

# COMMON SENSE CONTRACTING

VOLUME 19, NUMBER 2

SUMMER 2005

## Inside This Issue

- 501 2005 Florida Legislative Update
- 502 Employment Law: Lie Detector Tests
- 503 Nevada: No Damages for Delay
- 504 State Court "Eichleay" Decisions
- 505 Defective Work and CGL Coverage
- 506 North Carolina: Little Miller Act Coverage
- 507 COE and Design-Build Stipends

## 2005 FLORIDA LEGISLATIVE UPDATE

### 501 Overview

The Florida Legislature convened its 2005 regular session on Friday, May 6, 2005, with several bills affecting the construction industry being passed. The most significant impacts are in the areas of public payment bonds, mandatory warnings for direct contracts, changes to the lien law, local and state prompt payment acts, and regulation of the mold remediation industry. This article will discuss the various changes in the Florida laws and their effects on the construction industry.

#### Legislative Bills

#### I. SENATE BILL 652 – Public Construction Payment Bonds

1. Section 255.05(4) was amended to require all payment bonds under this section to be construed as statutory bonds and clarified that under no circumstances shall they

be construed as common law bonds.

2. Section 624.155(9) was created to clarify that a surety issuing a payment or performance bond for the construction or maintenance of a building or roadway project is not an insurer for purposes of a bad-faith claim under Section 624.155(1).

The amendment addresses an Eleventh Circuit case, *Dadeland Depot, Inc. v. St. Paul Fire & Marine Ins Co.*, 383 F.3d 1273, 1276 (11th Cir. 2004), which had been certified to the Florida Supreme Court (SC04-1828) for a ruling on several undecided questions of Florida law, including whether a performance bond surety is an "insurer" under the Florida bad faith statute, contained in Section 624.155, Fla. Stat. The certified question actually referenced only subsection (1)(b) of the statute; however, subsection (1)(a) also allows bad faith actions for claims handling, and the Surety Association of America, in an amicus brief, argued that no part of 624.155(1) should apply to sureties.

#### II. HOUSE BILL 113 – Changes to Florida Lien Law

1. Section 713.015 was amended to modify mandatory warnings for direct contracts relating to improvements for single or multiple family dwellings of up to four units. The mandatory warning must now be placed on the first page of the contract. Added language stating that Owner should stipulate in the contract that before any payment is made, the Contractor is required to provide Owner with a written release of lien from anyone who provided Owner with a Notice to Owner. The mandatory warnings are not required where the Owner is a licensed contractor or is a person who created parcels or offers parcels for sale or lease in the ordinary course of business.

2. Section 713.02(7) was amended to clarify that the unenforceability of a contract by an unlicensed contractor, subcontractor, or sub-subcontractor under Chapter 489 shall not affect the rights of any other persons to enforce its contract, lien or bond rights. The amendment further provides that the section does not affect the obligations of a surety that has provided a bond on behalf of an unlicensed contractor, subcontractor, or sub-

subcontractor. New language also states that the fact that a principal is unlicensed under Chapter 489 shall not serve as a defense to any claim on a bond or indemnity agreement.

3. Section 713.08(4)(c) was amended to state that the claim of lien “shall” be served on the Owner.

4. Section 713.13(1)(3) was amended to clarify that a 713.23 payment bond which is not attached to the notice of commencement may be used to transfer any recorded lien by recording the bond and serving a notice of bond. The amendment also adds that the notice requirements of section 713.23 apply to any claim against the bond; however, the time limits for serving the required notices begin to run from the *later* of the time specified in section 713.23 or the date the notice of bond is served on the lienor.

5. Section 713.135(1)(e) was added to provide that an issuing authority or building official may not require that a notice of commencement be recorded as a condition of the application, processing or issuance of a building permit.

6. Section 713.135(6)(a) was amended to permit the authority responsible for issuing building permits to accept a building permit application in an electronic format. The issuing authority is also required to provide Internet access to the electronic building permit applications in a searchable format.

7. Section 713.24(3) was amended to state that nothing in this section shall be construed to vest exclusive jurisdiction in the circuit courts over transfer bond claims for nonpayment of an amount within the monetary jurisdiction of the county courts.

8. Section 713.24(4) was amended to provide that if a proceeding to enforce a lien is commenced in a court of competent jurisdiction within the time frame specified in this section, an action commenced within one (1) year after the transfer, unless otherwise shortened by operation of law, in the same county or circuit court to recover against the security shall be deemed to have been brought as of the date of filing the action to enforce the lien, and the court shall have jurisdiction over the action.

The amendments to section 713.24 address the result reached by First District Court of Appeal in *W. W. Plastering, Inc. v. Chism Construction, Inc.*, 867 So.2d 600, 602 (Fla. 1st DCA 2004) where the First District ruled that the county court lost jurisdiction over a suit to foreclose a construction lien when the owners had transferred the lien to bond.

### III. HOUSE BILL 509 – Local & State Prompt Payment Act

1. The Florida Prompt Payment Act was renamed “Local Government Prompt Payment Act.” Section 218.735(7)(a) was added to set forth a requirement that every contract between a local government entity and a contractor must provide for the development of a list of items (i.e. punch list) required to satisfactorily complete the construction services purchased by the local government entity. The

amendment sets forth various schedules for development of the list dependent upon amount of contract (i.e. contract under \$10 million, the list must be developed within 30 days after reaching substantial completion).

2. Section 218.735(8) was added to set forth a schedule for withholding retainage by local government entities (i.e. 10% may be withheld until 50% completion; retainage must be reduced to 5% after 50% completion). Note the retainage provisions do not apply if the contract is for \$200,000 or less. The provisions also do not apply to projects which are federally funded and subject to federal laws that are contrary to Local Government Prompt Payment Act.

3. Section 255.0705 was created to set forth that sections 255.0705 – 255.078 may be cited as the Florida Prompt Payment Act. This section applies to State agencies and primarily tracks the requirements of the Local Government Prompt Payment Act, including the current amendments for preparation of punch lists and retainage. The provisions also do not apply if the contract is \$200,000 or less or where the project is federally funded and subject to federal laws that are contrary to Local Government Prompt Payment Act.

4. Section 255.05(2)(a)(2) was amended to add requirements that any notice of nonpayment served by a claimant who is not in privity with the contractor must specify the portion of the amount claimed for retainage.

