wages, and was found to be an indispensable party, had not been sued by the employees. Furthermore, the employer and the recruiter did not have a shared purpose sufficient to allege a scheme. In addition, the court found that the alleged damages were too speculative.

Conclusion

Given these decisions, an employer should carefully review their employment eligibility procedures to make sure that it has taken the proper steps in verifying employee eligibility. Form I-9 should be filled out completely, dated and signed by the appropriate individuals. A photocopy of the documents relied upon to verify employment eligibility should be attached to the Form I-9 and placed in the employee's file. Form I-9 must be kept by the employer either for three years after the date of hire or for one year after employment is terminated, whichever is later. The form must be available for inspection by the authorized U.S. Government officials.

If an employer receives evidence that the documentation presented to verify employment eligibility has been stolen, is forged or is fake, the employer should conduct a prompt and thorough investigation. If the results of the investigation demonstrate that the paperwork submitted to verify employment eligibility is unreliable, the employee should be terminated for failure to produce evidence that he/she is legally eligible for employment. The investigation should also be documented. In addition, all employers should make it clear to recruiters not to provide any illegal workers. This clarification should be put in writing and repeated on a yearly basis.

Documentation to Review

The following is a list of acceptable documents an employee may use to document his/her employment eligibility. When verifying employment eligibility, the employer should examine one document from Table A. In the alternative, examine one document from Table B and one document from Table C, and record the title, number and expiration date, if any, of the documents.

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TABLE A

Documents that Establish Both Identity and Employment Eligibility

1. U.S. Passport (unexpired or expired)
2. Certificate of U.S. Citizenship (*Form N-560 or N-561*)
3. Certificate of U.S. Naturalization (*Form N-560 or N-561*)
4. Unexpired foreign passport, with *1-551 stamp* or attached *Form 1-94* indicating unexpired employment authorization
5. Permanent Resident Card or Alien Registration Receipt Card with photograph (*Form 1-151 or 1-551*)
6. Unexpired Temporary Resident Card (*Form 1-688*)
7. Unexpired Employment Authorization Card (*Form I-688A*)
8. Unexpired Reentry Permit (*Form I-327*)
9. Unexpired Refugee Travel Document (*Form I-571*)
10. Unexpired Employment Authorization Document issued by DHS that contains a photograph (*Form 1-688B*)

TABLE B

Documents that Establish Identity

1. Driver's license or ID card issued by a state or outlying possession of the United States, provided it contains a photograph or information such as name, date of birth, gender, height, eye color and address
2. ID card issued by federal, state or local government agencies or entities, provided it contains a photograph or information such as name, date of birth, gender, height, eye color and address
3. School ID card with a photograph
4. Voter's registration card
5. U.S. Military card or draft record
6. Military dependent's ID card
7. U.S. Coast Guard Merchant Mariner Card
8. Native American tribal document
9. Driver's license issued by a Canadian government authority

For persons under age 18 who are unable to present a document listed above:

10. School record or report card
11. Clinic, doctor or hospital record
12. Day-care or nursery school record

TABLE C

Documents that Establish Employment Eligibility

1. U.S. social security card issued by the Social Security Administration (*other than a card stating it is not valid for employment*)
2. Certification of Birth Abroad issued by the Department of State (*Form FS-545* or *Form DS-1350*)
3. Original or certified copy of a birth certificate issued by a state, county, municipal authority or outlying possession of the United States bearing an official seal
4. Native American tribal document
5. U.S. Citizen ID Card (*Form 1-197*)
6. ID Card for use of Resident Citizen in the United States (*Form 1-179*)

Preserving Bond Coverage

511

Most construction contracts require the general contractor to obtain a performance bond in order to protect the owner in the event that the contractor defaults and cannot, or will not, complete its contractual obligation. Many general contractors obtain performance bonds for some or all of the key subcontractors. Once a claim is made under the performance bond, it is an unlikely scenario that the surety will immediately take over the contractor's responsibilities or pay another replacement contractor to complete the project. Thus, the question often arises: "What do I, as the claimant, need to know in order to protect my rights and trigger the surety's obligations under the performance bond?" As illustrated by the recent decision in *Seaboard Surety Co. v. Town of Greenfield*, 370 F.3d 215 (1st Cir. 2004) (hereinafter "*Greenfield*"), the volume of the communications to the surety may be less important than the precise nature of the notification(s) provided to the surety.

