BRADLEY ARANT ROSE & WHITE LLP **First Quarter 2005**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Court Holds That A Consultant Can Be Held Liable For Its Employee's Falsified Resume

In *Wartsila NSD North America, Inc. v. Hill International, Inc.*, 342 F. Supp. 2d 267 (D.N.J. 2004), Wartsila agreed to design, engineer, procure, construct, start up and test a diesel engine power plant in El Salvador. Wartsila subcontracted much of the plant's construction. Construction on the plant fell behind, leading to a number of disputes with subcontractors, and Wartsila hired Hill International in an effort to get the project back on track. Hill proposed one of its senior consultants, Richard LeFebvre, and attached a copy of LeFebvre's resume to the proposal. LeFebvre's resume indicated that he had a B.S., a B.A., had taken additional courses at another university, and that he was registered and licensed as a professional engineer in three states. After LeFebvre worked on Wartsila's project as a Hill employee for a period of time, Wartsila hired LeFebvre away from Hill, in order for LeFebvre to "provide assistance with construction and claims management on the Project."

Based on LeFebvre's advice, Wartsila pursued a number of claims against one of the project's larger subcontractors before the American Arbitration Association. During LeFebvre's testimony at the arbitration, it was discovered that LeFebvre had falsified items on his resume; it was also discovered that LeFebvre had improperly altered 'claim support' documents. The arbitration panel awarded $4.65 million in favor of the subcontractor and against Wartsila.

As a result of the unfavorable arbitration result, Wartsila brought an action against Hill International for negligence, fraud, and breach of contract. Hill moved for summary judgment, contending that, once Wartsila hired LeFebvre away from Hill, Hill no longer owed Wartsila a duty. The court disagreed, finding that "the duty in this case endured beyond the contractual period between the parties." The court further noted that "Hill maintained a duty to verify LeFebvre's credentials, regardless of his employment status as an independent contractor," and "as a consulting firm, Hill owed a duty to all of its clients and potential clients to ensure that its employees possessed the qualifications stated on their resumes."

The lesson here is simple: check your employees' (and potential employees') resumes for accuracy. This case involved a consulting firm, but its reasoning could easily be applied in other situations. Contractors: if you represent to an owner that your personnel have certain qualifications, and particularly if you provide the resumes of those personnel, make sure that the information you are providing regarding their qualifications is accurate.

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Electronic Data and Construction Claims and Litigation

Electronic data, and its instantaneous exchange and easy accessibility, has made our work more productive. "Experts" estimate that 90% of records are created and up to 70% are stored in digital form. This phenomenon, arising in only 20 years, leads to knotty issues regarding document retention policies. Electronic data falls into two large categories: email and all other (spreadsheets, schedules, word processing, etc.), and each presents its own special issues regarding its use. For example, email is quite informal, and leads users to say things they would not say in a "paper" memorandum or letter; scheduling data may be "written over" in the updating, with no thought given to preservation of a "file" copy of the electronic schedule being overwritten.

Retention of electronic data is another major issue, of growing concern to the courts. In a leading case in New York (*Zubulake v. UBS Warburg, LLC*), the federal trial court addressed the issues of retention of "e" documents (and of how to allocate the litigation costs of producing "e" data). What is increasingly clear is that you must preserve all "documents," including "e" documents (and things, such as individual computer drives), once it is reasonably certain litigation (or arbitration) is likely. Hence, "normal" destruction of information on backup tapes must be suspended, "swiping" of drives when an employee leaves and similar "routine" items may be problematic, once litigation is in the offing. Indeed, you and your company may be guilty of "spoliation" (destruction) of evidence by continuing routine "e" disposition policies.

This relatively new (and relatively undefined) area requires you to consider litigation-driven document retention requirements when adopting "e" policies and, even, in buying software. If you must stop disposing of backup tapes every 30 days because of litigation, does your software allow this to be done easily and economically, such that you may continue the policy for "e" documents not implicated by the litigation?

Hence, you may want to seek your lawyer's advice now about the implementation and adoption of document retention policies as well as about how those policies are affected by the growing body of law governing best discovery practices surrounding "e" documents.

Stormy Weather: Litigated In The Key Of $ (With Apologies To Irving Berlin And Harold Arlen)

"Whether it may rain or it may storm, they've got their contract to perform," so argued the US Navy in asking the Armed Services Board of Contract Appeals ("the Board") to reconsider its decision awarding the General Contractor 54 days of excusable delay for "unusually severe weather" under a military construction contract. But the Board was singing a different tune, "Stormy Weather" apparently, and decided that it was right the first time except for two days of good weather.

The case is *All-State Construction, Inc*, 04-2 BCA ¶ 32,778, ASBCA Nos 50,513, 50,516, and 54,681 (Sept. 22, 1004). The Contractor contracted with the Navy Department in September 1994 for the construction of a hazardous waste storage facility at a military base in New Jersey for $938,000 with a contract completion date eight months later in May, 1995. However, it was the contract that turned out to be hazardous. Ten years later, after three appearances at the Board, one appearance at the United State Court of Appeals for the Federal Circuit and the termination of the Contractor by the government for cause, the government and the Contractor were still fighting with no end in sight. This note focuses on the Board's treatment of weather conditions as excusable delay.

The contract included the standard contract clause "Default (Fixed Price Construction)," which gives the government the right to terminate the contract, take over the project and charge the Contractor for damages if the contractor is not "diligently" working towards completion of the project by the completion date. However, the clause also makes certain delays "excusable." The government cannot terminate the contract or charge the Contractor with damages for days of delay that are caused by "unforeseeable causes beyond the control and without the fault or negligence of the Contractor." The clause then lists examples, including "unusually severe weather."

In a July 2004 decision that covered multiple issues, the Board decided that the Contractor had been delayed by 54 days of "unusually severe weather" from December through March of 1995. The government looked at the Default Clause and focused on whether the contractor should have anticipated that there will be a number of days in the winter in New Jersey when it is too cold or there is too much snow to work outdoors. In other words, the Contractor was entitled to an extension of the completion date only for the number of days of bad whether in excess of normal. The Board rejected the government's interpretation, concluding that: "The term 'unusually severe weather' in the Default clause includes both an unusual number of days of severe weather at the work site or unusually severe weather conditions (e.g., unusually heavy snow or rain, unusually high tides, unusually high or low temperatures) during a particular period at the site."

The government also claimed that the Contractor was at fault because the Contractor's unexcused delays pushed the work into the winter period where delays due to severe weather were inevitable. The Board also rejected this argument. The Board concluded that a day of severe weather is excusable on its own, and that the reasons why the contract work was postponed are irrelevant. Further, the Contractor is entitled to a day of excusable delay even if the work also was slowed down by the Contractor's lack of diligence. Severe weather is the trump card.

This case offers several lessons. 1) Contractors should not overlook weather as a basis for excusable delay in government and private contracts, especially where there may be many factors causing delay at the same time or in close time periods. 2) Observe notice requirements. The Defaults clause, for example, requires the Contractor to notify the contracting officer

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within ten days after the start of a delay where the Contractor may seek an extension of the completion date. 3) From the perspective of the owner in a private contract, or the general contractor on a subcontract, it may be possible to place limits by defining "unusually severe weather" or similar terms. For example, if the project schedule includes or assumes a number of days for expected bad weather, this fact should be identified, and unusually severe weather should be defined as inclement weather in excess of the number of days in the schedule.

Subsequent Negotiations May Alter the Release in a Change Order

Parties executing change order agreements have at least two goals: settle specific claims, and define clearly the right to submit other claims in the future. Claims which are clearly included within a bilateral change order agreement are released; they normally cannot be resurrected or altered in the future. Claims which are expressly reserved may be brought in the future. Contractors may seek to reserve the right to claim in the future those items which are difficult, if not impossible, to measure when a change order is being negotiated. These include the impact of a change on future work, and the cumulative impact of changes (that is, the "ripple effect") on later work and the project schedule.

Problems arise when reservation language is ambiguous. Even when it is not ambiguous, however, the intent of the parties' reservation may be clarified by *later* negotiations concerning the impact of a change; if parties negotiate the impact of a change, that negotiation is evidence that the impact claim was not settled by the reservation. *England v. Sherman R. Smoot Corp.*, 388 F.3d 844 (Fed. Cir., Nov. 3, 2004).

In *Sherman*, the contractor and the Navy executed three bilateral change orders which increased the contract price but did not provide additional time. Each modification contained the following accord and satisfaction (i.e., settlement and release) language:

> Acceptance of this modification by the contractor constitutes an accord and satisfaction and represents payment in full for both time and money and for any and all costs, impact effect, and for delays and disruptions arising out of, or incidental to, the work as herein revised.

Thereafter, the contractor sought a fifty-one day extension to the schedule, plus time-related costs, for impact related to these three changes. The Contracting Officer negotiated, and proposed a unilateral change order, *excusing* fifty-one days of delay, but not providing a *compensable* time extension. The contractor rejected the non-compensable extension, arguing that the Navy's Project Engineer had agreed to grant compensable time. The contractor submitted a claim for compensable time, and when the claim was effectively denied, it filed an appeal pursuant to the Contract Disputes Act. The Navy then argued that the claim was barred by the accord and satisfaction language included in the bilateral change orders.

However, because the Navy continued to consider the contractor's claim for time, after the contractor signed the three change orders, these negotiations clarified the intent expressed in accord and satisfaction; the parties' negotiation of future time indicated that the parties did not intend the accord and satisfaction to release the contractor's claims for future impact to the schedule. "[C]ourts may refuse to bar a claim based upon the defense of accord and satisfaction where the parties continue to consider the claim after execution of a release." *Id.*, 388 F.3d at 849.

Contractors wishing to reserve the right to pursue future claims should, if possible, expressly reserve that right in clear, unambiguous language. The following may work in many situations:

> Contractor reserves the right to submit a claim in the future to recover costs related to time and impacts which are or may become due to Contractor or its Subcontractors in connection with this change, both alone and in connection with other changes. Contractor reserves its right to assert claims in the future to recover additional costs for time and impacts, to changed and unchanged work, arising out of or pertaining to this change, both alone and in connection with other changes.

However, recognizing that releases and reservations, in hindsight, may appear less clear than they did at signing, parties should be mindful that their treatment of claims after execution of a settlement agreement may shed light on their intent when signing the agreement, and that this treatment may help a fact finder determine how to apply an ambiguous release and reservation.

Buyer Beware: Massachusetts Appellate Court Holds That A Supplier's Erroneous Quotation Of Price To A Subcontractor Is Too Good To Rely On

The defendant, a wholesale supplier of heating and cooling equipment, distributed boilers manufactured by a company known as H.B. Smith. In August 2000, the defendant received an unsolicited fax from Smith quoting a price for three boilers needed for a construction job. Smith, in quoting the price of the boilers to the defendant, used the net price ($131,711) instead of the retail or trade price as it had in some past quotes. The discounted price and words "dealer cost" were hand-written next to the net price on the Smith quote form which was faxed unsolicited to a number of businesses. The defendant, however, mistook Smith's net price quote for a retail or trade price and, in accordance with industry practice, discounted the price for commercial customers ($88,200).

The plaintiff subcontractor received the defendant's unsolicited fax and calculated its sub-bid for the HVAC portion of the construction project using the erroneous retail or trade figure. Prior to submitting its bid, however, the plaintiff received an additional distributor's quote on the boilers for a net price of $146,345 (consistent with Smith's actual net price). The plaintiff subsequently was awarded the subcontract and began to shop for the lowest possible price. After a two week search, the plaintiff contacted the defendant and attempted to place an order for the boilers at the quoted erroneous dealer

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cost. The defendant informed the plaintiff that its quote had contained an error and that it would not sell the boilers at $88,200. The plaintiff ultimately paid $140,000 to another supplier and brought a breach of contract suit against the defendant for the difference in prices in a Massachusetts state court. *I & R Mech., Inc. v. Hazelton Mfg. Co.*, 817 N.E.2d 799 (Mass. App. Ct. 2004).

The trial court concluded that the plaintiff could not recover on the theory that it had relied on the defendant's price quotes when it submitted its bid because: 1) the defendant was a supplier that forwarded the manufacturer's price quotation to potential customers; 2) the defendant played no active role in researching the project specifications; 3) the defendant's price quotation was unsolicited by the plaintiff; 4) the defendant sent the price quotation to a large number of potential customers without the knowledge that they would be bidding on the project; and 5) the defendant's quotation only applied to supplying the product, and not to the performance of any services.

The appellate court, expanding on the lower court's holding that the plaintiff did not rely on the defendant's price quotation, referred to the Restatement (Second) of Contracts § 26:

> If the addressee of a proposal has reason to know that no offer is intended, there is no offer even though he understands it to be an offer. "Reason to know" depends not only on the words or other conduct, but also on the circumstances, including previous communications of the parties and the usages of their community or line of business.

The appellate court reasoned that the circumstances of the quote, coupled with the industry practice of bid shopping and the fact that the plaintiff did not feel bound by the defendant's initial quote and was actively shopping for the best bargain, gave the plaintiff "reason to know" that no offer was intended, even though subjectively it might have understood that the quote was an offer.

Moreover, the appellate court upheld the trial court's determination that any reliance that the plaintiff placed on the defendant's price quotation was unreasonable because of: 1) the disparity in price between the quote of the defendant and the other distributor being so great as to indicate an error; and 2) plaintiff's admissions that it actively sought a better price and did not consider itself bound to the defendant's price quotation.

The import of the case harkens back to the old truism: if an offer appears too good to be true, then it probably is. Regardless of whether telephone scams or innocent mistakes are involved, buyers who attempt to rely on such "sweetheart deals" may end up on the losing side of the ledger.

Colorado Arbitration Awards Cannot Be Challenged For Manifest Disregard

Construction contracts often require arbitration to resolve disputes. Arbitration proponents characterize arbitration as a convenient, speedy, efficient alternative to litigation in court. Arbitration awards are usually final and binding according to the terms of the arbitration clause or the rules that govern the arbitration. The Federal Arbitration Act, along with the Uniform Arbitration Act adopted by several states, enumerate only a few specific grounds for challenging an arbitration award, such as fraud, corruption, partiality, or misconduct by the arbitrators.

In some states and federal circuits, manifest disregard of the law is a "judge-made" non-statutory basis for attacking an arbitration award. Formulations differ, although mere error by the arbitrator is generally not enough. Some courts have held that an arbitration award may be vacated for manifest disregard of the law where an arbitrator willfully ignores well-known governing law. *See*, *e.g.*, *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Bobker*, 808 F.2d 930, 933-34 (2nd Cir. 1986). Other courts take a more restrictive view, with one court even ruling that manifest disregard only exists where the arbitrator's award directs the parties to violate the law. *See*, *e.g.*, *George Watts & Son, Inc. v. Tiffany & Co.*, 248 F.3d 577, 580-81 (7th Cir. 2001). On at least two occasions, the United States Supreme Court has indicated that an arbitration award made "in manifest disregard of the law" is not binding, although that Court has never attempted to define the precise meaning of manifest disregard. *See Wilko v. Swan*, 346 U.S. 427, 436-37 (1953); *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938, 942 (1995).

Other courts have refused to recognize any non-statutory grounds for vacating arbitration awards. For example, the Colorado Court of Appeals recently refused to recognize manifest disregard as a basis for challenging an arbitration award in *Coors Brewing Co. v. Cabo*, ___ P.3d ___, 2004 WL 2903515 (Colo. App. Dec. 16, 2004). The Court reasoned that the Colorado legislature recently adopted the Colorado Uniform Arbitration Act (the "CUAA"), which establishes five grounds for vacating an arbitration award, but does not recognize manifest disregard as one of them. The *Coors* court was unwilling to depart from the statute and rejected outright a manifest disregard challenge to an arbitration award by the losing party to the arbitration. The court criticized "manifest disregard" as an elusive concept that other courts have struggled to define clearly or consistently, and observed that challenges based on "manifest disregard" weakened the effectiveness and legitimacy of arbitration, by exposing simple, expedient arbitration awards to expensive, time consuming, post-award judicial review.

The parties in *Coors* apparently agreed that their arbitration was governed by Colorado state law, and the holding makes no attempt to address whether the manifest disregard is available under the Federal Arbitration Act.

Surety Bad Faith In Florida: Sue Now Or Sue Later?

If you perform general contracting in Florida, stay tuned for the Supreme Court of Florida's follow-up decision to *Dadeland Depot v. St. Paul Fire and Marine Ins.*, 383 F.3d 1273 (11th Cir. 2004). There, the Eleventh Circuit certified two questions to the Supreme Court of Florida, which affect a contractor's right to bring an action for bad faith against a surety.

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- Is a contractor, named the obligee in a bond, an "insured" pursuant to Florida's bad faith statute?
- If so, must a contractor prove that a surety's unreasonable failure to settle claims is a "general business practice" to recover for bad faith?

In *Dadeland Depot*, the developer interpreted Florida law to require a legal finding of the surety's failure to perform before filing a bad faith action. Thus, it did not raise a bad faith claim in an arbitration against the contractor and the surety. The surety claimed, after the developer won the arbitration and sued in a second case for bad faith, that the bad faith claim should have been brought in the arbitration and was barred. To clarify the procedure for bringing a bad faith case in Florida, the Eleventh Circuit certified three additional questions.

- Is an arbitrator's finding that the surety did not perform, and is bound to an award against a contractor, a sufficient prior finding to support a bad faith action?
- If not, does the arbitrator's decision bar a later action against the surety for bad faith?
- If the arbitrator finds that the surety's defenses fail, may the surety raise those defenses in a subsequent bad faith action?

For now, general contractors litigating in Florida against sureties should, if there are grounds for doing so, include a bad faith action in claims brought against contractors and sureties. They should seek proof of the surety's general business practices of claim investigation, which might require some contractors to review the scope of discovery allowed in arbitration pursuant to their standard contracts.

Condominium Warranties Mandated By Statute

Some states' legislatures have created a body of statutory law specifically for condominium construction and sales. When contracting to perform condominium work in such a state it is helpful to know whether there are statutes that affect your work.

Florida is one such state that has a body of statutory condominium law. Within the Florida statutory condominium law is a warranty provision that requires developers and builders to provide warranties that may differ from what is expected based on experience in other states or based on common law warranties.

In Florida a developer shall be deemed to have granted to the purchaser of each unit an implied warranty of fitness and merchantability for the purposes or uses intended. This warranty has a period of three years commencing with the completion of the building containing the unit. There are some variations to this general warranty within the statute for items such as personal property and components of buildings as opposed to individual units. The statute and other relevant law must be consulted for a complete understanding.

Similarly, the contractor and all subcontractors and suppliers grant to the developer and the purchaser of each unit implied warranties of fitness as to the work performed or materials supplied. These warranties extend to the roof, structure, mechanical and plumbing elements for a period of three years. As to other improvements and materials, the warranty period is one year.

Finally, the statutory warranties by the developer and builder extend to the benefit of each original owner as well as to successor owners.

When developing or constructing condominiums, it is important to know the applicable states' laws that govern such work so that consideration can be given to managing those risks through insurance, contracts, or otherwise.

Non-Parties Must Produce Documents in Arbitration

It is well known that courts will generally not enforce discovery subpoenas against non-parties where the case is being arbitrated. This has been a frustration of the arbitration process for many practitioners. However, recently, a New York federal court has confirmed a tool often used in arbitration.

In *Odfjell ASA v. Celanese AG* (2004 WL 2922152 (S.D. N.Y.)), the federal trial court held that subpoenas requiring the custodians of records and a former employee of non-parties to appear before the arbitration panel, testify, and produce requested documents were valid and enforceable. The arbitration claims involved assertions that Odfjell along with the other respondents had co-conspired in a scheme to fix prices, rig bids, and engage in anti-competitive conduct. Celanese and the other claimants had issued subpoenas to non-party affiliates of Stolt-Nielsen S.A and to a former employee of Stolt-Nielsen Transportation Group, Ltd. The subpoenas commanded the non-party representatives to "appear and testify in an arbitration proceeding" and to "bring with [them] and produce at that time and place any and all documents and things, of which [they] have custody or control, which are responsive." The non-parties refused to comply and the claimants filed a motion to compel compliance.

The court noted that Section 7 of the Federal Arbitration Act allows arbitrators to summon any person to appear before them and to require the witness to bring with her any book, record, document or paper which is deemed to be material to the case. The court held that the language of Section 7 does not specify a time in the arbitration process where this power can be invoked and found that Section 7 does not only apply to the time of the final hearing.

This is an important case because acquiring documents from non-parties and admitting these documents is often a major problem in arbitration. The way around this rule has been to summons the witness and require that they bring the requested documents to a special arbitration session convened for the purpose of receiving the subpoenaed information. The New York federal court has given this approach to acquiring non-party documents its stamp of approval.

Bradley Arant Lawyer Activities:

Winter 2005: Nick Gaede is teaching a course on the European Union at the University of Alabama School of Law in Tuscaloosa, Alabama.

November 1, 2004: Michael Knapp joined the Construction and Procurement Practice Group as a partner in the firm's

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Charlotte, North Carolina office. Michael Knapp has been practicing law since 1995. He served in the United States Navy as a Judge Advocate from 1995 to 1998. After his Navy service, he practiced construction and construction defect law in San Diego, California for five years before returning to the southeast. A graduate of Wake Forest Law School, Mr. Knapp holds a B.A. in Political Science/Economics from James Madison University.

December 2004: Wally Sears was named as one of a select group of 114 attorneys nationwide recognized for delivering the best client service. This honor was based on interviews of more than 200 corporate counsel of Fortune 1000 companies by BTI Consulting Group. Wally and the other 113 attorneys on the list were singled out, by name, in an unprompted manner as delivering superior client service.

December 1, 2004: Jim Archibald, Rhonda Caviedes, David Pugh and **Wally Sears** presented a one-day seminar on "Construction Management/Design-Build." Objectives of the seminar included: interpreting the design-build delivery system; understanding construction management; obtaining required licensing; and managing risk through insurance and bonding.

December 8-10, 2004: John Bond, Rhonda Caviedes, Nick Gaede, Arlan Lewis, Mabry Rogers, and **Wally Sears** attended the Construction Superconference in San Francisco, California. Nick Gaede served as Chair of the luncheon session on "Building for the Future: Considerations in Light of the Paris Airport Collapse and the World Trade Center."

2005: Axel Bolvig will serve on the General/Subcontractor Relations Committee of the Alabama Chapter of Associated Builders and Contractors, Inc.

January 2005: Nick Gaede became a member of The Construction Group Advisory Board for the *Construction Contracts Law Report.*

January 1, 2005: Joel Brown and **Arlan Lewis** became partners in the firm.

January 4, 2005: Chris Danley joined the Construction and Procurement Practice Group as an associate in the firm's Washington, D.C. office. Prior to joining the firm, Chris clerked for two federal judges: the Honorable Charles R. Butler, Jr. in the Southern District of Alabama and the Honorable Susan G. Braden on the United States Court of Federal Claims in Washington, D.C. Clerking on the two courts gives Chris experience in a wide variety of legal issues, including, among others, government contracts, tax, employment discrimination, admiralty, and intellectual property.

January 19, 2005: Mabry Rogers presented a client seminar on "Documentation and Record Keeping for Better Management" in Charlotte, North Carolina.

January 19, 2005: Rhonda Caviedes, Jonathan Head, Mitch Mudano, David Pugh, and **Wally Sears** presented a one-day seminar on "AIA Contracts." The focus was examination of AIA form contracts and their terms, including specific form contractual provisions, as well as the consequences of modifying the form language and suggestions to assist in contract negotiations was addressed.

January 24, 2005: J. R. Steele accepted a position as an associate in our Washington, D.C. office to start in the near future. J. R. has worked with us part-time while attending law school at American University.

January 25, 2005: Rhonda Caviedes and **Bob Greene** hosted a group of visiting Australian law students at the firm's Birmingham office. This was the fourth year that the firm has hosted this portion of the University of Alabama School of Law's exchange program with the Australian National University Faculty of Law. The students were provided an opportunity to learn about different practice areas of the American legal system, including: Construction Law, Environmental Law, Intellectual Property, Corporate Law, and General Litigation.

January 27, 2005: Arlan Lewis attended the ABA Forum on the Construction Industry's Winter Meeting entitled "Are Your Covered? Insurance Products for the Construction Projects" in New York City, New York.

January 27, 2005: David Pugh and **Mabry Rogers** presented at a one-day seminar on Building Codes. Discussions included legal pitfalls regarding code enforcement, the intent behind various code provisions, and the application of fundamentals of the International Building Code as it pertains to use and occupancy classifications, building construction types and building limitations.

February 2, 2005: Doug Eckert, John Hargrove, Arlan Lewis, Mitch Mudano and **David Pugh** presented a one-day seminar on "The Fundamentals of Construction Contracts: Understanding the Issues." Highlights of the seminar included basic contract principles, essential contract terms, model contract forms and clauses for different project delivery systems and dispute resolution.

February 24-27, 2005: Nick Gaede will become the President of The American College of Construction Lawyers (ACCL), an organization of 120 select lawyers from across the country dedicated to excellence in the specialized practice of construction law, at the annual meeting to be held in Tucson, Arizona.

March 30, 2005: Jim Archibald, Patrick Darby, David Pugh, Wally Sears, and **Sabra Wireman** will present a one-day seminar on Construction Insurance, Bonding and Liens. Topics that will be addressed include: Insurance Coverage, Private and Government Projects Bond Claims, Bankruptcy Issues, and Mechanic's Liens.

April 27, 2005: Jim Archibald, Rhonda Caviedes, David Pugh and **Wally Sears** will present a one-day seminar on "Construction Management/Design-Build."

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The lawyers at Bradley Arant Rose & White LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

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BRADLEY ARANT ROSE & WHITE LLP **Second Quarter 2005**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Survey of Condominium Warranties in Four Southern States

This article provides an overview of condominium warranty laws for North Carolina, South Carolina, Georgia and Florida. Given the numerous challenges associated with developing or constructing condominiums, it is essential to understand the applicable states' laws that govern such work so that consideration can be given to managing these risks through entity formation, insurance, contracts, or otherwise.

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North Carolina's general warranty law governs express and implied warranties that arise from the sale of a condominium unit. Under North Carolina's general warranty law, warranties run only from a vendor-builder to an initial vendee. Presumably, a developer of a condominium project would be considered the *initial vendee* of a condominium unit constructed by a general contractor. Thus, the developer, but not a subsequent purchaser, would be entitled to benefit from the warranties of a general contractor. There are several important caveats to the general rule, and the North Carolina statutes and other relevant law must be consulted for a complete understanding.

Under South Carolina law, a purchaser may sue a builder on both implied warranty and negligence theories despite the purchaser's lack of contractual privity with the builder. Thus, in South Carolina, a general contractor is subject to warranty and negligence claims from both developers and subsequent purchasers. Under South Carolina's statute of repose, these claims generally must be brought within thirteen years after the contractor completes construction.

Florida statutory law states that contractors, sub-contractors and suppliers grant to the developer and *original* purchaser of each condominium unit an *implied warranty of fitness* as to the work performed or materials supplied by them as follows: (i) Three years from the date of completion of construction of a building, a warranty as to the *roof and structural components* of the building and *mechanical and plumbing elements* serving a building, except mechanical elements serving only one unit; and (ii) One year after completion of all construction, a warranty as to all other improvements and materials. As to subsequent purchasers with whom a builder has no contractual relationship, the Florida courts have generally held that a remote purchaser can bring a *negligence action*, in the absence of privity, against the builder where it is foreseeable that the

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plaintiff will suffer the injury and damages sustained. Florida courts have also held that privity of contract is not an essential element in a negligence suit between a subsequent purchaser and the builder of a condominium project.

Georgia does not have a condominium statute to create implied warranty liability that flows from the builder to the homeowner. However, Georgia courts have generally held that the lack of privity between a current homeowner and builder does not preclude the current owner's cause of action against the builder for the *negligence* in construction of the home. Thus, any subsequent purchaser would be left with a *negligent construction* claim for bringing an action against a builder unless the contract provided otherwise.

As evidenced by this article, condominium laws significantly vary state by state. It is important for anyone involved in a condominium project to avail themselves of the intricacies of the state's law in which the project is proposed in order to develop and construct a successful project that complies with the law.

Read Your Flowdown Clause Carefully

For convenience and in order to shorten contracts, contractors often incorporate numerous other documents by reference. A very common incorporation is a subcontract's incorporation of the general contractor's contract with the owner, imposing many of the same rights and duties on the subcontractor as are imposed on the general contractor by the owner. While such clauses are essential for scope, work rules, etc., numerous general contractors and subcontractors have been surprised to learn that they may be held to risk-shifting clauses in the prime contract such as no damages for delay, pay-when-paid, and restrictive notice clauses.

In *American Nat. Electric Corp. v. Poythress Commercial Contractors Inc.*, a 2004 North Carolina appellate court case, an electrical subcontractor sued a general contractor for labor inefficiencies and loss of productivity allegedly caused by the general contractor and owner. The general contractor defended under a pay-when-paid rationale, claiming that since the owner had never paid it for delay, the subcontractor could not recover. The court noted that North Carolina statutes void pay-when-paid clauses, but went on to incorporate the restrictive notice provisions of the general contract. The flowdown language in the subcontract was not specific and did not mention the notice provisions being "flowed down." Even so, the court found that the plain import of the language, "the subcontractor agrees to be bound to the contractor by the terms of the general contract . . . and to assume toward the contractor all of the obligations and responsibilities" that the general contractor had assumed to the owner, incorporated fully the terms and conditions of the prime contract.

Subcontractors are not the only ones who have to worry about flowdown issues. Courts have also limited general contractors in delay damage suits against subcontractors by liquidated damages contained in the general contract with the owner. Subcontractors have thus used the flowdown clauses defensively to try to cap the general contractor's recovery of liquidated damages. Both general contractors and sub-contractors should be wary of generalized flowdown clauses, most likely opting to name, when possible, the provisions that will actually flow down.

Virginia Lien Law Overview

Compared to other jurisdictions, Virginia's mechanic's lien laws grant relatively high priority to liens. Because Virginia mechanic's liens are "inchoate," they "relate back" to and exist from the time labor or material is supplied to the property as long as the claimant properly notices, perfects, and enforces the lien. Therefore, a properly noticed, perfected, and enforced mechanic's lien can have priority over, or get paid before, a construction bank loan, and can survive a foreclosure, or a sale of the property, or a bankruptcy. However, Virginia mechanic's lien law is complicated and contains many potential pitfalls. A claimant must be careful to follow each step of the statutory process because omitting any step can prove fatal to the lien.

Notice of Intention: Virginia's lien laws differ from those of many other jurisdictions in that (except for certain residential dwelling units) Virginia does not require contractors to give notice of intention to claim a lien prior to commencing work. However, in order to perfect a lien, contractors must give notice of the filing of their lien.

Perfection:

Memorandum of Lien: To perfect a lien, a lien claimant must file a memorandum of lien in the clerk's office at the courthouse in the county or city in which the building or structure is located, no later than 90 days from the last day of the month in which he last performed labor or furnished material. In no event, however, may the memorandum be filed later than 90 days after the building or structure is completed, or the work on the building or structure is otherwise terminated.

The memorandum of lien must contain specific inform-ation, including, among other things, a statement of account verified by affidavit signed by the claimant or his agent, and a detailed description of the type of materials or services furnished.

Notice: To properly perfect his lien, a general contractor must file, along with the memorandum, a certification that he has mailed a copy of the memorandum to the owner. Sub-contractors, in addition to filing the memorandum, must give notice in writing to the owner of the property (or his agent)

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of the amount and character of the claim. Sub-subcontractors and suppliers must give notice in writing not only to the owner of the property, but also to the general contractor.

Amount and 150-Day Rule: One peculiarity of Virginia mechanic's lien law is the "150-Day Rule." Under this rule, a lien may not include amounts due for labor or materials furnished more than 150 days prior to the last day labor was performed or materials furnished on the job (retainage up to ten percent is excepted from this provision). Liens that included sums for work or materials furnished outside of the 150-day window have been determined to be unenforceable, in their entirety. A subsequent reduction of the amount claimed has been held ineffective to save the lien claim. Because violating the 150-Day Rule can be fatal to a lien claim, it is important for claimants to carefully analyze the amount claimed. The 150-day cut-off may not correspond precisely with a claimant's billing cycle, and therefore it may be necessary to perform a day-to-day analysis of work in order to comply with the rule.

In addition to the 150-day Rule, the amount for which a subcontractor may perfect a lien cannot exceed the amount for which the owner is indebted to the general contractor, at the time notice is given.

Enforcement: To enforce a mechanic's lien, a claimant must bring suit by filing a Bill of Complaint on the equity side of the court. Attention to this step is important because, unlike the majority of jurisdictions, Virginia state courts have retained a bifurcated system. Courts of general jurisdiction sit as courts of both law and equity, maintaining separate dockets and applying, to some degree, separate procedures.

With the complaint, the lien claimant is required to file an itemized statement of account showing the amount and character of work done or materials furnished, the prices charged, payments made (if any), the balance due, and the time from which interest is claimed. The accuracy of this statement of account must be verified by an affidavit signed by the lien claimant himself or his agent. A suit to enforce a mechanic's lien that fails to contain a proper itemized statement of account is ineffective and does not constitute proper filing so as to toll the statute of limitations.

Suit to enforce a mechanic's lien must be brought within six months from the date the memorandum of lien was recorded, or within 60 days from the time the building, structure or railroad was completed or the work otherwise terminated, whichever occurs later.

Also, it is important to ensure that all necessary parties to a mechanic's lien suit are named before the statute of limitations has run. If a necessary party is added after the statute of limitations has run, the mechanic's lien suit is subject to dismissal. Necessary parties can include a variety of parties with an interest in the property, including beneficiaries and trustees, judgment creditors, tax lien holders, and bond sureties.

Additional Remedy: In addition to the general lien remedies, Virginia law may provide other protections for subcontractors, sub-subcontractors, and suppliers by imposing liability upon an owner or general contractor for unpaid work. To take advantage of this protection, the subcontractor must give two notices in writing to the owner or general contractor: one before he begins work, and one after work is completed. Additional requirements regarding the timing, content, amount, and method for providing the notices are also detailed in the statute.

Timely fulfillment of each of the requirements for enforcing a mechanic's lien in Virginia is critical to the successful use of this remedy. The assistance of counsel familiar with Virginia mechanic's lien law can help guide contractors through the complex statutory process.

Contractor's Failure to Satisfy Contractual Prerequisites Impedes Lawsuit

In a ruling which emphasizes the need to strictly adhere to contractual dispute resolution processes, a federal appeals court dismissed a contractor's claims because the contractor failed to fully comply with contractual processes for resolving "claims."

In *Cameo Homes v. Kraus-Anderson Constr. Co.*, a 2005 case out of the Eighth Circuit Court of Appeals (the federal court supervising trial courts in Arkansas, Iowa, Minnesota, Missouri, Nebraska and the Dakotas), a contractor entered into contracts with the owner (the City of East Grand Forks, Minnesota). The contracts required the contractor to give written notice of claims to the project architect; under the terms of the contract, failure to present a written claim to the architect precluded later litigation. The contracts also distinguished "change orders," which modified the terms of a contract, from "claims," which were efforts to seek relief, as a matter of right, under an existing contract. Finally, the contracts provided that a construction manager had authority to oversee the contractor's performance, with any change order requests submitted and approved through the construction manager.

The contractor's lawsuit involved claims arising from the contractor's increased costs, which allegedly resulted from modified obligations imposed by the construction manager. The contractor submitted to the construction manager requests for change orders arising from the already-performed, modified work; such change order requests were denied. The contactor then sued to recover its additional costs. Though the contractor had submitted requests for "change orders" to the construction manager, the contractor

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never gave written notice of its "claims" to the project architect.

The owner argued that the contractor's claims were barred by the contractor's failure to satisfy the contractual process related to claims. In response, the contractor argued that the parties had, in practice, modified the contractual process for reporting "claims," allowing change orders to be submitted through the project architect and approved after a modified obligation had already been performed. Thus, the contractor argued, submission of the change order requests to the construction manager satisfied the contractual requirement of giving written notice to the project architect. In essence, the contractor's argument was that it complied with the spirit, if not the letter, of the contract.

The Court's ruling, by dismissing the contractor's claims, made very clear that the contractor was obligated to fully comply with the letter of contractual claims processes. The contractor's failure to do so was fatal to its claims. This case serves as another reminder that some contracts require parties to abide by contractual dispute resolution processes and satisfy contractual prerequisites to suit.

Contractual Indemnity: Notice to Indemnitor Must Be Timely; but Tardiness Without Prejudice Provides No Defense

The question often arises under construction contracts as to the right of indemnity from claims for personal injury or property damage. In a recent Alabama Supreme Court case, *Burkes Mechanical, Inc. v. Ft. James-Pennington, Inc.*, the issue of timely notice for contractual indemnity was considered. In this case, the court decided that, although the entity wanting indemnity (the "indemnitee") must timely notify the entity arguably owing indemnity (the "indemnitor") of the action against the indemnitee in order to preserve an indemnity claim, tardiness without prejudice provides no defense.

In the case, Burkes contracted to install "hardwood screening" at a paper mill, owned and operated by Ft. James. In the contract, Burkes agreed to indemnify Ft. James and name Ft. James as an additional insured on its CGL policy.

During the course of the work, a Burkes employee slipped and fell on the mill premises. The employee successfully filed a worker's compensation claim against Burkes. In addition, the employee sued Ft. James for negligence.

On two separate occasions, Ft. James sent demand letters to Burkes to defend and indemnify it for the employee's claims. Burkes never responded. Consequently, Ft. James filed a "third-party complaint" against Burkes and its CGL insurer. Ft. James thereafter settled the case with the employee for $875,000, and, in the subsequent trial against Burkes and its insurer, judgment was entered against Burkes for the amount of the settlement plus all fees and expenses in defending the action.