5. Section 255.05(10) was added to set forth restrictions on when an action solely for retainage may be brought. The action for retainage must be brought within one year of performance but not prior to occurrence of one of a series of exhaustive conditions. If none of the conditions set forth therein are satisfied, and an action to recover retainage cannot be instituted within the 1 year limitation period, the limitation period shall be extended 120 days after one of these conditions is satisfied.

This amendment has created a significant roadblock for subcontractors working on public projects to bring suit for retainage where the statute previously contained no restrictions on when such a suit could be filed. The amendment has placed subcontractors in the position of having to rely on the strength of the relationship between the public entity and the general contractor to ensure timely payment.

### IV. HOUSE BILL 315 – Regulation of Mold Remediation Providers

Section 489.1134 was enacted to provide educational and procedural requirements for mold remediation certification including discipline and training programs. Section 501.933 was passed to define requirements for practice as a mold assessor including exemptions, prohibited acts, penalties and requirements for liability insurance.

These new laws are extremely important for contractors who practice in the mold remediation industry because

prior to this bill the industry was largely unregulated. The bill does provide for certain exemptions from regulation thereby making it prudent for potentially regulated contractors to seek legal advice on whether they fall within the scope of the new law.

#### V. HOUSE BILL 291 – Condominium Association Defect Claims

Section 718.301 was amended to require that in a claim by an association against a developer alleging a construction defect, the defect must be examined and certified by an appropriately licensed engineer, design professional, contractor or otherwise licensed Florida individual or entity. Considering the growth of condominium defect litigation in Florida over the past few years it seems as if the legislature wanted to place additional obligations on the part of the condominium association bringing defect claims. However, the amendment fails to specify whether the condominium association is required to obtain the inspection prior to litigation.

#### Conclusion

The foregoing changes in the Florida Statutes will have a wide ranging impact on various members of the construction industry ranging from surety bond companies to local governments. With the scope of regulation by the Florida legislature over the construction industry growing and changing every year it has become increasingly important for members of the construction industry to familiarize themselves with the relevant statutes or obtain knowledgeable counsel to properly advise them on the current statutory framework.

*Leonard N. Ortiz*  
954/761-8700

*lnortiz@smithcurrie.com*

*Member: Florida State Bar Association*

## EMPLOYMENT LAW: LIE DETECTOR TESTS

**502** The Employee Polygraph Protection Act (EPPA), 29 U.S.C. § 2002(1), prohibits most employers from conducting lie detector tests on its employees or prospective employees, except under very limited exceptions. Moreover, it also prohibits employers from even suggesting or requesting that employees or prospective employees voluntarily submit to such a test.

There are a few exemptions to these prohibitions.

- Drug companies, security services companies and federal, state and local governments are exempted from these prohibitions.
- The Federal Government, in the performance of any counterintelligence function, may administer lie detector tests to:

- o Any employee of any contractor, expert or consultant under contract to the Department of Defense;
- o Any employee of any contractor, expert or consultant under contract to the Department of Energy in connection with the atomic energy defense activities; and
- o Any employee of any contractor of the FBI who is engaged in the performance of any work under the contract with the FBI
- Lie detector tests may be administered to employees who are reasonably suspected of workplace theft or other incidents causing the employer economic loss. The employer must first demonstrate, however, the following:
  - o The test must be administered in connection with an ongoing investigation involving economic loss or injury to the employer's business ;
  - o The employee must have had access to the subject of the investigation;
  - o The employer must have reasonable suspicion as to the employee's involvement in the loss; and
  - o The employer must provide the employee with a signed written notice that specifically:
    - identifies the economic loss at issue;
    - indicates that the employee had access to the property being investigated; and
    - describes the basis for the employer's reasonable suspicion.

In a recent case before the Eleventh Circuit Court of Appeals, the national defense and reasonable suspicion exemptions were tested by a Department of Defense contractor who was found to have fallen short of compliance with the strict requirements of the EPPA. In *Polkey v. Transtecs*, 404 F.3d 1264 (11<sup>th</sup> Cir. 2005), a defense contractor running the mailroom at a naval base was found to have violated the EPPA when it requested that an employee submit to a polygraph exam as part of an investigation into an incident of improper mail handling. The circuit court upheld the trial court's summary judgment ruling finding that neither the national defense exemption, nor the limited exemption for ongoing investigations was available to the defense contractor. The facts of the case as stated below indicated the precautions that must be taken by a private employer before it even suggests or requests that a lie detector test be taken by one of its employees.

Transtecs contracted with the Department of Defense ("DOD") to perform mailroom services at a naval base. Sabrina Polkey had been employed as the mailroom supervisor for Transtecs since October 1, 2000. Polkey supervised five other mailroom clerks. On January 11, 2002, at the end of the work day, Polkey discovered fourteen opened and undelivered Christmas cards in the wastebasket near the front computer. Ronnie Cole had

---

been assigned to work at the front computer that day. Mr. Cole's pay stub was also found in the same wastebasket.

Polkey immediately contacted her supervisor, Carl Kirtley, who began an investigation. All six mailroom employees were questioned and each denied opening the mail. Kirtley suspected that Cole was responsible, but had not eliminated the other employees. Transtecs decided to put each of the six employees through a polygraph examination as a defense tactic in the event the DOD pursued charges against the perpetrator.

Kirtley requested all six employees to submit to a polygraph examination. He indicated that their submission was voluntary and provided a release form. The release form did not, however, contain any information on the mail tampering incident or the basis for testing each individual and was not signed by any Transtecs official.

Cole took a polygraph examination the same day. The test results indicated that Cole was not being truthful when he denied opening the mail. Following receipt of these results, Kirtley admitted having no reason to suspect that Polkey was involved with the mail tampering incident.

Nonetheless, Kirtley encouraged the remainder of the mailroom employees to take the polygraph examination to clear their name. The employees expressed concern over the reliability of polygraph exams and refused to take the exam. A few days later, Polkey was fired for permitting package deliveries through the mailroom's back door, in violation of the naval base security procedures. Polkey brought suit against Transtecs for violation of the EPPA.