Understanding Bond Conditions

A performance bond surety's obligations are controlled by the specific terms of the bond and not just the terms of the contract. Just because a contractor or subcontractor has wholly failed to perform does not mean that the surety is absolutely and automatically obligated to take over the bonded contractor's work. While the terms of the bond are tied to the underlying construction contract, most bonds contain conditions that must independently be fulfilled before the surety becomes obligated to perform. A potential claimant on a performance bond needs to read and understand those actions necessary to perfect its rights under the performance bond. If a condition precedent is not satisfied or excused, the surety may be excused from its obligations or liability under the bond.

One of the critical conditions to a surety's liability is notice. Bond claimants need to appreciate that this notice requirement may apply to the default notice related to the principal's performance **and** to any subsequent breach by the surety of its bond obligations.

Notice of Principal's Default

One such condition is timely written notice. Once a claim is submitted, a surety will often avail itself of technical defenses such as lack of notice. When either the terms of the bond or the general contract require notice, a declaration of default to the surety must be clear, direct and unequivocal. *See, L & A Contracting Co. v. Southern Concrete Services, Inc.*, 17 F.3d 106, 111 (5th Cir. 1994). In *L & A Contracting*, the court stated that the notice must inform the surety that: (1) the principal has materially defaulted on its obligations under the terms of the general contract, (2) the owner has terminated the contract, and (3) the surety must begin to perform under the terms of the bond.

In addition, a bond claimant must also give the surety an opportunity to perform. Therefore, when the notice is given is critical. For example, in *Insurance Co. of North America v. Metropolitan Dade County*, 705 S.2d 33 (Fla. Dist. Ct. App. 1977), an owner sued the performance bond surety to recover for latent defects in construction work that had been performed ten years earlier. The defects were only first discovered when a hurricane blew off part of the roof. The problem was not, however, that the defects were not originally detectable, but rather that the owner did not give the surety notice of the defects until five months after the owner had made the repairs. The Florida Court of Appeals found that the owner's failure to provide timely notice deprived the surety of its right under the bond to complete the contract. The court held that the lack of timely notice was a material breach of the terms of the bond which, in turn, relieved the surety of all liability.

Notice of Surety's Default

In *Town of Greenfield*, Interstate Construction Company ("Interstate") contracted with the Town of Greenfield, Massachusetts ("Town") to renovate a middle school building. Seaboard Surety Company ("Seaboard") was the performance bond surety furnished by Interstate. This bond was written on an AIA A-312 form, which set forth in paragraph 3 the procedures to trigger the surety's obligations under the bond.

Interstate did not perform to the satisfaction of the Town, and the Town declared Interstate in default. The Town provided the proper notice to Seaboard, as required by paragraph 3 of the A-312 bond form. Seaboard investigated the Town's allegations that Interstate was in default and requested that the Town provide documentation. The Town did so, but there was disagreement about whether Seaboard was responsible for correcting certain water damage to the building. Seaboard and the Town negotiated concerning responsibility for the water damage. While these negotiations were going on, Seaboard did not bring in a replacement contractor to complete its principal's

(Interstate's) work. During this protracted process, the Town sent numerous letters to Seaboard describing the nature of the problems in the building and the critical nature to remedy defects and complete construction by the start of the upcoming school year.

Under the terms of the performance bond, once the basic notice obligations were satisfied, the surety obligations were set forth in paragraph 4 of the bond. That paragraph provides that the surety "shall promptly and at the Surety's expense" take one of a list of specified "actions". In *Town of Greenfield*, the action at issue was the surety's obligation to "[u]ndertake to perform and complete the Construction Contract itself, through its agents or through independent contractors."

Paragraph 5 of the bond provided that "[i]f the Surety does not proceed as provided in paragraph 4 with reasonable promptness, the Surety shall be deemed to be in default on the Bond fifteen days after receipt of an additional written notice from the Owner to the Surety demanding that the Surety perform its obligations under this Bond, and the Owner shall be entitled to enforce any remedy available to the Owner."