Burkes appealed the judgment on the ground, among others, that Ft. James did not timely notify Burkes of the claim.

The court disagreed with Burkes' contentions as to timely notice. The court found that notice must be timely in that it cannot be so late that the indemnitor is prejudiced in defending the claim. However, the court stated that tardiness without prejudice provides no defense. In this regard, Burkes tried to claim that it was prejudiced on the basis of its CGL insurer's denial of coverage. The facts of the case indicated that Burkes knew of the employee's injury and his subsequent action against Ft. James. Burkes attempted to rely on the lack of notice to its own CGL insurer of the claim. However, the court found that Burkes could not assert the consequences of its own default under the CGL policy as the basis for prejudice to avoid indemnity.

In conclusion, a contractor should always put its CGL policy insurer on notice of any indemnity claims, and it should seek its insurers' assistance immediately in replying to any indemnity demand. On a broader front, this case points to an important principle adopted by many courts, particularly in the insurance and indemnity context: "Notice" requirements may be subject to proof of prejudice arising from the lack of notice.

"Gotcha" Defeats Government Contractor's Claim for Overhead

Many contractor claims involve the same two recurring issues. These are responsibility for delay and the availability of certain types of damages. The recent Federal Circuit Court of Appeals case of *Singleton Contracting Corp. v. Harvey* considered both of these issues. Seizing upon a seemingly inconsequential shortfall by the contractor (the "Gotcha"), the *Singleton* Court held the contractor jointly responsible for a delay and then used that finding to deny the contractor's claim for overhead.

The contract in *Singleton* was with the federal government for Army base work. At the preconstruction conference, it became apparent to all sides that the government's plans were flawed and that the preconstruction conference would have to be reconvened after they were corrected. Almost a year later, the government terminated the contract for convenience, with revised plans never having been produced.

Thereafter, the contractor sought to work out a reconciliation for the termination. The contractor submitted a claim for overhead along with its claim for purchased material and related costs. Then came the "Gotcha." The

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government noticed that the contractor had not submitted a contractually required proof of insurance certificate at the preconstruction conference. Dispute the fact that the parties were waiting on revised plans to reconvene the preconstruction conference – at which time the certificate could have been produced – the Appeals Board and Court of Appeals held that the contractor was jointly responsible for the delay because it had not provided the insurance certificate.

Once this determination was made, it was used to deny the contractor's claim for overhead during the term of the delay. The contractor's claim for its unabsorbed overhead already had been audited and reduced from its actual overhead for the period to a percentage equal to the percentage of revenues that the Army contract would have been for the contractor during the period. Even after that reduction, the court held that none of this overhead could be obtained due to the contractor's failure to provide the insurance certificate for work never subject to a notice to proceed.

In addition to the unabsorbed overhead, the contractor sought an overhead percentage on its direct costs. These damages normally are available from the government. This calculation is performed by dividing the contractor's total indirect costs for the year of the contract and dividing that by the contractor's total direct costs for the period. That percentage then is used as an overhead rate to be multiplied by the direct costs under the contract. In the *Singleton* case, this overhead also was disallowed because the contractor failed to produce its total direct costs for the year.

If there is a lesson from the *Singleton* opinion, it is that government contractors must be ever vigilant. Immediately upon experiencing a delay such as in this case, a contractor should review its contractual obligations to make sure that it does not set up the government for any "Gotchas." Likewise, contractors should keep careful records of both direct and indirect costs for the period and fiscal year, including from all other contracts.

Broad Form Arbitration Clause May Not Apply to Statutory Claims

The United States Supreme Court has admonished state courts that doubts about the enforceability and scope of predispute arbitration agreements should be resolved in favor of arbitration. Similarly, the highest court in the State of New Jersey has held that "an agreement to arbitrate should be read liberally in favor of arbitration….". In spite of these pro-arbitration directives from higher courts, an appellate court in New Jersey recently held that a broad form arbitration clause did not apply to statutory claims by a homeowner against a builder.

In *Feinstein v. BDS Remodeling Services, LLC*, a New Jersey trial court ordered arbitration of all claims asserted by a homeowner against a home builder. Instead of going to arbitration, the homeowner appealed. A New Jersey intermediate appellate court held that the arbitration clause in the homeowner's contract with the builder did not require arbitration of claims under New Jersey's Consumer Fraud Act and Home Improvement Practices Act, even though the arbitration clause provided that "[a]ll claims or disputes between the Contractor and the Owner arising out of or relating to the Contract, or the breach thereof, shall be decided by arbitration. . . . According to the court, "the arbitration clause only applies to claims arising from the contract itself and not to statutory claims or claims stemming from the relationship and conduct of all the parties involved."

This narrow reading of the arbitration clause was justified, according to the appellate court, by its desire to preserve the homeowner's statutory rights. The appellate court found insufficient evidence to establish a knowing waiver, by the homeowner, of his statutory rights. According to the appellate court, an arbitration clause can require arbitration of statutory claims only if it encompasses those claims by its express terms.

Not all of the homeowner's claims were statutory claims. Indeed, the homeowner's sixteen count complaint asserted numerous common law claims, including breach of contract, breach of warranty, and negligence. Nonetheless, the appellate court ruled that none of the claims would be arbitrated: "Since plaintiffs' statutory claims are to be decided at trial, we conclude that the interests of judicial economy dictate that the trial court should decide all claims."

We do not know, at this time, whether the appellate court's ruling will be challenged on further appeal. The case illustrates that challenges to the scope or enforceability of arbitration clauses often find a sympathetic audience where the rights of consumers appear to be at stake. Indeed, most of the cases cited by the court involved employment contracts, and attempts by employers to force arbitration of state and federal statutory claims arising out of statutes intended to protect employees from discrimination. It is not clear that the New Jersey court would have reached the same conclusion if the owner had been a commercial owner.

Court Holds That a Contract Provision Requiring Arbitration Demand to Be Made Within 30 Days is Not Unreasonable

In *Holt & Holt, Inc. v. Choate Constr. Co.*, a 2004 Georgia Court of Appeals case, the court held that a contract's 30-day limitation period for filing an arbitration demand was not unreasonable.

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Holt & Holt, Inc. entered into a subcontract to perform drywall work for the general contractor, Choate. The subcontract contained an arbitration provision that provided "that arbitration proceedings shall be commenced by [Holt] not later than 30 days following [Holt's] receipt of notice of [Choate's] [decision to terminate or supplement]; otherwise, [Choate's] decision becomes final and binding."

On May 29, 2002, Choate sent Holt a certified letter informing Holt of Choate's decision to supplement Holt's work forces. Holt alleged that Choate breached the agreement, but did not file its demand for arbitration until November 5, 2002. Choate filed a motion to stay the arbitration, which the lower court granted. Holt appealed the stay of the arbitration, contending that the contract's 30-day period in which to file a claim for arbitration was an impermissibly short limitations period.

The Georgia Court of Appeals noted that "the parties to a contract may fix upon a shorter period, and the stipulation violates no principle of public policy, provided the period fixed be not so unreasonable as to show imposition or undue advantage in some way." Accordingly, the Court found that Holt had not demonstrated how the 30-day limitation was unreasonable. The Court also pointed out that the 30-day limitation provision was part of a standard contract, commonly used in the construction industry (the provision was from American Institute of Architects Form A201, and that contract has been endorsed by the Association of General Contractors of America). The court reasoned, "given that construction projects end, sometimes within a relatively short period of time from their commencement, it appears reasonable to limit the time within which to file arbitration claims so that disputes may be resolved expeditiously, preferably while the project is still underway, and with minimal delays and consequent expense to all involved."

Thus, parties to contracts should pay close attention to time limitation provisions in arbitration clauses, as this case indicates that courts may uphold these time limitations.

Liquidated Damages May Be Assessed Even Though the Government Delayed the Project

Ever wonder if the United States can collect liquidated damages when, by its own admission, it extends the project beyond the completion date? If you think this is an open and shut case in favor of the contractor, then you are wrong – the federal government can assess liquidated damages in this circumstance. A federal court specializing in government contracts (the United States Court of Federal Claims) stated that liquidated damages may be awarded even if the federal government, in part, caused the liquidated damages clause to trigger.

Due to "sequential" delay, i.e., where one party and then the other cause different delays during separate time periods, the plaintiff did not complete its contract at MacDill Air Force Base in Florida on time. *See Sunshine Constr. & Eng'g Inc. v. United States* (2005). As a result, the federal government assessed liquidated damages against the plaintiff for the entire amount of the delay (105 days). The plaintiff filed suit against the federal government seeking, among other relief, remission of liquidated damages. Prior to trial, the federal government agreed that the plaintiff was entitled to remission of liquidated damages for 22 of the 105 days.

After the federal government's admission that it caused part of the delay, the Court of Federal Claims was faced with the issue of whether to apportion or completely void the liquidated damages for the remaining 83 days. The Court noted that there are two conflicting rules for liquidated damages due to sequential delay. One rule states that where sequential delay is caused by both parties, then courts should annul any liquidated damages provision contained in the contract. The other rule states that the party seeking remission of liquidated damages for sequential delay must clearly show how the responsibility for the total delay should be divided.

Citing language from the United States Supreme Court and the United States Court of Appeals for the Federal Circuit, the Court of Federal Claims decided to allocate the liquidated damages that were caused by the sequential delay rather than voiding them altogether. Accordingly, the Court ordered the federal government to remit liquidated damages for the conceded 22 days. However, the federal government was allowed to retain the liquidated damages for the remaining 83 days because the plaintiff was not able to prove that they were excusable, i.e., caused by delay on the part of the federal government.

As for future projects where both the federal government and contractor are responsible for separate instances of delay during different time periods in the project, contractors should not expect a "Get Out of Jail Free" card with respect to liquidated damages; rather, contractors must be prepared to clearly demonstrate days of excusable delay.

NOTE: WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY CONTACT ANY ATTORNEY LISTED ON PAGE 8 OF THIS NEWSLETTER.

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Bradley Arant Lawyer Activities:

February 24-27, 2005: Nick Gaede and **Mabry Rogers** attended The American College of Construction Lawyers ("ACCL") annual meeting in Tucson, Arizona. Nick was installed as President of the ACCL, which is an organization of 120 select lawyers from across the country dedicated to excellence in the specialized practice of construction law.

March 2005: Mabry Rogers has recently been appointed to serve on the Construction Advisory Committee to The CPR Dispute Resolution Institute ("CPR"). The Construction Advisory Committee consists of high profiled construction lawyers lending a collaborative hand to CPR in the development of its construction dispute resolution services. CPR is a non-profit organization engaged in the development and advocacy of alternative dispute resolution processes for commercially related disputes.

March 30, 2005: Patrick Darby, Arlan Lewis, David Pugh, Wally Sears, and **Sabra Wireman** presented a one-day seminar on Construction Insurance, Bonding and Liens. Topics that were addressed included: Insurance Coverage, Private and Government Projects Bond Claims, Bankruptcy Issues, and Mechanic's Liens.

March 30, 2005: Joel Brown and **Rob Campbell** addressed the Alabama Chapter of the Associated Builders and Contractors, advising them of proposed legislation concerning amendments to Alabama's statute of repose for licensed contractors.

April 7-9, 2005: Arlan Lewis and **Stanley Bynum** attended the ABA Forum on the Construction Industry's 2005 Annual Meeting, "Construction from the Owner's Perspective: It's My Party So I Will Choose the Music," in New Orleans, Louisiana.

April 22-23, 2005: Nick Gaede hosted the Board of Governors meeting for the American College of Construction Lawyers in Birmingham, Alabama.

April 27, 2005: Jim Archibald, Rhonda Caviedes, David Pugh and **Wally Sears** presented a one-day seminar on "Construction Management/Design-Build." Objectives of the seminar included: interpreting the design-build delivery system; understanding construction management; obtaining required licensing; and managing risk through insurance and bonding.

May 5, 2005: **Wally Sears** conducted a seminar in Montgomery, Alabama, with Ted Trauner of Trauner Consulting Services, Inc., on "Tricks, Traps and Ploys Used in Construction Scheduling in Alabama."

May 17, 2005: **Wally Sears** will conduct a seminar in London, England on construction contract issues for a client's international sales and project management personnel.

May 19, 2005: **Wally Sears** will participate in the Forbes International Superconference in London, England. He will present on "LNG Facilities – Challenges and Opportunities for the Owner and the Contractor in the International Market."

May 18-20, 2005: **Mabry Rogers** will attend the American Arbitration Association Board of Directors' Meeting in Dublin, Ireland.

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BRADLEY ARANT ROSE & WHITE LLP Third Quarter 2005

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Can Someone Sue You For Losing Your Own Stuff?

Sounds like a crazy question. In limited circumstances, however, the answer can be yes.

This issue is known as "spoliation of evidence." The issue was raised in the recent Seventh Circuit (federal appeals court supervising Illinois, Indiana, West Virginia, and Wisconsin) case of *J.S. Sweet Company v. Sika Chemical Corp.* just decided in the Spring of this year. *Sweet* involved a bridge repair project for the New Harmony, Indiana toll bridge. *Sweet* and its potential impact on owners and contractors will be discussed below after a general introduction to the concept of spoliation of evidence.

Spoliation of evidence issues historically arose between parties to a lawsuit. For example, an owner in a pending case might send out a document production request through its attorney for shop drawings only to learn that the contractor lost or destroyed them. In this sort of situation, most jurisdictions would not allow a separate claim or cause of action against the offending party, but there still were serious consequences. The most serious consequence was that the judge in the case could tell the jury that they were free to assume that the missing documents would have proven liability on the part of the contractor. As serious as this consequence was, the concept of spoliation still was rather well-defined in that it applied to parties in a lawsuit or to companies who should have known of a potential lawsuit.

The concept now has expanded to entities not involved in the lawsuit, or what we call third parties. Because third parties by definition are not part of a pending lawsuit and thus cannot be subject to some sort of judicial sanction, spoliation claims against them necessarily must involve a direct claim of some sort. Often, the scenario involves a party losing a case – which it contends it lost because evidence was lost or destroyed by a third party – who then brings a separate case after the first one is over against that entity that lost the alleged critical evidence.

The Alabama Supreme Court recognized such a claim in 2000 in the case of *Smith v. Atkinson*. This case is a good contrast to the *Sweet* case from Indiana which will be discussed next. In *Smith*, the plaintiffs were injured in a car wreck and sued the manufacturer of the minivan in which they were riding. Unfortunately for them, the insurance company for the driver of the other car obtained the minivan

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but allowed it to be destroyed before the plaintiffs could use it in their case. As a result of these (some would say) compelling facts, the Alabama Supreme Court created the tort of spoliation of evidence. In such a case, a plaintiff must prove that (1) the defendant losing the evidence knew of the initial lawsuit, (2) the defendant had a duty to preserve the evidence due to a voluntary undertaking, an agreement, or a specific request, and (3) the missing evidence was vital to the party's case in the previous lawsuit. Because the plaintiffs in *Smith* could prove all three elements, mainly because the plaintiffs made repeated requests to the insurance company to preserve the minivan, the court held in their favor. Damages available in a tort case such as *Smith* are, of course, often hard to define and open-ended, so a defendant in such a case may face a serious claim.

Turning to the *Sweet* case, a very different set of facts led to a different result. Plaintiff J.S. Sweet was the general contractor for the New Harmony toll bridge resurfacing project. The defendant Sika was the manufacturer of the surfacing product which allegedly failed on the New Harmony Bridge. As already explained is usually the case, there was a lawsuit prior to the spoliation case between J.S. Sweet and Sika. The first case was between the owner and J.S. Sweet over defects in the bridge work and the owner's refusal to pay. The second (spoliation) case alleged that defendant manufacturer Sika interfered with the earlier litigation by spoliating evidence.

At issue in *Sweet* was a report allegedly prepared by an employee of the manufacturer at the time the surfacing product began to fail. The report involved photographs, personal notes, and perhaps some analysis, but that was contested. The *Sweet* Court first noted that Indiana was in the minority of states (like Alabama) that recognize the independent tort of spoliation of evidence. The elements of the tort essentially are the same as they are in Alabama – there must have been a special duty of the defendant to the plaintiff for preserving the evidence and the plaintiff must have been damaged due to the defendant's exclusive possession of the evidence.

The plaintiff contractor Sweet lost its claim in the Indiana case because (1) there was no special duty to Sweet by the manufacturer Sika because (inexplicably) Sweet never had asked for the report previously and (2) Sweet could not show that Sika possessed the evidence exclusively. In other words, Sweet lost because it failed to put Sika on notice and it could have done (and did) its own investigation of the failing surfacing material. It is not difficult to see how the possessor of the minivan (the very thing at issue in the case) in Alabama was held liable, especially considering the notice given, and how the surfacing manufacturer in Indiana was not.

What are some good guidelines with regard to spoliation of evidence? First, if you have a document, or a computer file, or especially a piece of evidence that only you possess (a burned piece of equipment or other material) which potentially could be the center of a legal dispute, always be very careful how you handle that evidence. Second, if you are put on notice of a lawsuit or pending legal action, make sure that records are kept about when that notice is received. Third, if you are taking possession of a piece of evidence from a construction or accident site for someone else, make sure that you have a clear understanding of what the other party expects you to do with the evidence and follow that understanding explicitly. Finally, if you have (and you should have) a document retention and destruction policy or procedure, follow that carefully without deviation (bearing in mind that certain corporate fraud and employment laws, among others, have specific document destruction restrictions). Don't get sued for losing your own stuff.

Government Weighs In

In a 2005 case that addressed several issues that contractors commonly encounter in making claims against the Government – what is an acceptable schedule analysis, what weight should be given to industry studies of labor productivity loss, applicability of the *Eichleay* formula to delay claims, and whether delays between owner and contractor may be apportioned – the Court of Federal Claims has given considerable guidance to claimants in *Sunshine Constr. & Eng'g, Inc. v. United States*.

The first two issues that the court addressed remind practitioners of the importance in selecting an expert carefully, as the opinion specifically rejects the claimant's position based on the thoroughness and credibility of the Government's expert. First, the court compared the two schedule analyses before it – fragnets by the claimant and an as-built analysis by the Government – and found that claimant did not establish that the use of fragnets was a recognized method of CPM analysis. The court did find the as-built analysis to be persuasive and used it as a basis to determine the fourth issue mentioned above, which is whether and how to apportion delays when both parties are at fault in some measure. Second, the court discounted the credibility of the Mechanical Contractors' Association of America (MCAA) factors for proving labor productivity loss, contrary to several other courts that have found the factors persuasive when applied properly. The court placed particular importance on the disclaimer preceding the MCAA Bulletin, which notes that the factors are merely generalizations and that conditions will vary on each project.

Since the Government's schedule analysis conceded some compensable delays, the court faced a decision regarding how to price the damages for that delay. Plaintiff priced its delay claim using the *Eichleay* formula, which is a rough ratio of billings for a given project to all projects within a specified time, despite recent holdings by the government contracting boards and the Federal Circuit that a job must be shut down

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before an *Eichleay* calculation is appropriate. Finding that all or substantially all of the work was never shut down, the court denied compensation for the delays.

Lastly, the court confronted a split of authority regarding whether delays may be apportioned between parties, each of whom caused some delay on the project, to determine whether liquidated damages applied. Early cases held that delay by both parties would simply result in the annulment of the liquidated damages clause. However, following the more recent trend in the law, the court held that where the schedule analysis permitted specific findings regarding which party was responsible for which days of delay, apportionment was the sounder and more equitable result. Therefore, the court, using the as-built schedule analysis as its guide, apportioned delays between the parties and remitted a portion of the liquidated damages for which the Government had already withheld funds.

Liability For Design Defects

In many jurisdictions, contractors discharge their duties under the contract by performing their work in compliance with the drawings and specifications supplied by the owner. This familiar principle, embodied in the *Spearin* doctrine, was summarized by the United States Supreme Court in 1918, when it wrote, "if the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications." Although the Supreme Court's rule applies generally to federal contracts where the government has supplied design documents to the contractor, the *Spearin* doctrine has been adopted in most states.

However, this spring, the United States Court of Appeals for the Fifth Circuit, which hears appeals arising in Texas, Louisiana, and Mississippi, confirmed that, under Texas law, "in order for an owner to breach a contract by supplying inadequate plans to a contractor . . . the contract [must] evidence an intent to shift the burden of risk of inadequate plans to the owner." *Interstate Contracting Corporation v. City of Dallas Texas*, issued April 22, 2005. The Court interpreted a contractual provision between the parties, stating that the contractor has visited the site, examined local conditions, and informed itself by independent tests and investigations of the difficulties of performing the work to conclude that the parties "intended to place the burden of risk for inadequate plans on [the contractor]."

This recent appellate court case appears to be at odds with the *Spearin* doctrine, as confirmed by two recent Board of Contract Appeals decisions which addressed who is responsible for design defects when there is a requirement for the contractor to provide engineered shop drawings or to verify certain details of a government's design. In *Trataros Construction, Inc. v. General Services Administration*, (2001), the Government Board of Contract Appeals held that an agency could not use a requirement for engineered shop drawings to cure deficiencies in the government's design. Similarly, in *Edsall Constr. Co.* (2001), the government was not allowed to shift the risk of design defects to the contractor based on a drawing note requiring the contractor to verify certain structural details.

The impact of the appellate court's *Interstate Contracting* opinion on any other project depends on many factors, including the specific language of the contract at issue. For contracts governed by Texas law, a contractor may consider how this recent decision could affect it, and should consider clarifying the owner's responsibility for defective drawings. The appellate court case offers the following examples of clauses that may shift the risk of defective drawings to the owner, if that is what the parties want to do: (1) "The Contractor will be furnished additional instructions and detail drawings necessary to carry out the work in the contract;" and (2) "The Contractor shall not be liable to the Owner or the Architect for any damages resulting from any such errors, inconsistencies or omissions in the Contract Documents."

If you have any questions about this case, or projects you are currently working on or considering for bid, please contact your lawyer for assistance.

Violation of Building Code Does Not Constitute Negligence Per Se

In the recent *Parker Building Services Co. v. Lightsey* case, a case of first impression in Alabama, the Alabama Supreme Court found that a violation of a city building code did not constitute negligence per se. As a result, the contractor was entitled to a new trial.

In 2001, while at his older sister's softball practice, a five-year old boy was playing on an observation deck at a facility in Homewood, Alabama. The boy crawled under the guardrail of the deck and stepped onto an adjacent roof that covered a bathroom. The roof collapsed and the boy fell to the floor sustaining major injuries.

In 1999, two years earlier, the owner of the facility had hired Parker Building to complete some repair work in the same area where the boy fell. At the time of the repairs, Homewood had adopted an ordinance that required a permit for repair jobs, as well as an ordinance that adopted the 1991 version of the Standard Building Code. Parker Building, however, failed to obtain a permit. In addition, Parker Building failed to have an inspector inspect the finished project.

At trial, an inspector testified that he would have rejected the work if he had known that the building would be used for public assembly. The trial court charged the jury on negli-

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gence per se, rather than prima facie negligence. The jury awarded the plaintiff $8,000,000. Parker Building moved for a new trial, which was denied. Parker Building appealed and the Alabama Supreme Court reversed the case.

The doctrine of negligence per se is based upon the concept that when the legislature enacts a law, anyone who violates it, and causes injury to someone that the law sought to protect, is liable for negligence. Hence, proof of violation of the law is proof of negligence. To constitute negligence per se, however, the violation must meet four elements: 1) the law must have been enacted to protect a class of persons, of which the plaintiff is a member; 2) the injury must be of the type contemplated by the law; 3) the defendant must have violated the law; and 4) the defendant's violation must have proximately caused the injury.

In this case, the court found the purpose of the Building Code is to protect the public at large, and not a specific class of persons. Therefore, the first element was not met and the court determined that negligence per se is not applicable to violations of the Building Code. However, the court did not intend for this opinion to extend to violations of "other" building codes, with different express purposes.

Although a violation may not constitute negligence per se, all construction parties are strongly urged to review local building codes and make sure they are in compliance.

Owner Waives Written Change Order Requirement by Orally Directing Changes at Meetings

In *Spraungel Construction v. West Bloomington Motel, Inc.*, the Court of Appeals of Minnesota ruled that an owner waived a requirement that all change orders be written, by orally authorizing change orders in meetings with the general contractor/architect.

The agreement between the owner and the general contractor/architect contained a provision stating that the agreement could "be amended only by written instrument … signed by both the Owner and the Design/Builder."

When the general contractor/architect submitted its request for final payment, the total contract price included an additional $189,626 in change order work. The owner refused to pay this amount, citing the provision in the contract that required all change order work be made via a written request. The general contractor/architect contended that the owner had waived the written change order requirement through its course of conduct.

The Court of Appeals of Minnesota agreed with the general contractor/architect. The court noted that the owner had authorized and paid for some extra work—work not included in the $189,626—that was not supported by written change orders. Furthermore, the court noted that minutes of project meetings indicated that changed or extra work was regularly discussed and approved. The court also noted evidence of other work that was performed, and never supported by written change orders. Thus, the court concluded that the owner waived the written change order requirement through its course of conduct.

If your contract requires written change requests, by no means should you depend on oral authorization to proceed with change work. In this case, there was an extensive paper trail, and, thus, this case should be viewed as an exception rather than a rule. The case does suggest, however, that the party requiring written change requests should protect itself by insisting on signed written change requests—if the party does not do so, it could find itself paying for extra work that it never authorized and for which it never intended to pay.

District of Columbia Lien Law Overview

Today the District of Columbia's mechanic lien law is virtually the same as it was when it was first enacted by statute in 1901. Of the three D.C. Metro jurisdictions (Maryland, D.C., and Virginia), D.C. lien law is the least developed. Due to this under-development of the law, filing and enforcing a D.C. mechanic's lien law is considerably different from the two surrounding jurisdictions. As in Virginia, the D.C. mechanic's lien is "inchoate" and attaches at the commencement of work. As discussed below, enforcement of the lien, however, is dependent on properly executing the subsequent statutory steps outlined in the D.C. Code.

D.C. lien law extends to general contractors and subcontractors, but unlike Virginia and Maryland, the District's mechanic lien rights do not extend to sub-subcontractors who are not "directly employed" by the original contractor. Therefore, a sub-subcontractor's mechanic's lien rights are substantially limited.

Perfection:

Notice: As in most jurisdictions, there are no lien rights in D.C. without proper filing of a mechanic's lien. Under D.C. Code, a contractor availing himself of a lien shall file a "Notice of Intention" to lien the property with D.C.'s Recorder of Deeds during construction or within 90-days after the completion of construction.

Notice, among other things, must include: a copy of a valid residential home improvement contractor's license issued by the D.C. Department of Consumer and Regulatory Affairs (if the project is commercial, and not residential, then a copy of a general business license in lieu of the home improvement contractor's license is required), a certificate of good standing issued by D.C.'s Department of Consumer and Regulatory Affairs within the past two years (if applicable), and a certificate or statement of good standing from the D.C. Office of Tax and Revenue including the contractor's local

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and federal tax identification numbers. These requirements can be particularly perilous for the contractor filing a "last-minute" Notice before the statutory period expires because securing the required documentation can take several business days. Therefore, a contractor, who intends to file a Notice of Lien, should assemble the necessary paperwork well in advance of the statutory deadline.

Both a general contractor and subcontractor must include the above information in their Notice of Intention to lien. However, D.C. Code gives a subcontractor an additional responsibility that the general contractor does not have. Besides filing the Notice with D.C.'s Recorder of Deeds, the subcontractor must serve the same notice upon the owner of the property upon which the lien is claimed.

Timing: D.C.'s mechanic's lien law contains a "sunset" provision. Therefore, if a contractor fails to file its Notice of Lien within the 90-day statutory period the lien "shall be deemed to have been paid and satisfied without any action on the part of the owner." D.C. law in these regards is substantially different than Virginia law. Unlike Virginia, where the courts use the completion of the claimant's work, the District, courts use completion of the building as the accrual point for filing of notice. This is an important distinction which should not be overlooked by contractors performing work in both D.C. and Virginia.

Enforcement: After a lien is properly filed, D.C. Code provides that a proceeding to enforce a lien is begun by filing a "Bill in Equity" in the D.C. Courts. The bill in equity must set forth: (1) a brief statement of the contract, (2) the amount due on the contract, (3) the time when the notice of lien was filed with the Recorder of Deeds, (4) a copy of the notice if one was served on owner in the case of a subcontractor, (5) time when the building or work on the building was completed, (6) a description of the premises and material facts concerning the work provided, and (7) a request that the premises be sold and that the proceeds of the sale be applied to the satisfaction of the lien.

The statutory time limit of the Code requires that the suit be filed to enforce the mechanic's lien at any time within 180 days of having filed its Notice of Lien or from the completion of the building, improvement, or repairs. Similar to the Notice time period requirement, a contractor, who fails to enforce his lien within 180 days, will lose his lien rights.

Due to the underdeveloped nature of D.C. mechanic's lien law and the importance of timely notice and enforcement, a general contractor or subcontractor contemplating a mechanic's lien in D.C. as a remedy would be well advised to seek counsel from an attorney who is familiar with the intricacies of D.C. lien law.

Read Your Coverage Policies Carefully

In *Hilton Head Resort v. General Star Indemnity Co.*, a 2005 South Carolina case concerning the repair/ replacement of mansard roofs on two condominium buildings, the South Carolina federal district court held that because the roofs had not collapsed, the insurance policy would not cover the replacement of the roofs.

The mansard roofs in question were originally constructed when the buildings were built in approximately 1981. In 1997, the asphalt shingles originally laid down were covered with aluminum shingles. In 1999, hurricane Floyd blew some of the aluminum shingles off the roofs and damages others. Hilton Head filed a wind damage claim with General Star. However, it was noted that the roof decking wood was treated with a fire-retardant, which may have deteriorated the wood in the mansard roofs. Hilton Head notified General Star that it had suffered a covered loss to the covered property, i.e. the collapse of the mansard roofs, with proof by its expert that the roofs were in "imminent danger of collapse," which could occur "without delay."

The district court found that a policy covering risks of direct physical loss *involving* collapse would cover the threat of loss from collapse. However, the district court found that in this case, the General Star policy only covered direct physical loss or damage *caused by* collapse. Because it was undisputed that none of the mansards, or any part of them, suffered an actual collapse during the applicable policy period, the district court found that General Star had no duty under the insurance policy to provide coverage. The district court noted that at most, Hilton Head had mansard roofs with deteriorated wood, in "imminent danger of collapse," which at the time had not caused any direct loss or damage to any covered property. Therefore, the district court found that General Star could not be said to have acted in bad faith, did not breach the contract of insurance, and did not breach any covenant of good faith and fair dealing.

It is important for you to read all coverage policies carefully, with the help of an insurance professional.

Safety Obligation Runs to Inspectors Too

A Louisiana state appellate court has recently upheld a lower court's decision to award a government inspector $40,250 plus $9,717.87 to the State for damages incurred when the government inspector fell into hot asphalt while she was inspecting a road project.

An employee for the State of Louisiana was working as an inspector for the State Department of Transportation which had contracted with Boh Bros. Construction Co. to provide asphalt and repair services on I-10. When the inspector was preparing to inspect a piece of asphalt that had been laid by

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Boh Bros., a Boh Bros. employee picked up a string line, causing the inspector to trip and fall into the hot asphalt.

Although the court reviewed Boh Bros. argument that the inspector contributed to her fall by walking across an uncompacted area that had been rolled only once, the court found that the inspector fell as a result of being tripped by the string line when it was inadvertently raised by one of the Boh Bros. employees. Further, the court found that it was a breach of Boh Bros. safety procedures to lift a line without looking when other persons are in the area.

Ultimately, the appellate court upheld damages awarded to the government inspector in the amount of $40,250 for injuries sustained as a result of her fall. The appellate court also upheld an award to the State in the amount of the inspector's medical expenses.

Safety must always be a priority on the job site. However, if an accident does occur, government contractors may be liable not only to the person involved in the accident but to the government agency awarding the contract. Therefore, as the saying goes, "accidents happen," but accidents may be avoided with proper safety measures that are strictly enforced.

Exciting Development in Bradley Arant's National Construction Practice

We are pleased to announce the expansion of the Firm's Construction and Procurement Law Practice as six new lawyers, lead by Douglas Patin, have joined our Washington, D.C. office, effective August 1, 2005. The addition of these six new lawyers (three partners and three associates who practiced together at Washington's Spriggs & Hollingsworth) provides key support for regional clients in the nation's capital and expands the Firm's established multi-office strengths in construction law and government contracts.

Doug Patin's litigation work has involved the spectrum of traditional construction and government procurement, and his experience includes bid protests, contract disputes, builder's risk and liability insurance disputes, bond claims, and jury trials. Doug is joined by new partner Robert Symon, whose experience also includes government contracts and bid protests, and new partner Michael Koplan, whose experience includes insurance liability coverage and bond claims. Also joining the Washington, D.C. office are new associates Eric Frechtel, Christyne Brennan, and Katherine Ruff, who will further build upon the Firm's Construction and Procurement Law Practice, along with partner Jefferey Komarow, Donna Crowe, Chris Danley, and J. R. Steele, associates in the Firm's existing Washington, D.C. office.

In addition to these construction lawyers, we are also joined by new partner Stephen R. Spivack, whose practice focuses on white collar criminal defense and investigation, and new partner Edward J. Beder, Jr., whose practice focuses on antitrust and insurance. New associate Dan Golden will be working in the white collar criminal defense area..

The expansion of our Washington, D.C. office provides us another opportunity to serve your needs anywhere in the country, including the nation's capital. Effective August 1, 2005, the address for our Washington, D.C. office has changed to 1133 Connecticut Avenue, NW, 12th Floor, Washington, DC 20036. The new office numbers and e-mail addresses are on the last page of this Newsletter.

Bradley Arant Lawyer Activities:

June 2005: Nick Gaede taught a course on International Arbitration at the University of Fribourg in Switzerland.

August 11, 2005: Wally Sears will be conducting a seminar in Mobile, AL with Ted Trauner of Trauner Consulting Services, Inc., on "Tricks, Traps and Ploys Used in Construction Scheduling in Alabama."

September 25-30, 2005: Nick Gaede will be participating in a program at the Conference of the International Bar Association meeting in Prague on International Construction contracting and dispute resolution provisions.

September 28, 2005: Jim Archibald, John Hargrove, Arlan Lewis, Jeff Peters and **Sabra Wiremen** will present a one day seminar on "The Fundamentals of Construction Contracts: Understanding the Issues." Highlights of the seminar included basic contract principles, essential contract terms, model contract forms and clauses for different project delivery systems and dispute resolution.

September 29-30, 2005: Arlan Lewis will attend the ABA Forum on the Construction Industry's 2005 Annual Fall Meeting in Toronto, Canada.

September 2005: J.R. Steele authored an article which will be published in the next Alabama Construction News titled "Florida's 2005 Legislative Session Brings Changes to the State's Construction Laws." The article highlights important legislative changes impacting the construction industry in the state of Florida.

NOTE: WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY CONTACT ANY ATTORNEY LISTED ON PAGE 7 OF THIS NEWSLETTER.

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BRADLEY ARANT ROSE & WHITE LLP Fourth Quarter 2005

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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A Category 5 Challenge for the Construction Industry

The impact of recent hurricanes on the construction industry extends far beyond the areas that were actually hit by the storms. Construction costs have increased, due to increased fuel costs, construction material costs, and labor costs. A substantial amount of the country's supply of rubber and cement previously arrived from overseas suppliers through the damaged Port of New Orleans, resulting in cost increases and shortages in these important materials. Many small construction firms locked into fixed price contracts have experienced major financial problems when labor, material, and operating costs vastly exceeded the assumptions underlying their contract prices.

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In some cases, *force majeure* contract clauses offer some protection. *Force majeure* clauses excuse a contractor's performance when external unforeseen factors, such as weather, acts of God, war or political unrest render the contractor's performance impossible, or at least substantially different from what was expected when the contract was signed. Not all contracts have *force majeure* clauses, however, forcing some contractors to seek refuge behind the legal doctrines of impossibility of performance, frustration of purpose, or commercial impracticability. Like *force majeure*, these doctrines provide that, in rare cases, a contractor's performance may be excused where factors beyond the contractor's control make performance impossible or impractical.

It is important to recognize, however, that *force majeure* and commercial impossibility are far from iron-clad excuses to performance or bases for equitable adjustment. For example, in the famous 1966 case of *Transatlantic Financial Corp. v. Untied States*, a court refused to find that a shipping contractor was entitled to recover increased costs it incurred when its chosen shipping route, through the Suez Canal, was blocked by political unrest in the Middle East. Even though the shipping contractor showed that it incurred substantial costs above its contract price when it had to travel around the Cape of Good Hope, the court concluded that the existence of an alternative route defeated the contractor's claim based on the doctrine of impossibility.

Force majeure and commercial impossibility arguments can succeed in some cases, and we anticipate that many contractors and subcontractors have suffered hurricane-related impacts that are recoverable under these

theories. Nonetheless, the market volatility, shortages, and other impacts of the hurricanes continue. For that reason, contractors, subcontractors, and developers should consider inserting hurricane-specific force majeure clauses in their contracts. Such a clause should say something like this:

> The parties acknowledge that Hurricane Katrina may increase the cost of obtaining materials, equipment, insurance or energy for the Project. Contractor has attempted to include reasonable assumptions in its Price for the consequences of Hurricane Katrina, but it may not be possible to predict all of the consequences of Hurricane Katrina on the Contractor's Price at this time. Where the price of any category of material, equipment, insurance, or energy increases during the term of the contract due to unforeseen effects of Hurricane Katrina, the Contract Sum shall be increased by change order. Such price increases shall be documented by vendor quotes, invoices, catalogs, receipts or other documents of commercial use.