Transtecs argued that the EPPA should not be interpreted to prohibit requests or suggestions for employees to take polygraph examinations if no examination is ever administered. The court found the plain language of the statute clearly prohibited requests and suggestions that employees submit to lie detector tests. In fact, the regulations to the statute even prohibit the placement of a lie detector instrument in the room where an employee is to be interrogated.

Transtecs further argued that its actions were exempt under the national defense exemption provided in the statute. Because it operated the mailroom under a DOD contract that provided for a secret clearance level, Transtecs claimed it was engaging in "counterintelligence operations." While failing to address whether the mailroom operations could constitute a counterintelligence activity, the court found that the national defense exemption only applied to lie detector testing conducted by the Federal Government; not tests conducted by private employers or contractors.

Finally, the court rejected Transtecs final argument that its actions were protected by the reasonable suspicion exemption. Specifically, the court found that Transtecs did not satisfy its burden of establishing reasonable suspicion as to Polkey's involvement in the mail tampering incident

so as to justify requesting Polkey to submit to a lie detector test. Kirtley admitted he had no reasonable suspicion to suspect Polkey's involvement after he received the outcome of Cole's polygraph test results. Rather, Polkey was requested to take the polygraph exam in order to absolve the company of any responsibility for the mail tampering incident.

The Polkey case demonstrates that all employers must be careful to inquire into the permissible means by which it may request, suggest or conduct a lie detector test before broaching the subject with an employee. An employer found to be in violation of the EPPA may be subject to a civil penalty of not more than \$10,000 and a private civil actions for damages. Furthermore, employees may not waive their rights under the EPPA unless such waiver is part of a written settlement agreement in response to a civil action filed under the EPPA.

*Catherine M. Hobart*  
404/582-8045

*cmhobart@smithcurrie.com*

Member: Georgia State Bar Association

---

## NEVADA: NO DAMAGES FOR DELAY

**503** Many construction contracts, both public and private, include provisions stating that the project owner will not be responsible for monetary damages resulting from delays to completion of the project. These provisions are commonly labeled as "no damage for delay" clauses. Similar clauses are often found in subcontract forms as general contractors seek to avoid delay-related liability to lower tier subcontractors. Courts typically hold these clauses valid and enforceable. However, many state courts have carved out exceptions to enforceability and hold no damage for delay clauses ineffective where the delay: (1) is caused by active interference by the party intended to benefit from the clause; (2) results from the beneficiary of the clause's fraud, misrepresentation, concealment or other bad faith; or (3) the delay is of such unreasonable duration as to amount to an abandonment of the project. Various state courts differ as to enforceability of no damage for delay clauses when delays are due to circumstances and of a nature not contemplated by the parties at the time they entered into the contract. In the case of *J.A. Jones Constr. Co. v. Lehrer McGovern Bovis, Inc.*, 89 P.3d 1009 (2004), the Supreme Court of Nevada provided its view on the issue, holding non-contemplated delays will not affect enforcement of no damage for delay provisions. However, a subsequent Nevada statute likely severely limits that court's ruling.

---

In *J.A. Jones*, Las Vegas Sands, Inc. awarded a construction management contract to Lehrer McGovern Bovis, Inc. (“LMB”) to construct an expansion to an exposition center. LMB negotiated a subcontract with J.A. Jones Construction Co. (“Jones”) for performance of structural concrete work on the project. The subcontract contained a no damage for delay clause, which provided in pertinent part:

Contractor expressly agrees not to make, and hereby waives, any claim for damages, including those resulting from increased labor or material costs, on account of any delay, obstruction or hindrance for any cause whatsoever, *whether or not foreseeable and whether or not anticipated* . . . and agrees that the sole right and remedy therefor shall be an extension of time . . . (emphasis added)

Because LMB had not performed necessary excavation work, as represented in its contract with Jones, Jones was forced to utilize less efficient and more costly methods of performance than planned and completed its work approximately eight months after the contract completion date of October 7, 1997. Jones sued LMB seeking, among other things, monetary damages resulting from the delay. In defense, LMB raised the no damage for delay clause contained in the parties’ contract.

At trial, Jones requested jury instructions concerning exceptions to the enforceability of no damage for delay clauses. The trial court refused the requested instruction, noting that no Nevada court had adopted the exceptions submitted by Jones. On appeal, the Nevada Supreme Court reversed in part and ordered jury instructions tailored specifically to no damage for delay clauses and consistent with the “implied covenant of good faith and fair dealing that exists in every Nevada contract.” These instructions were to address only the three exceptions expressly recognized by the court: (1) unreasonably lengthy delays amounting to project abandonment; (2) active interference by the benefited party; and (3) delays caused by fraud, concealment or other bad faith. In recognizing only three exceptions to the enforcement of no damage for delay clauses, the Nevada Supreme Court squarely rejected Jones’ request for recognition and instruction concerning an exemption for delays not contemplated by the parties when executing their contract.

In refusing to adopt Jones’ desired exception, the Nevada Supreme Court examined two leading cases, which address the issue and reached contrary conclusions. In *Corinno Civetta Constr. Co. v. City of New York*, 493 N.E.2d 905, 910 (1986), the New York Court of Appeals adopted an exception based on non-contemplated delays on the basis that a contractor cannot be presumed to have bargained away his right to bring a claim for damages for delays not contemplated by the parties when forming a contract. Conversely, the Wisconsin Supreme Court decision in *Gregory & Son, Inc. v. Guenther & Sons*, 432

N.W.2d 584, 587 (1988), was cited for the principle that no damage for delay clauses are meant to encompass unforeseen delays; and, knowing that such delays may occur, parties can bargain accordingly by adjusting their bids. The Nevada Supreme Court found this reasoning more persuasive and declined to recognize an exception to enforcement of no damage for delay clauses based upon non-contemplated delays.

The *J.A. Jones* decision was issued on May 19, 2004. Interestingly, the following Nevada statute, enacted in 2003, applies to all construction contracts executed after October 1, 2003:

[Any agreement] that attempts to . . . [r]equire a contractor or subcontractor to waive a claim the contractor or subcontractor may otherwise possess for delay damages or an extension or time for delays incurred, for any delay which is unreasonable under the circumstances, *not within the contemplation of the parties at the time the contract was entered into*, and for which the contractor is not responsible . . . is void.

N.R.S. § 108.2453(2)(e) (2003) (emphasis added).