Because of its concern that the renovation would not be complete in time for the beginning of the school year, the Town ultimately hired its own contractor to complete and correct Interstate's work. Seaboard alleged that the Town had failed to give the fifteen-day notice required by Paragraph 5 of the bond before it brought in a replacement contractor. Seaboard claimed that the Town had breached its notice duty under the performance bond and therefore the surety was excused from liability.

The Town asserted that Seaboard had breached its bond obligations by failing to promptly provide a replacement contractor to complete the project. Although the First Circuit acknowledged that the Town had sent Seaboard a number of letters complaining about Seaboard's failure to take action to promptly complete the project, the court held that these complaints did not meet the separate fifteen day notice requirements of paragraph 5 of the bond. The Town never said that Seaboard was in default of its bond obligations and its continued negotiation with Seaboard undercut the Town's position that the surety was in default. The court held that the Town failed to carry out its obligation to provide a "clear and direct default notice" to the surety. The Town's failure discharged the surety from all liability under the bond.

Comment

This case was different from the usual situation. Ordinarily, the dispute with the surety arises because of the obligee's failure to expressly declare the contractor in default and terminate the contractor's right to proceed. Until the contractor is declared in default, the surety's obligation to complete the work or pay for the cost of completing is not triggered. This is particularly important when an A-312 bond form is used. Court decisions are split as to whether an express declaration of default is required under the A-311 bond form, but the A-312 bond form sets

out specific events of default and does require notice of the principal's default to the surety in writing.

The notice of default requirement of these bond forms is not the only pitfall, as the *Greenfield* decision illustrates. There are other specific provisions in the bonds with which the obligee must comply or risk the loss of bond coverage. In *Greenfield*, the surety's actual knowledge of the Town's dissatisfaction with its lack of action to carry out its bond obligation was not sufficient. The requirement for an express written notice of default and a fifteen-day period within which the surety could obtain its own contractor and limit its damages had to be followed to the letter to preserve the claim on the bond.

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Pay When Paid and Pay if Paid Clauses Distinguished

512 Pay *when* paid and pay *if* paid clauses are commonly found in construction contracts. When negotiating a subcontract, a subcontractor's understanding of the distinction between the two types of clauses can mean the difference between being paid within a reasonable time or not being paid at all. For example, a valid and enforceable pay *if* paid clause in a subcontract would make the owner's payment to the general contractor a condition precedent to the general contractor's obligation to pay the subcontractor. Thus, if the owner never pays the general contractor for work performed by the subcontractor, the general contractor's obligation to pay the subcontractor is never triggered. Depending upon state law, pay *if* paid clauses are typically valid and enforceable where the clause unambiguously shifts the risk of nonpayment to the subcontractor and makes the owner's payment to the contractor a condition precedent.

In contrast to pay *if* paid clauses, pay *when* paid clauses do not necessarily establish a condition precedent to payment. Instead, courts often construe a pay *when* paid clause as establishing a reasonable time frame within which payment by the general contractor to the subcontractor will be made. Courts often find the existence of a pay *when* paid clause when the contract between the parties does not clearly shift the risk of the owner's nonpayment from the general contractor to the subcontractor. If the subcontract does not clearly shift the risk of nonpayment, courts will often interpret the subcontract as establishing a reasonable waiting period after which the general contractor must make payment to

the subcontractor regardless of whether the owner has paid the general contractor. This distinction can be critical.

Distinction Illustrated

In *Chapman Excavating Co., Inc. v. Fortney & Weygandt, Inc.*, Ohio Ct. App. No. 84005, 2004 WL 1631118 (Ohio App. 2004), (unpublished), the Ohio Court of Appeals distinguished between a pay *if* paid clause and a pay *when* paid clause. In *Chapman Excavating*, a subcontractor sued the general contractor, arguing that the contractor was required to pay the subcontractor even though the contractor had not been paid by the project owner. The general contractor asserted that it had no obligation to pay the subcontractor as it had not yet been paid by the owner.