This clause recognizes the fact that, even though the hurricane has passed, the impacts of the hurricane are ongoing and, in many cases, still unknown. Particularly along the Gulf Coast, where many businesses have closed, the infrastructure remains in disarray, and labor, supplies, and materials are unavailable, a contractor, subcontractor, or developer probably cannot propose a fixed price without such a clause, unless the proposed price includes a significant amount of contingency to cover the risks and uncertainties of post-hurricane impacts. While it may be tempting for an owner to resist such a clause and force the contractor to propose a fixed price and assume the risk of post-hurricane impacts, that approach may be short-sighted. The owner may pay too much, based on a proposal overloaded with contingency, or, worse still, may enter a contract destined for performance problems and litigation. By working together, owners, contractors, subcontractors, and suppliers can overcome the challenges of the recent hurricane disasters and help rebuild the damaged regions under fair, reasonable contracts that recognize, and account for, the realities of post-hurricane construction.

Electronic Discovery Failures Can Lose Your Case

Completing an object lesson that began with a judge's sanctions for discovery misconduct, a Florida jury recently returned a $1.45 billion verdict against investment house Morgan Stanley. The plaintiffs alleged that Morgan Stanley was complicit with accounting fraud by Sunbeam Corp. that resulted in its bankruptcy. A key discovery sanction ruling by the trial court judge — reversing the burden of proof and creating a presumption of fraud — was pivotal in the outcome of the case.

As sometimes occurs in commercial litigation, the plaintiffs requested e-mails and electronic data. The judge ordered Morgan Stanley to produce data from its oldest backup tapes and to sign a certification that all relevant documents had been produced. With the knowledge that more than 1,400 magnetic backup tapes had not been searched, a Morgan Stanley employee signed the certification. Additional searching by Morgan Stanley revealed even more data that it had not produced, yet Morgan Stanley did not notify the plaintiff or withdraw its certification for eight months.

The trial judge found Morgan Stanley's conduct deliberate, knowing, and undertaken in bad faith. She imposed five different sanctions, the most significant of which was the shift of the burden of proof to Morgan Stanley to prove it did not commit fraud. The other sanctions permitted the jury to draw an adverse inference of guilt from the conduct, to read a "statement of conclusive facts" regarding the conduct to the jury at a time during the trial chosen by the plaintiffs, to permit argument that Morgan Stanley's actions constituted malice or evil intent for punitive damages, and to impose costs.

In her sanctions order, the judge found "electronic data are the modern-day equivalent of the paper trail." This is a lesson to all litigants. As soon as litigation is *initiated, threatened, or anticipated*, your company needs to have a plan in place to let all personnel know (1) not to destroy data, and (2) to identify the data and bring it to the attention of the person designated by the Company. Clients are well-advised to consider use of an electronic discovery vendor (the failure to hire a vendor was a significant factor in the judge's sanctions opinion), in conjunction with counsel, early in the life cycle of a matter to avoid outcome-controlling events like those described above.

Bid Strategy Fails

In complying with the public interest objective of providing the lowest responsive, responsible bid, bidders on public works must read the specifications carefully. One issue that often arises is whether each "type" of site management position must be filled by a separate individual. M.A. Mortenson Company read the Corps of Engineers' specification regarding the Contractor Quality Control (CQC) staff to allow Mortenson to use the subcontractors' mechanical and electrical engineers to fill the role of a "mechanical engineer" and "electrical engineer" under the Mortenson "CQC System Manager." During performance, the COE required Mortenson to hire the two staff persons, on its payroll, and Mortenson did so,

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by hiring the two engineers that the subcontractors had hired and receiving a credit from the subcontractors. Mortenson filed for a change order, alleging duplication of effort (because the subcontractors alleged each had to fill the CQC function separately now) and because Mortenson's costs were greater than the credit it had received.

The Contracting Officer reviewed the claim, agreed he had misread the requirements that the CQC staff be on Mortenson's payroll, but denied quantum, because the CQC requirement had never changed. The ASBCA (05-2 BCA para. 33,014 (6/27/05) affirmed the Contracting Officer's decision on quantum. Moreover, it stated that the Contracting Officer was wrong in concluding he had caused a change to the Contract, in that "whether there has been a change to the contract requirements is a question of law," and the Contracting Officer's decision was "inconsequential" as a result. The ASBCA concluded it was not a change, because the CQC staff is to "act as the government's advocate" vis-à-vis the subcontractors' work.

Sharpen your pencils for the next bid strategy!

Florida Restricts *Eichleay* Formula By Adopting Federal Rule Regarding Home Office Overhead Costs

In *Broward County v. Brooks Builders*, a Florida intermediate appellate court recently found a contractor was not entitled to *Eichleay* damages for unabsorbed home office overhead costs. In doing so, the court adopted the more restrictive federal rule recently decided in *P.J. Dick, Inc. v. Principi*.

In the case, Broward County hired the contractor to build a fire station adjacent to a runway at the Fort Lauderdale airport. Due to changes and security complications, the project ran over in time and budget. As a result, the contractor sued the county for damages. In addition to damages for delays and unpaid or underpaid work, the contractor sued for home office overhead costs, calculated with the *Eichleay* formula.

The *Eichleay* approach to calculating home office overhead is described as follows: "Home office overhead costs are those costs that are expended for the benefit of the whole business, which by their nature cannot be attributed or charged to any particular contract. They are fixed costs that are allocated on a pro-rata basis among various contracts. When the government delays or disrupts contract performance, the contractor's stream of income decreases while the fixed costs allocated to that contract continue. The *Eichleay* formula 'seeks to equitably determine allocation of unabsorbed overhead to allow fair compensation of a contractor for government delay….'"

In order to recover home office overhead damages with *Eichleay* calculation method, a contractor must, according to some courts, prove three elements: 1) a government-imposed delay; 2) the government required the contractor to "stand by" during the delay; and 3) while "standing by," the contractor was unable to take on additional work. Recently, the Federal Court of Appeals ruled that the suspension required to fulfill the "standby" requirement is as follows: *The contractor must show effective suspension of much, if not all, of the work on the contract.* The Florida District Court of Appeal adopted this clarification that restricts the *Eichleay* formula.

The contractor in the case lost on its *Eichleay* approach based on the facts. The principal of the contractor testified: "We kept working the best we could." In addition, the contractor's monthly invoices, submitted as a trial exhibit, suggested that work continued. Indeed, the amounts requested by the contractor remained constant and rarely varied. Based on the facts, the court found that the contractor was not suspended and that the *Eichleay* calculated damages should be subtracted from the final judgment.

If this case is followed in Florida, the lesson learned: in order to recover damages for unabsorbed home office overhead costs in Florida, a contractor must demonstrate effective suspension of all of the work, or at most, continued performance of only minimal parts of the contract. Of course, you should consult your lawyer to discuss other methods to capture this very real aspect of delay damages.

ABC's of Attorneys' Fees

Clients always ask about attorneys' fees – how much will they be, how are they calculated, and, most importantly, does the loser have to pay the winner's fees? Absent a contractual agreement or the application of a special statute, the answer normally is no in the United States. This is especially the case when the attorneys' fees arise from the primary dispute between the parties to the litigation.

There is an exception to this rule in some jurisdictions, however, especially when the attorneys' fees arise as a result of a dispute with a third party over an issue not central to the primary litigation. The legal theory is called "equitable indemnity" or often "the ABC rule."

A Washington intermediate appellate court recently had the opportunity to consider the ABC rule in *Blueberry Place Homeowners Association v. Northward Construction Co. v. McDonald-Miller Residential, Inc*. The *Blueberry Place* Court stated the rule as follows:

1. A commits a wrongful act toward B;

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2. A's wrongful act causes B to become involved in litigation with C; and
3. C was not connected with the initial transaction or event which gave rise to the wrongful act by A against B.

A simple example of the application of the ABC rule would be as follows: Contractor A contracts with Owner B to build out its tenant space. During the course of construction, Contractor A causes flooding and damage to tenant C's space below Owner B's space. C sues B for the damage. B would in turn sue Contractor A for the damage to the other tenant's space along with its attorneys' fees incurred. This would be allowable under equitable indemnity or the ABC rule.

All three elements of the ABC rule must be met for it to apply, however, and all three were not met in *Blueberry Place.* In that case, the owner sued the contractor for defective heating work which damaged the property along with several other claims. The contractor in turn sued the heating subcontractor and sought attorneys' fees for the defense of the case with the owner. Because other claims had been brought by the owner against the contractor not involving the heating sub, the appellate court disallowed the claim for attorneys' fees. Additionally, the *Blueberry Place* Court rejected the contractor's attempt to recover apportioned fees against the subcontractor (those only related to the damage caused by the heating work and not related to the other claims). The court said that all three of the elements of ABC rule must apply before any attorneys' fees could be sought.

In complex litigation involving multiple parties, always explore whether there are any routes to recover your attorneys' fees, particularly a "standard" indemnity clause in the applicable contract. In the right jurisdiction, the ABC rule might apply if all of the elements are met and if a non conventional contractual indemnity clause do not apply.

Statutory Trumps Contractual: Court Rules to Apply Statutory, Rather than Contractual, Interest Rates to Court-Ordered Return of Liquidated Damages

An intermediate Ohio appellate court recently held that deductions from payments to the contractor, taken as liquidated damages for construction delays, did not constitute "late payments" within the meaning of the contract provision establishing an interest rate on late payments. As a result, the statutory interest rate, rather than the specified contractual rate, applied to the court-ordered reimbursement of unwarranted liquidated damages.

In *Dugan & Meyers Construction Company, Inc. v. State of Ohio Department of Administrative Services*, the Ohio Department of Administrative Services and Ohio State University ("OSU") engaged Dugan & Meyers ("D & M") as lead contractor for the general-trades portion of the construction of three buildings on the OSU campus. Although the construction work progressed on schedule throughout the first year, significant work delays began shortly thereafter. Because it felt D & M failed to implement an acceptable plan to correct the delay problem, OSU assigned the construction manager to take over lead contractor responsibilities. After contract completion, OSU deducted the replacement costs from D & M's contract price, as well as liquidated damages for D & M's part in the project delay. In response, D & M brought action against OSU for breach of contract. The trial court awarded D & M the full balance of the contract price plus prejudgment interest at the statutory rate of ten percent per annum.

On appeal, OSU argued that the trial court erred in ordering them to pay prejudgment interest at the statutory rate of ten percent per annum when the general contract specified a particular method of interest calculation. The appeals court held that deductions from payments to the contractor, taken as liquidated damages, that were later determined to be unwarranted, are not subject to the contract's late payment interest provision, and therefore the statutory interest appropriately applied. The court opined that payment of a judgment awarding return of wrongfully assessed liquidated damages, "strains the definition of 'late payment'." As a result, contractual provisions establishing interest rates on late payments do not apply to judgments awarding the return of wrongfully assessed liquidated damages.

The finding in *Dugan & Meyers* suggests a factor to evaluate with your lawyer in deducting liquidated damages from a contract price, as it could end up costing more if forced to reimburse the amount deducted plus statutory interest rates, as distinguishes from contractual rates (which are sometimes as low as zero). Obviously, the ruling does not render contractual provisions completely inapplicable. The court specifically notes, "[t]he cardinal purpose for judicial examination of any written instrument is to ascertain and give effect to the intent of the parties." And "'[t]he intent of the parties to a contract is presumed to reside in the language they chose to employ in the agreement.'" A more comprehensive contractual provision, specifically pertaining to deductions from payments taken as liquidated damages, may prevent the application of higher statutory interest rates.

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Jury Decides that Subcontractor Had No Duty to Field Verify Site Conditions

In *Gillingham Construction, Inc. v. Newby-Wiggins Construction, Inc.,* the Supreme Court of Idaho recently held that a jury reasonably concluded that an excavation subcontractor had no duty to take field measurements or verify field conditions.

Gillingham was the excavation subcontractor to Newby-Wiggins on the construction of a state headquarters building in Boise, Idaho. When site excavation was 85% complete, Gillingham discovered that the existing site elevations were much higher than shown on the Drawings and Specifications. Gillingham reported the condition to Newby-Wiggins, and the work was stopped until the problem was resolved. As a result, Gillingham submitted a claim to Newby-Wiggins for delays and additional excavation costs.

The prime contract included AIA Document A201-1987, General Conditions of the Contract for Construction. Article 3.2 of the General Conditions required the prime contractor to "take field measurements and verify field conditions and . . . carefully compare such field measurements and conditions and other information known to the Contractor with the Contract Documents before commencing activities." The subcontract expressly excluded survey work, but it also contained a flow-down provision stating, "Subcontractor agrees in respect to the Work to be bound to Contractor by all the obligations set forth in the Prime Contract that the Contractor has assumed." Neither Newby-Wiggins nor Gillingham verified existing elevations prior to commencement of work.

After Newby-Wiggins denied the claim, Gillingham filed suit. Newby-Wiggins contended that Gillingham was responsible for verifying the elevation of the site before commencing work, and had it done so, the delays and additional excavation could have been avoided by a minor redesign. Gillingham contended that Newby-Wiggins was responsible for verifying the elevation of the site, and had it done so, the problem would have been addressed before Gillingham commenced work.

It was undisputed that Gillingham's subcontract excluded survey work. The trial court held that the terms "take field measurements" and "verify field conditions" of the AIA General Conditions were ambiguous and allowed the jury to hear evidence as to their meaning. The Architect testified that field verification required some form of survey work. A witness for the state testified that a survey of the entire site would not be required to verify field conditions. The matter was submitted to the jury and the jury reached a verdict in favor of Gillingham.

On appeal, the Idaho Supreme Court upheld the jury's findings. The flow-down provision of the subcontract incorporated only those duties under the Prime Contract that were related to Gillingham's scope of work. The jury could reasonably conclude from the evidence that the prime contract field verification requirement did not flow down to Gillingham because field verification required some form of survey work. The jury could reasonably conclude Gillingham was not required to conduct field measurements and that this duty fell solely on Newby-Wiggins.

The lesson here is that words crafted for a particular contract ordinarily govern over boilerplate language. General flow-down language such as that used in the Gillingham subcontract can be given broad effect, but there are some prime contract obligations that should be tailored to a separate, specific flow-down clause. An experienced lawyer familiar with construction contracts and subcontracts should review contract documents at the outset of most major construction projects.

Is Damage to Your Subcontractor's (or Supplier's) Work Covered Under a Commercial Liability Policy?

In *Limbach Company LLC v. Zurich American Insurance Company*, the federal appeals court supervising federal courts in Maryland, North Carolina, South Carolina, Virginia, and West Virginia recently held that a modified work exclusion did not limit recovery of damages to subcontractors' work when damages occurred after the insured had completed its work and the work had been placed into use. The policy at issue contained an exclusion for: "'Property damage' to 'your work' arising out of it or any part of it and included in the 'products-completed operations hazard'." The exclusion did not apply "if the damaged work or the work out of which the damage [arose] was performed on [the insured's] behalf by a subcontractor."

During performance of its work, the insured, Limbach Company LLC, removed a shipping bar from a steamline pipe, which weakened the pipe and caused a leak after the Owner put the pipe to its intended use. The leak damaged: (1) the excavation and backfill performed by Limbach's subcontractor, (2) the steamline pipe supplied to Limbach, and (3) landscaping performed by others who were not subcontractors to Limbach. Limbach also had to remove concrete, which was not installed by Limbach or its subcontractors, in order to excavate and replace the damaged backfill and replace the damaged pipe. Limbach sought coverage from its commercial liability carrier, Zurich American Insurance Company, for these damages. The

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trial court dismissed all elements of Limbach's claim, whether or not the damaged work was that of Limbach's subcontractors or third parties, on the basis that the damages sought by Limbach were not within the scope of coverage under the policy based on the "damage to your work" exclusion.

The appeals court reversed the trial court and held that the "your work" exclusion did not preclude coverage for Limbach's damages either because: (1) the damaged work fell within the "your work" exclusion's exception for work performed by a subcontractor, or (2) the damaged work was performed by third parties and therefore, the "your work" exclusion did not apply. Most significantly, the appeals court held that the supplier of the steamline pipe was a subcontractor for purposes of the "your work" exclusion. The court reviewed the supplier's role on the project and determined that it was distinguishable from that of an "ordinary" supplier. Since the steamline pipe supplier "custom manufactured the steam pipe in accordance with the shop drawings and project specifications, and . . . provided on-site installation instructions," the Court held that the steamline pipe was manufactured by a "subcontractor" for purposes of the "your work" exclusion. Therefore, Limbach's damages were covered under the commercial liability policy.

Whenever damage occurs to an insured's work on a project after it is completed or is put to use, the damage will likely be covered by a general contractor's insurance if it involves or arises from a subcontractor's or even a supplier's work. This exception to the "your work" exclusion provides significant coverage not otherwise available if the damage occurs during construction.

Bradley Arant Lawyer Activities:

August 15 – November 21, 2005: Wally Sears is teaching a course on Construction Law at the University of Alabama School of Law, Tuscaloosa, Alabama.

August 22 – November 21, 2005: Nick Gaede is teaching a course on Negotiations at the Cumberland School of Law, Birmingham, Alabama.

September 28, 2005: Jim Archibald, John Hargrove, Jonathan Head, Arlan Lewis, Jeff Peters, and **Sabra Wiremen** presented a one-day seminar on "The Fundamentals of Construction Contracts: Understanding the Issues." Highlights of the seminar included basic contract principles, essential contract terms, model contract forms and clauses for different project delivery systems, and dispute resolution.

September 29-30, 2005: Arlan Lewis attended the ABA Forum for the Construction Industry's 2005 Annual Fall Meeting in Toronto, Canada.

September 25-30, 2005: Nick Gaede attended the International Bar Association meeting in Prague and participated in a panel program on international construction contracting and dispute resolution provisions.

September 30-October 1, 2005: David Bashford attended the North Carolina/South Carolina Construction Law Sections' Biennial Meeting in Ashville, North Carolina.

November 4, 2005: Doug Patin participated as a panelist in a session on Ethical Issues Arising in the Construction Industry at the 26th Annual Seminar on Construction and Public Contract Law in Charlottesville, Virginia.

November 4, 2005: David Pugh spoke on "How to Ensure You Are Getting Paid" at the Associated Builders and Contractors meeting in Birmingham, Alabama.

November 7-10, 2005: Arlan Lewis will be attending the Construction Users Roundtable's 2005 National Conference of Construction Owners in Naples, Florida.

November 7-10, 2005: Doug Patin will speak at a session on "Contractor Default Claims" at the IRMI Construction Risk Conference in Las Vegas, Nevada.

December 8-9, 2005: Wally Sears will be chairing a session on "Construction Management: Can Anyone Really Manage Construction?" at The "Contractor and Construction Manager Issues" Superconference in San Francisco.

December 15, 2005: David Pugh will be speaking at a seminar on "Building Codes" in Mobile, Alabama.

January 25, 2006: David Pugh and Mabry Rogers will speak at a seminar on "Building Codes in Alabama" in Birmingham, Alabama.

January 26, 2006: Arlan Lewis will be attending the ABA Mid-Winter Forum in New York City.

NOTE: WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY CONTACT ANY ATTORNEY LISTED ON PAGE 7 OF THIS NEWSLETTER.

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BRADLEY ARANT ROSE & WHITE LLP First Quarter 2006

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Axel Bolvig, III
John D. Bond, III (c)
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Are Government Officials Still Presumed To Act In Good Faith?

In *Tecom, Inc. v. U.S.,* Tecom, which had a contract administered by the Air Force to service and maintain vehicles at an Air Force Base complex, sought to recover additional compensation on behalf of its subcontractor. Tecom claimed that the Air Force breached certain implied duties that accompany contractual agreements.

Tecom argued that the Air Force breached the implied duties (a) of cooperation, (b) not to hinder or interfere with performance, and (c) of good faith and fair dealing. The Court first resolved to identify the appropriate standard of proof, including whether Tecom was required to prove by "clear and convincing evidence" that the Air Force had acted in bad faith. Mindful of the government's argument that its officials are legally *presumed* to act in good faith, the Court devoted more than a third of its 37-page decision to a detailed review of the "presumptions of regularity and good faith conduct," from their genesis in English law through numerous precedential decisions by United States courts dating from 1816 through the present day. The Court's examination included a review of the familiar standard in government contract law that "well-nigh irrefragable proof" is necessary to overcome the presumption that government officials act in good faith. After commenting that the jurisprudence in this area "has persisted in its elusiveness[,]" the Court, "following" the Federal Circuit's decision in *Am-Pro Protective Agency, Inc. v. U.S.* announced that the following guidelines governed its consideration of Tecom's claims:

(1) "[W]hen a government official is accused of fraud or quasi-criminal wrongdoing in the exercise of his official duties, there is a strong presumption of good faith conduct that must be rebutted by clear and convincing evidence."

(2) "When a government official acts under a duty to employ discretion, granted formally by law, regulation, or contract, and a lack of good faith is alleged that does not sink to the level of fraud or quasi-criminal wrongdoing, clear and convincing evidence is not needed to rebut the presumption. Instead, this may be inferred from a lack of substantial evidence [supporting the official's action], gross error, or the like."

(3) "[W]hen the government actions that are alleged are not formal, discretionary decisions, but instead the actions that might be taken by any party to a contract, the presumption of good faith has no application."

Turning to Tecom's claims, the Court noted that proof of fraud, quasi-criminal wrongdoing, "or even bad intent" historically is *not* required to establish breach of duty of good faith and fair dealing. The court stated that "[a]lthough this

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duty is stated in terms of 'good faith,' proof of bad intent does not appear to be required in order for a breach to be found." Accordingly, the presumption of good faith did *not* apply to Tecom's claims, and Tecom was required to prove breach only by the traditional "preponderance of the evidence" standard, not the higher standard of "clear and convincing evidence." Ultimately, the Court denied Tecom's motion and the government's cross-motion for summary judgment, finding a genuine factual dispute as to whether the government had breached its implied duties.

The *Tecom* decision, issued by the Court of Federal Claims, is *not* binding on any federal or state court, or even the Court of Federal Claims itself. It will be interesting to see whether trial courts in the future agree that the good faith presumption afforded government officials does not apply in ordinary breach cases. Further, it remains to be seen whether the U.S. Supreme Court or, more likely, the Federal Circuit – whose decisions *are* binding on the Court of Federal Claims – reacts to the *Tecom* Court's interpretation of *Am-Pro*, where the federal circuit affirmed the dismissal of the contractor's claims when the contractor failed to prove by "clear and convincing evidence" that the contracting officer breached his duty. Thus, unlike *Am-Pro, Tecom* held that the presumption of good faith is inapplicable to alleged breaches of the government's implied duty of good faith and fair dealing. With this possible split of authority, we will continue to closely watch any new developments!

More Condo Work on the Coast: "Condo Conversions"

For those of you who have done condominium work on the Gulf Coast, you already know it has been booming. There is plenty of repair and renovation work to be done to address the effects of back-to-back highly destructive hurricane seasons. In addition, there is much new construction. Adding to the mix of "traditional" condominium work, however, is a dramatic increase in condominium conversion projects.

In a condominium conversion, an existing complex is converted from its past use into the condominium form of ownership. Quite often, these conversions involve buildings in which space was previously available for rent such as an existing apartment building. Some news reports indicate that literally thousands of former apartment rental units were converted to condominiums in Florida last year. To protect the rights of those affected – primarily the existing residential tenants – the State of Florida has passed legislation known as the "Roth Act" which sets forth guidelines for performing a condo conversion.

If an owner/developer intends to perform a condo conversion in Florida, one of the first things which must be done pursuant to the Roth Act, is to provide notice of the intended conversion to all existing tenants. The Notice must first be drafted and submitted for approval to the Division of Florida Land Sales, Condominiums, and Mobile Homes. At a minimum, the notice must declare the intended conversion, identify the developer and inform the tenant of his rights to extend the lease or purchase a unit.

Under the Roth Act, tenants who have lived in the apartment unit to be converted continuously for at least the 180 days prior to the notice, have a right of first refusal to purchase the converted unit. Such a tenant must receive a written offer to purchase within 90 days after the notice of the intended conversion, which offer shall remain open for 45 days after receipt. Even afterwards, should the developer change the terms of purchase at any time, the offer must be made again to the former tenant under the revised terms. The renewed offer must remain open for another 10 days.

Primarily because condo conversions do not involve new construction, the requirements of the Roth Act place a high burden on developers to investigate and disclose the conditions of the existing building to any potential purchaser. For example, the date and type of the original construction, the prior uses of the building and whether any termite damage and/or infestation have been detected must be disclosed. In addition, various components and/or systems of the building must be described and detailed including the age, estimated remaining useful life, estimated current replacement cost and structural soundness. The disclosures must be certified by an architect or engineer. Furthermore, the developer must establish certain reserve accounts for deferred maintenance items or, alternatively, give warranties or post a surety bond with respect to the continued viability of certain systems.

The dramatic increase in popularity of the condo conversion project should continue to add to the backlog of potential work for contractors on the Florida coast. However, owners, developers, designers and contractors who are involved in the process should be aware of the Roth Act and make sure they have fully complied with its provisions before proceeding with a condo conversion.

For A Forum Selection Clause to be Effective, Careful Consideration Must Be Given to its Wording

In *American Soda, LLP v. U.S. Wastewater Group*, the Tenth Circuit Court of Appeals (the federal court supervising trial courts in Colorado, Kansas, New Mexico, Oklahoma, Utah, and Wyoming) recently held that the forum selection clause in a contract was binding on the parties to the contract, and that the courts of the state specified in the clause were the exclusive forum for the adjudication of disputes arising out of the contract. The holding was based on the specific wording of the forum selection clause at issue, and the decision warrants careful analysis because the difference of just a few words might have resulted in a contrary outcome.

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The case involved a breach of contract action. In the contract between the parties, there was a forum selection clause that read:

> *Both Contractor and Company hereby submit to the jurisdiction of the Courts of the State of Colorado and agree that the Courts of the State of Colorado/Arbitrator shall be the exclusive forum for the resolution of any disputes related to or arising out of this Term Agreement.*

The plaintiff filed suit in state court. The defendant thereafter removed the action to a federal court. The federal court on a motion by the plaintiff, sent the case back to state court, holding that the language present in the forum selection clause "unequivocally and exclusively designated any court of the State of Colorado for the resolution of disputes arising out of the contract," and did not allow for the case to be adjudicated in federal court.

On appeal, the defendant argued that the federal court's order remanding the case to state court was erroneous. The defendant based its argument on two points: (1) that the language of the forum clause specifying "Courts of the State of Colorado" could include the federal court sitting in Colorado; and (2) that the forum selection clause was permissive rather than mandatory. The federal court of appeals rejected both of the defendant's arguments.

In regards to the first argument, the appellate court agreed with the federal court's holding that "the federal court located in Colorado is not a court of the State of Colorado but rather a court of the United States of America." In so holding, the court also relied on a Fifth Circuit Court of Appeals (the federal court supervising courts in Texas, Mississippi, and Louisiana) decision interpreting a similar provision. The provision at issue in that case referred to the "Courts of Texas," whereby the Fifth District court interpreted that phrase as referring exclusively to Texas state courts.

On the defendant's second argument, that the forum selection clause was permissive rather than mandatory, the court noted that there were only two situations in which it would interpret a forum selection clause to be mandatory: (1) "when venue is specified and the designation is accompanied by mandatory or obligatory language; and (2) when a jurisdiction is specified and the clause contains language indicating the parties' intent to make venue exclusive, which applied to the clause agreed upon by the parties in this case.

There are two important lessons to be taken from this decision. First, when evaluating a forum selection clause in a contract, examine whether the language speaks of submitting to the jurisdiction of the courts "of" a state or "in" a state. If the clause refers to the parties' submitting to the jurisdiction to the courts "of" a certain state, it will likely be interpreted as referring specifically to state level courts. Consequently, a party would likely be unable to have the action adjudicated in the federal court system, if the opposing party prefers to be heard in the state court. Secondly, a forum selection clause will likely be construed as mandatory if (1) a specific venue is specified (such as a particular county or tribunal) and the specification is accompanied by mandatory or obligatory language; or (2) only a jurisdiction is specified (example- "the courts of the state of Colorado") and there is some additional language indicating the parties' intent to make venue exclusive.

The drafting of a forum selection clause must be done with caution and attention to detail. Careful selection of the language used can result in an opposing party being bound to the drafter's chosen forum. Alternatively, ambiguous or indefinite language can render the clause ineffective for its desired purpose.

Subcontractor Attempts to 'Get Around' a Pay-if-Paid Clause—Gets Slapped With Punitive Damages

In *Environmental Energy Partners, Inc. v. Siemens Building Technologies, Inc.,* EEP served as general contractor on an energy management project for a hospital ("the hospital"). EEP subcontracted with Siemens for Siemens to perform the last phase of the work on the project. The subcontract between EEP and Siemens contained a provision stating: "No payment due [Siemens] unless [EEP] receives payment [from the hospital]."

Siemens fell behind on the project, and the Missouri court noted that it was the only subcontractor that failed to complete its part of the project on time. The court also noted that, "[t]hroughout the project, Siemens failed to provide the documentation required, including backup detail that would support invoices submitted." As a result of this and other deficiencies in Siemens's performance, the hospital elected to withhold the final payment to EEP until Siemens completed its work.

Siemens filed suit against the hospital and EEP. Before trial, EEP learned that the hospital and Siemens had entered into a settlement agreement, whereby the hospital agreed to pay Siemens the sum of $148,475, which was the amount the hospital had been withholding from EEP under its contract with EEP. The settlement agreement also contained a provision whereby Siemens and the hospital agreed to keep the terms and conditions of the agreement confidential.

The trial court rendered judgment in favor of EEP and against Siemens, and the trial court also awarded EEP punitive damages. The Missouri Court of Appeals upheld the trial court's award of punitive damages. The court noted that Siemens failed to complete its work on schedule, ceased communicating with EEP during the course of the project, and failed to provide necessary information to EEP. The court also noted that Siemens negotiated an agreement with the

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hospital that resulted in Siemens receiving funds that, by contract, were owed EEP, and that Siemens kept this agreement confidential. Ultimately the Missouri Court of Appeals held that "Siemens' conduct imposed unwarranted obligations and harm upon EEP that went beyond concrete damages compensatory awards could address. Punitive damages were appropriate in these circumstances to deter such conduct in future business affairs and for purposes of retribution."

It is impossible to know whether another jurisdiction would uphold an award of punitive damages under the same or similar facts. However, the case serves as a warning that subcontractors should not attempt to get around "pay-if-paid" or "pay-when-paid" clauses by secretly seeking payment directly from an owner, because courts may not look favorably on this type of conduct.

"But You Knew What Was Going On!"

In the recent case of *D.W.H. Painting Company, Inc. v. D.W. Ward Construction Company*, the Court of Appeals of North Carolina reaffirmed the potentially harsh rule that general knowledge expressed at weekly progress meetings concerning the existence of ongoing injury – whether losses, extra costs or delay – may not be sufficient notice to preserve a contractor's right to bring a later claim for recovery. The opinion, however, left open the possibility of significant exceptions that might save an injured contractor's claim.

D.W. Ward, a prime contractor on a multi-prime public project in North Carolina, sought recovery from other prime contractors for damages to the work of D.W. Ward's painting subcontractor, allegedly caused by those other prime contractors pursuant to North Carolina law, allowing for prime contractors on a public construction project to be held directly liable for damages incurred by the other prime contractors despite lack of contractual privity.

According to the evidence at trial, the damage at issue was discovered by D.W. Ward's subcontractor in March 2001. Between April and June 2001, the damage was repaired, and the subcontractor invoiced D.W. Ward for the additional work. In August 2001, at D.W. Ward's request and insistence, the State's project designer sent letters to the other prime contractors informing them of the damage and requesting contribution for payment of the subcontractor's invoices for the repair work. The trial court found that D.W. Ward failed to provide "timely and effective notice" of the damage at issue pursuant to the interpretation of certain standard-form language in all prime contractors' contracts with the State: The right to seek damages is conditioned upon the provision of "timely and effective notice" adequate to "enable the contractor allegedly responsible for [the] damage an opportunity to inspect the damage and to reach a prompt and equitable settlement or resolution with the prime contractor whose work was damaged."

In part, D.W. Ward contended that the other prime contractors had received sufficient notice of their responsibility for the damages at issue through discussions at several weekly progress meetings. In addressing D.W. Ward's contention, the Court of Appeals restated the rule on State construction projects in North Carolina that "notice provided in weekly project meeting is sufficient only where an aggrieved contractor gives 'written or verbal notice of potential claims [or] … notice that it is suffering economic harm.'" According to the Court of Appeals, non-specific statements and discussions at weekly project meetings regarding damages generally on the project are not sufficient notice to preserve a prime contractor's subsequent right to seek recovery. Hence, had the contractor timely given non-written, but specific, notice of its "suffering economic harm" and intention to assert "potential claims" for economic damages, the Court of Appeals might have deemed the notice "sufficient" and allowed the action to proceed.

The advisable action for any contractor incurring loss, extra costs or delay on a construction project is to comply with contractual notice requirements. Although seeking to avoid conflict, confrontation or criticism, especially early in a project, by remaining ambiguous about the cause or existence of injury is natural, subsequently pointing to equivocal and/or vague statements made during meetings on the project may not convince an adjudicator to grant relief from the harsh bar of recovery for notice failure. However, if an injured contractor gives specific and unequivocal notice, whether orally or in writing, of its "suffering economic harm" and its intention to assert "potential claims" for economic damages, courts (including those in North Carolina) may allow the contractor to bring a subsequent action asserting such claims, despite technical non-compliance with contractual notice requirements.

Contracting "Around" the FAA

Despite the convenience and (sometimes) cost-savings of arbitration, many clients continue to be frustrated by the lack of judicial review available of arbitral awards, particularly those that give no rationale at all for their conclusions. Federal courts have been loathe to grant any relief, commonly declaring that they have neither the time nor the inclination to revisit the merits of arbitrated cases. Against this backdrop, a recent First Circuit U. S. Court of Appeals (the federal court supervising trial courts in Maine, Massachusetts, New Hampshire, Puerto Rico, and Rhode Island) case considered whether and how parties may contract for a different standard of judicial review of an arbitration award.

The ordinary standard of review for an arbitral award under the Federal Arbitration Act ("FAA") is limited to circumstances of fraud, evidence of partiality or bias, exceeding of an arbitrator's powers, or manifest disregard of the law. The last ground, while seeming to provide some

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hope for parties when there is a legal error, has largely proved fruitless. Because arbitration is a creature of contract, parties may try to contract for a different standard of review if they choose, and the First Circuit agreed with this choice. However, the party complaining about the arbitral award claimed that a simple choice of law clause that made the parties subject to Puerto Rican law was sufficient to displace the FAA's limited standard of review. The First Circuit disagreed, noting the conflict between the federal policy of favoring arbitrability and contracting parties' ability to write their own agreements, and held that "the mere inclusion of a generic choice of law clause within the arbitration agreement is not sufficient to require the application of state law concerning the scope of review, since there is a strong federal policy requiring limited review." The court summarized its holding as follows: "We hold that the judicial review provisions of the FAA can be displaced only by explicit contractual language evidencing the parties' clear intent to subject the arbitration award to a different standard of review."

Readers may be familiar with other "clear statement" tests enunciated by the United States Supreme Court and other courts, which do not settle disputes but simply spawn further disputes about how "clear" the "clear statement" made has to be. For that reason, this decision is likely to settle very little on the underlying important question of whether arbitrators' legal errors are reviewable. Arbitration in the construction industry was originally adopted to obtain speedy, efficient decisions from knowledgeable arbitrators. If that is the goal for you and your company – and it is a goal increasingly difficult to achieve in the current arbitration environment – then broad judicial review may be seen as inimical to that goal. If, on the other hand, you believe that judicial review provides a "safe harbor" from a miscarriage of justice, and if you believe that broad judicial review is an even safer harbor, then you and your legal advisor should study the implications of *Puerto Rico Telephone Co., Inc. v. U.S. Phone Man. Co.* (the case under review) to craft language that would broaden the narrow judicial review provided for under the FAA or under most state statutes. Our advice is that parties drafting their arbitration agreements give careful consideration to whether they desire a reasoned award from an arbitrator and whether it is sensible to contract for full review of legal errors, perhaps maintaining a bar against the review of factual disputes.

Owner Faces Double Payment Where Construction Management Firm Failed to Forward Payments to Subcontractors

Is it possible for an owner to be held liable to subcontractors who performed work on its job when the owner has already paid its construction manager (who kept the money and filed for bankruptcy)? The Mississippi Supreme Court addressed this issue in the recent case of *Aladdin Construction Co. v. John Hancock Life Insurance Co.*, and held an owner could be held liable (twice) under certain circumstances. The owner in the case, John Hancock Life Insurance Company, entered into an agreement with McMo, Inc. to provide project management services (e.g., solicit and analyze bids, negotiate agreements, route payments to the subcontractors, generally oversee the construction process) in the construction of a shopping mall. McMo entered into contracts with the subcontractors, to which the owner was not a named party, but failed to forward the owner's payments to the subcontractors. When McMo filed for bankruptcy, the unpaid subcontractors looked to the owner for payment.