To date, no Nevada court has interpreted or applied N.R.S. § 108.2453(2)(e). Though arguments could be made concerning the “may otherwise possess” and “unreasonable under the circumstances” language, this statute appears to effectively reverse the *J.A. Jones* decision. Uncertainty exists because the statute was enacted prior to the *J.A. Jones* decision, but the Nevada Supreme Court failed to address it because the contract at issue was executed prior to October 1, 2003. Adding to this uncertainty is Nevada law’s failure to define delays “not within the contemplation of the parties.” For these reasons, parties to Nevada construction contracts containing no damage for delay clauses must carefully evaluate potential causes of delay on a project specific basis and contractors should adjust their bids accordingly. In the alternative, parties may wish to negotiate and contractually define categories of potential delay to allow a more precise quantification of risk which must then be allocated amongst the parties.

Jason D. McLarry  
404/582-8047

[jdmclarry@smithcurrie.com](mailto:jdmclarry@smithcurrie.com)

Member: Georgia and Nevada State Bar Associations

---

## STATE COURT “EICHLEAY” DECISIONS

**504** The rules for recovery of unabsorbed home office overhead damages are well established for federal government contracts. The rules for private, state and local contracts are far less clear. The following is a survey of state court decisions over the last ten years dealing with use of the

*Eichleay* formula as a measure of unabsorbed home office overhead damages.

### Unabsorbed Home Office Overhead

Delays to a construction project can cause a contractor two distinct types of overhead damages. First, extending the project performance period can increase the cost of supervision and other time related general conditions costs incurred at the project site. This is typically referred to as “extended field overhead.” Second, extending the project performance period can prevent a contractor from taking on new work and, thereby, reduce the contractor’s overall income for the extended performance period. If the contractor’s income is reduced, it has less money to pay or “absorb” its home office overhead costs. This is typically referred to as “unabsorbed home office overhead.”

### The *Eichleay* Formula

The cost of extended field overhead can generally be determined from a contractor’s project cost reports. The cost of unabsorbed home office overhead is much more difficult to calculate. Over the last 40 years the boards of contract appeals and Federal Circuit Court of Appeals have developed the *Eichleay* formula as an equitable method of calculating unabsorbed home office overhead. The *Eichleay* formula, which takes its name from an Armed Services Board of Contract Appeals case, *Eichleay Corp.*, ASBCA No. 5183, 60-2 ASBCA ¶ 2688, multiplies the contractor’s allowable home office overhead for the contract period by the ratio of total billings for the delayed contract to the contractor’s total billings for the contract period to determine the home office overhead allocable to the delayed contract. This overhead number is divided by total performance days to obtain a daily overhead rate. This daily rate multiplied by the total days of compensable delay is the amount of unabsorbed home office overhead.

Over the last ten years, no fewer than twelve states have considered use of the *Eichleay* formula in some fashion or another. The following is a brief survey of those state cases in alphabetical order by state.

### California

In *Howard Contracting, Inc. v. G.A. McDonald Construction Co., Inc.*, 71 Cal. App. 4th 38, 83 Cal. Rptr. 2d 590 (1999), the Court of Appeal, Second District, Division 7 accepted use of the *Eichleay* formula to calculate unabsorbed home office overhead on a claim against a municipality. It is interesting to note that the city conceded that *Eichleay* formula was the proper industry standard for analyzing construction delay claims. Because the city did not timely disclose its expert witness, the court accepted the contractor’s experts application of the *Eichleay* formula and refused to hear the city’s opposing argument.

In an unpublished decision, *Dept. of Transportation v. Heritage Engineering Construction, Inc.*, 2004 WL 1637638, the California Court of Appeal, Second District, Division 3, California DOT conceded use of the *Eichleay* formula was appropriate, but argued the contractor was

not entitled to recovery because it was able to and did perform work on other jobs during the delay. The court affirmed the award of home office overhead damages, refusing to follow what DOT argued was federal law on this point.

### Connecticut

In *M.J. Daly & Sons, Inc. v. City of West Haven*, 1999 WL 793807, Unpublished Decision, the Superior Court of Connecticut found that the *Eichleay* formula, although not named as such, was adopted in Connecticut by *Southern New England Contracting Co. v. State*, 345 A.2d 550 (1974). The court reduced the contractor’s recovery by the number of delay days the contractor was responsible for, but did not consider any other defenses to use of the formula.

### Florida

In *Triple R Paving, Inc. v. Broward County*, 774 So.2d 50 (Fla. App. 2000), the Fourth District Court of Appeal affirmed use of the *Eichleay* formula using the three-part federal test: (1) a government caused delay occurred; (2) the contractor was required to “stand by” during the delay; and (3) while “standing by” the contractor was unable to take on additional work. The court also applied the federal burden of proof, finding that if the contractor proves the first two elements, the burden shifts to the government to show that it was not impractical for the contractor to obtain replacement work or that the contractor’s inability to obtain replacement work was not caused by the government. The court reversed an award in favor of the county because it found the jury instructions used at trial did not properly set out these tests.

### Maryland

In *Gladwynne Construction Co. v. Mayor and City Council of Baltimore*, 807 A.2d 1141 (Md. App. 2002) the Maryland Court of Special Appeals expressly adopted use of the *Eichleay* formula based on federal precedent including the three-part test and shifting burden of proof adopted in *Triple R Paving* above. The city did not object to use of the *Eichleay* formula, but argued that the contractor had found replacement work during the delay. The trial court ruled in the city’s favor on this issue. The appeals court remanded the case because it found (1) that the contractor had bid on the replacement work before the city caused delay began and (2) the contractor’s bonding capacity was limited during the delay period.

### North Carolina

In *Biemann & Rowell Co. v. The Donohoe Companies, Inc.*, 2000 WL 33954580, Unpublished Decision, a North Carolina trial court stated that use of the *Eichleay* formula is appropriate for suspension of work but not delay damages. The court did not elaborate and there appears to be no North Carolina appellate case adopting use of the *Eichleay* formula.