The contractor made its last payment to the subcontractor in June 2000. In September 2000, the subcontractor requested final payment. In April 2002, the contractor filed suit against the owner for what the contractor contended was an undisputed contract balance. The subcontractor later filed suit against the contractor in April 2003, after waiting two and one half years to be paid. The contractor filed a motion for summary judgment in the subcontractor's suit relying, in part, on the pay *when* paid provision of the subcontract. The contractor acknowledged that it had not paid the subcontractor its final payment, but contended that actual payment by the owner to the contractor would establish the "reasonable time" for payment to the subcontractor. The contractor argued that a "reasonable time" for payment lasts until the prospect of payment from the owner is impossible or, arguably, until the contractor demonstrated an unwillingness to pursue payment from the owner. Apparently, the contractor relied on the fact that it was actively pursuing payment from the owner through litigation. The contractor contended that it anticipated reaching a settlement with the owner that involved installment payments over time.

The subcontract agreement provided that "[p]artial payments of the Subcontract Sum shall be made within ten (10) days after payment is received by [Contractor] from Owner. . . . Final payment constituting the entire unpaid balance of the Subcontract Sum, shall be made by [Contractor] to the Sub when the Sub's work is fully performed in accordance with the requirements of the Contract Documents." The subcontractor acknowledged the ten day payment cycle for partial progress payments and conceded that it expected that a reasonable time for final payment would be longer than the time period needed to process progress payments. The subcontractor presented evidence, however, that a "reasonable time" to wait before final payment would be due would be thirty days, but no more than sixty days. The trial court was not persuaded by the subcontractor's evidence. Instead, the trial court relied on the subcontract language and granted the contractor's motion for summary judgment. The trial court determined that payment was due under the pay *when* paid provision within ten days from the date the contractor receives payment from the owner. Because the

contractor had not yet received payment from the owner, the final payment to the subcontractor was not due.

The subcontractor appealed arguing that the trial court had erroneously converted the pay *when* paid provision into a pay *if* paid provision and that the court had, in essence, erroneously determined that the contractor’s “reasonable time” for payment would expire only when payment from the owner became impossible. The appellate court agreed and reversed the trial court, holding that the trial court erred in granting the motion from summary judgment because the contractor failed to demonstrate that a reasonable time for payment had not lapsed.

The appellate court noted the distinction between pay *when* paid and pay *if* paid contract provisions. The court set forth this distinction in the following manner:

Under a “pay-if-paid” provision, the general contractor is required to pay a subcontractor only if the owner pays the general contractor; the risk of owner non-payment falls upon the subcontractor. (citations omitted) Under a “pay-when-paid” clause, however, a general contractor agrees to pay a subcontractor within a period of time after the general is paid by the owner, and the risk of owner non-payment falls upon the general contractor.

x x x

[A] “pay-when-paid” clause does not set a condition precedent to the general contractor’s duty to pay the subcontractor, but rather constitutes an absolute promise to pay, fixing payment by the owner as a reasonable time for when payment to the subcontractor is to be made.

In *Chapman Excavating*, the court saw no reason to shift the usual credit risk of an owner’s nonpayment from the contractor—who had assumed that risk—to the subcontractor. The court noted that the clear intention of the parties was that the subcontractor would be paid by the general contractor for the labor and materials that the subcontractor furnished and installed in the project. The court characterized that “to be the normal construction of the relationship between the parties.” The court indicated that the provision at issue was designed to postpone payment to the subcontractor for a reasonable period of time after the work was completed, during which the contractor would be afforded an opportunity to procure from the owner the funds necessary to pay the subcontractor. In the appellate court’s view, to construe the provision as requiring the subcontractor to wait to be paid for an indefinite period of time until the contractor has been paid by the owner, which may never occur, was to give the provision an unreasonable construction, which the parties did not intend at the time the subcontract was executed.

Reasonable Payment Period Defined

The appellate court recognized two methods for determining what constitutes a “reasonable time” for payment. Under one method, courts look to the language of other provisions within the contract at issue that set forth the time periods for performance of analogous acts. When presented with a pay *when* paid contract provision

that fails to shift the risk of nonpayment to the subcontractor, the court noted that it is required to construe the provision itself as establishing a reasonable time for payment. Thus, based on the provision at issue, ten days would have been reasonable. Using the second method, the courts look to case law where courts have determined, as a matter of law, when a reasonable time has elapsed. The Court of Appeals cited cases where other courts had found that a “reasonable time” for payment had elapsed where the subcontractor had waited four months, six months, and three and one half years for payment. Based on its application of these two methods, the court held that the contractor failed to demonstrate that a reasonable time for payment had not lapsed where the subcontractor had waited for payment for two and one half years before filing suit and where the subcontractor had presented evidence that a maximum waiting period of sixty days would have been a reasonable time for payment.