The owner argued that McMo was acting as a general contractor, not its agent, and, pursuant to Mississippi law, the subcontractors' failure to file a stop-payment notice barred their recovery. The court defined "general contractor" as "the party to the building contract who is charged with the total construction and who enters into sub-contracts for such work as electrical, plumbing and the like." It also noted that courts have defined "construction manager" as an owner's agent who hires in his principal's name. The court stated that the actions or agreements of the parties, and ultimately their intent, are determinative. The evidence showed that it was possible McMo acted as the owner's agent despite the owner not being a party to the contracts with the subcontractors and the construction management contract not stating McMo was acting as the owner's agent. Such evidence included the fact that 1) the owner controlled the manner of payment to the plaintiffs, per the contract between owner and McMo; 2) the owner's complaint filed against McMo in Florida stated the owner "entrusted" the payments to McMo, which were made out to McMo, much like an escrow agreement; 3) the payments to McMo for services performed were separated from payments to the plaintiffs; and 4) McMo sought no profit from the construction itself, unlike a general contractor who seeks to make a profit from the actual construction.

Even if the subcontractors did not prove McMo was the owner's agent, however, the court stated the subcontractors could recover for breach of contract if they proved they were third-party beneficiaries to the contract. A non-party to a contract (in this case, the subcontractors) may enforce a contractual provision if the parties to the contract made such a provision for the primary benefit of the non-party. The evidence showed that provisions within McMo's agreement with the owner directly named the subcontractors and set forth the owner's obligation to pay the subcontractors through McMo.

Therefore, if the subcontractors could prove at trial that McMo acted as the owner's agent *or* that they were third-party beneficiaries to the construction management contract, the owner's payments to McMo did not satisfy its debt to the

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subcontractors, and the subcontractors could recover payment directly from the owner.

Owners who enter into construction management agreements should be mindful of the implications of this decision. An owner may pay twice if a court finds the construction manager acted as the owner's agent, and the manager fails to forward the payments to the subcontractors. Courts analyzing whether an agency relationship exists look to both words and actions. Thus, owners who wish to avoid such a situation should draft their construction management contracts in a way that makes clear the intention that the construction managers are not acting as the owners' agents and not maintaining control over the payment process as the owner did in this case.

Bradley Arant Lawyer Activities:

November 4, 2005: Doug Patin participated as a panelist in a session on "Ethical Issues Arising in the Construction Industry" at the 26th Annual Seminar on Construction and Public Contract Law in Charlottesville, Virginia.

November 4, 2005: Axel Bolvig presented a seminar on the topic "How to Assure You Get Paid" to the Associated Builders & Contractors, Inc., Alabama Chapter.

November 7-10, 2005: Arlan Lewis attended the Construction Users Roundtable's 2005 National Conference of Construction Owners in Naples, Florida.

November 9, 2005: Doug Patin presented a session on "Contractor Default Claims" at the IRMI Construction Risk Conference in Las Vegas, Nevada.

December 4, 2005: Doug Patin, Mike Koplan, and Bob Symon presented a seminar on "Risk Management" for project managers in Arlington, Virginia.

December 8-9, 2005: Wally Sears chaired a session on "Construction Management: Can Anyone Really Manage Construction?" at the "Contractor and Construction Manager Issues" Superconference in San Francisco. **John Bond, Colin Stockton, and Sabra Wiremen** also attended the Superconference.

December 15, 2005: David Pugh presented a seminar on "Building Codes" in Mobile, Alabama.

January 17, 2006: Mabry Rogers presented an in-house seminar for a client regarding FAR compliance.

January 25, 2006: David Pugh presented a seminar on "Building Codes" in Birmingham, Alabama.

January 26, 2006: Rhonda Andreen, Stanley Bynum, Donna Crowe, Eric Frechtel, Arlan Lewis, and David Owen attended the ABA Forum on the Construction Industry's Midwinter Meeting, "Expecting the Unexpected: Anticipating and Managing Key Risks to Successful Projects," in New York City.

January 27, 2006: Stanley Bynum, Donna Crowe, Eric Frechtel, and Arlan Lewis attended the ABA/TIPS Fidelity and Surety 2006 Annual Midwinter Meeting in New York City.

February 26, 2006: Nick Gaede will preside as President of the annual meeting of the American College of Construction Lawyers, on Sanibel Island, Florida.

March 16, 2006: Jim Archibald, Patrick Darby, Arlan Lewis, David Pugh, and Sabra Wireman will present a seminar on "Construction Insurance, Bonding and Liens in Alabama," in Birmingham, Alabama.

2006: Axel Bolvig will serve as a member of the 2006 General-Subcontractor Committee of Associated Builders & Contractors, Inc., Alabama Chapter.

2006: Joel Brown and Rob Campbell will serve as members of the 2006 Legislative Committee of Associated Builders & Contractors, Inc., Alabama Chapter. **Joel Brown** also will continue to serve as a member of the Education Committee of the ABC Alabama Chapter.

2006: Rob Campbell will serve as member of the Legislative Committee and **Joel Brown** will serve as a member of the Small Business Committee of the Business Council of Alabama.

NOTE: WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY CONTACT ANY ATTORNEY LISTED ON PAGE 7 OF THIS NEWSLETTER.

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The lawyers at Bradley Arant Rose & White LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

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BRADLEY ARANT ROSE & WHITE LLP Second Quarter 2006

CONSTRUCTION AND PROCUREMENT LAW NEWS

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Courts' Review of Arbitration Awards For Manifest Disregard of the Law Varies

A spate of recent cases shows that the ability to obtain meaningful review of an arbitration award for manifest disregard of the law may depend disproportionately on the location of the arbitration and the federal circuit in which the award will be enforced. The Seventh Circuit Court of Appeals (supervising trial courts in Indiana, Illinois, and Wisconsin) and the Eleventh Circuit Court of Appeals (supervising trial courts in Alabama, Florida, and Georgia) have taken very aggressive positions in opposition to any substantive review of arbitration awards unless an arbitrator unequivocally announces the intention to disregard the law. The Fourth Circuit Court of Appeals (supervising trial courts in North Carolina, South Carolina, Virginia, and West Virginia) and the Fifth Circuit Court of Appeals (supervising trial courts in Louisiana, Mississippi, and Texas), however, scrutinize contract cases much more closely and have recently set aside arbitration awards for arbitrators' failure to follow clear contractual mandates. There appears to be a sufficient split in the federal circuits to indicate the need for clarification by the U.S. Supreme Court.

Manifest disregard of the law is not one of the enumerated grounds for vacating an arbitration award in the Federal Arbitration Act. The U.S. Supreme Court created the doctrine of manifest disregard of the law over forty years ago without explicitly marking out its boundaries, leading to considerable litigation over the details. Since there are other grounds for vacating an award for procedural irregularity, manifest disregard unquestionably has at its core a substantive component, *i.e.*, some review of the merits of the case. This idea is very troublesome to some judges, in light of the federal policies favoring arbitration and the limited judicial review of arbitration awards. The doctrine immediately raises questions in construction cases about whether a contract itself is the law to be disregarded.

The following cases provide a glimpse of how confused and confusing the jurisprudence on this issue is in the various federal circuits. *Patten v. Signator Ins. Agency* (4th Cir. March 13, 2006) (reversing the district court's decision to affirm an arbitration award because the arbitrator's award did not "draw its essence" from the parties' contract); *CUNA Mut. Ins. Soc'y v. Int'l Union 39* (7th Cir. March 16, 2006) (awarding sanctions for challenging award; stating challenge can succeed "only when the arbitrator must have based his award on some body of thought, or feeling, or policy, or law that is outside the contract."); *B.L. Harbert International, LLC v. Hercules Steel Company* (11th Cir. Feb. 28, 2006) (affirming award and establishing rule requiring express arbitrator statement regarding intent to disregard law; rule existed in previous concurring opinion only); *Cytyc Corp. v. Deka*

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Prods., LP (1st Cir. March 01, 2006) (affirming award, but writing that if "the panel neglected to offer any interpretation of the text" of the contract or its interpretation were "unfounded in reason and fact," vacation would be an appropriate remedy); *Spero Elec. Corp. v. Int'l Bhd. of Elec. Workers* (6th Cir. February 28, 2006) (award vacated when it conflicted with the written collective bargaining agreement).

With the proliferation of arbitration clauses in commercial and consumer contracts, it is not surprising that this issue is being litigated frequently. Parties should know before they enter into an arbitration agreement whether their federal circuit allows substantive review or not, in order to ensure finality or the possibility of review, as desired.

Owners Beware: Allowing Contractor to Continue Without Setting New Deadline Waives Completion Deadline and Liquidated Damages Are Lost

In *RDP Royal Palm Hotel, L.P. v. Clark Construction*, the U.S. Court of Appeals for the Eleventh Circuit (supervising trial courts in Alabama, Florida, and Georgia) ruled that an owner waived the completion date by allowing construction to continue and not setting a new date. The end result was the loss of the owner's right to assess liquidated damages.

The case arose out of a multi-million dollar construction project. The owner entered into a Guaranteed Maximum Price ("GMP") contract with the general contractor for the construction of a resort hotel in Miami Beach. The contract allowed 518 calendar days for substantial completion and the owner had a right to liquidated damages if the project was late. The contract also allowed for change orders, where the GMP and substantial completion deadline would be adjusted accordingly.

Throughout the course of the project, the contractor encountered numerous problems. For example, the contractor found a buried sea wall and contaminated soil. The owner also decided that the existing hotel, which was to be renovated, was too deteriorated and had to be demolished and completely reconstructed. Needless to say, as a result, the owner issued hundreds of change orders. The contractor requested numerous time extensions and increases to the GMP. However, despite the owner's assurances, the parties never resolved the time and money issues.

The substantial completion deadline came and went. Construction continued. The owner issued more change orders and the contractor continued to work based on those changes. The owner accepted the contractor's continued performance and made payments. The owner did not set a new deadline. Eventually, when the owner stopped making payments, the contractor ceased its work. The owner hired another contractor to complete the project.

The owner and contractor sued each other. The owner asserted that the contractor caused a two year delay to the completion date. The owner sought liquidated damages. However, the trial court found that the owner waived the completion deadline by accepting the contractor's continued performance. The court ruled that in the absence of a new deadline, the owner was not entitled to recover liquidated damages.

The federal appeals court affirmed the ruling that rejected the owner's argument. The court opined: "[The owner] allowed the substantial completion date … to pass without setting a new deadline and continued issuing change orders … requiring [the contractor] to perform additional work. [The owner's] conduct … constituted waiver of the 'time is of the essence' provision in the contract. In addition, [the owner] failed to set a new substantial completion date, thus it failed to reserve its right to enforce the liquidated damages provision …."

The lesson learned: an owner cannot rely on a completion date and later cry "foul" when the date is not met, if it supported continued performance and actually issued changes after the expiration of the date. More importantly, in order to preserve the right to liquidated damages, an owner is encouraged to reset the completion date if it allows the contractor to continue working.

Supreme Court of Alabama Holds That an Exclusive Venue Clause and Arbitration Clause Did Not Conflict

In a case involving a dispute over specially-fabricated pressure vessels, the Supreme Court of Alabama has held that a clause reading "the venue for any litigation hereunder or related hereto shall be in Mobile County, Alabama, and hereby consents to the jurisdiction of the courts located therein" did not prevent arbitration.

As is common in the manufacturing context, the fabricator provided a proposal on the condition that it became part of the ultimate agreement between the parties. The buyer made the fabricator's proposal a contract document and attached it to the contract between the parties. The proposal incorporated a set of terms and conditions by reference containing a broad-form arbitration clause, but there was a dispute between the parties regarding whether the terms and conditions were physically attached to the proposal.

The Supreme Court of Alabama first recited the law regarding incorporation by reference, noting that no "magic words" are required for incorporation. The court rejected the buyer's position that the proposal was included only in order to provide the scope of the work to be done because contract language to that effect, which is common, was not included. The court then reached what was the real crux of the dispute between the parties, *i.e.*, whether the exclusive venue clause for "any litigation" was repugnant to or mutually exclusive with an arbitration clause. The court followed the precedent of the Fifth Circuit Court of Appeals (supervising trial courts in Louisiana, Mississippi, and Texas) and held that when the arbitration clause and venue clause were read in *pari materia,* as they must be, there was no conflict in the provisions. Interpreted correctly, the provisions mean the venue "for any litigation hereunder *that is not arbitrated under the broad- form clause* shall be in Mobile County, Alabama."

The court reiterated its rejection of the position that arbitration clauses must be called out in any special fashion or physically appended to the contract, when other contractual provisions are not similarly singled out.

This case is instructive for contract drafters. It teaches that the mere insertion of "exclusive venue" contract language does

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not preclude arbitration. Parties should always demand to see any contractual terms and conditions that may affect their agreement before signing it, so both parties share an understanding of what they have agreed to.

State of Florida Court of Appeal Rules Punitive Damages Available in Arbitration

If a fraud claim falls within the scope of an arbitration clause, then punitive damages will be available in arbitration for that claim unless the parties have agreed otherwise according to a recent ruling by the Florida Second District Court of Appeal. The ruling was issued in *Morton v. Polivchak* which involved a contract for sale of real estate in 2002.

The buyer in that transaction obtained a property disclosure statement from the seller which stated that the seller was unaware of any drainage problems on the property. The contract documents contained an arbitration provision. After the closing, the buyer alleged that there were in fact drainage problems and filed a demand for arbitration pursuant to the American Arbitration Association rules. In that proceeding, the buyer alleged fraud and sought punitive damages.

The arbitration panel ruled that it had no power to award punitive damages. In response, the buyer filed suit in circuit court alleging fraud and seeking punitive damages. The seller filed a motion to compel arbitration and essentially seeking an order which would send the matter back to arbitration. The trial court dismissed the matter stating that it did not have the authority to intervene in a pending arbitration.

On appeal, the appellate court reversed. It did so on the basis that, under both Florida and federal precedent, the courts must determine the arbitrability of an issue unless the parties "clearly and unmistakably" agreed that arbitrability would be decided in arbitration. There was no such provision in the subject contract. Furthermore, there was no waiver by the buyer on the issue of arbitrability simply because he sought arbitration. Therefore, the circuit court was required to rule on the arbitrability of punitive damages as requested by the buyer.

Then, turning to the issue of punitive damages itself, the court ruled that if a fraud claim was available in the dispute in arbitration - that is, if it was not barred by the agreement between the parties – then the normal remedies available for the claim should be available in that arbitration. Thus, if the fraud claim could be brought in this case, than the punitive damages claim should not be rejected. The case was remanded to the circuit court to decide those issues.

Notably, the *Morton* court rejected the argument that prior Florida decisions prohibited punitive damages in arbitration. The court examined those opinions and determined that there were no fraud or other claims that would have supported punitive damages in those cases, and that was the reason punitives were not available earlier and not simply because those matters were in arbitration.

The lesson here is a drafting one. If a party wishes to avoid punitive damages in arbitration, it must carefully insert that language into the contract documents. Indeed, if it desires to avoid a trip to the courthouse at all, it further must require language in the contract which clearly states that the arbitrator will have the power to determine arbitrability as well. Of course, if the arbitration cannot hear punitive claims, such a clause may invite arbitration and litigation, concurrently.

Townhouse Mold Case Presents Lessons in Careful Contract Drafting and Responsibility For Storage of Materials

In *Stanley Martin Cos., Inc. v. Universal Forest Products Shoffner LLC*, a builder sued a supplier to recover damages for mold contamination in trusses used to build a 24 unit townhouse complex known as Quince Orchard Park Development in Gaithersburg, Maryland. The builder, Stanley Martin Companies ("SMC"), sued Universal Forest Products Shoffner LLC ("Shoffner"), the truss supplier, alleging breach of contract, negligence, contractual indemnification, common-law indemnification, and contribution. The U. S. District Court of Maryland granted in part and denied in part Shoffner's Motion for Summary Judgment and SMC's Motion to Strike Inadmissible Evidence.

SMC is a D.C.-area builder and Shoffner is a manufacturer and distributor of wood products. Shoffner supplied wood trusses for the townhouses. Late in construction, after some owners had taken occupancy, an owner told SMC that she had mold on the trusses in her basement. Soon, other owners reported similar mold contamination in their basements.

SMC hired Mantech Environmental ("Mantech") to investigate and take air and surface samples. Meanwhile, some owners complained to the City of Gaithersburg, which in turn hired Patuxent Environmental Group, Inc. ("Patuxent") to investigate the claims. Patuxent reported that the trusses likely "played a substantial role" in the mold growth. Guidelines were established for decontamination of the units. Each owner consented to the implementation of the remediation protocols, and the remediation process began.

While remediation was ongoing, 14 of the 24 owners filed suit against both SMC and Shoffner, seeking $150 million in damages. SMC and Shoffner temporarily tabled their disputes and agreed to a "Tolling Agreement" suspending all applicable limitations periods, yet reserving for each party the right to sue beyond the statutory time limit.

Remediation was completed in late 2003. With their homes free of mold, the 14 owners who filed suit settled their claims for nuisance value. Though the lawsuit was settled for a nominal amount, remediation cost approximately $2 million. SMC then filed suit against Shoffner, seeking recovery of remediation costs. After extensive discovery, Shoffner filed a Motion for Summary Judgment. SMC filed a Motion to Strike much of Shoffner's evidence as inadmissible.

Shoffner argued that SMC was barred from recovery because of: (1) its failure to timely demand arbitration; (2) its failure to reject the goods in a timely manner and failure to provide Shoffner with timely notice of any alleged breach; and (3) its waiver, through its conduct, of contractual provisions having to do with delivery and storage of the trusses.

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The contract contained an arbitration agreement dictating that the arbitration demand be made in writing within a reasonable time. Shoffner argued that SMC waited more than one year after the trusses were brought to the site without initiating arbitration; therefore, all claims should be deemed waived. The court held that the failure to demand arbitration did not amount to a waiver of all judicial remedies. Moreover, under the applicable law, the arbitration clause in question appeared to have been intended to apply only to disputes that arose during construction, not afterwards. Accordingly this portion of Shoffner's Motion for Summary Judgment was denied.

Shoffner also argued that SMC failed to timely reject the trusses or to timely notify Shoffner of its alleged breach. Shoffner argued that SMC should have noticed the alleged defect upon delivery or within the next several weeks. SMC said it had no knowledge of the defect at delivery because the mold was not visible, no owners had complained, and construction of the majority of units had not begun. Because SMC only gained its understanding of the nature and extent of the problem after the investigations conducted by Patuxent, and because thereafter it timely notified Shoffner that the trusses likely "played a substantial role" in the mold growth, the court also denied this portion of Shoffner's Motion for Summary Judgment.

Shoffner also contended that it could not be held in breach of the provision requiring it to "protect all materials by placing them in secured areas, covering them with polyurethane (supplied by the General Contractor), and elevating them off ground or basement floor," because under Maryland law, SMC waived this term by its conduct. Maryland law clearly provides that parties may waive contract terms by their conduct. Upon delivery of the trusses to the construction site, SMC's site construction manager assumed responsibility for placement and storage of the trusses. Thus, there was no way for Shoffner to maintain responsibility and control over the trusses or assure their protection from the elements. The court granted Shoffner's motion as to this count.

This case highlights two important issues facing construction contractors. First, it is of the utmost importance that the arbitration clause be carefully worded to have the desired force and effect. Second, it is important to make all construction personnel aware of the requirements for storage and care of materials delivered to the construction site. The issues can be addressed through properly worded contract clauses and an understanding of the responsibilities bestowed in the contract.

Small Case Reaches Large Decision in "Pay When Paid" Debate

Saad Construction Company ("Saad") entered into a contract under which Saad was to serve as general contractor for the construction of a middle school for the owner ("Owner"). Hartford Accident and Indemnity Company ("Hartford") was Saad's surety on the job, and Saad entered into a subcontract ("the Subcontract") with Cochran Plastering ("Cochran") for Cochran to perform work on the job as Saad's subcontractor.

The Subcontract provided that Saad would make periodic progress payments, subject to five percent retainage. The Subcontract also provided that "[f]inal payment shall then be made to [Cochran] within fifteen (15) days following [Saad's] receipt of payment from [the Owner]." Upon receiving each payment, Cochran signed a certification, certifying that "payments, less applicable retention, have been made through the period covered by previous payments received from [Saad]." After construction of the school, Cochran submitted a final invoice for $12,849.27; this amount did not include any retainage. Although Saad had not paid the $12,849.27—and, thus, Cochran had not been paid in full—Cochran nonetheless executed a full release, indicating that it had been paid in full. After executing the release, Cochran requested payment of the $12,849.27 from Saad, but Saad required that Cochran first provide lien-waiver and tax documents before the payment could be made. Accordingly, a Cochran representative went to deliver the documents to Saad. However, the Cochran representative ended up in a physical altercation with Saad's president. The Cochran representative did not leave the required documents, but he submitted them a few weeks later. Saad still did not pay the $12,849.27, and Cochran sued Hartford to recover $22,191.19—which included the payment due, plus retainage—plus interest and attorney fees.

Saad intervened in the suit and filed a third-party claim alleging assault and trespass against Cochran, and Cochran filed a claim alleging assault against Saad. While the complaint was pending, Saad sent Cochran a check in the amount of $12,849.27. Cochran negotiated the check but sent a letter to Saad indicating that it was not waiving or releasing any claims against Saad. The trial court tried the defenses of release and accord and satisfaction, and found in favor of Cochran. The trial court awarded Cochran $9,341.92 in retainage and $1,709.08 in interest, plus attorneys' fees in the amount of $21,577.50, and costs. Hartford appealed, and the Alabama Court of Civil Appeals affirmed.

The court dealt specifically with the "pay when paid" issues as follows:

Hartford argued that the Owner's payment to Saad was a condition precedent to Saad's payment to Cochran. In making this argument, Hartford relied on the provision of the Subcontract stating that final payment shall be made to Cochran "within fifteen (15) days following [Saad's] receipt of payment from [the Owner]." The court examined the Subcontract, and found "[w]hen read in its entirety … the 'final payment' provision of the [Subcontract] does not support the interpretation advanced by Hartford." Saad received a progress payment from the Owner that covered the work that Cochran completed, but Saad made no payment to Cochran. The court also cited *Federal Insurance Co. v. Kruger, Inc.*, noting that the court in *Kruger* determined that a similar clause was merely a timing mechanism for final payment. Further, the court reiterated the precept that a surety cannot assert a pay-when-paid clause contained in a contract between a contractor and a subcontractor, as a defense to its liability under a payment bond. Thus, the court rejected Hartford's condition precedent argument.

In other holdings, the court's results were as follows:

1) Hartford also argued that Cochran's claims were released via the release executed by Cochran prior to final payment. The Court examined the release and noted that Saad was supposed to pay $12,849.27 and that the release was

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contingent upon this payment. In addition, because the release did not specify a time for payment, the Court concluded that the release was ambiguous. The Court also noted that Saad did not make the payment until nearly a year after the release was signed, despite the fact that industry practice only allowed Saad 30 days to pay. The Court ultimately stated that "[t]he evidence supports a conclusion that the [release] was not supported by consideration;" therefore, the Court held that the trial court did not err in refusing to enforce the terms of the release.

2) The Court next considered Hartford's defense of accord and satisfaction. Hartford contended that Cochran's cashing of the check amounted to an accord and satisfaction. The Court outlined the elements of accord and satisfaction as: 1) proper subject matter; 2) competent parties; 3) assent or meeting of the minds; and 4) consideration. The Court then noted that there was no indication on the check sent to Cochran that it was intended to be in full satisfaction of the debt owed. Thus, the Court held that the trial court did not err in holding that there was no accord and satisfaction.

3) Finally, the Court addressed Hartford's challenge to the attorney's fee awarded by the trial court. The Court noted that, under Alabama law, a party suing a surety may seek a reasonable attorney's fee. Hartford argued that the figure awarded was excessive, but the Court disagreed. The Court noted that Cochran's attorney submitted an affidavit and detailed description of the fees incurred, and held that the trial court did not abuse its discretion in awarding the attorney's fee. Thus, the Court affirmed the trial court on all four issues.

Can Lower-Tier Parties Initiate a Payment Freeze?: Supreme Court of North Carolina's Recent Decision Protects Lower-Tier Subcontractors and Suppliers

A recent ruling from the North Carolina Supreme Court exposes owners, contractors and higher-tier subcontractors to liability for money owed to lower-tier subcontractors or suppliers. According to the court in *O&M Industries v. Smith Engineering Company*, upon receipt of a Notice of Claim of Lien Upon Funds from a lower-tier subcontractor or supplier, all parties up the contractual chain will incur direct liability to the unpaid claimant upon making any subsequent payments. Merely retaining amounts equal to or in excess of the amount claimed will not shield a recipient against direct liability. While protecting participants in the construction process that arguably have the least amount of control over their own destiny, this ruling could have the collateral effect of substantially disrupting cash flow and cash-driven progress on ongoing construction projects.

North Carolina General Statute Section 44A-20 protects lower-tier parties from non-payment on a construction project by the use of a Notice of Claim of Lien Upon Funds ("Lien on Funds") against all parties up the contractual chain. Upon receipt of a Lien on Funds:

(1) All recipients must retain funds up to the total amount claimed in the Lien on Funds; and

(2) In the event a recipient makes any further payments down the contractual chain, such recipient shall become directly liable to the claimant to the extent of any such payments.

The owner in the *O&M* case, Kurz Transfer Products, LP ("Kurz"), contracted with Smith Engineering Company ("Smith") to provide design and construction of a regenerative thermal oxidizer system at the site of a manufacturing facility operated by Kurz. In turn, Smith subcontracted with the plaintiff, O&M Industries ("O&M"), to provide construction and delivery of a three-canister thermal oxidizer for incorporation into the larger system. O&M subsequently performed by shipping the constructed oxidizer to the project site in June 2001.

Believing Smith to be in financial trouble, O&M served Kurz with a Lien on Funds on June 8, 2001 in the amount of $113,655.00. Although O&M had constructed the oxidizer as of that date, O&M had not yet delivered it to the site. *See* N.C. GEN. STAT. §§ 44A-18(5) (North Carolina law allows for a Lien on Funds "earned" but not yet "due"). Following receipt of the Lien on Funds, Kurz made two payments to Smith totaling $314,831.25. Smith ceased work on the project in August 2001 and soon after filed for bankruptcy protection. Kurz retained and withheld payment from Smith in excess of the $113,655.00 claimed in O&M's original Lien on Funds. Subsequently, Kurz argued that it was not obligated to make any further payment to O&M, since the cost to complete the project following Smith's abandonment would exceed any amounts owed from Smith to O&M. Prior North Carolina courts have recognized that additional funds necessary to finish a project can be set off against amounts liened on the project. The *O&M* court found that neither the retention of funds, nor the subsequent claim of set-off, would be sufficient for Kurz to avoid personal liability. According to the court, any payment made by Kurz down the contractual chain after receipt of the Lien on Funds resulted in Kurz being directly liable to O&M for any amounts paid. Therefore, while a recipient is required to "retain" funds up to the amount of the Lien on Funds, mere retention, subject to subsequent set-off, will not shield the recipient from liability. The recipient has a separate and independent obligation to withhold further payments down the contractual chain, discharge the Lien on Funds or face direct liability up to any amount paid.

The *O&M* decision appears to leave recipients of a Lien on Funds with few "good" options. To avoid being forced into a payment freeze or incurring direct liability due to subsequent payment, recipients have the following options: (1) attempt to determine the potential validity of the claim; (2) pressure lower-tier parties to resolve the payment dispute, resulting in discharge of the Lien on Funds; (3) make payment in full to the claimant, which requires interfering in a lower-tier contractual arrangement and risking double-liability; (4) discharge the Lien on Funds by either purchasing a bond for the amount claimed or making payment in full to the clerk of court, resulting in additional costs and impacting project cash flow; or (5) escrowing the funds as a part of "payment" to the next tier down. If the recipient does not dispute the amount in the Lien on Funds is presently due, the best option may be payment of the claimed amount to the clerk of court or to escrow. Payment to the clerk of court will discharge the Lien on Funds and leave it to the lower-tier contracting parties to litigate their respective rights to those funds. However,

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as a Lien on Funds can be filed for amounts "earned" but not yet "due", the recipient may not be in a position to pay the claimed amount in full to the clerk of court. In such cases, the costs of purchasing a bond to discharge the Lien on Funds may be necessary to avoid straining project cash flow.

The recent *O&M* ruling, while admirably protecting lower-tier participants in the construction process, imposes a new burden and risk on owners, general contractors and higher-tier subcontractors. Close attention and management of payment status all the way down the contractual chain will help control and mitigate the risk, but recipients must be prepared to act quickly and prudently upon receiving a Lien on Funds to avoid being forced into a payment freeze or incurring direct liability due to improper payment.

No "Cookie Cutter" use of an A/E's Plans

Regardless of the kind of delivery system used for a project, the design documents represent the intellectual property of some person or company. As such, they are protected, often by contract, but always by virtue of state and federal law. The Ninth Federal Circuit Court (supervising trial courts in Alaska, Arizona, California, Idaho, Montana, Nevada, Oregon, and Washington) recently enjoined a developer from using a designer's documents for a master planned community in north-western Las Vegas. In *LGS Architects, Inc., vs. Concordia Homes of Nevada,* decided on January 11, 2006, the developer and the designer agreed to a license by which the developer was allowed to reuse the designer's plans for 80 homes in the planned community. When the developer decided to use the plans to build another 68 homes in an adjacent planned community, it failed to tender the precise amount required for "reuse" under the licensing agreement, and it failed to obtain the designer's agreement to the reuse. Hence, the license was violated, and the designer was entitled to an injunction against use of its drawings, a return of the drawings, and any public display by the developer of the designer's plans.

Clearly, designers should guard carefully their intellectual property rights, as is provided for example in the standard AIA documents. Developers, their financial backers, and contractors should be aware of the designer's rights and should purchase, at the front end of a project with repeatable features (such as a planned community, or a group of similar office buildings), the "reuse" license with a fee for reuse negotiated in the initial contract. Otherwise, the use of the design may be enjoined, a project halted, and any use (including photographs) of the design prevented.

Bradley Arant Lawyer Activities:

2006: Axel Bolvig will serve as a member of the 2006 General-Subcontractor Committee of Associated Builders & Contractors, Inc., Alabama Chapter.

2006: Joel Brown and Rob Campbell will serve as members of the 2006 Legislative Committee of Associated Builders & Contractors, Inc., Alabama Chapter. **Joel Brown** also will continue to serve as a member of the Education Committee of the ABC Alabama Chapter.

2006: Rob Campbell will serve as member of the Legislative Committee and **Joel Brown** will serve as a member of the Small Business Committee of the Business Council of Alabama.

January 17, 2006: Mabry Rogers presented an in-house seminar for a client regarding FAR compliance.

January 25, 2006: David Pugh presented a seminar on "Building Codes" in Birmingham, Alabama.

January 26, 2006: Rhonda Andreen, Stanley Bynum, Donna Crowe, Eric Frechtel, Arlan Lewis, and David Owen attended the ABA Forum on the Construction Industry's Midwinter Meeting, "Expecting the Unexpected: Anticipating and Managing Key Risks to Successful Projects," in New York City.

January 27, 2006: Stanley Bynum, Donna Crowe, Eric Frechtel, and Arlan Lewis attended the ABA/TIPS Fidelity and Surety 2006 Annual Midwinter Meeting in New York City.

March 16, 2006: Patrick Darby, Arlan Lewis, David Pugh, Harold Stephens, and Sabra Wireman presented a seminar on "Construction Insurance, Bonding and Liens in Alabama," in Birmingham, Alabama.

March 29, 2006: Jonathan Head and Joel Brown spoke to the Associated Builders and Contractors at their Annual Day on the Hill Meeting in Montgomery, Alabama.

April 18, 2006: David Owen presented a seminar to the Birmingham Chapter of the Alabama Society of Professional Engineers on the topic "Professional Services Contracts, Risk Allocation, Litigation and Discovery."

May 8, 2006: Wally Sears will be the panel leader for a presentation on "LNG Facilities – Challenges and Opportunities for the Owner and the Contractor in the International Market" at the International Construction Superconference in London, UK.

May 9, 2006: Wally Sears will present an in-house seminar to a client on basic construction contract law principles and the importance of good record keeping.

May 18-19, 2006: Rhonda Andreen and Arlan Lewis will attend the ABA Forum on the Construction Industry's Annual Meeting, "Swimming with the Sharks: Litigating the Construction Case and More," in San Diego.

June 2006: Nick Gaede will be teaching a course on International Arbitration in Fribourg, Switzerland. The course will be attended by students from the University of Alabama and the University of Fribourg Schools of Law.

June 14, 2006: David Bashford, John Bond, Eric Frechtel, Michael Knapp, Doug Patin, Mabry Rogers and Colin Stockton will present a seminar titled "Legal Issues Facing the Construction Professional: The Most Common Pitfalls and How to Avoid Them in North Carolina" in Charlotte, North Carolina.

NOTE: WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY CONTACT ANY ATTORNEY LISTED ON PAGE 7 OF THIS NEWSLETTER.

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This newsletter is a periodic publication of Bradley Arant Rose & White LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact your lawyer or any of the lawyers in our group whose names, telephone numbers and E-mail addresses are listed below; or visit our web site at www.bradleyarant.com.

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BRADLEY ARANT ROSE & WHITE LLP

Third Quarter 2006

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Contractors Beware: Immigration Reform Already Is Here

For a variety of reasons, the immigration debate moved to center stage this year. Much of the recent interest arises from border security, and much of the federal government's enforcement efforts have focused on entities actually aiding in the trafficking of illegals. However, bills are pending now in Congress which will affect contractors directly, and, more importantly, the Department of Homeland Security ("DHS") already has taken new initiatives and issued important proposed regulations which apply to contractor employers now.

Employers in the construction industry have reason to be concerned. Some estimates indicate that seventeen percent of unauthorized workers are employed in construction. That equates to well over a million illegals in construction, or about 20 percent of the construction workforce. Fully 40 percent of new construction jobs are filled by Hispanics. Unlike what many might expect, the concentration of new immigrants is in the Deep South. What does this mean? As government enforcement begins to shift or to expand from traffickers to general employers, the construction industry likely will be targeted first.

As background, recall that the law which enacted I-9 compliance, the Immigration Reform and Control Act ("IRCA"), went into effect in 1986. Since then, the primary obligation on employers was to complete I-9 forms on each employee. IRCA really contained minimal enforcement mechanisms (primarily administrative fines). The whole focus of the legislation was establishing documentation requirements designed to prevent the hiring and retention of unauthorized workers by employers. Later IRCA was refined and amended by the Illegal Immigration Reform and Responsibility Act of 1996 ("IRIRA"). IRIRA did establish some criminal penalties for smuggling, document fraud, and unauthorized employment related to smuggling. Still, enforcement mechanisms against employers were

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very weak. In addition, workers (and some employers) continued to dodge the requirements by using false documentation or failing to maintain the documentation required. Because enforcement was lax in this period few fines were assessed and the ones that were given to employers were relatively small and often resolved through compromise agreements.

From a legislative standpoint, those two laws bring us up to date. Last year, a bill was introduced in the House aimed at tightening border security. That bill made employers the enforcers of the law by requiring them to verify the status of all new hires and current employees. Fines of $25,000 for paperwork violations were included. The Senate later began considering its own bill which has additional provisions allowing illegals to become citizens and describing a guest worker plan. The differences in the bills make it likely that a compromise major immigration reform bill will take some time to pass.

Turning to historical enforcement activity, the number of workplace enforcement actions was extremely low throughout the 1990's. However, things have begun to change, and we can expect much more enforcement in the future. The huge governmental agency which was created in the aftermath of 9-11, The Department of Homeland Security ("DHS") contains sub-agencies dealing with immigration including U.S. Immigration and Citizenship Services (formerly INS), which oversees immigration benefits and the immigration enforcement agency, Immigration and Customs Enforcement ("ICE").

This year, ICE announced an interior immigration enforcement initiative. In June of this year, Julie Myers, the Assistant Secretary of the Department of Homeland Security, testified before the Senate Judiciary Committee about immigration workforce enforcement. Explaining that ICE has learned that it is not effective to approach the situation "piece meal" by assessing administrative fines against individual employers, ICE is planning to target companies who unlawfully employ aliens and to detain and to remove the workers in an expeditious manner. By operating this way, the agency hopes to send a strong message to foreign nationals in their home countries that they will not be able to move from job to job in the U.S. once ICE shuts down their employer.

In an effort to achieve these goals, ICE increasingly is bringing criminal charges against employers in addition to bringing charges for civil penalties. Criminal charges against employers who hire illegal workers include charges for money laundering and knowingly harboring and transporting illegal aliens. Recently there have been instances in which contractors who were working on government projects were charged with False Claims Act violations when the Social Security numbers of some of the workers on the claims form were not valid. By making examples of certain employers in high-profile cases, ICE hopes to discourage the practice of employing illegals by other employers.

Clearly, ICE also is trying to work with other government agencies to use any available avenue stop the use of illegal workers. These include the Office of Special Counsel, the Social Security Administration, the Department of Labor, and the Internal Revenue Service. By using existing laws of these other agencies, working together, and bringing more criminal actions rather than civil actions, the U.S. government hopes to change the landscape of immigration enforcement even before actual immigration reform legislation is passed.

The statistics paint poignantly the picture of the new workforce enforcement environment. While in 1997 only three employers were charged with workplace violations, and only 862 employees were charged with working illegally, those numbers rose in 2005 to 178 charges against employers and 1,160 charges against illegal workers. The enforcement actions continue to increase. Between October of 2005 and June of 2006, ICE initiated 592 investigations at critical infrastructure worksites, up 48 percent from 2005 year totals. Many of the sites investigated were construction sites. Security sensitive sites and critical infrastructure facilities are still the most likely construction sites to be watched and possibly raided. These include military facilities, airports, federal buildings, nuclear plants, chemical plants, and financial institutions.