### Ohio

In *Complete General Construction Co. v. Ohio Dept. of*

---

*Transportation*, 760 N.E.2d 364 (2002) the Ohio Supreme Court approved use of the *Eichleay* formula based on the federal standard also adopted by Maryland and Florida. The court further held that trial courts must give owners an opportunity to dispute particular cost elements included in a contractor's overhead claim and gave tacit approval to the Federal Acquisition Regulation's distinction between allowable and unallowable costs. In addition, the court ruled that the *Eichleay* formula was but one way of determining unabsorbed overhead costs and specifically approved use of the "direct cost" method as well.

### Pennsylvania

In *Paliotta v. Dept. of Transportation*, 750 A.2d 388 (2000) the contractor sought to recover home office overhead for delays caused by design defects. However, D.O.T. regulations incorporated as part of the contract provided that home office overhead cannot be included in any delay claim against the Department. The Commonwealth Court of Pennsylvania found this contractual limitation did not violate the contractor's constitutional rights and that home office overhead damages were, therefore, barred. The court did not address whether the *Eichleay* formula could be used in the absence of a contractual bar on home office overhead damages.

### Tennessee

In *Precision Mechanical Contractors v. Metropolitan Development & Housing Agency*, 2001 WL 1285900 (Tenn. App. 2001) the owner appealed the trial court's ruling that the *Eichleay* formula was an appropriate method of calculating delay damages. The court of appeals found for the owner on other grounds and, therefore, refused to address the *Eichleay* issue.

### Texas

In *Alamo Community College District v. Browning Construction Co.*, 131 S.W.2d 146 (Tex. App. 2004) the owner appealed an award of home office overhead arguing that Texas law did not recognize the *Eichleay* method of calculating damages. However, the appeals court found that cases cited by the owner had expressly declined to decide that issue. The court further found that, because the owner had failed to present authority for its contention that Texas did not recognize the *Eichleay* formula, the issue was waived. The court did not address the merits of the owner's *Eichleay* argument.

### Virginia

In *Fairfax County Redevelopment & Housing Authority v. Worcester Brothers Co.*, 514 S.E.2d 147 (Va. 1999) the Virginia Supreme Court specifically approved use of the *Eichleay* formula as one acceptable method of calculating the portion of home office expenses attributable to delay. Like the Ohio Supreme Court, the Virginia Supreme Court expressly held that *Eichleay* formula is not the only possible method of calculating damages. That court did not address the restrictive three-part federal test expressly

adopted by Maryland, Florida, and Ohio for application of the *Eichleay* formula.

### Washington

The State of Washington has recognized the applicability of the *Eichleay* formula since 1984. *Golf Landscaping v. Century Construction Co.*, 696 P.2d 590 (Wash. App. 1984). In *D.A. Zaluga Construction v. Spokane Airports Board*, 2000 WL 1269667, Unpublished Opinion, the court of appeals upheld the trial court's finding that a jury award of *Eichleay* damages based on expert testimony was not a "liquidated" sum so as to allow a further award of pre-judgment interest.

### Wisconsin

In *Marino Construction Co. v. Renner Architects*, 1997 WL 629874, Unpublished Disposition, the Wisconsin Court of Appeals refused to decide the contractor's claim that the trial court erred by prohibiting proof regarding the *Eichleay* formula. The court noted that "the *Eichleay* Formula applies in construction cases where the contractor is forced to stand by and is precluded from taking other work because of a delay for which the owner is responsible." However, the court found the contractor's argument insufficiently developed to allow a decision.

### Practical Implications

Contractors seeking to recover unabsorbed home office overhead in courts that have not specifically addressed the *Eichleay* formula can justifiably argue that the weight and trend of state court decisions over the last ten years soundly supports adoption of the *Eichleay* formula. More importantly, these state court decisions, particularly those that have not adopted the three-part federal test, are less restrictive than recent decisions by the Court of Appeals for the Federal Circuit which have severely limited use of the *Eichleay* formula. Smart contractors will cite favorable state court decisions in place of less favorable federal circuit decisions.

Charles W. Surasky

404/582-8022

[cwsurasky@smithcurrie.com](mailto:cwsurasky@smithcurrie.com)

Member: Georgia, Florida, and South Carolina  
State Bar Associations

---

## DEFECTIVE WORK AND CGL COVERAGE

### 505 Introduction

Commercial General Liability ("CGL") insurance policies are intended to protect the contractor who holds the policy as well as other named insureds from risk of losses due to bodily injury or property damage caused to others. Those types of policies are not intended to protect an insured contractor from losses suffered in replacing or repairing defective work or to make a project conform to contractual requirements. Indeed, both the

South Carolina Supreme Court, in *L-J, Inc. v. Bituminous Fire and Marine Insurance Company*, 2004 WL 1775571 (August 9, 2004, SC Supreme Court), and the Georgia Court of Appeals, in *Sawhorse, Inc. v. Southern Guaranty Insurance Company of Georgia*, 604 S.E. 2d 541 (Ga. App. 2004), addressed those issues and concluded that under the laws of those states that the cost for correcting a contractor's defective work is not covered by a CGL insurance policy. In reaching those conclusions, both of those courts characterized the risk of those types of losses as business risk that should be borne by the contractor and made a point to distinguish it from the risk of bodily injury or property damage suffered by others that would be covered by such CGL policies.

### *L-J, Inc. Decision*

In *L-J, Inc. v. Bituminous Fire and Marine Insurance Company*, the Supreme Court of South Carolina held that damage caused by faulty workmanship of the insured contractor was not caused by an "occurrence" as defined under the CGL policy, and therefore the damage was not covered by the policy. In *L-J*, the insured contractor entered into a contract with a developer pursuant to which it performed site development work and constructed roads for a subdivision project. Within four years of the contractor's completion of the work, the roads had deteriorated to such an extent that the developer sued the contractor for breach of contract, breach of warranty and negligence. The contractor ultimately agreed to pay \$750,000 in settlement of the lawsuit and then looked to the insurers that issued the CGL policies for the project to recoup its costs. Three of those insurers contributed to the settlement while one, Bituminous Fire and Marine Insurance Company ("Bituminous"), refused to do so. As a result, the contractor and the other three insurance companies filed a lawsuit against Bituminous seeking contribution toward the settlement amount.