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Notice Requirements May be Deadly

513 Overview

Strict compliance with your contract’s notice and timing provisions are never more necessary than when faced with a project delay giving rise to a claim for damages or additional contract time. Increasingly, courts are strictly enforcing such provisions, often to the detriment of contractors who are caught off guard or unaware of their contract requirements. When confronted by an unanticipated delay, contractors should determine whether the delay could entitle them to damages or extra contract time and if so immediately follow the notice provisions specified in the contract. Failure to do so, if raised as a defense by the owner to payment of damages or a grant of extra time, may result in denial of the claim. Even the owner’s actual knowledge of the project delay may not salvage the claim of a contractor who fails to comply with their contract’s notice and timing requirements.

The Seemingly Unfair Result

The damaging, and seemingly unfair result, of a subcontractor’s failure to comply with a contractual notice of delay provision is easily seen in the recent case *American Nat’l Elec. Corp. v. Poythress Contractors, Inc.*, 167 N.C. App. 97, 604 S.E. 2d 315 (2004). In *American Nat’l* a general contractor, Poythress, and a subcontractor, American Nat’l Elec. Corp. (ANE), executed a subcontract by which ANE would supply all material and labor to perform the electrical work on the Cary Fire Station No. 6. Pursuant to the subcontract, Poythress was to prepare and deliver a project CPM schedule which ANE agreed to follow. According to the CPM schedule, ANE was to complete its work in 144 days. Due to alterations made to the scheduling

and sequence of ANE's work by Poythress, ANE was unable to complete its work for over 200 days.

The subcontract contained both a notice and timing requirement with which ANE had to comply to preserve a claim for delay damages. Specifically, the subcontract between ANE and Poythress incorporated the contract between Poythress and the owner. The subcontract required that ANE utilize the notice of delay provisions specified in the prime contract. That contract provision stated that "claims for delay must be made, in writing, to the project architect and owner within 21 days after the occurrence of any event giving rise to the claim or within 21 days after the claimant first recognizes the condition giving rise to the claim." ANE gave verbal notice to Poythress' project superintendent in April 2000 that ANE's work was not only being delayed but also adversely impacted by the schedule and sequence changes implemented by Poythress. ANE did not notify Poythress via letter as required by the contract until late September 2000. This failure to comply with contractual notice provisions prevented ANE from recovering on its claim for delay damages. The court found compelling the contract obligations that bind "the parties to a time certain during which notice of delay for compensation must be given." The contract time was not observed and the claim was denied.

Not a Unique Case

This same result has occurred in other cases. A similar "Notice of Delay" clause containing a written notice requirement and a timing requirement was at issue in *Biemann and Rowell Co. v. Donohoe Companies, Inc.*, 147 N.C. App. 239, 556 S.E.2d 1 (2001). In *Biemann*, a heating and ventilating subcontractor sued for delay compensation. The court found that Biemann had an express contractual obligation when delayed by another contractor to request an extension of time in writing to the architect and owner within twenty days following the cause of the delay. Biemann's failure to follow the contract requirement led to a denial of its claim. The court rejected Biemann's argument that discussions at weekly foreman's meetings and monthly progress meetings with the architect and owner constituted sufficient notice. While these meetings may have provided constructive notice, Biemann never gave written or verbal notice of potential claims at these meetings.