In addition to these stepped up enforcement efforts, two new regulations came out this summer related to workplace enforcement. First, DHS issued a proposed regulation explaining steps employers should take when receiving a Social Security no-match letter. These are the customary letters to employers informing them that certain of their employees have incorrect Social Security numbers. This regulation sets forth a "safe harbor" for employers who take these suggested actions after receipt of such a letter. The first step is for the employer to check its records to determine if there was an error. If there was no error, the employer then should ask the employee to resolve the problem with the Social Security Administration. This step should be taken within 14 days, which is a reasonable time according to the regulations. If the matter still is not resolved, an employer needs to reverify the employee's work authorization within 60 days using the same procedure as the original I-9 procedure but with added precautions. At this point the employer cannot use any document containing the Social Security number that is the

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subject of the no-match letter, and no document without a photograph can be used to establish identity. If this fails, the employee must be discharged.

The second proposed regulation involves the manner in which I-9 forms can be kept electronically. In general, these forms must meet certain standards including legibility and readability. The forms must be indexed. The regulations do allow for electronic signatures. It is likely no accident that this regulation comes out at this time of increased workplace enforcement. ICE will be able to search these forms more quickly and effectively if they are kept in an electronic format. It is important to note that employers are not required to keep the I-9 forms in electronic format, but it is an available option.

Given the increasing number of raids and criminal charges being brought against employers of illegal aliens and these new regulations, it is obvious that employers face a new environment of increased immigration enforcement. The careful contractor needs to study its practices and adjust procedures as necessary. The following ten guidelines can provide a starting point for reviewing the practices of your business:

Remember: Failure to verify will lead to discharge of the employee, and not to mention a possible enforcement action. Thus, hours of training and morale building will be lost if the employee is discharged.

What Can Contractors Do In This Changing Environment?

1. Make sure that I-9 forms are in order and perform a self-audit or have an outside firm conduct one if one has not been done recently.

2. Make sure that I-9 forms are kept separately from personnel files and that documents are purged when it is legally permissible. I-9's must be kept for the full period of employment and one year afterward, subject to a minimum period of three years after the date of hire.

3. Have a plan in place to respond to Social Security no-match letters.

4. Have a designated person assigned the responsibility for keeping up with the I-9 process.

5. Take appropriate steps to see that subcontractors have an I-9 system that is in compliance.

6. Be sure that the person in charge of I-9 compliance examines and copies the original documents and attaches them to the I-9.

7. If mistakes are discovered in an audit, make corrections and initial and date them on the current date (do not back date; do not white out).

8. Be certain that the company does not have constructive or actual knowledge that an employee is not work authorized. For example if an employee admits he is not work authorized or requests that you as the employer sponsor him for a work visa, this information is inconsistent with the belief that the employee is legally authorized to work.

9. If you have a federal or state contract, consider taking additional precautions such as requiring subcontractors to verify all Social Security numbers for workers, in addition to performing customary I-9 compliance. These jobs will be subject to increased scrutiny, could result in raids and, at a minimum, the negative publicity associated with such raids, and would result in false claims act charges for improper social security numbers.

10. Create an action plan so that your company will be prepared in the event of an ICE audit:

a. In case of a raid, you *immediately* should call your lawyer. As with any governmental criminal investigation, the subject of the investigation has the right to remain silent and does not have to talk with the investigators.

b. Just as you would prepare an action plan for a possible OSHA visit, do so now in the event of a future visit by ICE. Designate a point person to be in charge of the investigation on behalf of the company. Be aware that if ICE comes without a warrant, the company representative should ask for three days to provide I-9 documents, and the company should not waive that right. However, if the government comes with a warrant, the three day period has no application.

c. In advance of any investigation, talk to your workers about the possibility of an ICE enforcement action and let them know that they do not have to talk to the agents. Recently there have been reported occurrences of agents badgering Hispanic workers by name calling, and it is important that contact between the workers and the agents be kept to a minimum because such activity can result in confusion and incorrect information.

d. Plan to use a conference room or other area that is separate from the worksite as a place to supply documents and have your point person meet with government agents. Be certain to get the business card of the investigator and have someone take notes of the meeting so that you have a record of everything discussed

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and requested. Do not be surprised if you have on your premises agents from a variety of government agencies including ICE, the Department of Labor, the Office of Special Counsel, and possibly others such as Housing and Urban Development if it is a government funded project.

Recent Decisions May Require Licensed Engineers to Testify

1. **Alabama**

The decision on July 28, 2006 has raised many questions concerning the scope of its applicability. The decision holds that any "engineering" subject can be testified about only by an engineer licensed in Alabama. It is unclear whether testimony pertaining to estimating or scheduling would be governed by the holding. Additionally, it is questionable whether this holding will apply to testimony in Federal courts or arbitration proceedings. Bradley Arant Rose & White LLP will be monitoring this issue closely and will provide an update in forthcoming newsletters.

2. **Illinois**

A recent Illinois Supreme Court decision examined whether an engineer must be licensed in Illinois before being allowed to testify as an expert in litigation there. The case concerned a motor vehicle accident in which a car crossed a raised median and collided with another vehicle. The Plaintiff, a surviving passenger in the vehicle that did not cross the median, filed suit against multiple parties, including the designers of the intersection where the accident occurred. Her claims included negligence against the designers.

Plaintiff filed a pleading that contained an affidavit from her expert witness, whose opinion was that the defendants failed to meet the ordinary standard of care in their design of the intersection. Plaintiff's expert was a civil engineer who was licensed in the District of Columbia but not in Illinois. The Defendant filed a motion to strike the affidavit.

The Illinois Supreme Court's decision examined only the narrow issue of whether licensure as a professional engineer in Illinois is a prerequisite to testifying as an expert witness in a civil case there. The court held that while the presence of an Illinois license may be a factor for a trial court to consider in deciding on whether to allow an expert witness, the lack of such license is not a bar to giving expert testimony in a civil case. In reaching its decision, the court noted that there is no predetermined formula for how an expert acquires specialized knowledge or experience, and also that expert testimony is admissible if the expert is qualified by knowledge, skill, experience, training, or education and the testimony will assist the trier of fact in understanding the evidence.

Despite the court's holding, there exist multiple reasons why a party would want to have its engineering expert licensed in the state before attempting to have them deemed qualified as an expert there. First, as was mentioned earlier, licensing is still a factor that a trial court can consider in determining whether the individual should be permitted to give expert testimony. Additionally, an engineer who testifies in a state without being licensed there might be committing a criminal act (While this litigation was on-going the Illinois Department of Professional Regulation issued a cease and desist order against the expert; the order found that the expert was engaged in the practice of professional engineering without a license). The Illinois Supreme Court held that a witness would not necessarily be precluded from testifying as an expert just because the giving of such testimony could constitute a criminal act, but the court reasoned that whether the engineer might have been committing a criminal act by testifying was a separate issue to be decided in a separate proceeding.

A party would be well advised to obtain in-state licensure of an engineering expert. The lack of such licensure could be a consideration that the trial court uses, along with others, to disallow the relevant witness. Additionally, the expert could be opening himself/herself up to criminal liability by offering such testimony. Generally, it is easy for an engineer to become licensed in a state where he/she will testify. A small amount of effort to attain such licensure initially could prevent larger problems for both the party and the expert further down the road.

Supreme Court Reaffirms Challenges To Contracts To Be Determined By Arbitrator When Contracts Contain Arbitration Clause

In *Buckeye Check Cashing, Inc. v. Cardegena*, the United States Supreme Court reaffirmed how a challenge to the validity of a contract should be handled when an arbitration clause is included within the contract at issue. In the case, the claimants brought a class action in Florida state court alleging that Buckeye was charging illegal interest rates. Specifically at issue were the terms of a Deferred Deposit and Disclosure Agreement each claimant was forced to sign when they cashed their checks. Of importance in this matter was the fact that Buckeye included a clause which required all disputes to proceed to arbitration.

Consistent with the arbitration provision contained in the agreement, Buckeye requested the court to compel the claims to arbitration. The claimants opposed this demand

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and responded that the arbitration clause at issue was of no effect given the fact that the agreements (which contained the arbitration clause) were void because the argument violated various state lending and consumer protection laws. The claimants argued that the court, rather than an arbitrator, should determine whether the contracts were void.

In ruling that a challenge to a contract as a whole, and not specifically to a contract's arbitration clause, must be determined by the arbitrator, the Supreme Court rested on three long standing propositions. First, as a matter of the Federal Arbitration Act, an arbitration provision is severable from the remainder of the contract. Second, unless a challenge is directed to the arbitration clause itself, the arbitrator must first establish whether the contract is valid. Third, these arbitration principles apply to both state and federal cases.

Using the three propositions described above, the Supreme Court determined that regardless of whether the matter was filed in state or federal court, because the claimants were challenging the legality of the contract as a whole and not specifically the arbitration provision, the arbitration provision was enforceable separate and apart from the contract. As such, the court held that a challenge to the contract should be determined by an arbitrator, not the court.

Even if one opposes arbitration, this case is welcome news in clarifying the scope of the initial challenge to an arbitration proceeding, lending certainty in an area where uncertainty has crept in because of the movement of arbitration out of its "founding" nests of construction and labor into consumer transactions.

Alabama's First Interpretation of its Private Prompt Payment Statute

The Supreme Court of Alabama recently answered completely new questions regarding its private prompt payment statute ("the Act"). The Act requires owners to pay general contractors, and general contractors to pay subcontractors, in a timely fashion (either pursuant to the contractual terms the parties agreed on, or within statutorily prescribed times). It requires a payor to state its disputes in writing, if any, with a contractor or subcontractor's bill within either fifteen or five days, respectively. If a payor fails to state its dispute in writing and does not pay timely, it is subject to twelve percent simple interest and attorneys' fees on the unpaid amounts.

The Act is largely untested in litigation, as are many of the relatively new prompt payment acts around the country. One question payors have had regards the "bona fide dispute" provision, which allows a payor to withhold up to two times the amount of a disputed portion of a payment request, and whether a payor would still be liable for interest and fees if it eventually lost the dispute. The Supreme Court of Alabama has held that a payor is not responsible for interest if it loses a bona fide dispute, but that it remains responsible for attorneys' fees. "We conclude that the statute provides for awarding attorney fees irrespective of whether a party is entitled to interest…."

The court also answered two ancillary issues in its opinion. First, a payor who withholds money and prevails at trial is entitled to an award of attorneys' fees. In the court's words, the provision for attorneys' fees can "cut both ways." Second, the court held that the specific use of "judgment" with relation to an award of attorneys' fees meant that a party who wins at trial may not receive an award of fees for its appellate expenses.

Courts in other states have not always made the sharp distinction between recovery of interest and fees, but Alabama's statute is written differently, wrote the Court. This decision may produce some peculiar results where the amount of fees is high when compared to the principal amount recovered, but is faithful to the text of the Act that reads "the party in whose favor a judgment is rendered ***shall be entitled*** to recover payment of reasonable attorneys' fees…." (emphasis added)

Oregon Court Clarifies the Obligations of a CGL Carrier to its Additional Insured

Construction projects can be dangerous. In spite of efforts by owners and contractors to promote a safe workplace, injuries occur. Prime contractors often seek contractual protection from injury claims, by obtaining indemnity agreements in their subcontracts. In addition, prime contractors will require their subcontractors to name them as an "additional insured" under their subcontractors' commercial general liability ("CGL") insurance. If the subcontract is followed and enforced, the prime contractor should be able to tender a personal injury claim or lawsuit directly to its subcontractor's CGL carrier, and the subcontractor's CGL carrier would be obligated to defend the prime and pay the claim, in accordance with the subcontractor's CGL policy. This approach makes sense where the indemnifying subcontractor is responsible for causing the injury, but it may not make sense where the injury is unrelated to the subcontractor's activities.

In Oregon, the State legislature enacted Or. Rev. Stat. Section 30.140, that generally declares such arrangements void as against the public policy of Oregon. ORS Section 30.140(1) provides that "any provision in a construction

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agreement that requires a person or that person's surety or insurer to indemnify another against liability for damage . . . caused in whole or in part by the negligence of the indemnitee is void." Like many anti-indemnity statutes, the purpose for this statute is to eliminate indemnity clauses that create a "license to be negligent." The Oregon legislature apparently feared that prime contractors would have no incentive to assure safety if they knew that any liability could be passed down to their subcontractors' CGL carriers, regardless of their own fault. In one case, the Oregon Supreme Court applied this provision to invalidate a provision requiring a subcontractor to procure additional insured coverage for its prime contractor. *Walsh Construction Co. v. Mutual of Enumclaw*, 104 P.2d 1146 (Or. 2005). In that case, there was no evidence that the subcontractor caused the injury for which the prime contractor was seeking additional insured protection.

The Oregon Statute has an exception. Section 30.140(2) preserves indemnity agreements, and agreements to provide additional insured protection, where the liability "arises out of the fault of the indemnitor, or the fault of the indemnitor's agents, representatives, or subcontractors." The "license to be negligent" concerns that motivated adoption of the statute do not exist where the subcontractor that was required to obtain additional insured coverage for the prime contractor was at fault for the injury.

In *Hoffman Construction Company v. Travelers Indemnity Insurance Company*, (Nov. 28, 2005), a federal district court in Oregon applied the exception stated in Section 30.140(2) and found that a subcontractor's CGL carrier was obligated to provide a defense and coverage to an additional insured prime contractor where there was evidence that the subcontractor was at fault for the injury. The case arose out of an injury suffered by a workman in the "clean room" of a Hewlett Packard plant being constructed by Hoffman. The "clean room" mostly involved work by one of Hoffman's subcontractors, Advanced Technologies Group ("ATG"). Hoffman was an additional insured under ATG's CGL policy, issued by Travelers. When the injured worker asserted a claim against Hoffman, Hoffman tendered the claim to Travelers.

The Court rejected Travelers' attempt to obtain a summary judgment dismissal of Hoffman's request for indemnity based on Section 30.140(1) and *Walsh*, reasoning that Travelers was obligated to defend and indemnify Hoffman because ATG was arguably at fault for the injury. Even thought the injured worker was not an ATG employee, the Court found that ATG's failure to properly construct temporary steps in the "clean room" may have caused the injury. Therefore, Travelers' obligation to defend and indemnify Hoffman as an additional insured was preserved by the Section 30.140(2) exception. The Court ordered Travelers to defend and indemnify Hoffman, granting Hoffman's cross-motion for summary judgment.

In some states, including Oregon, indemnity clauses that purport to indemnify a prime contractor against its own negligence are not enforceable. In these states, *Walsh* and *Hoffman* illustrate that a similar approach may be applied to additional insured clauses in subcontract agreements. You should consult the particular laws of each state in which you work, to assure that your subcontracts, including any indemnity and insurance requirements stated in your subcontracts, are enforceable. In states like Oregon, it makes sense to draft your indemnity and additional insured clauses in such a way that the obligation is limited to situations where your subcontractor, or the agents of your subcontractor, are partially or entirely at fault for the personal injury or property damage for which indemnity and coverage will be sought.

One final practical point about "additional insured" obligations: every prime contractor should have in place a procedure for confirming that its subcontractors have in fact procured the additional insured coverage required by the terms of the subcontract. Far too often, the subcontractor fails to procure the "additional insured" coverage for the prime contractor, and the prime contractor is left exposed. If the subcontract clauses are written properly, and steps are undertaken to assure that appropriate insurance is in place, the prime contractor can be protected from any personal injuries that arise from the subcontractor's work.

Recovery of Bid Preparation Costs Requires Causal Connection to Basis of Bid Protest Action

When a government agency solicits work through the competitive bid process, it is obligated to consider all bids fairly and honestly. A breach of this obligation often allows a bid protester to seek recovery of its bid preparation costs as part of its remedy. However, bid protesters cannot assume that the existence of a bid irregularity automatically entitles them to recover their bid preparation costs. In *Lakloey, Inc. v. University of Alaska*, the Supreme Court of Alaska held that a bid protester was not entitled to recover its bid preparation costs where there was no evidence that the bidding irregularities wasted costs already expended in bid preparation or otherwise caused the protester to incur additional costs.

On March 5, 2003, the University of Alaska solicited bids for improvements to an existing facility. All bids were to be opened at 2 p.m. on March 20, 2003. Lakloey

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submitted its bid before 2 p.m. on March 20. Before 2 p.m., but after Lakloey submitted its bid, the university issued Addendum #2 which changed several bid criteria, adjusted the amount of required builder's insurance, and changed the bid opening date to April 1. Lakloey submitted a protest letter to the university alleging that the issuance of Addendum #2 violated the conditions of the solicitation, the university's procurement regulations, and Alaska's procurement code. The university rejected Lakloey's protest and Lakloey appealed the denial on March 31. Despite its pending protest, Lakloey submitted another bid on April 1. All of the bids exceeded the available project funds and were therefore rejected by the university.

Alaska Statute 36.30.585 limits a successful bid protester's damages to "reasonable bid or proposal preparation costs." Lakloey argued that several bid irregularities had occurred and thus, under the statute, it was entitled to its full bid preparation costs. First, by allowing only 15 days for the preparation of bids, the university violated Alaska Statute 36.30.130 which requires at least 21 days between the dates of solicitation and bid opening. The university had also failed to provide written justification for the reduced bidding period. The court agreed that the university had violated the statute, but held that Lakloey had not alleged, much less proved, that it suffered any damages caused by the shortened bidding period or the lack of written justification. Consequently, this violation did not entitle Lakloey to recover its bid preparation costs.

Lakloey also argued that the issuance of Addendum #2 on the originally scheduled bid opening date violated a statement in the instructions to bidders that any addenda would be issued no later than the day before bid opening. The court held that Lakloey had not asserted that it acted any differently between March 19 and 2 p.m. March 20, than it would have if Addendum #2 had been issued on March 19. Moreover, because Lakloey was able to submit a bid for the solicitation as modified by Addendum #2, its pre-Addendum #2 non-insurance-related bid preparation costs were not wasted. Thus, Lakloey had not demonstrated that it had relied to its detriment on the representations made about the timing of addenda and was not entitled to recover any bid preparation costs.

The court's decision in *Lakloey* illustrates that, in order to recover bid preparation costs, successful bid protesters should be prepared to demonstrate a causal connection between the basis of the bid protest and the additional costs incurred, or resources wasted, in bid preparation.

Contractors in Maryland May Acquire an Interlocutory Mechanics' Lien Without Waiving Their Contractual Rights to Arbitrate

The Court of Appeals of Maryland recently held that a contractor does not waive its contractual right to compel arbitration merely by obtaining an interlocutory mechanics' lien.

The Maryland Code, which sets out the requirements for filing and enforcing a mechanics' lien at Md. Code Ann., Real Prop. § 9-101 *et seq.*, provides that a petition to establish and enforce a mechanics' lien be filed within 180 days after the work has been finished or materials have been furnished. From the petition and any exhibits filed by the contractor, the court may conclude that there is a reasonable ground for a lien to attach and enter an order directing the owner to file an answer as to why the lien should not attach. The court's order will also set a date for a hearing on the petition. After reviewing the record, the court may either enter a final order establishing or denying the lien in the amount not in dispute, or enter an interlocutory order which: 1) establishes the lien; 2) describes the property to which it attaches; 3) states the amount of the claim; 4) states the amount of bond that the owner may file to have the lien released; 5) may require the claimant to files a bond; and 6) assigns a date for the trial of all matters at issue.

In *Brendsel v. Winchester Constr. Co.*, a contractor sought payment from a property owner for whom it had provided labor and materials. The contractor filed a petition to establish and enforce a mechanics' lien which, among other things, sought a stay of proceedings after an interlocutory lien was established pending the outcome of an arbitration proceeding between the parties. In response to the court's order to show cause why a lien should not be granted, the owner filed an answer denying that any amount was due the contractor and a counterclaim seeking damages for overcharging and defective work.

At the same time as the answer and counterclaim were filed, the parties filed a consent motion in which they agreed to postpone the scheduled hearing on the request of an interlocutory mechanics' lien, to conduct limited discovery, and to permit an interlocutory lien to be established during the discovery period in the amount sought by the contractor. In addition, the parties expressly agreed in the motion that "neither this Consent Motion nor their activities during the Discovery Period, nor the issuance of the interlocutory lien order proposed hereunder, shall prohibit or waive any party's right to proceed in arbitration, or to object thereto, to the same extent as if this

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Motion had not been filed and the actions proposed hereunder had not been taken."

Shortly after receipt of the consent motion, the court entered an interlocutory mechanics' lien in the amount sought by the contractor and declared that neither the consent motion, discovery conducted during the discovery period, nor the order would prohibit or waive the parties' rights to arbitration. That same day, the owners filed an amended answer and counterclaim. The contractor answered the counterclaim, asserting, among other things, that the counterclaim was subject to arbitration. After limited discovery which included depositions, the owner filed a motion for partial summary judgment on its counterclaim to which the contractor responded with a petition to compel arbitration and stay all further judicial proceedings on the grounds that the counterclaim was subject to arbitration. The owner opposed the petition, arguing that the contractor had waived its right to arbitration by seeking a mechanics' lien and by failing to provide written notice of a demand for arbitration within a reasonable time after the dispute had arisen.

Considering the totality of the circumstances and citing the decisions from other courts, the Maryland Court of Appeals declined to adopt a *per se* rule that the mere seeking of an interlocutory lien constitutes a waiver of arbitration. The court made it clear that "with respect to waiver of a contractual right to arbitrate disputes, that waiver involves a matter of intent that ordinarily turns on the factual circumstances of each case and that the intention to waive must be clearly established and will not be inferred from equivocal acts or language." As the *Brendsel* court further explained, an interlocutory mechanics' lien is in the nature of a provisional remedy sought to maintain the status quo so that an arbitration proceeding can have meaning.

Given the predominant view across jurisdictions that the availability of such provisional remedies is permitted under the Federal and Uniform Arbitration Acts and does not conflict with the right to enforce arbitration agreements, the *Brendsel* holding is likely indicative of how courts will consider an interlocutory mechanics' lien in light of a party's right to arbitrate.

Joint Venture Management Strategies

Joint Ventures can be problematical, particularly for the minority venturer. In a helpful decision, the Armed Services Board of Contract Appeals allowed the minority member of the JV to appeal under the Contract Disputes Act of 1978, despite the fact that the JV's Management Committee (controlled by the majority partner) did not authorize the appeal. The issue between the Government and the JV was the amount of work to be performed by the JV's own forces as the prime contractor. The JV itself refused to dispute the Government post-contract award requirement of 25%, so the minority partner disputed the directive. The Government asked that the dispute be dismissed because the JV Management Committee did not authorize the dispute.

The ASBCA based its decision on the fact that the minority partner had taken the refusal to authorize an appeal to the arbitration dispute resolution process authorized by the JV Agreement. The question to the arbitrator was whether the managing partner's (and thus the Management Committee's) decision was proper with respect to the dispute. The arbitrator ruled it was not and granted the minority partner the right to challenge the Government's directive. The ASBCA found that the managing partner had agreed to be bound by arbitration of JV disputes and that the arbitrator's authority to award remedies was unlimited. Finally, the ASBCA held it was not limited to looking only at the JV Agreement or to the terms of the JV-Government contract to determine who had the authority to act on behalf of the JV.

Hence, this case (*Sarang-National Joint Venture,* ASBCA, 2006), provides a strategy for a minority JV partner to attempt to obtain redress for a wrong done the JV, where the majority partner objects. The strategy is not limited to an arbitration provision within the JV agreement, because the minority partner might have sought similar relief from a court under a Declaratory Judgment action.

Mold Remediation Specialists Beware! Court Finds Specialist Liable for Recommending Unnecessary Remedial Services

Mold remediation specialists may be liable to their clients for breach of contract when recommending remedial services not justified by the circumstances. In *Moore v. Chodrow*, the Florida Fourth District Court of Appeals found a mold remediation specialist liable to homeowners for performing remedial services after testing revealed such services were unnecessary. In *Moore*, the homeowners discovered a mold problem caused by a water leak in their condominium. Their contractor, who was not experienced in mold remediation, recommended a mold remediation specialist, Talmadge Moore, to address the issue. Moore inspected their condominium and performed tests. He recommended that the homeowners move out immediately, for health reasons, and entered into a contract with the homeowners for the rental of air scrubbers and dehumidifiers. The contract stated that the machines "are needed to control further damage caused by airborne mold." Moore further stated that he would monitor and

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change the filters on the equipment multiple times daily. The test results revealed that the mold levels inside the house were less than the levels outside. This is significant because the homeowners' expert testified that a health risk only arises when the mold levels inside the house are greater than those outside. Thus, the court found that the homeowners did not need to rent the machines. Moore, however, failed to share the results of the testing with the homeowners and further recommended that they continue to rent the machines. After some 300 days (at $400/day) of using the machines and employing the specialist's services, the homeowners contacted another specialist who advised them the machines were not necessary and had not been necessary at the time of testing. Further adding to the homeowners' case was the fact that Moore failed to properly place and monitor the equipment under the terms of the contract. Although Moore sued for payment of rental fees under the contract, the court found Moore at fault for breach of contract, and the homeowners were relieved from paying additional rental fees despite Moore's argument that he had not breached the contract. As this case illustrates, mold remediation specialists should, "at a minimum" (as the court directly stated), share testing results with their clients (in this case, that testing showed no airborne mold problem), before advising them to pursue a course of treatment. Moreover, when the testing does not support a course of treatment, specialists are best served not recommending potentially unnecessary services, unless confirming with the client, in writing, that the client elects to continue despite the specialists' advice that such services are probably not necessary.

New Contractor Licensing Requirements in Georgia

For those contractors performing, or considering performing, work in Georgia, be aware of Georgia's new contractor licensing requirements. *See,* O.C.G.A. §§ 43-41-1 through 43-41-17. The new law creates a statewide licensing requirement for all residential and general contractors in Georgia as well as "at risk" construction managers and the entity performing the construction component of design/build contracts. July 7, 2007 is the deadline by which everyone covered by the new law must have obtained a license.

The new law provided grace periods, all of which are now expired, for companies to apply for exemption from the examination requirements of the new law. All new applicants will be required to submit to the examination process.

The law contemplates three classes of license: (a) residential – basic for single and two family home construction; (b) residential – light commercial for buildings less than four stories, either wood or metal frame, brick veneer, 25,000 square feet or less, prefabricated structures and pre-engineered structures; and (c) general contracting for unlimited contracting work, including the lower "residential" classes.

BARW Hosts Associated Builder's & Contractor's "Future Leaders" Classes

The Alabama Chapter of The Associated Builders and Contractors is presently conducting its 2006/2007 "Future Leaders in Construction" Course ("FLIC"). Bradley Arant Rose & White is hosting the FLIC class sessions for ABC in Bradley Arant's Birmingham office. FLIC has been highly praised and well received as an excellent training and networking opportunity for ABC member employees who have exhibited leadership potential. The training days for this course are August 2nd, 9th, 16th and 23rd. The keynote speakers scheduled for the luncheons held on each of the course days are Jody Saiia of **Saiia Construction, LLC**, Bill Morton of **The Robins & Morton Group**, Geoff Golden of **Golden & Associates Construction** and Craig Beatty of **C.S. Beatty Construction**. Bradley Arant is very pleased to have the opportunity to host the course and wishes to extend ABC a special thanks for the opportunity to participate in the training of tomorrow's construction leaders.

Bradley Arant Lawyer Activities:

May 8, 2006: Wally Sears was the panel leader for a presentation on "LNG Facilities – Challenges and Opportunities for the Owner and the Contractor in the International Market" at the International Construction Superconference in London, UK.

May 9, 2006: Wally Sears presented an in-house seminar to a client on basic construction contract law principles and the importance of good record keeping.

May 18-19, 2006: Rhonda Andreen and Arlan Lewis attended the ABA Forum on the Construction Industry's Annual Meeting, "Swimming with the Sharks: Litigating the Construction Case and More," in San Diego.

June 2006: Nick Gaede taught a course on International Arbitration in Fribourg, Switzerland. The course was attended by students from the University of Alabama and the University of Fribourg Schools of Law.

June 6 and 8, 2006: **Wally Sears and Jim Archibald** presented two one-day seminars to sales, procurement, and project management employees of a large EPC contractor client on construction contracts, record keeping, and project execution in Beaumont and Tyler, Texas.

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June 14, 2006: David Bashford, John Bond, Eric Frechtel, Michael Knapp, Doug Patin, Mabry Rogers and Colin Stockton presented a seminar titled "Legal Issues Facing the Construction Professional: The Most Common Pitfalls and How to Avoid Them in North Carolina" in Charlotte, North Carolina.

June 28, 2006: David Owen lectured on the topic of "Legal Aspects of Construction Management" as part of a graduate course at the University of Alabama at Birmingham's School of Engineering.

July 19-21: Arlan Lewis and Mabry Rogers attended the 2006 ALFA Construction Practice Group Seminar on the topic of "Construction Claims – A Roadmap to Success: How Construction Professionals, Insurers and Counsel Prevent Claims and Limit Exposure." This was the first annual meeting of ALFA's newly formed Construction Practice Group.

July 22, 2006: John Bond and Wally Sears made a presentation on price escalation, force majeure, and black box (performance essential vendor equipment) liabilities at a large EPC Contractor's in-house seminar for senior management personnel in Las Vegas, Nevada.

July 25, 2006: Donna Crowe, Eric Frechtel, and J.R. Steele presented a seminar titled "Construction Lien Law" in Washington, DC on Maryland, District of Columbia, and Virginia mechanic's lien laws.

August 21- November 20, 2006: Wally Sears will teach a Construction Law course at the University of Alabama School of Law.

August 24, 2006: Axel Bolvig and Rhonda Andreen will present the legal portion of a seminar titled "Managing Construction Projects" in Birmingham, Alabama.

September 2006: An article titled "Mechanic's Liens in Alabama" written by **Axel Bolvig and Rhonda Andreen** will be published in the September issue of the National Association of Credit Managers' magazine.

September 28, 2006: Sabra Barnett, Rob Campbell, John Hargrove, Mitch Mudano, and David Pugh will present a seminar titled "Fundamentals of Construction Contracting" in Birmingham, Alabama.

October 2006: Mabry Rogers is the coordinator and will be one of the speakers at a Bradley Arant conducted client seminar to be presented at a client's headquarters in New York on the topics of Sarbanes-Oxley compliance for public companies and the upcoming changes regarding electronic discovery embodied in the Federal Rules of Civil Procedure. New York CLE credit will be given for the seminar.

NOTE: WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY CONTACT ANY ATTORNEY LISTED ON PAGE 7 OF THIS NEWSLETTER.

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BRADLEY ARANT ROSE & WHITE LLP Fourth Quarter 2006

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Update on Engineer Testimony Rules and Regulations

As was touched on in the third quarter newsletter, a July 28, 2006 opinion by the Supreme Court of Alabama announced a dramatic change to legal standards for expert engineering testimony in Alabama. The court was faced with the meaning of a 1997 amendment to Alabama's engineering licensure statute, which added the word "testimony" to the definition of what constitutes the "practice of engineering" in Alabama. The court held that, as a result of the 1997 amendment, an expert seeking to provide testimony on issues related to engineering must be a licensed Professional Engineer ("PE") with the State Board of Licensure for Professional Engineers and Land Surveyors ("the Board").

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In addition to the evidentiary implications of the recent Supreme Court holding, there are also criminal penalties for violation of the licensing statute. The Alabama Code makes it a Class A misdemeanor for anyone to practice, or hold himself or herself out as qualified to practice engineering within this state without being licensed by the Licensure Board. This fact raises the stakes for lawyers, engineers, and litigants seeking to understand the effects of this ruling.

The decision leaves many questions unanswered. For example, it does not explore whether the administrative definition and licensing statute apply to engineering tasks performed in other jurisdictions for litigation pending in Alabama, including: 1) design, research, testing, and production engineering conducted by manufacturing employees; 2) engineering analysis done outside the State of Alabama; or 3) testimony from a deposition conducted outside the State. These were not considered by the Alabama court.

In response to the uncertainty created by the recent decision, the Board held a public meeting on August 10-11, 2006, to receive comments from interested parties, including members of the legal and engineering communities. In response to the issues raised at the hearing, the Board, on August 28, 2006 issued an advisory opinion further outlining the Board's definition of "testimony." That advisory opinion provides, in part, as follows:

> [T]estimony that constitutes the practice of engineering is also limited by the Board's administrative definition of testimony by being applicable only to testimony related to engineering activities in the State of Alabama. This opinion, for instance, would not prevent a person who is not

> licensed in engineering in Alabama from testifying in Alabama about engineering work or design performed outside of Alabama, such as the design of an automobile part or other product designed outside of the State of Alabama, nor would it prevent an unlicensed individual from offering opposing testimony should the court declare the opposing expert otherwise qualified.

This excerpt, taken together with the definition of "testimony" in the Board's regulations, suggests that the Board intends for an expert who conducts all of his or her "engineering work" in a foreign state to be allowed to testify in Alabama without violating the licensure statute. While the Board has attempted to clarify and narrow the scope of the recent ruling, substantial uncertainty remains.

If an engineer's activities are not exempted under the advisory opinion, or if a trial court determines that the witness is engaged in the practice of engineering, he or she must have an Alabama Engineering license in order to testify. Alabama provides reciprocal licensure for engineers who are currently licensed in another state. Additionally, the Board may authorize an applicant licensed in another state to practice engineering on a temporary basis while his or her application is pending.

Alabama's next legislative session does not begin until February 2007. Until the legislature addresses the situation, litigants should carefully plan their strategies in cases where engineering testimony is needed.

Other states have recently ruled on this issue as well. The South Carolina Supreme Court recently refused to endorse an interpretation of the professional engineer licensing statute that had the potential of either preventing out of state experts from testifying in South Carolina courts or imposing the burden of getting licensed in South Carolina simply to be permitted to provide forensic testimony. Additionally, the Supreme Court of Illinois held that while the presence of an Illinois license may be a factor for a trial court to consider in deciding on whether to allow an expert witness, the lack of such license is not a bar to giving expert testimony in a civil case.

Prohibiting A Bid By Another Company May Be Problematic

Public bidding depends on free and open competition to obtain the lowest responsive price. Prospective bidders must be wary of any practice which might be construed to limit competition. In a recent decision by the federal appellate court that supervises federal trial courts on the west coast, a distributor for Johnson Controls ("JCI") alleged it had been instructed by JCI, pursuant to its distributorship agreement with JCI, not to submit bids on at least two public projects (Long Beach VA Hospital; University of California, Riverside). Apparently the distributor complied and then filed an arbitration (under the distributorship agreement) alleging antitrust and interference with the contract. The arbitrators found in the distributor's favor. The distributor also filed a qui tam action alleging violation of the federal and California False Claims Acts. Whether bid-rigging can be a violation of either the federal or California False Claims Acts is a complex issue that generally requires full development of the factual underpinning for "false certification" or "fraud in the inducement" theories regarding the government's award of the underlying contract. Hence, the distributor was allowed to go forward with its qui tam suit against JCI.

We have no reasons to believe that preventing bids by potential competitors occurs frequently, if at all. To the extent your company encounters such a situation (or suspects it), you will want to seek your lawyer's guidance.

Claims To The Government Must Be Certified In Good Faith

On October 13, 2006, the Court of Federal Claims issued an opinion reminding contractors that certified claims to the government must be "made in good faith" and that "to the extent a contractor increases the claim submission by the fraudulent addition of items or costs or by misrepresenting its claim items or costs," the contractor will be "liable to the government for an amount equal to such unsupported part of the claim."

The general contractor certified a claim for $64 million in equitable adjustments even though only $13.4 million of the claim constituted "incurred damages," with the remaining $50 million as projected future costs. After the government denied its claim, the contractor filed a complaint seeking damages in the full amount of the claim, without distinguishing the incurred from the future costs.

The court held that the Contract Disputes Act requires that claims be certified in "good faith" and that "the amount requested [must] accurately reflect[] the contract adjustment for which the contractor believes the government is liable." After listening to testimony of the contractor's own witnesses, the court found that the contractor had submitted the claim as a negotiating ploy; that the general contractor did not believe that the government owed it $64 million as a matter of right; and that its claim was "an attempt to defraud the United States." The court stated that even though a contractor may claim future expenses, the contractor's claim must show that projected costs are in good faith, in compliance with the FAR, and clearly identified as costs not yet incurred.

The court found in favor of the government on its counterclaims against the contractor for fraud. The court held that the contractor made its claim for purposes other than a good faith belief that the government owed the contractor the amount certified in its claim and awarded the government $50 million, the amount of the certified claim that was "fraudulent

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without question." In doing so, the court chastised not only the contractor, Daewoo, but its lawyer and consultant as well.

A contractor must only certify a claim in the amount that it believes in good faith is due and that at the time of certification the data submitted is accurate and complete to the best of the contractor's knowledge. Further, the court noted that a contractor cannot "cure" a fraudulent claim. Therefore, this case reminds contractors that before certifying claims to the government, it is important to include only costs and pricing amounts for which the contractor believes in good faith the government is liable. When the claim includes the claims of subcontractors, the contractor must believe the subcontractor has stated a *prima facie* case, but need not audit the subcontractor's claim.

Attorneys' Fees in Arbitration: Be Careful What You Ask For

It is not uncommon for an arbitration agreement to be silent about whether the arbitrator(s) may award attorneys' fees. Even so, the parties often ask for their attorneys' fees once arbitration is underway. After all, if you don't ask for them, you won't get them, and the other side will probably ask for them anyway. We can always withdraw the request later. Or so goes one school of thought. Recently, the federal appeals court supervising trial courts in Colorado, Kansas, New Mexico, Oklahoma, Utah and Wyoming decided that such a request for attorneys' fees would cost the losing party $193,000.