At both the trial court level and at the South Carolina Court of Appeals, Bituminous argued that there had not been an "occurrence" as defined by the policy, which was necessary to trigger coverage. Affirming the trial court, the Court of Appeals rejected this argument and held that the property damage did constitute such an "occurrence". Bituminous then petitioned the Supreme Court of South Carolina arguing that "the Court of Appeals err[ed] in finding that the premature road deterioration constituted an 'occurrence' as defined by the CGL insurance policy."

### *Lower Court Decision Overturned*

The Supreme Court of South Carolina reversed the court of appeals and held that the property damage did not fall within the contractual definition of "occurrence" under the CGL policy. The court began its analysis by setting forth the language contained in the applicable provisions in Bituminous's CGL policy. That policy provided that it would "pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' . . . caused by an 'occurrence'." The policy defined "occurrence" to mean "an accident,

including continuous or repeated exposure to substantially the same general harmful conditions."

The court held that while the damage to the roadway could constitute property damage, no "occurrence" as defined by the CGL policy took place. According to deposition testimony, the causes of the road damage that led to its premature deterioration were actually negligent acts by the contractor during design and construction of the road. Those negligent acts included:

- Failure to adequately prepare the subgrade;
- Improper design of the drainage system;
- Construction of a insufficiently thick road course, inadequate to handle heavy loads; and
- Improper design of curb edge detail.

The court held that all of those negligent acts were contributing factors and that all were examples of faulty workmanship which in that case did not fall within the contractual definition of "occurrence" pursuant to Bituminous's CGL policy.

The court did note, however, that faulty workmanship could give rise to an insurable loss and could constitute an "occurrence" as defined by Bituminous's CGL policy if that faulty workmanship caused bodily injury or property damage to *another*. Indeed, the very type of insurable loss contemplated by the definition of "occurrence" contained in Bituminous's policy was an accident causing such injury or damage to another. However, in the case at issue, the court noted that the contractor in *L-J, Inc.*, was merely attempting to shift to Bituminous the economic loss suffered by the developer due to the contractor's own failure to properly design and construct the roadway system.

### *Sawhorse, Inc. Decision*

In *Sawhorse, Inc. v. Southern Guaranty Insurance Company of Georgia*, the Georgia Court of Appeals held that insured contractor's liability for damage to a project caused by its failure to properly perform the work was excluded from coverage of CGL policy. In *Sawhorse*, the insured contractor entered into a contract with homeowners to perform work on an existing house, including certain renovations to the existing first floor and the addition of a new second-floor. During construction of the project, one of the insured contractor's subcontractors failed to install necessary support beams causing substantial damage to the second floor addition. The homeowners also claimed that failure to install the support beams also damaged the existing structure of the original one-story house. The contractor attempted to repair the damage by installing the support beams and incurred costs in excess of \$41,000. Subsequently, the contractor sued the homeowners for unpaid contract balance and the homeowners counterclaimed, asserting, among other things, that the contractor failed to properly construct the renovations and negligently attempted to repair certain defects. The contractor sought reimbursement under its CGL policy of all of its costs relating to the project and the

house. The insurer denied coverage, asserting that its CGL policy did not cover the contractor's claim. At the trial court, the insurer received a judgment in its favor. The contractor appealed.

### Georgia Court of Appeals' Opinion

The Georgia Court of Appeals affirmed the grant of summary judgment as to the damage and repairs to the second-floor addition, but reversed as to the alleged damage to the first-floor holding that factual issues remained as to the nature and cause of that damage.

In reaching its conclusion as to the second-floor addition, the court looked to the applicable language in the CGL policy. The policy contained "business risk" exclusions "designed to exclude coverage for defective workmanship by the insured builder causing damage to the construction project itself," as follows:

This insurance does not apply to ... "[p]roperty damage" to ... (5)[t]hat particular part of real property on which contractor or any contractors or subcontractors work directly or indirectly on contractor's behalf are performing operations, if the 'property damage' arises out of those operations; or (6)[t]hat particular part of any property that must be restored, repaired or replaced because 'your work' was incorrectly performed on it ... Paragraph (6) of this exclusion does not apply to "property damage" included in the "products-completed operations hazard".

The contractor argued that summary judgment should not have been granted because questions of fact remained as to whether the work was completed at the time the damage occurred, and, as a result, whether the damage was within the "products-completed operations hazard." However, the record reflected that the damage to the second-floor occurred prior to the contractor attempting to perform remedial work which included installation of the missing support beams. The contractor basically argued that the remedial work constituted repair of an otherwise finished project. The court summarily rejected this analysis, stating that "it defies logic to conclude that a second-story structure lacking necessary support beams is 'complete.'" Accordingly, the court held that the "products-completed operations hazard" did not remove the contractor's claim regarding damage to the second-floor addition from the business risk exclusion and that summary judgment was appropriate as to that claim.

With respect to the alleged damage to the existing first-floor structure, the insurer had argued that the damage to the existing structure included faulty work performed by the contractor on that floor, which would be damage to the project itself. However, the insurer also noted in its brief that the homeowner's claim also included damage to the existing structure that might be related to the second-floor addition, which could be damage to other property. The court held that the cause of that damage was not clear, and, as a result, it was not possible to determine the nature of

the damage to the first floor and whether it was covered by the CGL policy. Elsewhere in the opinion the court had described the types of risks faced by contractors and whether those risks were covered by CGL policies, stating as follows:

There are two kinds of risks that are incurred by a contractor. The first is the business risk borne by the contractor to replace or repair defective work to make the building project conform to the agreed contractual requirements. This type of risk is not covered by the policy, and the business risk exclusions in the policy make this clear. The second is the risk that the defective or faulty workmanship will cause injury to people or damage to other property. Because of the potentially limitless liability associated with this risk, it is the type for which ... commercial general liability coverage is contemplated.

Accordingly, the court held that questions of fact remained as to coverage for the damage to the first-floor structure, thus rendering summary judgment improper as to that issue.

Finally, the insurer argued that it was entitled to summary judgment because there had been no "occurrence" within the meaning of the policy. Since the court had concluded that questions of fact remained with respect to whether the damage to the first floor was excluded from coverage or not, it examined the issue of whether that damage to the first-floor had been caused by an "occurrence". The CGL policy, just as in *L-J*, set forth that coverage extended to "property damage" [that] is caused by an "occurrence" and defined "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." The court interpreted the insurer's argument to be that faulty workmanship could not constitute an "occurrence" within the meaning of the policy. The court rejected this argument and indicated, in a somewhat roundabout way, that an "occurrence" is simply an event not intended by the insured that causes damage to *other* property. The court had previously stated that it could not determine from the record whether the damage was to other property and now stated that there was no evidence presented that the contractor had intended for the faulty workmanship to occur. Accordingly, the court held that the insurer was not entitled to summary judgment based upon the definition of "occurrence" set forth in the policy.