Likewise, in *DOT v. FRU-CON Constr. Corp.*, 206 Ga. App. 821, 426 S.E.2d 905 (1993), FRU-CON was delayed in the performance of its bridge construction by the failure of the grading contractor to complete the grading within the time specified in their contract. The contract contained an extension of time clause which provided that "if the normal progress of the work is delayed for reasons beyond his control, the contractor shall within fifteen days after the start of such delay, file a written request to the engineer for an extension of time." FRU-CON did not make a timely written request with the DOT for extension of time to complete. When *FRU-CON* went beyond their project

completion date, they were assessed liquidated damages. The court stated that if FRU-CON "wished to excuse any untimely performance of its work based upon the untimely performance of the preliminary grading work they were required to give DOT written notice within 15 days of the date that the graders were otherwise contractually required to have completed their work. . . FRU-CON argued unsuccessfully that DOT had actual knowledge that the graders had not timely completed their work. The DOT's knowledge that the graders had not timely completed their work was not evidence, however, that DOT waived the requirement that FRU-CON, apply for an extension. The court stated that "if DOT's mere knowledge of the delay were sufficient, the provision requiring timely written request for an extension of time would be meaningless and superfluous."

Effect of Actual Knowledge

Contractors often argue that the owner knew of, or, like in *Poythress*, caused the delay in an attempt to avoid the harsh ramifications of their failure to provide timely written notice of a claim. This argument was addressed by the court in *Assoc. Mech. Contractors v. Eby*, 983 F. Supp. 1121 (M.D. Ga. 1997). In that court's opinion the owner's knowledge that there were problems with the scheduling of the project was not tantamount to knowledge that the contractor was incurring damages or intending to file a claim. Thus, the requirement for written notice of the claim for damages was not satisfied. While owners often have actual knowledge of a contractor's delay, a contractor is ill advised to rely on this knowledge as excusing the need for factual written notice.

Written Notice vs. Timely Notice

Of the standard contract requirements - written notice within a specified time - courts are more likely to reasonably construe the requirement for written notice. In *DOT v. Dalton Paving & Constr., Inc.*, 227 Ga. App. 207, 489 S.E.2d 329 (1997) the court found that the contractor had presented evidence that was "'in the spirit' of the contract provision" and allowed the case to be presented to a jury. This more liberal treatment of the notice requirements can also be found in government contracts where courts have allowed claims to proceed if the lack of notice did not cause any real prejudice to the government's ability either to defend against the contractor's claim, or to limit damages. See *Seaboard Lumber Co. v. United States*, 45 Fed. Cl. 404 (1999), citing *Hoel-Steffen Const. Co. v. United States*, 197 Ct. Cl. 561 456 F.2d 760 (1972). Some states will seize upon any fact or circumstance growing out of the conduct of the parties tending to show waiver of strict compliance with contract requirements. Reliance on a court to reasonably construe your contract to avoid forfeiture or analyze your conduct to determine if strict compliance with the contract has been waived is ill advised.

Comment

Most notice provisions provide for additional time or damages 'if the work is delayed for reasons beyond the contractor's control.' When a delay occurs which may

support an award of damages or grant of extra contract time, provide detailed, timely, written notice pursuant to the terms of your contract. It is wise to provide notice of even questionable claims for damages and extra time. There is no penalty for providing notice of a potential claim. Failing to provide notice, however, can have disastrous business consequences.

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Reverse Auctions

514 Overview

Over the past several years significant publicity and controversy arose when the concept of “reverse bid” procedures was proposed for federal procurement. The Associated General Contractors of America (“AGC”), as well as other industry groups, strongly opposed the procedures as being inimitable to the federal bid procurement process. One significant concern was that during a “reverse bid auction” all bids are disclosed to all bidders. This concept appeared on its face to be contrary to federal procurement statutes and the Federal Acquisition Regulation.

However, in a February 23, 2005 bid protest decision, the Comptroller General of the United States Government Accountability Office (“GAO”) upheld the “reverse bid auction” process in connection with a Housing and Urban Development (HUD) procurement. *Matter of MTB Group, Inc.*, B-295463, 2005 CPD ¶ 40 (Feb. 23, 2005). While this bid protest decision addressed an acquisition under FAR Part 13 (Simplified Acquisition Procedures), the legal rationale applied by the GAO in the *MTB* decision provides a legal basis for other federal agencies to use the “reverse bid auction” procedure for virtually all procurements.

Background and Analysis

Under one of its programs, HUD annually requires rental housing to be inspected to determine if the units meet HUD’s fitness for habitation requirements. In anticipation of awarding inspection contracts for some 330 properties in Georgia and Pennsylvania, HUD notified prospective bidders that the agency would utilize “reverse bid auction” procedures under the “Simplified Acquisition Procedures” of FAR Part 13.