In that case, Hollern initiated arbitration against Wachovia claiming that a Wachovia broker acted negligently and breached its fiduciary duties in managing a family trust. The account agreement between Hollern and Wachovia called for arbitration of all disputes according to either NASD or NYSE procedures, but was silent as to the award of attorneys' fees in the arbitration. Hollern chose NASD procedures, which grant arbitrators the authority to award attorneys' fees.

In her statement of claim, Hollern sought attorneys' fees. Wachovia likewise sought attorneys' fees in its answer. In addition, both parties signed an NASD Arbitration Uniform Submission Agreement in which they agreed to submit the issues identified in their pleadings to arbitration.

At the conclusion of the arbitration, the arbitrators asked the parties to submit affidavits of attorneys' fees. In her submission, Hollern argued that an award of attorneys' fees was not only permitted under NASD's procedures, but also under a Colorado statute, which she argued was applicable. Wachovia also relied on Colorado law in support of its claim for attorneys' fees.

The arbitrators issued an award denying Hollern's claims in their entirety and awarding Wachovia $193,000 in attorneys' fees under the Colorado statute.

Hollern filed a motion in district court to have the attorneys' fees portion of the award set aside. Hollern argued that the arbitrators erred in applying Colorado law and exceeded their powers in awarding attorneys' fees. According to Hollern, Virginia law governed the dispute and required that the parties expressly authorize an award of attorneys' in their arbitration agreement. Because the account agreement between Hollern and Wachovia contained no such express authorization, Hollern contended that the award of attorneys' fees was improper. The district court agreed and vacated the attorneys' fees portion of the award.

The appellate court reversed the district court. It found that even if Virginia law applied and required the parties to expressly authorize an award of attorneys' fees in their arbitration agreement, Hollern and Wachovia satisfied that requirement. Although the account agreement itself did not expressly permit an award of attorneys' fees, the parties' subsequent submissions to the arbitrators, in particular the Uniform Submission Agreement and the attorneys' fees affidavits, amended the original arbitration agreement to expressly authorize attorneys' fees.

Attorneys' fees can be a significant risk and expense in arbitration or litigation. One way to make that risk and expense more predictable in arbitration is to expressly address the arbitrator's authority to award attorneys' fees in the arbitration agreement. Where the arbitration agreement is silent, parties should be aware that certain conduct during the arbitration, such as specific requests for the award of attorneys' fees, may be found to modify their agreement, and that later withdrawal of such a request may not undo the modification.

Condominium Projects: Assessment of Risks

As the real estate market fluctuates, an owner/developer may seek to convert what started as a residential construction project (e.g., rental apartments) to a condominium/cooperative project. Such a transition creates increased risks for the contractor and should be evaluated carefully before agreed to by the contractor. For example, although a contractor may have insurance coverage for completed operations for residential work, that coverage may exclude condominiums and cooperatives. One reason for such an exclusion is that warranty obligations on residential projects are sometimes shorter in duration than warranties on condominium or cooperative projects. Indeed, in the District of Columbia, a 2-year warranty against structural defects is required by statute for condominiums. Another increased risk to the contractor arises from the multiple ownership aspect of a condominium project. Whereas, for a residential project, the contractor generally must satisfy only one owner at project completion, for a condominium project the contractor is subject to the standards, opinions and demands of multiple owners, and thus a higher level of individual scrutiny regarding material and workmanship. This tends to complicate, extend and increase

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the costs of the punchlist, close-out and warranty phases. Multiple ownership may also expose the contractor to potential lawsuits by multiple owners for construction defects, warranty issues, mold-related liability, and other claims.

While the laws of the jurisdiction where the project is located and the specific obligations in the proposed construction contract are paramount considerations for a contractor's risk assessment and choices, there are several contractual ways a contractor can try to partially mitigate the increased risks associated with a change from apartments to condominiums or cooperatives. For example, the contractor can price the cost of the change and add it to the contract price. This could take the form of an additional lump sum for labor and material per condominium unit, an additional lump sum for an expanded QA/QC plan, additional monthly amounts for extended warranty periods, or numerous other options. Contractors should carefully consult with their estimating team to make sure all cost issues are addressed.

Another way for a contractor to partially mitigate the increased risk is to contractually limit its liability. This could take the form of a cap on warranty liability, an indemnity and hold harmless agreement from the owner/developer for claims brought by individual owners, express waivers of liability by the owner/developer, and other contractual limits. In addition, there are several insurance carriers that offer project-specific insurance policies designed for residential exposure for both apartments and condominiums.

Because the risks of a condominium project are affected not only by the specific obligations expressed in the contract but also by the different laws of the various states, contractors should consult legal counsel to make sure their risk assessments address relevant legal issues.

How Much is Too Much? Preliminary Litigation and Waiver of the Right to Compel Arbitration

In a recent case, the Supreme Court of Alabama held that a general contractor's filing of a motion to dismiss and an Answer before filing a motion to compel arbitration was not a substantial invocation of the litigation process, as would constitute waiver of its right to compel arbitration.

Zedot, acting as a general contractor on a construction project in Jefferson County, entered into a subcontract with Red Sullivan's Conditioned Air Services, Inc. ("CAS") that contained an arbitration clause. However, after Zedot terminated CAS citing deficient work, CAS ignored the arbitration clause and sued in state court.

Zedot filed a Motion to Dismiss, arguing that the statute of limitations barred CAS's claim. The court converted the motion to a motion for summary judgment. After the court denied summary judgment, Zedot filed an answer to CAS's complaint as well as a counterclaim alleging breach of contract. In its answer, Zedot pleaded arbitration as an affirmative defense, stating that it asserted its counterclaim only to preserve that claim. One month later, CAS filed an answer to Zedot's counterclaim. A month after that, Zedot filed a motion to compel arbitration. CAS opposed the motion, arguing that Zedot had waived its right to arbitration by participating in the litigation process. The trial court agreed with CAS and denied Zedot's motion to compel arbitration, and Zedot appealed.

The Alabama Supreme Court reversed, adopting the "substantiality" test used by most courts in analyzing waiver of arbitration. The court stated that a party opposing arbitration "must demonstrate that the movant has substantially invoked the litigation process and thereby the opposing party would be substantially prejudiced if the case were submitted to arbitration." It then referred to the Federal Arbitration Act's preference for enforcing arbitration clauses, and to Alabama's presumption against waiver of the right to compel arbitration. The court stated that the fact that the motion was converted to a motion for summary judgment was not dispositive of the issue. Significantly, the court noted that the summary judgment motion did not impose upon CAS a burden to engage in discovery in order to oppose the motion.

The court held that CAS was not substantially prejudiced by having to arbitrate. Only four months had passed from the filing of the complaint to the filing of the answer, which claimed arbitration as an affirmative defense. No discovery had taken place, and no hearings were held. The court also noted that Zedot's initial motion to dismiss was based on the statute of limitations, and that Zedot had not had judgment entered against it on any aspect of CAS's claim.

One can glean an important lesson from this decision. The court found significant the fact that little discovery had taken place, and that Zedot had mentioned arbitration as an affirmative defense in its answer. When deciding whether to invoke an arbitration clause, sooner is always safer than later. Had Zedot answered and counterclaimed without mentioning arbitration in its answer, it is possible that the court would have decided that Zedot had substantially invoked the litigation process to CAS's prejudice, and therefore waived its right to compel arbitration.

No Notice? No Worries?

The rule that contractors who bring claims for damages based on differing site conditions must first provide "prompt written notice" to the contracting officer continues to be eroded in the government contract context. A recent Armed Services Board of Contract Appeals ("ASBCA" or "Board") opinion follows this current trend in the caselaw.

The recent ASBCA case, relying on four previous ASBCA decisions, held that in order to invoke the notice requirement contained in standard FAR clause 52.236-2 as a defense to a differing site condition claim, the government

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must establish that "it was prejudiced by the absence of the required notice." Furthermore, the Board held that the notice requirement is "waived if the government has actual or constructive notice of the conditions encountered," in spite of the words in FAR 52.236-2 that "the Contractor shall promptly and before conditions are disturbed, give a written notice to the contracting officer of" differing site conditions.

In this case, the contractor received a contract to bury electrical cable at Fort Carson, Colorado. The contract required the contractor to place the electrical cable underground and dig 4 to 6 inch conduits along a five-mile route. The basis of the differing site condition claim was that after the contractor began digging the conduits, the company discovered that the soil along the route was filled with underground debris including rebar, concrete and asphalt. The contractor claimed the debris constituted a differing site condition and that it was entitled to damage done to its drill as a result of this condition. The Board concluded that the differing site condition claim was valid.

In regard to notice, the Board found that the contractor discovered the differing site condition as of October 1 and that the government did not receive written notice of the conditions until December 12. However, the Board found that the contracting officer was aware of the condition as a result of several site visits and phone calls on the part of the contractor. The contractor continued to incur damage until it finished the job the following November and during that time continued to inform the government that the damage to its drill was a result of the differing site condition.

The Board made no finding as to the exact date the government gained actual or constructive notice of the differing site condition but nevertheless held that because the government had actual notice of the condition and was not prejudiced by a lack of written notice, the notice requirement was not a bar to the contractor's differing site condition claim. In so holding, the Board relied on the rule that "the written notice requirements are not construed hypertechnically to deny legitimate contractor claims when the government was aware of the operative facts." Thus, as a result of this case and cases like it, the written notice requirement in FAR 52.236-2 will not bar recovery in a differing site condition case if the government has knowledge of the condition or was not prejudiced by the lack of written notice.

Public Bid Laws and Bid Documents Requirements are Strictly Enforced -- Or Else

A recent case decided by the Louisiana Supreme Court articulates the standard that public bid document and bid law requirements must be strictly followed. Louisiana, like many jurisdictions, has adopted statutory requirements for the administration of public contracting projects. Often, the public bid package distributed to potential contractors is confusing, inconsistent, and invites error. However, a recent Louisiana case makes clear that in Louisiana it is critical to comply with *all* of the requirements in *all* of the bid documents or an awarded project may go to a competitor.

In this case, the City of New Orleans issued the requirements for a demolition project in a seven-page bid package. The bid documents required that a copy of the City's invitation to bid be attached to the back of the submitted bid package. Hamp's Construction was the low bidder on the base package and the second low bidder on the alternative package. The City accepted the alternative package and awarded the project to the low bidder, Concrete Busters of Louisiana, Inc.

The second low bidder challenged the award because Concrete Busters had not attached the required "City invitation" to the back of its bid submission. The trial court focused on the satisfaction of "substantive formalities" and found for the City and for Concrete Busters. The appellate court disagreed and held that the bid requirements were to be strictly applied. Hamp's Construction argued that a public entity cannot waive any deviation from the bid requirements, so it was irrelevant whether the failure to attach an invitation was insignificant or "substantive." After tracing the development of public bidding law, the Louisiana Supreme Court held that the statute calling for compliance with the bidding requirements was not ambiguous, that the multiple revisions had made it clear that bid documents were to be strictly applied, and that the requirements could not be waived.

Further, the court held that a public entity cannot waive the requirements of the advertisement to bidders, the bid form, or the public bid law. Nor can the public entity distinguish between waivable and non-waivable, or substantive and non-substantive requirements in those documents. A "right to reject all bids" clause does not allow the public entity to circumvent the bid rules. The court focused on the application of the Louisiana statute that states: "the provisions and requirements of this [bid law], those stated in the advertisement for bids, and those required on the bid form shall not be waived by any public entity."

The practical relevance of this case centers on compliance with the requirements of the bid package. One can see that a simple error or omission can lead to disastrous results, either by not being awarded the job or having to fight the award in court. Public entities and contractors need to take to heart the significance of each requirement that is presented in a bid package because each one counts, and according to Louisiana, there is no room for waiver.

OSHA Violation Admissible to Show Construction Company's Negligence in Action Brought by Non-Employee

The Nebraska Supreme Court recently held a violation of an Occupational Safety and Health Administration (OSHA)

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regulation may be admissible as evidence of negligence where a third party non-employee brings a negligence action against a construction company.

In the summer of 2001, fire damaged John Orduna's home in Omaha, Nebraska. The fire caused extensive damage to the home, forcing Orduna to move out until it was repaired. Orduna subsequently hired Total Construction Services ("Total") to repair the home. After construction began, Orduna stopped by the house one night to collect some of his personal belongings from the basement. Meanwhile, Total had removed the basement stairwell and failed to erect any guardrails across the doorway—OSHA regulations provide that *employees* shall be protected from falling more than 6 feet by guardrails, covers, or personal arrest systems. Not knowing the stairwell had been removed, Orduna fell through the dark opening to the basement floor and fractured his ankle.

Orduna filed a negligence action against Total alleging the construction company was negligent in failing to keep the premises safe, failing to warn him of the unsafe or hazardous conditions on the premises and violating specific OSHA regulations. At trial, Total argued that any evidence of OSHA violations should be excluded since Orduna was not an employee and the regulations therefore did not apply to him. However, the trial court disagreed, reasoning that while OSHA exists to protect employees from unsafe work conditions, it should apply equally to any person who legitimately finds himself in the same place as an employee. Accordingly, the trial court allowed the jury to consider any OSHA violations it found as evidence of whether or not Total had been negligent.

On appeal, the Nebraska Supreme Court upheld the $183,000 jury verdict in favor of Orduna, finding evidence of OSHA violations is relevant and admissible in negligence actions involving an employer and non-employee. The court did limit its holding by recognizing that a violation will not establish negligence as a matter of law, but rather is evidence the fact finder may consider in deciding the issue of negligence. The court also noted that some OSHA regulations impose a higher standard of conduct on employers than would normally be recognized in the industry with respect to third parties and non-employees. In such cases where a non-employee brings suit, the employer would be permitted to argue those circumstances to the jury.

This case emphasizes the importance of complying with OSHA at all times. OSHA regulations help in securing the safety of employees and non-employees alike, but perhaps more importantly, they can help shield employers from exposure to unwelcome litigation and liability.

Bradley Arant Lawyer Activities:

August 21- November 20, 2006: Wally Sears is teaching a Construction Law course at the University of Alabama School of Law.

August 24, 2006: Axel Bolvig and Rhonda Andreen presented the legal portion of a seminar titled "Managing Construction Projects" in Birmingham, Alabama.`

September 2006: Axel Bolvig has been recognized for inclusion in *The Best Lawyers in America* in the specialty of Construction Law.

September 2006: An article titled "Mechanic's Liens in Alabama" written by **Axel Bolvig and Rhonda Andreen** was published in the September issue of the National Association of Credit Managers' magazine.

September 28, 2006: Rob Campbell, John Hargrove, Mitch Mudano, and David Pugh presented a seminar titled "Fundamentals of Construction Contracting" in Birmingham, Alabama.

September 29, 2006: Michael Knapp lectured on the topic of project documentation at the Federated Electrical Contractors' Fall Meeting in Anaheim, California.

October 2006: David Owen completed the Associated Builders and Contractors' Future Leaders in Construction Program

October 5, 2006: Mabry Rogers coordinated and was one of the speakers at a Bradley Arant conducted client seminar presented at a client's headquarters in New York on the topics of Sarbanes-Oxley compliance for public companies and the upcoming changes regarding electronic discovery embodied in the Federal Rules of Civil Procedure. New York CLE credit was given for the seminar.

October 10, 2006: Doug Patin presented a session on Builder's Risk Issues during the Construction Café at the International Risk Management Institute (IRMI) Construction Risk Conference in San Diego, California.

October 12-13, 2006: Rhonda Andreen, David Bashford, Jonathan Head, Michael Knapp, and Arlan Lewis attended the ABA Forum on the Construction Industry's Fall Meeting in Scottsdale, Arizona.

October 25, 2006: **Chris Danley, J. R. Steele, and Doug Patin** attended the Court of Federal Claims 19th Annual Judicial Conference in Washington, D.C.

NOTE: WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY CONTACT ANY ATTORNEY LISTED ON PAGE 7 OF THIS NEWSLETTER.

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BRADLEY ARANT ROSE & WHITE LLP First Quarter 2007

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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The Costly Burden of E-Discovery: One State's Approach to Compelling and Allocating Costs for Production from Back-Up Tapes

Recently, issues concerning the allowable scope of costly and time-consuming electronic discovery have received considerable attention by courts and legal commentators. A growing number of companies are installing technology that records and stores all electronic data produced or received by its personnel on back-up electronic tapes for the purpose of recovering lost information in the event of catastrophic computer failures. Generally, this technology takes a global "snap-shot" of all electronic data on the corporate network at pre-determined intervals (often each night) and records the data on off-site back-up tapes. To accommodate the volume of information stored with each "snap-shot," the back-up tapes are not designed to be searchable for individual documents, users or subject matter. The restoration process is costly, requiring a total reproduction of all electronic data stored during each "snap-shot," and is usually only considered worthwhile in the instance of a total system loss. In addition, because new information is created, received and deleted between "snap-shots," any search for documents over a given period of time will require a full reproduction of all back-up tapes utilized during that time period.

In legal disputes, these electronic back-up tapes provide parties with another source of potential discovery, as the archived data on those back-up tapes may contain information or electronic versions of documents not otherwise available. Courts around the country faced with discovery requests seeking production from such back-up tapes have attempted to balance the benefit of obtaining information with the substantial cost and burden associated with the reproduction efforts described above, resulting in a variety of "tests" and "factors" offered by the courts in different jurisdictions.

A recent pair of opinions from the North Carolina Business Court provide a useful analysis of balancing between the benefit and costs associated with so-called "e-discovery" from electronic back-up tapes. In the two opinions at issue, the Business Court highlighted a useful distinction between the obligations of parties to a lawsuit and those of non-parties with no direct role in the pending lawsuit, as well as how specific cost and benefit factors would be weighed in each

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instance to determine the extent and nature of required production. We treat them at unusual length because of the growing importance of this issue.

The Cases and Discovery Requests

In the first of its opinions, the court addressed the production obligations for a non-party insurance broker (represented by this firm) subject to a subpoena served by an insurer-defendant that had been sued by the insured-plaintiff in a coverage dispute. Despite the broker having already produced extensive hard-copy documentation in response to the insurer's subpoena, the insurer sought an order from the court requiring the non-party broker to forensically retrieve and produce e-mails from eight of its employees over a two-year period contained on approximately 350 to 400 electronic backup tapes. The non-party broker, complaining that the request was "unreasonable, oppressive and an undue burden," offered evidence that it would incur costs of approximately $1,395,960 to $1,400,920 associated with the identification, restoration, extraction, conversion, and processing of e-mails on its back-up tapes as required to comply with the insurer's request.

In the second of its opinions, the court addressed the production obligations of a party to the lawsuit in the context of a request for production. In this case, the plaintiff alleged that the corporate and individual defendants improperly made use of and disclosed trade secret information belonging to plaintiff. Through a request for production, defendants sought documents relating to the development and implementation of the alleged trade secrets by plaintiff, specifically, including a large number of e-mails stored on electronic back-up tapes concerning the original development of the trade secret information. Plaintiff offered evidence that in order to comply with defendants' request, it would have to restore over 400 backup tapes at a cost in excess of $54,000.

The Factors for Consideration

In both cases, after considering a number of other tests offered by courts from other jurisdictions, the Business Court refused to adopt a separate test specifically for electronic discovery and based its decision on the general rules of discovery already in place.

In the case of non-party production, the court refused to compel the requested discovery, articulating the following factors that should be considered under North Carolina rules in deciding whether to compel such e-discovery from a non-party: (1) the size of the expense and the burden of production placed upon a non-party; (2) the breadth of the information sought; (3) the availability of the requested information from other sources, (4) the fact that the information sought was on inaccessible back-up tapes; (5) the absence of any unwarranted or suspicious destruction of information; and (6) the level of marginal utility (*i.e.*, the likelihood that a request would unearth critical information weighed against the cost of complying with the request) shown at this stage of the proceedings.

When addressing the discovery request from a party in the second case, the court ordered the requested production, but held that the requesting party would have to share in the costs of the production effort. In the context of a request for retrieval of documentation stored on the back-up tapes of a party to the lawsuit, the court articulated a slightly different set of factors under North Carolina rules for consideration: (1) the burden and expense of production; (2) the needs of the case; (3) the amount in controversy; (4) any limitations on the parties' resources; and (5) the importance of the issues at stake.

Party vs. Non-Party Production

Distinctions between the factors considered by the Business Court in addressing party and non-party e-discovery, as well as the different results in the court's ultimate decisions in those two contexts, evidence the additional protections that courts will afford non-parties. Generally, as demonstrated by the above distinctions in the court's analysis, the two opinions evidence a clear judicial intent to distinguish between e-discovery requests directed towards parties and non-parties, with requests for production from non-parties receiving additional scrutiny and protections against being unduly burdensome.

Protecting Your Company

For those seeking to avoid being compelled to reproduce information and documentation from electronic back-up tapes, most of the relevant factors a court would consider will be outside of your companies' control, *e.g.*, whether or not your company will be a party to the lawsuit, the amount in controversy in the lawsuit, and the necessity of the information requested in the context of the issues at stake in the lawsuit. However, this pair of opinions from the North Carolina court does indicate at least two interrelated steps that companies can take to minimize their potential exposure to being compelled to produce information from electronic back-up tapes.

In the first opinion, the court noted that the broker offered evidence of its corporate policy during the time period in question "requir[ing] that a printed copy of every computer-generated document, including those forwarded to the client, and every subst[antive] e-mail discussion … be maintained as part of the insurance placement file." According to the court, this policy made it likely that the requesting party had already received all relevant documentation through prior hard-copy productions by the non-party. Therefore, the court believe the probable utility of ordering the expensive and burdensome reproduction of information from back-up tapes was greatly lessened, which argued strongly in favor of refusing to order the requested production. By (a) enacting and enforcing corporate policies requiring employees to retain all relevant and substantive emails and (b) producing those files in

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response to an appropriate discovery request, a company can take proactive steps towards strengthening its later arguments to avoid a costly production of e-mails from electronic back-up tapes.

Conclusion

As companies become more technically sophisticated and seek to protect their information through the use of back-up systems, the potential advantages of being able to review all a company's e-information will push many parties to seek costly discovery from back-up systems from parties as well as non-parties to lawsuits. As evidenced by the two opinions discussed above, the determination of whether to allow such discovery and how to allocate the associated costs will be factual in nature and unique to each case, with many of the factors outside of the parties' control. However, companies can put themselves in a stronger position to argue against production or in favor of cost shifting by instituting the policy discussed above and complying with discovery requests in good faith.

Statutory Payment Bond Notice: Florida Appeals Court Holds Work "Complete," Even If Tasks Remained To Be Performed To Obtain a Certificate of Occupancy

Clients frequently ask the question, "When does the time for me to file a lien begin to run?" The question is an important one because failure to file within the statutory mandated time will result in the loss of lien rights. Most states have statutes which require payment bonds on public projects, which payment bonds, in effect, stand in place of the statutory lien rights. A few states, including Florida, have statutes which allow for statutory payment bonds on private projects. The other states with similar statutes are Louisiana, Mississippi, Texas, and Utah. Remember, statutory lien rights, including payment bonds, are in derogation of the common law (*i.e.,* without a statute, you would have no rights) so courts tend to construe such statutory rights strictly.

In a recent decision by the Florida Court of Appeals, the court denied a subcontractor's claim against such a statutory payment bond for failure to provide timely notice. <u>The issue of interest for this Construction Newsletter is the way the Court defined "completion" of the work</u>.

Florida's statutory payment bond statute requires "as a condition precedent to recovery under the bond" written notice by lien claimant of non-payment to the contractor and the surety not later than 90 days of the "final furnishing of labor, services or materials."

While acknowledging that "there are no steadfast rules to apply" in determining what is "final furnishing," the court affirmed a lower court ruling granting summary judgment that as a matter of law:

1. the performance of a final inspection was not required for "final furnishing;"

2. the completion of punch list work was not required for "final furnishing;" and

3. the fact that 1 and 2 needed to be performed for the owner to obtain a certificate of occupancy did not prevent a finding that "final furnishing" had occurred earlier.

The Court defined each of 1, 2, and 3 above as "minor tasks . . . and were simply insufficient to extend the 90-day period for perfecting a bond claim under the statutory bond . . . *Id.* at 699. A key fact relied upon by the Court was that <u>more than 90 days prior to giving its written notice, the subcontractor had submitted two notarized pay applications asserting the work was 100% complete</u> and sought payment of retainage.

Whether the work is complete (or there has been a "final furnishing") is usually a question of fact. The somewhat surprising aspect of this case is that the Florida court held that as a matter of law the subcontractor lien claimant's pay application asserting 100% completion established that the work was complete even though the local authorities had not accepted the work was "complete" so a certificate of occupancy could be issued.

The lessons from this case are the following:

<u>First</u>, if in doubt as to when the work is "complete," file the necessary notice at the earliest time. <u>Second</u>, do not assume that courts understand the construction process and will make a logical decision as to when your work was complete based on "the real world." <u>Third</u>, some sureties will attempt to use every technical defense to defeat claims against the bonds they issue, and as evidenced by this case, sometimes they are successful in having a court make what appears to be a somewhat questionable decision. <u>Fourth</u>, at least in Florida, be careful about claiming in writing that your work is 100% complete and final payment is due, unless that is in fact the case. And, if you take the position in writing that your work is 100% complete, assume the statutory notice period has begun from the date you claim to be complete and file your lien notice within that period of time.

Having A Sophisticated Website Could Mean That You or Your Company Are Subject to a Lawsuit in ANY State

In a Louisiana appellate court case the plaintiff, Quality Design and Construction, Inc., bought from the defendant, Tuff Coat Manufacturing, Inc., for the Defendant to install a polyurethane coat for use on concrete at a water park being constructed by the General. After installation, pigment from the coating leached, causing damage to the park.

The General sued the vendor to recover for the damage allegedly caused by the product. In response, the vendor, a Colorado corporation, contended that it did not have sufficient minimum contacts with the State of Louisiana, and thus, the Louisiana court could not exercise personal jurisdiction over it. The vendor presented an affidavit and other evidence in

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attempting to prove that it did not have the requisite minimum contacts with the State of Louisiana. However, the court's determination hinged on an examination of the vendor's website, and whether that website constituted the requisite minimum contacts with Louisiana for jurisdictional purposes. The website was an informational website, and web users could not purchase the vendor's product via the website. However, the website did provide contact information, including a mailing address and a toll-free telephone number, whereby web users could contact the vendor to place an order. Once the vendor received an order in this manner, it fills the order and ships the order, FOB Montrose, Colorado (i.e. ownership was transferred to the customer once the product left the vendor's loading dock).

The website allowed customers to add their names to a list of customers on one of the webpages, but the customer had to first initiate contact with the vendor to do so. That page listed one Louisiana company as one of its customers; however, the vendor did not sell directly to that company—it was just an end-user of the product.

In analyzing the website, the court utilized an analysis based on a website and noted that "the exercise of jurisdiction is determined by examining the level of interactivity and commercial nature of the exchange of information that occurs on the Web site." The Louisiana court held that the lower court properly sustained the vendor's objection for lack of personal jurisdiction. The court noted that the website did not provide a means for users to make purchases online, and also that the website was not one in which users received regular or repeated information that could be downloaded from the website. The court summed up by stating, "the website merely provides promotional and contact information regarding [the vendor] and its products."

The existence or non-existence of personal jurisdiction always depends on the unique facts of each case. However, this case suggests that if you have a comprehensive, interactive website, that enables web-users to purchase your product or services through the website itself, you could possibly be hauled into court in <u>any</u> state in which a customer is located when it purchases your product or services.

Inadvertent Disclosure or Waiver: The Importance of a Privilege Log When Producing Documents

When producing documents in a lawsuit, there is a fine line between inadvertent disclosure and waiver of the attorney-client privilege. This is why the importance of a privilege log cannot be stressed enough in document production. In a recent case in the United States District Court for the Northern District of Illinois, the court found that the defendant waived privilege as to documents produced because it failed to provide a simultaneous privilege log.

The facts of the case emphasize the crucial nature of a privilege log. The defendant produced its documents at its headquarters (which may also be ill-advised). The defendant did not provide a privilege log. Almost two months later, defendant requested the return of three documents, totaling 17 pages. Two weeks later, defendant requested the return of additional documents, approximately 146 pages. Still later, defendant revised its request to about 129 pages. The defendant failed to produce a privilege log at any of these times.

The defendant's story was that its counsel reviewed the documents and marked four of thirty notebooks not to be produced because they contained privileged documents, work product and irrelevant trade secrets. However, due to a clerical mistake, all of the notebooks were produced for inspection at the defendant's headquarters. When the defendant tried to claw back the documents, the plaintiff refused and asked the court to find that the defendant waived privilege. The defendant claimed inadvertent disclosure.

The court used a three-step approach in its analysis: 1) Whether the documents were privileged; 2) Whether the disclosure was inadvertent; and 3) Whether the privilege was waived. Although the documents were deemed privileged, the court found that the defendant's disclosure was not inadvertent. The primary reason for this finding was that the defendant did not provide a privilege log. The court stated:

> While the absence of the privilege log is not in itself damning evidence that the disclosure was inadvertent, the presence of a privilege log prior to disclosure that contains all the privileged documents at issue would be significant evidence that the disclosure was inadvertent. It would demonstrate clearly that [defendant] intended to keep certain documents from being disclosed.

In determining that the privilege was waived, the court used a balancing test and considered the following five factors: 1) the reasonableness of the precautions taken to prevent disclosure; 2) the time taken to rectify the error; 3) the scope of the discovery; 4) the extent of the disclosure; and 5) the overriding issue of fairness. The court again found that the defendant's failure to provide a privilege log was not reasonable.

The lesson learned is that if a party intends to withhold documents based on the assertion of any privilege, a privilege log should always be provided.

Construction Companies and Freedom of Speech

Contractors often are disappointed in the public bidding arena. Various types of protests can be filed in these situations, usually challenging the contractor's rejection as the lowest responsible and responsive bidder. Contractors in some jurisdictions can be more creative, however.

The Fifth Circuit Court of Appeals (overseeing federal courts in Louisiana, Mississippi, and Texas) has held that corporations can have free speech rights under the First Amendment to the United States Constitution (even though the corporation cannot vote, run for office, join a political

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party, be employed by the government, or be counted in a census). Thus, if a corporation can have free speech rights, it can sue a governmental entity for retaliation.

In the recent Fifth Circuit case, a rejected contractor sued the contracting city, Lubbock, Texas, for violating its freedom of speech rights. The contractor previously sued and won a lawsuit against another Texas city, El Paso, which lawsuit allegedly involved a matter of public concern. During the bidding process, the city officials in the new city, Lubbock, allegedly told the contractor that they thought that it was "litigation happy" because of the earlier lawsuit against El Paso. Despite being the apparent lowest and best bidder, the plaintiff contractor thereafter was not awarded the bid by Lubbock.

The Fifth Circuit decided several key issues in favor of the disappointed bidder. Because the lawsuit was a retaliation claim, the contractor had to show that (1) there was an adverse decision, (2) the speech proceeding the decision was a matter of public and not purely private concern, (3) the contractor's interest in commenting on the matters of public concern outweighed the city's interest in promoting efficiency, and (4) the public comment must have motivated the adverse decision at issue.

The court sided with the contractor on all counts. The contractor's new lawsuit was thus on solid ground because it alleged that it did not receive the bid because it had sued a different city in a different place for a different reason.

On one level, this recent decision appears consistent with law in other areas. For example, a potential employer need not have a prior relationship with a new job applicant in order for the applicant to sue for many different types of retaliation (such as for being a union activist). However, the recent Fifth Circuit opinion provides another creative way for disappointed contractors to challenge work awarded to competitors.

Does a Commercial General Liability Policy Provide Coverage for Claims by an Entity that Did Not Exist During the Policy Period?

Recently a California appellate court clarified a commercial general liability insurance company's duty to defend against claims of construction defects and rejected the insurance company's attempts to limit its obligations in such an instance. The case involved claims by a homeowners' association against the prior owner and developer of a large residential condominium project seeking damages caused by mold infiltration, including cost of remediation, costs to repair the damaged property, relocation, diminution in value and loss of use. The association estimated that their damages exceeded $20 million. The prior owner and developer tendered their defense to their insurance company under a formerly existing commercial general liability policy effective during the early stages of construction. Specifically, during the course of the project, Standard Fire Insurance Company issued an occurrence-based commercial general liability policy covering the period of August 6, 1991 to August 6, 1992. The policy was actually cancelled effective June 26, 1992. The policy language provided coverage for bodily injury or property damage only if such injury or damage occurred during the policy period.

Prior to trial, the insurance company filed a motion with the court seeking a determination that it owed no obligation to defend the prior owner and developer under the policy. The insurance company alleged that the homeowners' association and the individual owners could not have been damaged during the policy period, since the association had not even been formed until *after* expiration of the policy, and the individual owners had not yet purchased their interests. Therefore, the insurance company reasoned that the association and the individual owners could not have suffered any damages during that time period. The homeowners' association countered by arguing that damage occurred to the project during the policy period, and it was immaterial who owned or possessed an interest in the property at the time of the damage.

Central to resolution of the matter were the conclusions of the association's consultants that significant damage to the condominium units had occurred as early as 1990 and continued throughout the insurance policy's coverage period. For purposes of its motion, the insurance company agreed that the property had suffered damage during the policy period, but argued that the court should focus on when the *claimants* were actually damaged versus when the alleged wrongful *acts* were committed. In sum, the insurance company argued that the occurrence that would trigger coverage should be established when the *complaining party* was damaged, not the property.

The trial court accepted the insurance company's arguments and ruled that the company had no duty to provide coverage under the applicable policy. In reversing the trial court and rejecting the insurance company's position, the California appellate court ruled that coverage was triggered by damage to the property during the coverage period. The appellate court examined a long line of California insurance cases and found it significant that, despite the position of the insurance company, the property was actually owned by one of the insureds (prior owner and developer) at the time the damage occurred. More importantly, the appellate court noted that the policy did not expressly require that the "eventual claimant own the property at the time the property is damaged for coverage to ensue." Therefore, the pertinent question for triggering coverage was not *who* owned the property at the time of the alleged damage, but rather did the alleged *damage* occur during the policy period.

There are two major lessons to be learned by this decision. First, it is significant to determine whether the applicable commercial general liability policy is an "occurrence based" or "claims based" policy. Under an "occurrence based" policy, coverage is typically triggered,

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and thus there is liability under the policy in effect, when the damage occurred. Conversely, under a "claims based" policy, coverage is typically triggered when the claim is discovered. Second, it is important to further examine the applicable policy to determine whether the language of the policy requires the claimant to possess an ownership interest in the property at the time the damage occurs in order to trigger coverage. We expect that future policies will reflect changes to limit coverage and minimize risks of coverage in these instances.

Work Plans and Plain Meanings by the Wayside: Government Contractors Must Ensure Industry Terms and Scope of Work Are Defined in Contract Specifications Before Submitting Bids

A recent decision by the Court of Federal Appeals illustrates the need for contractors to carefully review and implement changes to government contract specifications, in writing, before bids are submitted. TEG entered into a contract with HUD to remove asbestos-containing material in the Geneva Towers in San Francisco. During pre-award discussions, an ambiguity in the contract specifications led TEG to question whether it was required to remove asbestos-containing materials in the pores, cracks and voids of the concrete of the building. In response, HUD issued a revised specification that stated "[a]sbestos-containing materials applied to concrete, masonry, wood and nonporous surfaces . . . shall be cleaned to a degree that no traces of debris or residue are visible." Despite the change, TEG disputed whether the contract required TEG to abate asbestos-containing material in the pores and cracks of the buildings' surfaces after work began, arguing that the specifications only required that "surfaces," as defined in common usage dictionaries, be cleaned such that no "debris" and "residue" existed. TEG reasoned that it did not have to remove material in pores and cracks because it was not "debris" or "residue" on a "surface." TEG also asserted that it was only required to comply with the work plan it submitted where conflicts existed between the contract specifications and TEG's work plan because the work plan was physically attached to the contract and the bid regulations had required that TEG submit a detailed work plan. These disputes led to delays, cost overruns and the assessment of liquidated damages against TEG. TEG sued HUD over the dispute in the Court of Federal Claims. The court sided with HUD on each issue, holding that the contract required TEG to abate all visible debris and residue, including visible debris and residue in cracks and pores, and that the contract specifications trumped its work plan because the work plan was not incorporated into the contract. TEG appealed the court's decision to the United States Court of Appeals for the Federal Circuit.

The Court of Appeals affirmed the lower court's holding that the plain language of the contract required that all visible debris or residue had to be removed, including debris and residue visible within cracks and pores. Significantly, despite finding that there was no ambiguity in the contract's language, the court stated that a court could look to the parties' course of dealing to confirm that the parties intended to go by the plain language of the contract (citing the pre-award discussion between the TEG and HUD to confirm that TEG understood the visibility standard). Additionally, because the terms of art "debris" and "residue" were not defined in the contract, the court held that the lower court did not err in looking to evidence of trade custom to define the terms as being any debris and residue (under the ASTM definition, all debris and residue is assumed to contain asbestos). The court also found that the lower court correctly held that the contract specifications, rather than TEG's work plan, governed the terms of contract performance because the contract did not state that the work plan was to be integrated into the contract and supersede contract specifications; the work plan, which was as an extrinsic document (i.e., one not incorporated into the contract), could not be used to contradict or modify the contract (the concept that extrinsic documents cannot be used to contradict or modify a contract is known as the "parol evidence" rule); and holding that work plans are not incorporated into contracts, absent specific incorporation by reference, was "in accordance with the general principle that the government is entitled to strict compliance with contract specifications," a principle that prevents contractors from submitting low bids and then substituting materials inferior to those specified by contract specifications. The court's holding is significant because, oftentimes, contract specifications and work plans will have significant differences, many of which require the contractor to do more work than called for under its work plan. This case only confirms the fact that contractors cannot rely on work plans submitted with, and even attached to, government contracts.