### Practical Implications

Although the analyses by the respective courts in reaching the results in the cases discussed above were quite different, the results themselves were substantially identical. In both cases the CGL policies at issue were held not to cover losses suffered as a result of damage to the project itself that was caused by the contractor. In other words, at least in South Carolina and Georgia, a contractor's CGL policy will not cover business risk, which both courts stated should be borne by the contractor.

An important lesson to take from the above cases is that the language of the policy itself is extremely important in determining coverage. In both of the cases, the courts basically applied the language contained in the policies. Accordingly, you should make sure that you understand the terms and conditions set forth in your insurance policy. Since most insurance policies are quite complicated and difficult to read, it is a good idea to consult with an insurance agent or attorney to make sure that you have a good understanding of what is and is not covered by your policy.

Finally, despite the similarity of the results in the above cases, it is important to remember that standard form insurance policies are often interpreted differently in different states. Identical terms in a policy may provide coverage for a situation in one state while not providing coverage for an identical situation in another state. Because of this, when starting a project in a state regarding which you are not thoroughly familiar, you should determine how the laws of that state impact your coverage, which again should include consultation with your insurance agent and/or attorney. Based upon this determination you can then decide whether you want or need to purchase additional coverage.

Andrew R. McBride  
404/582-8063

armcbride@smithcurrie.com

Member: Georgia and New Jersey State Bar  
Associations

## NORTH CAROLINA: LITTLE MILLER ACT COVERAGE

**506** A unanimous panel of the North Carolina Court of Appeals recently distinguished application of North Carolina's Little Miller Act from application of the federal Miller Act in circumstances of a payment bond claim by a supplier against a prime contractor's surety where the supplier had contracted only with the second-tier subcontractor. *HSI North Carolina, LLC v. Diversified Fire Protection of Wilmington, Inc., John W. Wheeler, III, N.C. Monroe Construction Company, and Travelers Casualty & Surety Company of America*, 611 S.E. 2d 224 (N.C. Ct. App. 2005).

In 2001 the North Carolina State Ports Authority entered into a prime contract with N.C. Monroe Construction Company as general contractor ("Monroe") for construction of the Transit Shed T-6 Expansion Project (the "Project"). The Project was bonded as required by N.C. Gen. Stat. § 44A-26 by Travelers Casualty & Surety Company (the "Surety"). Monroe contracted with Diversified Fire Protection ("Diversified"), as a first tier subcontractor, to install a fire protection system for the Project. Diversified assigned the subcontract for the work at the Project to a subsidiary ("Wilmington") for installation

of the fire protection system. Thereafter, Wilmington as a second-tier subcontractor, purchased materials for the Project's fire protection system from the plaintiff. When the plaintiff was not paid by Wilmington for the materials, the plaintiff gave written notice to the prime contractor defendant Monroe of a payment bond claim pursuant to N.C. Gen. Stat. § 44A-27(b). Plaintiff then instituted an action against all defendants to recover payment for materials supplied for use at the Project.

All parties moved for summary judgment. Upon conclusion of the hearing, the court granted summary judgment for the plaintiff and awarded damages in the amount of \$91,676.09 plus interest and denied the defendants' motions for summary judgment.

### "Subcontractor" Defined

In their arguments for summary judgment, defendants contended that the definition of "subcontractor" in the North Carolina Little Miller Act did not encompass a second-tier subcontractor. Therefore the plaintiff, which had contracted with Wilmington, a second-tier subcontractor, had no claim under the North Carolina statute. In support of this construction of the state statute, the defendants contended that the North Carolina courts had not previously interpreted the provision of the Little Miller Act regarding the definition of "subcontractor," and that therefore this provision must be interpreted in accordance with federal precedent which would have precluded recovery by the plaintiff/supplier. The court rejected this argument on the basis of previous decisions that had noted that "guidance" can be obtained from federal interpretations of the Miller Act on which the corresponding state act is modeled, but that such interpretations are not binding. *Syro Steel Co. v. Hubbell Highway Signs, Inc.*, 108 N.C. App. 529, 534 (1993). The court further justified its conclusion by stating that such federal precedent regarding the definition of "subcontractor" would be of no use because unlike the federal Miller Act which provides no definition for the term "subcontractor" (*MacEvoy v. United States*, 322 U.S. 102, 108 (1944)), the North Carolina Little Miller Act does specifically define the term "subcontractor."

Under §44A-25(6) of the North Carolina Little Miller Act, the term "subcontractor" is defined as "...any person who has contracted to furnish labor or materials to, or who has performed labor for, a contractor **or another subcontractor** in connection with a construction contract." N.C. Gen. Stat. §44A-25(6). (Emphasis added)

The court's rationale then invoked application of §44A-27(b) which specifies that:

Any claimant who has a direct contractual relationship with **any subcontractor** but has no contractual relationship, express or implied, with the contractor may bring an action on the payment bond only if he has given written notice to contractor within 120 days from the date on which the claimant performed the last of the labor or furnished the last

of the materials for which he claims payment[.]  
(Emphasis added)

The Supreme Court of North Carolina has held on several occasions that “[w]here the language of a statute is clear and unambiguous, there is no room for judicial construction[,] and the court must give [the statute] its plain and definite meaning, and are without power to interpolate or superimpose, provisions and limitations not contained therein.” *Walker v. Board of Trustees of the N. C. Local Government Employees Retirement System*, 348 N.C. 63, 65-66 (1998).