In a reverse bid auction, bidders offer multiple and consecutively lower bids in a web based auction process. At the end of the bidding period a standard contract award is made to the bidder offering the lowest bid (price) for goods or services. During the bidding process, competing bidders know the ranking of their bids versus other bidders and can lower their bids accordingly.

Using the analogy of an E-Bay bid, the objective is that the offeror will do business with the bidder offering the most attractive (“highest”) price for an item. However, in a “reverse bid auction,” the intent is to award a bid to the

firm that offers to provide a item, good or service for the lowest price.

In an E-Bay auction there is a specified time and date that the bidding period will terminate. Prior to the end of the bidding period, each bidder has the opportunity to submit increasingly higher bids. As on the E-Bay web site, they can see when another offeror submits a higher bid. In a reverse bid auction, on the designated web site each bidder can view information (relative ranking or possibly price) related to its competitors, and, up until the auction terminates, each bidder (or offeror) has the opportunity to submit an increasingly lower bid price.

In the solicitation that resulted in the *MTB* protest, HUD advised bidders that under the reverse bid auction procedures purchase orders would be awarded to the bidder that proposed the lowest price for providing inspection services. Furthermore, HUD limited competition to those firms who agreed to participate in the “reverse auction,” a condition of which was that each bidder’s bid would be disclosed to other bidders during the auction process.

MTB protested, contending the reverse bid auction process violated the Office of Federal Procurement Policy Act (OFFPA) (41 U.S.C. § 423(a)) and FAR implementing regulations (FAR 3.104-3 and 3.104-4). 41 U.S.C. § 423(a) provides that “(no)..personother than as provided by law, (shall) knowingly disclose contractor bid or proposal information or source selection information before the award of a Federal agency procurement contract to which the information relates.” Violations of this statute may result in both criminal and civil penalties.

The GAO denied *MTB*’s protest finding that the prohibitions in 41 U.S.C. § 423(a) were not “absolute.” The GAO acknowledged there were no bid protest decisions or administrative interpretations specifically addressing reverse bid auction procedures, which included the actual disclosure of bid prices. Nevertheless, citing 41 U.S.C. 423(h)(1), the GAO concluded that the OFFPA did not “restrict the disclosure of information to, or its receipt by, any person or class of persons authorized in accordance with applicable agency regulations or procedures, to receive the information,”.

Furthermore, the GAO concluded that the OFFPA did not restrict a contractor from disclosing its own quote or proposal information or the recipient from receiving that information. Even though HUD required price disclosure as a precondition to participating in the procurement, the disclosure was pursuant to the reverse bid auction procurement procedures established by the agency.

The GAO concluded that neither the OFFPA nor the FAR established an absolute prohibition against disclosure of price information, and that prior decisions of the U.S. Court of Federal Claims and the GAO supported the proposition that bid prices may be disclosed under certain circumstances. *DGS Contract Serv., Inc. v. United States*, 43 Fed. Cl. 227 (1999) and *Ocean Servs., LLC.*, B292511.2, 2003 CPD ¶ 206.

Comments

Even though the FAR does not expressly recognize reverse bid auctions as a procurement vehicle for goods and services, it does not expressly prohibit the government from using auctions. In addition, FAR 1.102(d) provides that a procurement procedure is permissible where not specifically prohibited (i.e. if not prohibited by the FAR or statute, it is allowable). Also, the FAR encourages agencies to use innovative procedures to the maximum extent practicable (FAR 13.003(h)), and FAR 13.003(d) and 13.003(f) encourages agencies to use electronic purchasing techniques and to maximize the use of electronic commerce.

While the HUD procurement for inspection services was undertaken specifically under the Simplified Acquisition Procedures of FAR Part 13, the GAO's decision generally supports across the board agency use of reverse bid auction procedures. Under the GAO's decision, federal agency utilization of reverse bid auctions for construction, research and development, supplies and services, etc., would, unless prohibited by a specific FAR provision, be allowable. However, it is not anticipated that many federal agencies will utilize the reverse auction bid procedures for significant procurements for construction projects.