Before submitting a bid, government contractors should ensure that all industry terms, especially those subject to industry definitions that differ from their plain meanings, and the contractor's scope of work are specifically defined within the contract's specifications. While this may require extra work and diligence on behalf of the contractor, it is advisable. Once bids are received, the parol evidence rule may prevent a court from looking at documents not incorporated in the contract to define the parties' agreement, and government contractors failing to take these extra steps may find themselves performing work they never intended to perform.

OSHA Review Commission Hears Case on "Multi-Employer Citation Policy"

For nearly three decades, OSHA has applied a "multi-employer citation policy" in determining whether to cite a general contractor whose subcontractor creates a hazardous condition which violates an OSHA standard. Under this policy, which is outlined in OSHA Directive No. CPL 2-0.124, a general contractor can be cited as the "controlling employer" even though the general contractor did not create the hazard and its employees were not exposed to it. This policy is based

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on the idea that, if the general contractor has general supervisory power over the worksite, including the power to correct safety violations itself or have others correct them, it must exercise "reasonable care" to detect and prevent violations on the site. Over the years, thousands of citations against general contractors have been issued under this "multi-employer citation policy" and there have been relatively few legal challenges to it.

However, in October 2006, the OSHA Review Commission heard oral arguments in a case in which a Texas-based general contractor has challenged the legality of OSHA's "multi-employer citation policy." In that case, Summit Contracting was the general contractor for the construction of a college dormitory in Little Rock, Arkansas. While on the project, Summit's masonry subcontractor failed to ensure that its employees were utilizing fall protection as required by OSHA's standards. OSHA cited Summit for this violation under its "multi-employer citation policy," alleging that, as the "controlling employer," Summit had a duty to detect the violations and make the subcontractor correct them. After an Administrative Law Judge ruled in OSHA's favor, Summit appealed the citation to the Review Commission. Summit has argued that neither the OSH Act nor any valid regulation imposes on one employer a duty to ensure that a separate employer complies with OSHA and that OSHA has no statutory authority to issue a citation against it for violations committed by its separate subcontractor. The OSHA Review Commission appears to be intrigued by Summit's case as this is the first time in nine years that it has heard oral arguments in an ALJ appeal.

According to reports, the biggest obstacle for Summit may be the many years of precedent growing out of OSHA's long standing enforcement of the policy. Some of the members of the Review Commission panel questioned the attorney for Summit about this established precedent, indicating that they may be reluctant to reverse course. On the other hand, one of the panel members questioned OSHA's attorney about reservations concerning the policy which have been expressed by several judges on the U.S. Court of Appeals for the D.C. Circuit (one of the circuit courts to which Summit ultimately could appeal an unfavorable OSHA Review Commission ruling). Other panel members suggested that they had concerns with the scope of the policy, including which factors were relevant to whether a general contractor has the requisite control over its subcontractors. One commissioner remarked that he did not understand why OSHA had not drawn a "bright line" to define the scope of a general contractor's responsibility for taking action to correct a subcontractor's violations.

While this case may not ultimately result in any change in the law, it does reflect some growing interest in the efficacy of this long-standing policy. The Review Commission's decision remains pending.

Intention that Party Shall be Indemnified for its Own Negligence Must be Expressly Stated in Unequivocal Terms

In the context of indemnity provisions in construction contracts, one area of particular importance is whether a party will be indemnified for damages resulting from its own negligence. In New Jersey, the law requires that indemnification provisions must expressly state in unequivocal terms that a party intends to indemnify the indemnitee against losses resulting from its own negligence. Recently, a New Jersey court found a general contractor liable for damages resulting from its own negligence due to ambiguous indemnity provisions in a sub-contract.

In that case, Raimondo (general contractor) sought indemnification from Weir (sub-contractor) after settling a personal injury action filed by one of Weir's employees for damages he sustained while working on the job. Under Article 11 of the sub-contract, Weir agreed to indemnify the owner and Raimondo against all claims arising out of Weir's work:

> …*to the extent caused* in whole or in part by any negligent act or omission of [Weir] or any one directly or indirectly employed by [Weir] or anyone for whose acts [Weir] may be liable, regardless of whether it is caused in part by a party indemnified hereunder.

In addition, a separate indemnification provision in a rider to the sub-contract provided:

> Weir…shall indemnify…Raimondo…against any and all claims and demands…caused in whole or in part by the acts or omission of [Weir]…or any other person directly or indirectly employed by [Weir], or any of them while engaged in the performance of the Work or any activity associated therewith or relative thereto.

In determining whether Weir should indemnify Raimondo for its own negligence, the court reiterated that a contract will not be construed to indemnify an indemnitee for its own negligence unless such an intention is expressed in unequivocal terms. In other words, the contract must specifically reference the negligence or fault of the indemnitee. Accordingly, the court examined the two indemnification provisions and found they did not expressly state in unequivocal terms the intent that Weir would fully indemnify Raimondo for damages resulting from Raimondo's own negligence. Furthermore, the court found the inclusion of the two different indemnification provision in the same contract created additional ambiguity. Thus the terms of the contract taken as a whole did not meet the standard that indemnity for a party's own negligence must be expressed in unequivocal terms.

The practical lesson here is that parties should pay particular attention to indemnity provisions in form construction

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contracts during the contract negotiation process. In some instances, as in New Jersey, state law requires specific language in order for a party to be indemnified for its own negligence. In this case, a simple revision of the indemnification provision in the contract negotiation process could have prevented unwanted and costly litigation while providing the general contractor with indemnification for its own negligence.

Does An Architect Owe A Duty To the Surety?

The federal district court of Maryland dismissed a subcontractor's surety's negligence claims against the project architect. The surety, which had incurred expenses in completing its principal's installation of exterior panels and in financing the remediation and replacement of panels that had been improperly installed, claimed that the architect had failed to inspect and supervise the work of the contractors. Under Maryland's formulation of the economic loss doctrine, the Court observed that a plaintiff suffering only economic loss must show an "intimate nexus" between plaintiff and defendant by establishing either contractual privity or its equivalent. Here, in the absence of contractual privity between the architect and the subcontractor's surety, or a contractual relationship intended to benefit the surety or its principal, the key question was whether an "intimate nexus" existed between the architect and the subcontractor's surety. Under Maryland law, an architect's duty to use due care in inspection extends to those foreseeably subjected to the risk of personal injury created by the dangerous condition, including liability for the reasonable costs of correcting the dangerous condition where no injury occurs. Under the facts alleged by the surety regarding improperly installed panels, the architect owed a duty to the owner. However, that duty alone did *not* extend to the subcontractor's surety. Because the surety failed to allege facts necessary to show privity or its equivalent between itself and the architect, the surety could not recover under a negligence theory against the architect.

Bradley Arant Lawyer Activities:

Axel Bolvig will serve another term on the 2007 General Contractor/Subcontractor Relations Committee of the Alabama Chapter of Associated Builders and Contractors.

Nick Gaede will teach an EU law course at the University of Alabama and a Negotiation course at Samford University's Cumberland School of Law. He will also teach a course in International Arbitration at Fribourg University, Fribourg Switzerland in June. This is a joint program with the University of Alabama School of Law.

David Hume attended a three-day Federal Government Contracting seminar in Washington, D.C. through George Washington University in late January as well as a U.S. Green Building Council LEED Technical Review last November.

Axel Bolvig has joined **Nick Gaede**, **Mabry Rogers**, and **Walter Sears** for inclusion in The Best Lawyers in America for 2007 in Construction Law.

The Bradley Arant Construction Practice Group held an "in-house" Learning Day on January 23, 2007. The presentation centered on Sureties and Builder's Risk issues. **Doug Patin** of Bradley Arant's D.C. office, Doug Wheeler of AON and Richard J. West, II of BE&K, Inc. spoke on the issues.

Arlan Lewis attended the American Bar Association Construction Industry Forum Joint Mid-Winter Meeting in San Francisco, California on January 24-25, 2007.

Michael Knapp and **David Bashford** attended the Carolinas AGC 2007 Convention in St. Thomas, Virgin Islands January 25-28, 2007.

Mabry Rogers and **Nick Gaede** will attend the annual American College of Construction Lawyers ("ACCL") meeting in Dana Point, California, February 22-25, 2007.

Mabry Rogers and **Rhonda Andreen** will teach a seminar for Board of Education leaders on the pitfalls of construction contracts. **Alan Zeigler** will moderate the program and the tentative date for the Seminar is February 27, 2007.

Joel Brown, **Patrick Darby**, **Arlan Lewis**, and **David Pugh** will speak at a Seminar entitled *Construction Insurance, Bonding, and Liens* on March 16, 2007. Details and registration information for this Lorman Seminar in Birmingham, Alabama can be found at www.lorman.com or 866-352-9539.

Wayne Drinkwater, **Rob Dodson**, **Will Manuel**, **David Farr**, **David Pugh**, **David Owen** and **Ed Everitt** will present a construction "Hot Topics" seminar in Jackson, Mississippi on March 29, 2007, focusing on issues in the hurricane rebuilding effort.

Bradley Arant will conduct a seminar entitled Government Contracting 2.0 in Huntsville, Alabama which is tentatively scheduled for April 2007. The program will discuss topics concerning government claims, project bidding, ethical considerations, and the rights of the contractor. The program will include a special luncheon speaker Don Bishop of Indyne, Inc.

Mabry Rogers will appear on a panel with Joseph Manko and Rodd Bender tentatively scheduled for April 2007, in an ABA teleconference on Environmental Law from the construction perspective. The panel will be moderated by Rhonda Andreen.

For more information on any of these activities or speaking engagements, please contact Rebecca Harris at 205-521-8504.

NOTE: WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY CONTACT ANY ATTORNEY LISTED ON PAGE 9 OF THIS NEWSLETTER.

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BRADLEY ARANT ROSE & WHITE LLP **Second Quarter 2007**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Joel E. Brown	A. H. Gaede, Jr.	Arlan D. Lewis	David W. Owen	Robert J. Symon (d.c.)

VA Must Pay Unpaid Rent

The United States Court of Federal Claims has ordered the Department of Veterans Affairs ("VA") to pay $17.9 million (plus interest) for unpaid rent, finding that the VA improperly terminated its lease and breached its duty of good faith and fair dealing.

Moreland Corporation ("Moreland") constructed a two-story building in Las Vegas to be used as a VA medical clinic. When Moreland completed construction of the building, the VA took occupancy and began its monthly rental payments under a 15-year lease After occupying the building for five years, the VA terminated the lease for default but continued to occupy the building for nine months. At that point, the VA stopped paying its rent and moved to other facilities.

Moreland filed its suit against the VA asserting wrongful termination. The VA argued that it had terminated the lease for default due to Moreland's alleged failure to repair structural deficiencies in a timely manner which allegedly resulted in the building being unsafe for continued occupancy.

The court found that although the building was not "perfectly constructed," the defects were largely cosmetic and easily could have been repaired if the VA had permitted Moreland to do so. The court afforded greater weight to Moreland's expert who testified that the building was not unsafe for the VA's occupancy, especially in light of the fact that VA used and occupied the building without interruption for more than five years, and remained in the building for nine months after termination.

The court also found that the VA breached its duty of good faith and fair dealing with Moreland. Of particular note is the Court's finding that, "In the present case, the conduct of certain VA officials was deplorable by any measure, be it 'clear and convincing' or some lesser standard." The VA initially used alleged building deficiencies in late 2000 as a pretext to have Moreland bear the expense of conducting a structural loading study that VA later used to add a roof-mounted air conditioning system. Additionally, the VA's contracting officer denied Moreland's earlier construction-related claims in the amount of $300,000 based upon VA counsel's recommendation that the claims should be denied "as a means of gaining leverage over Moreland." Court decisions mandate that contracting officers must make independent decisions based on the merits of a contractor's claim. By denying Moreland's good faith meritorious claims in order to gain some advantage over the contractor, the VA

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acted in bad faith. The court thus affirms that the good faith requirement is reciprocal.

In finding that the VA improperly terminated the lease for default, the court also found that the parties had clearly manifested their consent to delete the clause entitling the VA to terminate the lease for convenience. Therefore, the court ordered the VA to pay the net unpaid rent plus interest.

Fifth Circuit Expands Liability of Engineers and Architects

Recently, the United States Court of Appeals for the Fifth Circuit (covering Texas, Louisiana and Mississippi) found that a project engineer could be held liable to a project owner's surety for negligently failing to inspect the workmanship of a contractor and improperly recommending payment, despite the absence of a contractual obligation of the engineer to guarantee workmanship on the project.

The Hancock County Water and Sewer District (the District) contracted with the general contractor to construct a sewage collection system. When the contractor failed to perform, the contractor's surety, Lyndon Property Insurance Company stepped in to complete the project with another contractor. After completion of the project, the surety filed suit against the project engineer for negligence, breach of contract and breach of warranty, alleging that it was required to spend in excess of $900,000 to fix and test defective work done by the prior contractor. The project engineer argued that an exculpatory clause in the contract with the District saved it from liability to anyone except the District. The project engineer argued that it had "disclaimed, by contract, potential liability to a surety standing in the shoes of the District." The trial court agreed and dismissed the case.

The case was appealed to the Fifth Circuit, which held that the surety was entitled to "stand in the shoes" of the District and bring the claim against the engineer, based on the doctrine of equitable subrogation. The court rejected the engineer's argument that an exculpatory clause in the contract relieved it of liability, and instead held that the owner could not "bargain away the engineer's potential duty to a surety that would step into the [owner's] shoes under the doctrine of equitable subrogation." The court further found that while the contract did not clearly impose a duty on the engineer to guarantee the workmanship of the contractor, it did support a duty of the engineer to inspect the work before recommending payment. The court also left open the possibility of imposing liability in egregious cases even where there is no contractual duty to guarantee a contractor's work, if the engineer failed to "meet the standard of employing ordinary professional skills and diligence."

As a result of the Fifth Circuit's holding, engineers and architects can now be subjected to liability for negligent inspection of a project even when no contractual obligation to inspect or guarantee workmanship exists. While this expanded liability may be limited only to "egregious" cases, the determination of whether a particular case is "egregious" will almost always be a question of fact that will be decided by a jury or ultimate finder of fact.

Unlicensed Contractor in Florida Unable to Seek Equitable Remedies

In a recent Florida case, an owner sought a finding from the court that an unlicensed contractor could not recover for work performed. The case arose out of the new construction of a multi-million dollar dairy facility. The contractors were responsible for building commodity barns, a mechanic's shop, a fuel depot, a milking center, four barns and two travel lanes. During construction a dispute arose that resulted in the owner terminating the contractors, after paying approximately $1.4 million dollars. The contractors sought money for work and labor done and also were pursuing a lien claim in state court for about $900,000.

The issue asserted by the owner was whether the defendants were required to hold a construction license. In Florida there is a two-pronged analysis to qualify as a "contractor." First, the party must "construct, repair, alter, remodel, add to, demolish, subtract from or improve" a structure. Second, the party who engages in such an undertaking must have a job scope that is "substantially similar" to a job scope described in the statute (Fla. Stat. § 489.105(3)(a) through (q)). The statute includes subsections for "general contractor," "roofing contractor" and "specialty contractor."

The court found that the defendants in the case clearly met the first prong of the definition of "contractor." The case centered on the second prong. Although they were hired to construct the whole structural component of the project, the court concluded that the defendants did not qualify as general contractors. However, because the defendants did contract and perform the roofing work, the court found that they were roofing contractors, which requires a license under Florida law.

The next issue in the case was whether the unlicensed contractors could seek equitable remedies (on a theory of benefit conferred) in court. The relevant Florida statute provides:

> As a matter of public policy, contracts entered into on or after October 1, 1990, by an unlicensed contractor shall be unenforceable in law <u>or in equity</u> by the unlicensed contractor.

Fla. Stat. § 489.128(1) (emphasis added). The court analyzed whether the statute violated the access to the courts provision found in the Florida Constitution. Based on the Florida Legislature's clear intent that it deems it necessary in the

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interest of the public health, safety and welfare to regulate the construction industry, the court held that the statute does not violate the Florida Constitution.

In addition, it should be noted that it is also a crime in Florida, as in most states, to perform work as an unlicensed contractor. The lesson learned here for any contractor is to always make sure you have a license where it is required to perform work in any jurisdiction. Otherwise, you may be forfeiting your rights to seek money damages or a lien in court. In other words, if you are unlicensed, you may have lost your day in court.

New Washington Case Holds Contractor Exposure Under Indemnity Clause Is Not Limited to Tort Claims

A recent Washington state appellate case has held that a subcontractor can be liable to a general contractor for the costs of defending and settling third-party contract and defective work claims under standard indemnity provisions contained in the subcontract. The decision is most significant in that it overturned the trial court's holding that such indemnity provisions subject a subcontractor to liability for third-party tort claims only (as opposed to third-party contract claims). In so holding, the court rejected the defendant/subcontractor's arguments that a court-made notion -- the "economic loss rule" -- barred such claims.

The dispute arose when the general contractor sought indemnity from various subcontractors to recover damages it incurred in defending against and settling a condominium homeowners association's claim alleging construction defects. The court held that the condo association's construction defect claims (even though they sounded in contract) were within the scope of the indemnity provision and that under such provision the subcontractor could be held liable for both the costs of defending the claims and the amount paid out to remedy the defects.

Upon a reading of the relevant indemnity provision, the decision is not remarkable. The indemnity clause read in a relevant part:

> SUBCONTRACTOR shall defend, indemnify, and hold CONTRACTOR harmless from *any and all claims, demands, losses and liabilities to or by third parties arising from, resulting from, or connected with, services performed or to be performed under this Subcontract* by SUBCONTRACTOR or SUB-CONTRACTOR'S agents, employees, subtier Subcontractors, and suppliers *to the fullest extent permitted by law and subject to the limitations provided below:* [contract went on to describe that the indemnity provision "shall not" apply to various types of tort claims]

Based on this language, the court held that "the indemnity provision at issue herein clearly and unambiguously is so broad as to provide that the types of claims for which the subcontractor must defend and indemnify include contract claims." The court noted that for the subcontractor to succeed in arguing that the indemnity provision only applied to tort claims, the court would have to "read the contract as though, in the first sentence above-quoted, the word "tort" was placed between the word "all" and the word "claims." It refused to do so. Moreover, as to the provisions of the contract dealing with tort damages, the court held "the only reasonable construction of the phrase, 'subject to the limitations provided below,' is that the parties merely included specific limitations *on* tort actions, not that they limited the subcontractor's duty *to* tort actions."

In defending the trial court's decision, the subcontractor raised the "economic loss rule" and cited a 1994 Washington case "as supporting a bright line between tort and contract in construction claims." However, the court succinctly distinguished the earlier decision, which dealt only with "whether the economic loss rule prevents a general contractor from recovering purely economic damages in tort" from the general's breach of contract claim based on the indemnity agreement.

While the decision appears sound, this case may not be done yet. Given that the trial court and appellate court reached directly opposite decisions, it is likely that this case will be appealed.

Fifth Circuit Review of Arbitration Awards Continues to be Vigorous

The Fifth Circuit U.S. Court of Appeals (covering Texas, Louisiana, and Mississippi) recently vacated an arbitration award because the arbitrator applied the incorrect legal test. While such a challenge is usually unavailable in vacating arbitration decisions, the parties had agreed to more liberal judicial review in their agreement. Further, the Fifth Circuit has taken a more aggressive stance in reviewing arbitration awards, even absent parties' agreements of heightened review, than have several other federal circuits (notably the Seventh Circuit (Wisconsin, Illinois, and Indiana) and Eleventh Circuit (Alabama, Georgia, and Florida)).

The general rule for a court reviewing an arbitration award is not whether the arbitrator applied the law correctly, but whether the arbitrator applied the law *at all*. The arbitrator must have "manifestly disregarded" the law, which in some circuits means that short of an arbitrator announcing his intention to disregard the law or failing to decline an attorney's invitation to do so, there is no manifest disregard. In the Fifth Circuit, however, "manifest disregard" has been given a slightly broader reading and has been used to vacate a

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number of arbitration awards based on the courts' disagreement with arbitrators' application of the law.

However, because arbitration is a matter of contractual intent, the parties to an arbitration agreement have generally been permitted to decide what level of judicial review they want. Notwithstanding the general policy of limited review, courts often permit parties freedom in contract to set the rules for deciding their disputes. The Fifth Circuit wrote, "The parties are free … to structure their arbitration agreement as they see fit, including an expansion of the judicial review of an arbitration award beyond the scope of the [Federal Arbitration Act]." The court went on, applying heightened review, to determine that the arbitrator had applied the law but had done so erroneously, and vacated the award.

Parties doing business in Texas, Louisiana, or Mississippi are advised to consider the level of judicial review they consider appropriate before signing an arbitration agreement. If traditional, limited arbitral review is the goal, the parties may wish to include language in their agreement that states a strict manifest disregard standard and may even wish to define that term explicitly to avoid the broadened review available in the Fifth Circuit.

Surprise!—Liability Under A Surety's Payment Bond Extends To Storage Fees Charged By A Subcontractor Under An Informal Subsequent Agreement

Recently, the United States District Court for the District of Connecticut ruled on the extent of a surety's liability under a payment bond to pay for a subcontractor's storage fees under a separate storage agreement subsequent to a purchase order agreement between the general contractor and a subcontractor. The general contractor, White Oak Corporation ("White Oak") entered into a 1994 purchasing agreement with the subcontractor, Steward Machine Company ("Steward"), to supply certain large-scale bridge building machinery for construction of the Tomlinson Bridge in New Haven, Connecticut. This equipment included four particular items, operating machinery, counterweight ropes and accessories, counterweight sheaves and lock machinery. As required by CONN. GEN. STAT. § 49-41 for public works projects, White Oak secured a payment bond from the surety, National Union Fire Insurance Company of Pittsburgh, PA ("National Union"). The Steward/White Oak Purchase Agreement (the "Purchase Agreement") contained this critical provision regarding delivery of the machinery to White Oak, "Delivery will commence within 12 months from approval of the drawings and be complete within 18 months from approval of the drawings. Seller shall make all deliveries in accordance with Buyer's schedule." However, the Connecticut Department of Transportation's ("CDOT") approval of the drawings for each item occurred over several years.

By September 1996, the sheaves, the first items required at the job site, were completed. However, White Oak and CDOT were not prepared to accept delivery of the sheaves at the bridge work site. White Oak was also unprepared to accept delivery of the other fabricated machinery at the bridge work site when it was completed by Steward. As a result, White Oak and Steward began discussions over a long term storage agreement because it was "inevitable" that Steward would have to store the machinery. White Oak also consulted with CDOT over the necessary storage and protection options for the machinery. CDOT opted for one particular storage option at Steward, but informed White Oak that costs for storage were to be assumed by White Oak until such time as it can be shown that the project delays necessitating storage resulted from CDOT's action or inaction.

White Oak prepared an internal memorandum to its project manager acknowledging that, "the sheaves must be stored at [Steward] beyond the original delivery date and that there are certain additional costs associated with the storage that could not be anticipated by Steward." However, neither CDOT nor White Oak ever paid any of the invoiced amounts for storage or interest charged under Steward's storage invoices. The storage of the machinery took up significant space at Steward's facility impacting its ability to perform other jobs.

Because of White Oak's failure to pay the Purchase Agreement or storage invoices in full, Steward filed a notice of claim with National Union in December 1999 and filed suit in federal court in May 2000. Steward claimed that White Oak breached its subsequent agreement to pay for the storage fees charged by Steward for storing the machinery past the delivery deadlines in the Purchase Agreement. White Oak, in opposition, argued that no formal storage agreement was ever executed by the parties, and that the integration clause of the Purchase Agreement barred its oral modification to include Steward's claimed storage agreement with White Oak. Using traditional contract law principles, the Court held that a valid storage agreement existed between Steward and White Oak. The Court fixed the compensation due to Steward based on the last date under the terms of the Purchase Agreement under which White Oak had to accept delivery of the machinery and the date on which White Oak ultimately demanded delivery of the machinery.

As in many construction claim cases and contract cases in general, *Steward Machine* demonstrates the value in taking time to fully spell out the terms and conditions of any agreement to provide services between parties in writing, particularly when those services are not clearly within the initial contract between the contractor and general contractor/owner. *Steward Machine* is also instructive in showing that state Little Miller Acts can extend the potential liability of a general contractor and payment bond surety to

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expenses beyond those envisioned in the initial party contracts and bonded work.

An Ounce of Prevention – Developing a Construction Site SWPPP

A Stormwater Pollution Prevention Plan – an SWPPP – is yet another acronym added to the construction industry's toolbox by the U.S. Environmental Protection Agency ("EPA"), which, like most government acronyms raises many questions, such as: Who needs one? Where is it required? What does it entail? Why do I care? Managing stormwater runoff, sediment, and erosion issues associated with construction sites is nothing new; however, things are changing – prevention, through the creation and implementation of an SWPPP or a similarly named plan, is the name of the game, and an SWPPP is required in order to obtain the all-important stormwater permit.

In January 2007, EPA published a document to provide interim guidance to those in the construction industry that need National Pollutant Discharge Elimination System ("NPDES") permit coverage for stormwater discharges, as well as provide the public and regulators information regarding how EPA intends to exercise its discretion in implementing the Clean Water Act ("CWA") and its implementing regulations. A copy of the interim document and related information is located on EPA's website at http://www.epa.gov/npdes/swpppguide. It is 50 pages or so, but it is well written and handy.

Who needs an SWPPP and where is it required? The Clean Water Act and related federal regulations require construction site "operators" (depending on the state, an "operator" could be the owner, developer, general contractor, independent subcontractors, government officials, companies or corporations – there may even be multiple operators at a construction site each requiring an individual permit, or each qualifying under an overall site permit) to obtain an NPDES permit for stormwater discharges where construction activities such as clearing, grading, and excavating will disturb one or more acre (including smaller sites in a common plan of development or sale such as housing developments, sub-divisions, industrial parks, and commercial developments). Construction-related activities such as material staging areas, stockpiles, borrow pits, fueling areas, and equipment storage areas require NPDES permit coverage, also. There are rare instances when a contractor may be eligible for a waiver, for instance if construction activities will occur during a time of year with low predicted rainfall.

Next, what is required in an SWPPP? Stormwater runoff from a construction site, if not managed properly, may contain trash, debris, sediment, oil, grease, pesticides, and other toxics that can pollute the environment and be harmful to human health. Construction site operators are required to control and prevent detrimental impacts of stormwater runoff by implementing Best Management Practices ("BMPs") including silt fences, sedimentation ponds, seeding, and general good housekeeping practices – picking up trash and disposing of it properly. Although an SWPPP contains BMPs, it goes further and includes, among other things, a written description of the BMPs to be used in each phase of the project, a site description, a schedule of major planned activities, the name of the person in charge of inspections for compliance and updating of the SWPPP, identification of potential pollutants, plans and procedures to reduce pollutants (for example: stabilize the site, protect slopes and channels, control the perimeter of the construction site, protect nearby waters, and minimize the area and duration of exposed soils), maintenance and inspection procedures, responsibilities of the parties involved on the project, procedures for amendments, and required certifications.

Finally, should you care about developing and following an SWPPP? Of course, it is the law! Failure to develop, maintain, and implement an SWPPP may result in significant fines from EPA or a state environmental agency. As an aid to construction site operators, EPA's guidance document provides tips on an SWPP implementation, maintaining your BMPs, inspection schedules, record keeping, and an overview of compliance problems encountered.

EPA's interim guidance document is a useful reference for owners, general contractors, and subcontractors involved on certain construction sites; however, the guidance document is not the law – EPA and state decision makers "retain the discretion to adopt approaches on a case-by-case basis that differ from [the] guidance where appropriate." Currently, EPA is the NPDES permitting authority in Massachusetts, New Hampshire, New Mexico, Idaho, Alaska, the District of Columbia, Puerto Rico, the U.S. territories (excluding the Virgin Islands), most Native American treaty lands, and for federal facilities in four states. Therefore, because EPA and state-issued permits can vary, you should first determine which entity has jurisdiction for your construction site and review your construction general permit to determine the exact requirements that apply to developing your site-specific SWPPP. Also, do not forget that local governments such as cities, towns, and counties may have their own construction site-related requirements, which may or may not be in compliance with federal or state NPDES requirements.

For easy use, the EPA hyperlink above provides a template for an SWPPP, and it provides links to the water quality standards in most jurisdictions.

Surety Paid in Full

A federal trial court in New York recently found that a surety, having taken over a school construction project after substantial completion, was not responsible for any delays,

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but in fact was entitled to the outstanding balance of the contract as well as additional costs.

Upon performance and completion of its obligations in accordance with the bond, Travelers sought payment of the outstanding contract balance plus additional costs. The school system responded with a demand for delay damages.

The court found that pursuant to the school system's notice of default against its general contractor, Travelers assumed responsibility for project completion. However, evidence indicated that at the time Travelers intervened, the project was substantially complete with 98.6% of the work performed. The court found that the architect failed to certify completion for six months after the general contractor had declared substantial completion and suggested that the delay in issuing the substantial completion certificate was due, at least in part, to an agreement between the owner and the architect that gave the architect a contingent financial interest in the outcome of the litigation.

The court denied the school system's counterclaim for delay damages, concluding that "either by mistake or obvious error" the architect delayed the certification of substantial performance for six months because by "any measure of reasonable determination, substantial completion was achieved before the claimed default date." The court further noted that the evidence supported a finding of unreasonableness or constructive fraud by the architect in refusing to certify an earlier date. The court pointed to that fact that several months prior to the notice of default, the architect entered into an agreement with the school system, which gave the architect a contingent financial interest in the outcome of litigation over the construction site at issue. The court stated that the existence of an agreement whereby the architect consented to support the school system in any legal action regarding the project and its contingent fee interest in the outcome of the litigation was circumstantial evidence of an incentive or bias in favor of the school system and of constructive fraud in delaying the issuance of the substantial completion certification.

The court granted Travelers the outstanding contract balance and additional costs and denied the school system's delay claims. This ruling stands as a caution to architects to maintain objectivity as the independent interpreter of building contract documents and the judge of contract performance.

Failure To Include Material Escalation Clause Prevents Recovery Of Spike In Steel Costs

The Armed Services Board of Contract Appeals recently held that a subcontractor whose contract was silent regarding steel price escalation failed to prove commercial impracticability. Spindler Construction Corporation won a fixed-price design-build contract for the erection of a new aircraft maintenance hangar at Hill Air Force Base, Utah. The contract contained the standard federal contract dispute clause, but did not contain any language addressing possible material costs increases. Spindler executed a fixed-price subcontract with Sanpete Steel to "provide all construction of Structural Steel Fabrication and Erection." As with the prime contract, the subcontract also failed to include price adjustment language or material costs changes.

The cost to Sanpete for the pre-fabricated steel overran by $200,000 or 23 percent. Sanpete claimed the increase in the cost of steel made its performance "impracticable by the occurrence of a contingency that nonoccurrence of which was a basic assumption on which the contract was made," Utah Code Ann. § 70A-2-615, Sanpete submitted a claim to Spindler for recovery of the "unforeseen steel cost increase." The contracting officer denied Spindler's claim made under the Contract Disputes Act stating that she could "grant a request for relief only under the specific terms of the contract."

Through Spindler, Sanpete appealed and asserted that the "[d]ramatic increase in steel prices … was a supervening event that made Sanpete Steel's performance of the contract … commercially impracticable." The increase in Sanpete's costs amounted to less than a five percent increase to the total cost of the subcontract and less than a two percent increase to the total costs of the prime contract. Courts have determined that to maintain a claim based on commercial impracticability, the claimant must prove that a supervening event made performance impracticable; the non-occurrence of the event was a basic assumption upon which the contract was based; the occurrence of the event was not the contractor's fault; and that the contractor did not assume the risk of occurrence. The Armed Services Board of Contract Appeals denied the claim based on the judgment that commercial impracticability was not established by the undisputed facts. The Board determined that the supervening market fluctuation in the price of steel did not render contract performance impracticable, citing instances in which cost overruns of as much as 70 percent did not make performance commercially impracticable. Because the contract was fixed-price and failed to include an economic price adjustment clause, the general risk of performance and price increases fell on the contractor and could not, therefore, be considered.

Parties should consider including clauses to address foreseeable risks in their contracts. The commercial impracticability doctrine, uncertain under all but the very worst circumstances, does not often yield recovery in the absence of a contractual basis. In federal contracts, one might look for an escalation clause, or decline to bid.

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Bradley Arant Lawyer Activities:

In February and March, Bradley Arant hosted the Associated Builders & Contractors 2007 "Future Leaders in Construction 101" program. This successful program will continue in May where Bradley Arant will host the 2007 "Future Leaders in Construction 102" classes in the Birmingham office.

David Pugh recently spoke to project managers and superintendents of Associated Builders & Contractors members on practical construction contract issues. The seminar was held on February 8, 2007.

Joel Brown was recently selected as one of thirty lawyers for the 2007 class of the Alabama State Bar Leadership Forum. The Leadership Forum selects committed and involved lawyers willing and able to fill significant leadership roles in their state and local bar associations, in professional and civic associations, and to serve as role models in matters of ethics and professionalism.

On March 8, 2007, **David Pugh** spoke to the Facilities Department personnel at the University of Alabama about practical construction contracting issues.

Arlan Lewis, **David Pugh**, **Patrick Darby**, and **Joel Brown** recently presented a seminar entitled *Construction Insurance, Bonding, and Liens in Alabama* in Birmingham, Alabama on March 16, 2007.

On February 27, 2007, **Rhonda Andreen** and **Mabry Rogers** presented a program on public construction contracting issues to selected Board of Education representatives.

On March 6, 2007, **Mabry Rogers** presented a risk management seminar to a client's construction management team in Virginia.

David Pugh, **Wally Sears**, **Ed Everitt**, **David Pharr**, **Will Manuel**, **Rob Dodson** and **Jeremy Becker-Welts** presented a seminar on "*Current Issues in Mississippi Construction Law*." The seminar was conducted on March 29, 2007.

Mitch Mudano recently attended the Alabama Remodeling Excellence Awards in March 2007.

Rhonda Andreen, **Arlan Lewis**, and **Michael Knapp** recently attended the ABA Construction Law Forum's Annual Meeting in San Juan, Puerto Rico in April 2007.

The Birmingham City Council recently appointed **Mabry Rogers** to the Construction Board of Adjustments and Appeals for the City of Birmingham. The Board is charged with hearing appeals from rulings as to the applicability of the Building Code to proposed or existing construction conditions.

David Hume recently presented *The Green Building Movement: a primer on the concepts, systems, and perspectives surrounding issues of Green Building* at Georgia Tech on April 5, 2007. The presentation discussed current trends in the marketplace for sustainable building and development, as well as the impact that regulation and standardization may have on the construction industry.

David Hume distributed a thesis entitled *Green Practices: Building with Environmentally Sound Considerations* to several industry groups and MBA students. This paper presents information about sustainable construction methods and products, the impact cost for implementation of "green design," some possible drawbacks and benefits to Green Construction, and offers several cases studies on possible design alternatives to conventional construction.

Mabry Rogers and **Rhonda Andreen** will speak at an ABA Construction Forum Teleconference entitled *You're Going to Put What Where: Managing Environmental Issues at Construction Projects*, along with Joseph Manko and Rodd Bender of the Pennsylvania Bar. The Program will be held on May 15, 2007 at 1:00 pm (Eastern). For more information, please visit the ABA website for this program at http://www.abanet.org/cle/programs/t07ygt1.html.

Nick Gaede will teach an upcoming class on International Arbitration from June 3-7, 2007. This class is part of a Joint Program with the University of Alabama School of Law and the University of Fribourg located in Fribourg, Switzerland.

For more information on any of these activities or speaking engagements, please contact Rebecca Harris at 205-521-8504.

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BRADLEY ARANT ROSE & WHITE LLP Third Quarter 2007

CONSTRUCTION AND PROCUREMENT LAW NEWS

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Are you Building Green?

Environmental issues are at the forefront of today's media coverage. Although this is not a new topic, the present movement is impacting virtually every industry. Construction is no exception and is actually one of the industries receiving attention. Current practices focus on sustainable construction and the LEED system.

What is sustainable construction or green building? The EPA defines green building as the practice of creating healthier and more resource-efficient models of construction, renovation, operation, maintenance, and demolition. Elements of green building include energy, water, and material conservation; waste reduction and reuse; and indoor environmental quality.

Several organizations have standardized the green building concept by creating a design framework where project teams can achieve various levels of certification through sustainable design and construction. The most recognized structure for certification is the LEED system developed by the U.S. Green Building Council ("USGBC"). The USGBC is comprised of over 10,000 members from all parts of the design and construction industries. This industry-guided organization developed the LEED system to standardize green building design, development, and construction. Although this system is fairly rigorous and paperwork intensive, owners are implementing LEED at a rapidly increasing rate throughout the United States. The number of registered projects has grown significantly in the past few years.

LEED is an acronym for Leadership in Energy and Environment Design, which is "a national consensus-based, market-driven building rating system designed to accelerate the development and implementation of green building practices." The system has gained substantial acceptance throughout the United States and is often a model throughout the world. The program is subject to critical review by member composed committees and through test pilot programs.

LEED is broken into several building categories including: New Commercial Construction, Existing Buildings, Commercial Interiors, Core and Shell Developments, Homes, Neighborhood Development, Schools, and Retail. Once a

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LEED system is selected, the project team must develop a building concept to incorporate the requisite LEED criteria for certification. The design team can obtain a criteria checklist for the specific LEED system at issue to tally points throughout the design and construction process. In addition, the USGBC produces a reference guide that is system-specific to assist designers and contractors as the project progresses through stages.