The North Carolina Court of Appeals concluded its opinion regarding application of the state’s Little Miller Act allowing recovery from the surety by the supplier to a second-tier subcontractor by stating:

The legislature has specifically defined the term in question, subcontractor, to include both individuals who have contracted to provide materials directly to the contractor, *as well as those who have contracted with subcontractors, sometimes referred to as first- and second-tier subcontractors*, under the construction contract. The language of § 44A-27, further, specifically provides that a claimant who has a direct contractual relationship with *any subcontractor* may bring an action on the payment bond. *Id.* By its plain language, therefore, the statutory definition includes first- and second-tier subcontractors to the construction contract. (Emphasis added)

#### Comment

This distinction made by the North Carolina Court of

Appeals for application of the North Carolina Little Miller Act is premised on the state statute’s clear and unambiguous definition of the term “subcontractor.” The court, however, does set out in a footnote in its opinion that “...although we find Wilmington a second-tier subcontractor to qualify under the terms of the statute, we do not reach the question as to whether a third-tier subcontractor would qualify under the statute, as this question is not presently before us.” However, the statutory definition of “subcontractor” upon which the court relied does not distinguish between any tier of subcontractor. Given the previous holdings of the North Carolina Supreme Court relating to construction of “clear and unambiguous” statutory language, subsequent appellate decision may conclude that a supplier providing materials to a subcontractor in any tier may recover under the Little Miller Act for the State of North Carolina unless the legislature enacts statutory language limiting payment bond claim recoveries by suppliers from a specific tier subcontractor.

Robert J. Greene, Jr.  
704/334-3459

[rjgreene@smithcurrie.com](mailto:rjgreene@smithcurrie.com)

Member: North Carolina State Bar Association

## COE and Design-Build Stipends

**507** On May 19, 2005, the U.S. Army Corps of Engineers (“COE”) issued Engineering and Construction Bulletin No. 2005-7 providing guidance for the use of stipends on Military Construction projects procured using two-phase design-build selection procedures.

The bulletin and the accompanying document (legal memorandum) are fairly long. However, some of the key points are:

- Payment of stipends is not a mandatory requirement.
- The COE’s customer or client must approve the payment of stipends.
- Stipends are to be paid to unsuccessful Phase 2 offerors, who submitted proposals meeting the requirements of the solicitation.
- The stipend payment will be the same for all qualifying unsuccessful Phase 2 offerors.
- Stipends shall not be used to acquire ownership or rights to use unsuccessful proposals.

If you would like a complete copy of this bulletin and the accompanying legal opinion, which contains further guidance on the use of stipends, please feel free to contact the undersigned.

Thomas J. Kelleher, Jr.  
404/582-8016

[tjkelleher@smithcurrie.com](mailto:tjkelleher@smithcurrie.com)

Member: Georgia and Virginia State Bar Associations

### Common Sense Contracting Electronic PDF Edition

For over 18 years, Smith, Currie & Hancock attorneys have been pleased to write and publish a practical newsletter for our clients and friends in the construction industry. During that period of time, we have continually sought to improve the newsletter’s value to you.

Consistent with that goal, our newsletter is now available in an electronic (pdf) format. All that you need to read and print copies of the newsletter is a copy of the **Acrobat** software program. A no cost version of that software is available at [www.adobe.com](http://www.adobe.com). If you wish to receive future issues of our newsletter in an electronic format, please provide us the e-mail address which should be used for that purpose. You may e-mail that address to [schnewsletter@smithcurrie.com](mailto:schnewsletter@smithcurrie.com).

Receiving the newsletter in an electronic format will ensure quicker delivery, facilitate distribution of copies within your organization, as well as reducing our mailing expense. We urge you to consider and utilize this option.

## UPCOMING SEMINARS

**Contract Review Workshop**, July 14, 2005, Carolinas AGC, Crown Plaza, Hilton Head, SC. *Rolly L. Chambers, Robert J. Greene, Jr., Gregory L. Shelton, and Steele B. Windle.*

**AIA Contracts**, July 15, 2005, Lorman Education Services, Pensacola, FL. *F. Alan Cummings and S. Elysha Luken.*

**The Contractor's Perspective on Construction Defects**, July 15, 2005, The Seminar Group, Atlanta, GA. *Philip E. Beck.*

**Human Resource Issues**, July 19, 2005, Carolina AGC Contractor's Business Academy, Greensboro, NC. *Catherine M. Hobart.*

**Construction and Labor Law Update**, August 4, 2005, Georgia Branch, Associated General Contractors of America, Atlanta, GA. *Philip E. Beck, James K. Bidgood, Jr., Catherine M. Hobart, and Thomas J. Kelleher, Jr.*

**Construction Dispute and Claim Avoidance**, August 5, 2005, Georgia Branch, Associated General Contractors of America, Atlanta, GA. *Philip E. Beck, James K. Bidgood, Jr., Catherine M. Hobart, and Thomas J. Kelleher, Jr.*

**Practical Construction Law for Florida Contractors**, August 16-17, 2005, Florida East Coast Chapter, Associated Builders & Contractors, Inc., Ft. Lauderdale, FL. *S. Gregory Joy, Thomas J. Kelleher, Jr., S. Elysha Luken, Joseph C. Staak, and Brian A. Wolf.*

**Practical Construction Law for Florida Contractors**, August 18-19, 2005, Orlando, FL. *S. Gregory Joy, Thomas J. Kelleher, Jr., S. Elysha Luken, Joseph C. Staak, and Brian A. Wolf.*

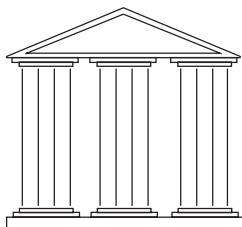
**Construction Dispute and Claim Avoidance/Construction Law Update**, August 25-26, 2005, Alabama Chapter of the Associated Builders and Contractors, Inc., Birmingham, AL. *Philip E. Beck, James K. Bidgood, Jr., Catherine M. Hobart, S. Gregory Joy, Thomas J. Kelleher, Jr., and Eric L. Nelson.*

**An Executive Overview on Mold**, September 14, 2005, Georgia Tech Research Institute, Atlanta, GA. *James K. Bidgood, Jr.*

**Mold for the Construction Industry**, September 15, 2005, Georgia Tech Research Institute, Atlanta, GA. *Philip E. Beck.*

**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.*



### Smith, Currie & Hancock LLP

233 Peachtree Street, N.E.  
Suite 2600  
Atlanta, Georgia 30303-1530  
404/521-3800

PRESORTED STANDARD  
US POSTAGE  
PAID  
PERMIT NO. 4866  
ATLANTA, GA

Address Service Requested