In July, 2003 the U.S. Army Corps of Engineers reported on a one year pilot program regarding use of reverse bid auction procurements in conjunction with the Corps' "broad, diverse, and complex ...engineering-acquisition mission." In that report the Corps concluded that while the reverse bid auction procedure was a valuable procurement tool, and was in many instances appropriate for commodity procurements, the process was not particularly suited to procurement for construction.

One of the Corps' conclusions was that "there was no proof that reverse auctioning provided a significant or marginal edge over the sealed bid process for construction projects. In fact there is NO valid measurement method to project any claim of significant or marginal savings from reverse auctions" (emphasis in original Corps' report).

While the Corps' report is not binding on other federal agencies, the Corps is a major federal construction agency and it may be reasonably anticipated that other federal agencies will seriously consider the Corps' conclusions and recommendations, particularly regarding construction projects.

Accordingly, while the "reverse bid auction procedures" will continue to be a valuable "arrow in the quiver" of a federal agency's director of procurement, it is entirely possible that the reverse bid auction procedures will not be broadly applied other than perhaps to the acquisition of commodity goods and services.

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Editor's Note: For a copy of the Corps' report, please feel free to contact the author of this article.

UPCOMING SEMINARS

Forum on Managing Construction Project Risks, October 5, 2005, McDonough Bolyard Peck Consulting Engineers, Wyndham Midtown Hotel, Atlanta, GA. *Phil Beck.*

EPC and Design-Build Contracting, October 6-7, 2005, Federal Publications, Washington, D.C. *James F. Butler and Eric L. Nelson.*

Human Resources Issues, October 11, 2005, AGC's Contractor's Business Academy, Wilmington, NC. *Catherine M. Hobart.*

Best Practices in Claims Avoidance and Resolution, October 20-22, 2005, GA AGC Fall Management Conference, Charleston, SC. *Hubert J. Bell, Jr.*

Government Contracting: Changes, Differing Site Conditions & Delays, November 2, 2005, Lorman Education Services, Omaha, NE. *Thomas J. Kelleher, Jr.*

EPC Contracting, November 14, 2005, Lima, Peru. *James F. Butler.*

EPC Contracting, November 16, 2005, Santiago, Chile. *James F. Butler.*

EPC Contracting, November 17, 2005, Sao Paulo, Brazil. *James F. Butler.*

EPC Contracting, November 18, 2005. Buenos Aires, Argentina. *James F. Butler.*

The Best Time to Lock in the Price, December 8, 2005, Construction Superconference, The Sheraton Palace Hotel, San Francisco, CA. *Robert C. Chambers.*

AIA Contracts, December 8, 2005, Raleigh, NC. *Harry Bivens, Rolly Chambers, Gregory Shelton and Al Windle.*

Construction Risk Roulette – The Construction Manager's Role in Improving Everyone's Odds of Winning, December 9, 2005, Construction Superconference, The Sheraton Palace Hotel, San Francisco, CA. *Philip E. Beck, Reginald M. Jones.*

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.

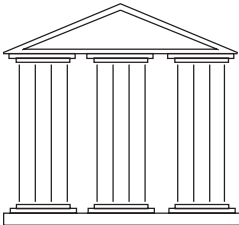
Notice to Florida Licensed Contractors

For many contractors, 2006 is the deadline for obtaining your mandatory fourteen (14) hours of continuing education ("CE") credits to maintain your Florida contractors license. These requirements include one hour of workplace safety, one hour of workers' compensation, one hour of business practice and eleven hours of general topics. Smith, Currie & Hancock LLP is an approved course sponsor (Provider No. 0000998) by the Florida Construction Industry Licensing Board (FCILB).

In order to avoid a conflict between the busy summer construction season and the deadline for CE credits, we have scheduled a program to be held in Atlanta, Georgia on January 12 and 13, 2006. This course will provide fourteen hours of CE credit including all three of the mandatory hours. In addition, if several of your key personnel hold Florida licenses, an in-house program may be more cost efficient. If you are interested in more information on this FCILB sanctioned course, please contact Tom Kelleher at Smith, Currie & Hancock LLP, 404/582-8016; fax: 404/688-0671; or e-mail: tjkelleher@smithcurrie.com

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

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



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