Generally, four possible certification levels are achievable under the LEED systems: Certified, Silver, Gold, and Platinum. As an example, the LEED-NC (New Construction) basic certification level requires a minimum of twenty-six points, a silver certification requires thirty-three points, a gold certification requires thirty-nine points, and a platinum certification requires a minimum of fifty-two points, with a maximum of sixty-nine points. The system is divided into six different point groupings: (1) Sustainable Sites; (2) Water Efficiency; (3) Energy and Atmosphere; (4) Materials and Resources; (5) Indoor Environment Quality; and (6) Innovation and Design Process. In some instances, prerequisites must be met before any points are given to a project. Although each LEED system is similarly structured, they focus on different criteria. Thus, reviewing the requirements for the selected system is good practice prior to initiating the conceptual design phase of the project.

Upfront costs can be prohibitive and project management can be more difficult if the entire project team has not "bought in" to the concept. Moreover, LEED systems (and other green building programs) have been criticized for shortcomings such as inflexibility and regional biases. However, the USGBC is implementing new strategies to address some of these critiques.

A project team should become familiar with LEED requirements to avoid potential pitfalls when considering a green project or LEED system. Usually green projects use a design-build project delivery system to facilitate participation by all team members. However, not all projects can be constructed using the design-build method. In fact, state bid laws often limit the type of delivery system a governmental authority can use for construction. Nonetheless, providing clear plans, specifications, and expectations in the bidding phase may help limit future issues that arise when the contractor is not involved early in the project. Owners, governmental authorities, and developers have challenging decisions to make in the planning phase of construction projects. Implementing a green building design for a project can yield significant returns for a project, but owners and project teams should look at the additional cost and time to determine if going green is a worthwhile investment.

Spearin Doctrine Cannot Protect against Delay due to Plan Changes

In 1918, the U.S. Supreme Court decided the case of *United States v. Spearin*, and established what has become known in the area of construction law as the *Spearin* doctrine. The *Spearin* doctrine provides that a contractor who is bound to build according to plans and specifications prepared and furnished by the owner should not be held responsible for the consequences of defects in those plans and specifications.

A recent decision by the Ohio Supreme Court declined to extend the *Spearin* doctrine to cover a contractor's cumulative impact damages for delay caused by errors in the contract drawings. In doing so, the court limited the doctrine to claims related to job site conditions. In this case, the general contractor, Dugan & Meyers ("D&M"), contracted to build three buildings on the campus of Ohio State University. The contract contained some key provisions: (1) time is of the essence, (2) a no-damages-for-delay clause, which provided that an extension of time would be the contractor's sole remedy for delay, and (3) a specific procedure to be followed in the event of a project delay and that the contractor's failure to follow that procedure—request an extension of time in writing within ten days after the occurrence of a project delay—shall constitute a waiver by the Contractor of any claim for a time extension or mitigation of liquidated damages. Through the course of construction D&M failed to comply with the contract's procedural requirement for requesting time extensions and thus waived its claims for additional time.

After the construction schedule fell behind and attempts to bring the project back on schedule were unsuccessful, OSU relieved D&M of its duties under the contract and substituted another contractor to complete the project. When OSU assessed D&M for the cost to complete and liquidated damages, D&M filed a lawsuit against the State for breach of contract. At trial, the referee determined the principal cause of the delay to be the "existence of an excessive number of errors" in the design documents and awarded D&M nearly $3.4 million for its cumulative impact damages under the *Spearin* doctrine. However, the court of appeals reversed the trial court's finding as contrary to Ohio law as well as the express provisions of the contract, which D&M appealed to the Ohio Supreme Court.

The issue before the Ohio Supreme Court was whether the *Spearin* doctrine is recognized in Ohio, and if so, whether there is a limit to its application. The court reasoned that *Spearin* involved the existence of a site condition that prevented completion of the project and that Ohio courts have recognized *Spearin* in cases involving government contracts where the government impliedly warrants the accuracy of its representations on the contract documents regarding job site conditions. However, the court agreed with the court of

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appeals and declined to extend the doctrine to cases involving delay due to plan changes. Importantly, the court recognized that *Spearin* does not invalidate express contractual provisions, and thus D&M could not escape its no-damages-for-delay clause and its waiver of claims for additional time when D&M failed to comply with the contract's procedural requirement for requesting time extensions.

Since the execution of the contract, the Ohio Legislature has declared no damages for delay clauses void and unenforceable as against public policy when the cause of delay is a result of the owner's act or failure to act. However, the lesson in this cases is that even if the contractor believes the delays are caused by the owner, it should comply with the contractual notification procedures or else risk waiving its claim.

Another Bite at the Apple: Enhanced Judicial Review of Arbitration Awards

Agreements to arbitrate disputes are everywhere – from software licenses to construction contracts – and for good reason: private arbitration can be a faster, cheaper alternative to the public court system. Arbitrators with expertise in the subject matter of the dispute can be hand-picked by the parties, and the arbitration proceedings can be tailored to the needs of the dispute. The arbitrators' expertise allows for a quick understanding of the issues, which in turn saves time and expense. Congress recognized these benefits when it passed the Federal Arbitration Act (FAA), which secures the right of private parties to enforce arbitration agreements affecting interstate commerce.

Under the FAA, an arbitration award is final and binding, and can be vacated by a court on very limited grounds, such as where the award was procured by corruption, fraud, partiality, or misbehavior by the arbitrator. Typically, the arbitration award is not subject to attack solely because it is "wrong." When parties attempt to strengthen the ability of a court to set aside an arbitration award, they risk undermining the benefits of finality.

The U.S. Supreme Court recently agreed to hear a case from the Ninth Circuit (appellate court governing Alaska, Arizona, California, Guam, Hawaii, Idaho, Montana, Nevada, Oregon, and Washington) which illustrates this point. In this case, the arbitration agreement between the parties stated that a court should vacate an award "where the arbitrator's conclusions of law are erroneous." As a result of this heightened review, the arbitrator's award was reviewed and reversed by the federal district court – twice. On the second go round, the district court set aside the arbitrator's award as "implausible." The Ninth Circuit reversed, arguing that "implausibility" is not a ground for vacating an arbitration decision under the FAA. According to the appellate court, private parties may not contractually impose their own standard of review on the courts.

Other appellate courts disagree, including the First Circuit (governing district courts in Maine, Massachusetts, New Hampshire, Puerto Rico, and Rhode Island), the Third Circuit (appellate court for Delaware, New Jersey, Pennsylvania and the Virgin Islands), the Fourth Circuit (covering North Carolina, South Carolina, Virginia and West Virginia), the Fifth Circuit (appellate court for Georgia, Mississippi, and Texas), and the Sixth Circuit (governing district courts in Kansas, Michigan, Ohio, and Tennessee). These courts argue instead that the purpose of the FAA is to enforce the terms of private arbitration agreements and that just as private parties may contractually limit the issues which they will arbitrate, so too may they specify the deference a court should give to the arbitrator's decision.

Regardless of where the Supreme Court comes down on the issue, enhanced judicial review of arbitration awards can destroy many of the benefits of arbitration. In the case under review, the dispute was the subject of two rounds of arbitration, a district court trial, two Ninth Circuit appeals, and eventually, a U.S. Supreme Court appeal. Granted, nobody wants to be stuck with an arbitrator's erroneous decision, but that risk is tempered by the ability to choose a neutral arbitrator with expertise in the particular field. It also must be weighed against the other benefits of arbitration, such as achieving a faster resolution at lower cost in a non-public setting. Subjecting the arbitration decision to the sort of review agreed to by the parties may hinder these benefits by giving the losing party an extra bite at the apple.

The Trend: Courts are Finding Defective Workmanship Does Not Constitute an "Event" or "Occurrence" for CGL Coverage

Commercial general liability ("CGL") insurance policies are generally intended to protect the insured from liability for injury or damage to the persons or property of others. While claims related to costs associated with repairing or replacing the insured's defective workmanship are often excluded pursuant to specific policy exclusions (usually work product exclusions), many courts are finding that such defective workmanship will not even constitute an "event" or "occurrence" as necessary to initially trigger CGL coverage, regardless of the existence of applicable exclusions. These decisions have significant burden of proof implications favoring the insurer.

In April 2007, a federal district court in Missouri grappled with this very issue. The dispute arose from the construction of a training facility at Fort Riley, Kansas. The facility was designed with underground support structures capable of withholding the weight of heavy vehicles, such as

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tanks. Duct banks contained within the underground structural support were constructed entirely by subcontractors. The Army Corp of Engineers noted deficiencies in the duct banks, and BCE (the general contractor) paid for correcting the construction deficiencies, reseeding of repaired areas, and repaving of roadways that were ripped up during construction. BCE filed a claim for payment of all costs associated with the repairs under the property damages clause of their CGL insurance policy. In any CGL, the term that triggers coverage is usually "event" or "occurrence." The federal district court of Missouri followed the standard interpretation that both event and occurrence generally mean, "an accident including continuous or repeated exposure to substantially the same general harmful conditions." The court denied coverage, holding that defective workmanship is synonymous with a breach of contract or negligence claim, and these claims are not terms that fall under the general "event" or "occurrence" meanings that would trigger coverage. In other words, the insurer did not meet the burden of proof for triggering coverage. Thus, the court denied coverage right from the beginning, and various exclusions (with the burden of proof shifting to the insured) made no difference in the outcome.

More importantly, the Federal Tenth Circuit Court of Appeals for the United States (supervising trial courts in Utah, Wyoming, Colorado, New Mexico, Kansas, and Oklahoma) has joined this trend. In a February 2007 case, Adair (the general contractor) sought indemnity from St. Paul for a $2.5 million arbitration award setoff for construction defects in work done by Adair's subcontractors. Like the Missouri federal district court, the Tenth Circuit held that deficiencies in work done by Adair's subcontractors were not covered under the general contractor's CGL insurance policy, because defective workmanship does not trigger CGL coverage. In addition, the court had the following harsh words for such defective workmanship claims: "[A] general contractor should not be able to turn to its failure to complete construction according to the contract into a covered event by bootstrapping on its subcontractor's negligence. Obviously, CGL's are not intended to provide an anticipatory guarantee of quality of work and general contractors should be aware of this."

All parties conducting business under CGL insurance policies should be aware of this trend. Some jurisdictions still hold on to the old rule that workmanship defects trigger coverage under CGL policies, subject only to potentially applicable exclusions. Before engaging in construction projects under a CGL policy, all parties should contact counsel to find out what the relevant rule is in their jurisdiction.

OSHA Review Commission Rejects "Controlling Employer" Liability On Construction Jobsites

On April 27, 2007, the OSHA Review Commission issued a decision significantly altering OSHA's long-standing multi-employer citation policy. In that decision, the Review Commission held that, on construction worksites, OSHA may not issue a safety hazard citation to a "controlling" general contractor who was not responsible for creating the hazard and whose own employees were not exposed to it. If this decision is allowed to stand, it will fundamentally change the way OSHA must carry out its jobsite safety enforcement responsibilities.

Shortly after the Occupational Health and Safety Act was enacted in 1970, the Secretary of Labor issued a regulation which stated that each construction industry employer was required to "*protect the employment and places of employment of each of his employees engaged in construction work by complying with the appropriate [OSHA] standards.* . . ." Despite the fact that this regulation appears to hold employers responsible only for protecting the safety of their own workers, OSHA historically has taken a more aggressive enforcement approach. Under OSHA's multi-employer citation policy, which has been followed for over thirty years, a general contractor with supervisory control over the worksite may be cited for a safety hazard even though it did not create the hazard and none of its own employees were exposed to it. This policy has led to thousands of OSHA citations being issued against general contractors for safety violations committed by subcontractors. However, the recent decision appears to have changed the playing field, at least for now.

Summit Contractors was the general contractor for the construction of a college dormitory in Little Rock, Arkansas. During the course of the project, Summit's masonry subcontractor allegedly failed to make certain that its employees were utilizing fall protection as required by OSHA's standards. After conducting a worksite inspection, OSHA cited Summit as the "controlling employer," alleging that Summit had failed to detect the hazard and see that it was remediated by the subcontractor. Summit argued that OSHA had acted improperly because it had no authority under the OSH Act or the implementing regulation to cite a general contractor whose own employees were never exposed to the safety hazard. After an ALJ ruled in favor of OSHA, upholding OSHA's long-standing enforcement policy, Summit appealed.

In a 2-1 decision, the Review Commission vacated the citation based on the italicized words above, interpreting that regulation to require a construction contractor to comply with OSHA's safety standards only as to its own employees.

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This decision represents an important change in workplace safety law, but a few points should be noted.

- OSHA has already filed an appeal seeking to have the decision overturned, and it is impossible to predict how this appeal will turn out. Many observers believe that an appellate court will be inclined to defer to the Review Commission, but there is some prior judicial precedent supporting enforcement of the "controlling employer" doctrine. In the meantime, it is unlikely that OSHA will change its enforcement policy while the matter is on appeal. It is also unclear how the "controlling employer" citations now in the pipeline will be resolved. General contractors who have received OSHA citations under this doctrine should consider taking steps to get those citations vacated.

- If upheld, this *Summit* decision would relieve a general contractor from OSHA liability as the controlling employer, but it would not prevent OSHA from citing the general contractor if (1) the general contractor creates the safety hazard or (2) the general contractor's own employees are exposed to it. Those are independent grounds on which OSHA can issue a citation and they are not impacted by the Review Commission's recent decision. Moreover, the decision could lead to additional citations against subcontractors because OSHA may feel compelled to give increased scrutiny to subcontractor safety compliance.

- The decision is applicable only to employers doing construction work and not to general industry employers. The regulation only applies to "employees engaged in construction work." Contractors engaged in other types of work – such as maintenance – are unaffected by *Summit*. It is the nature of the work, not the nature of the entity performing it, which is determinative.

- The regulations could be amended in a way which undoes the recent decision and allows OSHA to continue to enforce its long-standing citation policy.

- There is no binding effect on state laws regulating workplace safety, which exist in approximately half the states. If a general contractor does construction work in a state covered by a state OSHA enforcement scheme, the contractor should not assume that the state's enforcement approach will change as a result of this recent case.

Enforcing the United States Person Clause in Government Contracts

In a recent bid protest case, the Government Accountability Office ("GAO") sustained the protest of an embassy construction project award, reaching the conclusion that the contract for the embassy had been awarded improperly to a contractor that was not a "United States person."

The protest arose out of bids for the design and construction of a New Embassy Complex in Djibouti, Djibouti, by the State Department. The State Department received six proposals, including proposals from Caddell Construction Company and AIC-SP.

The State Department originally awarded a contract to AIC-SP as the low bidder. AIC-SP had only existed for 35 days when it was pre-qualified by the State Department, so Caddell, the second low-bidder, protested the award to the GAO. On January 10, 2007, GAO issued a Decision sustaining Caddell's protest.

After the GAO's decision, the State Department advised Caddell that it had re-affirmed the award to AIC-SP in a *de facto* joint venture with its parent company, AICI, and decided to proceed with awarding the contract to AIC-SP and AICI based on a corrected bid that expressly provided that AIC-SP and its parent AICI were bidding as a *de facto* joint venture.

Caddell protested again, claiming that the *de facto* joint venture did not meet the requirements for a "United States person." Under the Security Act, bidders for embassy projects must demonstrate that they are "United States persons" to bid on the project.

In its second protest, Caddell claimed that AIC-SP failed to meet this requirement. The GAO again agreed, and sustained the protest, concluding that the State Department had violated the ordinary meaning of the words in the statute.

Court Holds that Homeowners/Condominium Associations Had Standing to Sue EIFS Manufacturer Even Though EIFS Installed Prior to Associations' Existence

Although it may seem like common sense that a party not in existence at the time an alleged misrepresentation was made cannot bring a fraud claim based on that misrepresentation, at least one court has held a party can in certain cases. In a recent New Jersey appeals court case, the court held that a homeowners association had standing to bring suit for fraud against a manufacturer of an Exterior Insulation Finish System (EIFS), used in the construction of common elements of a residential condominium development, even though the homeowners/condominium associations were formed after misrepresentations and omissions were allegedly made by the manufacturer. The case arose out of alleged construction defects at the Porte Liberte development in Jersey City, New Jersey. After years of litigation with various parties, including the general contractor and the manufacturer of the EIFS, the plaintiffs amended their complaint to assert a

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claim against the EIFS manufacturer for fraud, alleging that during contract negotiations, the manufacturer made certain false advertisements and representations to and withheld information from the developer and the general contractor regarding the water-impermeability of the EIFS. Although the plaintiffs were clearly not parties to these negotiations, they alleged that they were "third-party" beneficiaries of the contract between the manufacturer and the general contractor, and, therefore, they could assert their claims. The manufacturer argued that because the plaintiffs had not even been formed at the time of the contract negotiations, they could not have been recipients of the manufacturer's alleged misrepresentations and omissions, and therefore, they could not have participated in the decision to utilize the EIFS at Port Liberte. The trial court agreed.

The appeals court reversed, holding that a condominium association is the intended beneficiary of a developer's actions; therefore, any subcontractor or materialman entering into a contract or supplying a product for use in the construction of the common elements after the developer registers the condominium with the Department of Community Affairs, pursuant to New Jersey law, is on constructive notice that representations made to, and omissions withheld from, the developer will be deemed as if they were made to, or withheld from, the association, once the association assumes control of the condominium. Thus, homeowner/condominium associations have standing to assert fraud claims against third-party contractors and materialmen for fraud leading to defects in common elements, regardless of whether the association formally existed at the time the misrepresentation was made. The court reasoned that the unique relationship, created by New Jersey law, between condominium associations and developers (i.e., developer controls association until a certain time; fiduciary relationship is created between developer and association) allows an association to step into the developer's shoes when control is passed to the association. The court further noted that other New Jersey courts have employed the same reasoning in holding that a condominium association had standing to sue for defects that arose prior to the association's formation.

Add this case to your sensitivity about condominium construction.

Contractor's Promise to Owner of No Liability for Additional Work Costs Held Unenforceable

A recent North Carolina opinion held that a project manager's email purporting to absolve the owner from liability for costs associated with installing an additional HVAC unit was not supported by consideration and, therefore, did not create an enforceable contract. Furthermore, the lack of a written change order did not preclude the owner from having to pay for the additional work, despite a contractual provision requiring all changes be approved in writing.

Cameron Park II ("Cameron") entered into a contract with Inland Construction Company ("Inland") to construct improvements on a commercial building. The contract stipulated that all changes to the work be incorporated by written change order. The plans anticipated two phases of work, with the first phase calling for improvements to the building's first floor, including installation of a 4 ton HVAC unit, and the second phase calling for improvements to the building's second floor, including installation of several additional HVAC units. Following completion of phase one, the owner eliminated phase two, leaving only the 4 ton HVAC unit that both parties agreed was inadequate for the entire building.

Cameron's architect rejected Inland's proposed solution to replace the 4 ton HVAC unit with a 7.5 ton unit. Instead, the architect proposed and directed installation of an additional 4 ton HVAC unit. In response, Inland's project manager sent an email to Cameron stating that the costs of the additional HVAC unit installation would be resolved between Inland and the architect at no cost to Cameron. The work was completed without a written change order being executed or even presented to Cameron. Subsequently, Inland's president demanded payment from Cameron for the additional installation work, and Cameron refused to pay citing the prior email sent by Inland's project manager.

Inland brought a claim for breach of contract, and the trial court granted summary judgment in favor of Inland that it was entitled to payment from Cameron of all costs associated with the additional installation work, including interest on unpaid amounts. On appeal, Cameron argued the email sent by Inland's project manager created an enforceable contract, whereby Inland waived any right to recover the additional installation costs from Cameron. Alternatively, Cameron argued that Inland's failure to obtain a written change order for the additional work barred Inland from subsequently seeking recovery of the associated costs.

The North Carolina Court of Appeals held that the project manager's email did not create an enforceable contract obligation, because the email was not supported by sufficient consideration. Said another way, because Inland did not receive anything of value in exchange for the purported waiver contained in the email, Inland would not be contractually bound by such waiver language. Consistent with North Carolina precedent, the Court of Appeals also rejected Cameron's reliance on the lack of a written change order. According to the Court of Appeals, even where a contract provides that any modification shall be in writing, a written contract provision may be waived or modified by subsequent oral agreement or by conduct which naturally and justly leads

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the other party to believe the provision of the contract was waived or modified. Since Cameron, by and through its architect, directed Inland to perform installation of the additional HVAC unit, Cameron was responsible and liable for payment to Inland associated with the additional work performed under the orally modified contract.

The recent appellate opinion is a cautionary tale for all those involved in construction projects. A party's prior assurance or promise without more may not be enough to protect against a later claim for recovery. The determination of whether a promise is supported by sufficient consideration to create an enforceable contract is a heavily factual determination, which courts will determine on a case-by-case basis. In addition, states have varying legal standards for what can constitute sufficient consideration, as well as related equitable doctrines that may change the outcome. Those seeking to rely on assurances or promises made by others during the course of a construction project are well advised to consult their legal counsel as to whether such reliance is legally justified by the applicable law and circumstances.

Bradley Arant Lawyer Activities:

Mitch Mudano participated in a live ALI-ABA webcast on June 4, 2007 for "Hurricanes and Windstorms: Litigation, Claims and Public Policy Consequences."

Nick Gaede was elected President of the Birmingham Committee on Foreign Relations. The purpose of the organization is to expand knowledge and understanding of foreign affairs, exchange ideas, recognize free speech and enjoy fellowship and conviviality.

Joel Brown was selected as one of 30 lawyers in the 2007 class of the State Bar Leadership Forum. The leadership forum selects committed and involved lawyers willing and able to fill significant leadership roles in their state and local bar associations, in professional and civic associations, and to serve as role models in matters of ethics and professionalism.

Nick Gaede was recently appointed to the Alabama Access to Justice Commission by the Chief Justice of the Alabama Supreme Court.

Rhonda Andreen will speak at a seminar entitled "Managing Construction Projects in Alabama" on August 24, 2007 in Birmingham, AL. The seminar will cover topics related to prime and subcontracts, document management, dispute resolution, and insurance.

Mabry Rogers, **Arlan Lewis**, **David Hume**, and **Rhonda Andreen** will present a statewide seminar to an invited group of public officials on "Public Procurement in Alabama," focusing specifically on spending anticipated under recently approved bond measures for public education. The seminar will be held September 11, 2007.

Ed Everitt and **Mitch Mudano** will present to the National Steel Mill Credit Group on September 20, 2007. The seminar will cover the subject of mechanics' liens. There will be approximately twenty companies in attendance, which will include some of the largest steel mills in the United States and Canada.

Michael Knapp, **Arlan Lewis**, **Mitch Mudano**, **Jeff Peters**, and **David Pugh** will present "The Fundamentals of Construction Contracts: Understanding the Issues" in Birmingham, AL on December 13, 2007. This seminar will cover contract principles, dispute resolution, project delivery systems, and subcontracting issues.

Joel Brown, **Patrick Darby**, **Arlan Lewis**, and **David Pugh** will present a seminar entitled "Construction Insurance, Bonding and Liens in Alabama" in Birmingham, AL on March 18, 2008.

For more information on any of these activities or speaking engagements, please contact Rebecca Harris at 205-521-8504.

You can find this newsletter and past newsletters on our website at www.bradleyarant.com/pg.construct.cfm.

NOTE: WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY CONTACT ANY ATTORNEY LISTED ON PAGE 8 OF THIS NEWSLETTER.

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The lawyers at Bradley Arant Rose & White LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

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BRADLEY ARANT ROSE & WHITE LLP Fourth Quarter 2007

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Court Issues Injunction Blocking Social Security "No-Match" Rule

Every year, thousands of employers receive "no-match" notices from the Social Security Administration ("SSA") advising them that the W-2 information provided for certain employees does not match the information in the SSA's database. The stated purpose of these notices is not immigration enforcement, but to help the SSA ensure that the employees' social security allocations are correct. Nevertheless, employers are often justifiably concerned that, if an employee identified in a "no-match" notice is found to be unauthorized to work, the notice could give rise to a finding that the employer had knowledge of the employee's unauthorized status and potentially lead to liability under the federal immigration laws. This can be particularly troublesome when the "no-match" notice identifies, in large or disproportionate numbers, employees in those ethnic groups widely known to have large numbers of undocumented workers. As a result, there has been much uncertainty about how employers should respond when they receive one of these "no-match" notices.

On August 10, 2007, the Department of Homeland Security ("DHS") issued a rule which expressly stated that a "no-match" notice is the type of information that could lead to a finding that the employer had constructive knowledge of an employee's unauthorized status. This rule also outlined, for the first time, a protocol for response which the DHS said was "reasonable" and which, if followed by the employer, would prevent the employer from being deemed to have constructive knowledge based on the "no-match" notice. However, the rule also made clear that, if the employer did not follow the DHS's "reasonable" response protocol, it faced an increased risk of liability under the immigration laws.

Under the protocol authorized by the new DHS rule, the employer would be required to give a "mismatched" employee ninety (90) days to clear up the discrepancy with the SSA. If the employee could not do that, the employer would then have to re-verify the employee's work authorization using documents other than those bearing the questionable Social Security number. If the employee were unable to resolve the discrepancy with the SSA and could not produce these additional documents, the employer would be required to terminate the employee.

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This new DHS rule was set to go into effect on September 14, 2007 and the SSA indicated that it planned to start mass mailings of "no-match" notices on September 4. However, the rule was very controversial and drew immediate opposition from numerous employee advocacy and industry groups.

In late August, several diverse organizations, including the AFL-CIO and the U. S. Chamber of Commerce, filed a lawsuit in the United States District Court for the Northern District of California challenging the DHS rule. In their Complaint, the plaintiffs argued that the new rule was inconsistent with the federal immigration laws, gave the DHS and the SSA impermissible authority, and would lead to discrimination and result in the firing of lawful workers. The plaintiffs filed a motion for preliminary injunction, which was heard on October 1.

On October 10, in *American Federation of Labor v. Chertoff*, U. S. District Judge Charles R. Breyer granted the plaintiffs' motion for preliminary injunction, barring implementation of the new DHS rule. In his decision, Judge Breyer found that the rule would cause immediate harm to both employees and employers, and held that the plaintiffs had raised serious concerns about its legality. The Judge relied on an SSA report indicating that its database contained numerous errors, and concluded that a rule which used the database for firings would discriminate against tens of thousands of legal workers and place an unfair burden on employers. The Judge also held that there were serious questions as to whether the DHS had exceeded its authority under the Administrative Procedures Act by failing to provide a reasoned analysis for its change in position – inherent in the new rule – that an employer who receives a "no-match" letter can now, without any other evidence of illegality, be held liable under the immigration laws.

It is uncertain what this ultimately will mean for employers. DHS has not indicated whether it will appeal the decision but, presumably, at some point, SSA will resume sending out "no-match" notices. While most construction industry players are pleased with Judge Breyer's ruling, it is still unclear how employers are to respond when a "no-match" letter is received. As some analysts have pointed out, these developments highlight how difficult it is to change the status quo on immigration enforcement without meaningful comprehensive reform.

If you receive a "no match" notice, we recommend that you immediately discuss the notice with your counsel.

Strict Construction: The Cost of Non-Compliance with Lien Laws

A "mechanic's lien" is the term used for any lien on real property in favor of a person or entity furnishing labor or materials used in or for the erection of buildings or making improvements to real property. Mechanic's liens are created by statute and they confer priority or "secured" creditor status to defined entities or persons who contribute labor or materials to improve real property, such as a contractor. But, in simpler terms, all of the requirements of the lien statutes must be strictly complied with in order to perfect statutory mechanic's lien rights; otherwise, they are nonenforceable.

In Alabama (as in most states), a lien will be lost if at least three steps are not performed: (1) comply with applicable notice requirements; (2) file an appropriate verified statement of lien in the proper probate office within the statutory period of time; and (3) file suit to enforce or "perfect" the lien within six months from when the entire indebtedness accrues (the period is different in different states). Once these last two steps are performed in a timely manner, the lien relates back to the date that the labor and materials were provided, and the lien claimant has priority over other creditors whose claims arose after the commencement of the work.

In some instances, another party may acquire an interest in a piece of property after a lien claimant's work has begun but before a lien is filed on the property. For example, an investor may purchase a condominium in a condominium development long after the construction of the building has begun, but before the contractor files a lien on the property. In that case, if the contractor wants his lien to be superior to the interest of the investor whose interest was acquired after work began, but before the filing of the lien, he must join the investor as a defendant when he files suit to enforce the lien within the six month statutory period, provided he has actual knowledge or constructive notice of the investor's subsequently acquired interest at the time of filing suit. Otherwise the investor will take the condominium free and clear of the contractor's lien. Therefore, when a subsequent purchaser of property is not joined as a defendant in a suit to enforce a lien, it doesn't matter whether that person had knowledge of the lien; when the six month statutory period expires, the subsequent purchaser's interest becomes superior to the mechanic's lien.

This important rule is illustrated in a recent decided by the Supreme Court of Alabama. In *Hutto Construction, Inc. v. Buffalo Holdings, LLC*, Hutto contracted with the Lessee of a piece of property to construct a condominium development on the property. After work began, but before Hutto filed the claim of lien, the owner mortgaged the property to the Bank. When Hutto filed suit to enforce its lien, it named the Owner and Lessee as defendants, but neglected to join the Bank, despite its knowledge of the mortgage. Subsequently, the Bank foreclosed on the property and sold it to Buffalo Holdings. Since the bank had never been named as a defendant to the suit to enforce the lien and the six month statutory period had long since expired, Buffalo took the property free and clear of Hutto's lien.

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This case is a good reminder that the intricate requirements of the lien law must be strictly adhered to; otherwise, those persons who the lien statutes were originally designed to help will be left without a lien remedy.

Construction Defects and Commercial Liability Insurance

Contractors are frequently faced with defending claims of faulty or defective construction. As a result, whether the contractor's general liability insurer is required to defend those claims and whether there is any coverage for those claims is frequently an issue. The Supreme Court of Texas recently addressed these issues, and the opinion is potentially quite helpful to contractors.

In *Lamar Homes, Inc. v. Mid-Continent Casualty, Co.*, a homeowner accused the homebuilder, Lamar, of having constructed a defective foundation. Lamar forwarded the lawsuit to its commercial general liability ("CGL") carrier, Mid-Continent Casualty, seeking defense and indemnification under the policy. Mid-Continent refused to defend so Lamar sued Mid-Continent. On appeal, the Texas Supreme Court held that Mid-Continent was wrong.

The homeowners did not allege any property damage other than to the work itself. That is, they accused the contractor of faulty construction of the structure but did not allege any damage to contents. Under most CGL policies, the insured's own work is expressly excluded. Mid-Continent argued that since there were no allegations of property damage other than to the work itself, then (a) there was no "accident" or "occurrence" sufficient to trigger its duty to defend or indemnify Lamar, and (b) there was no "property damage" sufficient to trigger the duty to defend or indemnify Lamar.

The court disagreed with Mid-Continent on both counts. The court discussed at length that faulty work, unless done intentionally, could still constitute an "accident" or "occurrence" in that no reasonable contractor would intend to damage its work. Mid-Continent argued to the contrary based on whether the damaged property was the insured's work or third-party property. The court was not persuaded, holding that it does not matter that the damaged work was the insured's work since, at least in a standard CGL policy, typically "no logical basis within the 'occurrence' definition allows for distinguishing between damage to the insured's work and damage to some third party's property." Thus, defective work could constitute an "accident" or "occurrence" obligating the insurer at least to defend.

Next, Mid-Continent argued the allegations of "property damage" were irrelevant because they dealt solely with the insured's work. The policy language – from a standard Insurance Services Organization ("ISO") form CGL policy – did not suggest the limitation urged by Mid-Continent. Any damage, including damage to the work itself, so long as caused by an "accident" or "occurrence" was sufficient to trigger Mid-Continent's duty to defend.

Additionally, the Court found that Mid-Continent could be liable for enhanced damages due to its failure adequately to respond to Lamar's claim. This particular finding was based upon Texas' "Prompt Payment of Claims" statute found at Article 21.55 of the Texas Insurance Code.

Bear in mind that the outcome could vary from state to state based on different rulings by other state courts and variations in the language of specific insurance policies, particularly if the policy at issue has been modified from standard ISO language. Nonetheless, this is a strong opinion in favor of contractor's seeking help from their insurers in defending faulty workmanship claims.

Contractor Work on Condominium Common Areas may be Subject to Homebuilder Licensing

"We hold that condominium units are 'residential property' . . . and, therefore, contractors renovating or otherwise improving the common areas of condominium buildings are required to be licensed." So writes the District of Columbia Court of Appeals in a recent decision that may have implications for contractors doing condominium work.

In *Carlson Construction Co. v. Dupont West Condominium, Inc.*, the contractor performed its work only on the common areas of the condominium. However, because the D.C. regulations include "grounds appurtenant" in the definition of "residential property," the principal dispute between the parties was whether a condominium was in fact a "single-family dwelling." This term was undefined in the regulation. The court noted that the home improvement regulations had preceded municipal recognition of condominium ownership of property in the District of Columbia. It reasoned that since condominiums were to be treated just as any other owned residential property for zoning, land use, subdivision or building code purposes, it would create a "bizarre result" to exclude condominiums from the definition of a "single-family dwelling."

As always with licensure issues, we advise you to check with the licensure authority ahead of time with any questions about the applicability of a licensure scheme to your project. In jurisdictions with non-recovery statutes—and particularly that require reimbursement of monies already paid, as occurs in D.C.—the financial disaster associated with non-licensure is simply not worth the risk of non-licensure.

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Surety Fails to Limit Subcontract Bonds to "Erection-Only"

In *Walbridge Aldinger Co. ex rel. Prospect Steel Co. v. CBN Steel Construction, Inc.*, Walbridge Aldinger entered into a subcontract with CBN Steel Construction for the fabrication and erection of structural steel on a project for the University of Michigan. The subcontract amount was $2.6 Million. Shortly thereafter, CBN advised Walbridge that it could not provide payment and performance bonds for the entire subcontract scope of work.

CBN's surety issued a letter stating that it would execute a performance and payment bond only for the erection of the steel and that Prospect, CBN's fabrication subcontractor, would issue a dual obligee bond (to CBN and Walbridge) for its portion of the work.

CBN's surety issued performance and payment bonds naming CBN as principal and Walbridge as obligee in the amount of $1.5 Million. Prospect obtained dual obligee bonds in the amount of $1.1 Million.

CBN went out of business before its work was completed. Prospect filed suit against CBN's surety on the payment bond.

The surety defended the claim on the basis that the bond was intended to cover only erection of the steel, not fabrication, and that the proper claimants on the payment bond were only those who had provided labor or equipment to erect the steel. The surety referred to its letter stating its willingness to bond only the erection portion of the work, to the reduced penal sum of the bond, and to the dual obligee bond issued on behalf of Prospect which, it alleged, further reflected its intention not to bond the materials and fabrication portion of the subcontract work. However, in issuing the payment bond, the surety used a standard form that identified and incorporated by reference the entire subcontract between Walbridge and CBN. The surety did not modify the payment bond to expressly exclude the materials and fabrication portion of the subcontract work.

CBN's surety filed a motion for summary judgment seeking dismissal of Prospect's claim. In ruling for Prospect, the court stated that the payment bond issued by CBN's surety was clear and unambiguous. It covered "all labor, material, or both, used or reasonably required for use in the performance of [the subcontract]." Further, it incorporated the entire subcontract by reference. The subcontract included both the furnishing and erection of the structural steel. On its face, the payment bond appeared to be a clear and complete expression of the obligations of the subcontractor and the surety. Absent ambiguity, the court would not consider the letter written by the surety, the reduced amount of the penal sum of the bond, or the existence of the dual obligee bonds issued on behalf of Prospect.

This case illustrates the risks associated with the failure to properly modify standard form documents to reflect special arrangements. Documents such as contracts and bonds are usually regarded as reflecting the entire bargain of the parties, absent clear reference to external documents. Those who use standard forms should take care to clearly express the terms of the bargain and to modify standard language as necessary to reflect the entire agreement of the parties.

An Ounce of Prevention: Utilize Choice of Law Clauses But Check Local Law

A recent case in New York proves a useful reminder to participants in the construction industry to bargain for desired choice of law clauses in your contracts but to remember that sometimes a choice of law clause may be trumped by local law. Thus, it is always worthwhile to inspect the law of an unfamiliar jurisdiction before beginning work in a new location.

On September 10, 1999, Telergy Metro LLC (the "Owner") contracted with Mastec North America, Inc. (the "General Contractor") to construct a fiber optic telecommunications network in New York. The General Contractor subcontracted with Welsbach Electric Corp. (the "Subcontractor") to do the electrical work for the project.

The subcontract contained a pay-if-paid clause, which conditioned payment to the Subcontractor upon the General Contractor's receipt of payment from the Owner. The subcontract also contained a termination clause: if the general contract was terminated, the subcontract would be terminated on the same basis and effective date, and the Subcontractor's recovery limited to what it could recover from the Owner. Finally, the subcontract contained a choice of law provision in favor of Florida law.

In August 2001, the Owner became insolvent and terminated the general contract, effectively terminating the subcontract. The Subcontractor sued the General Contractor for the unpaid balance of its subcontract; the General Contractor had not been paid these amounts.

New York courts hold that pay-if-paid clauses violate § 34 of the Lien Law and are unenforceable because they restricts a subcontractor's right to file or enforce a lien. In contrast, Florida enforces pay-if-paid clauses. The question for the court became whether New York's policy against restricting a subcontractor's lien rights trumped the parties' contractual choice of law.

Generally, courts will enforce a choice of law clause as long as the chosen law bears a reasonable relationship to the parties or the transaction. However, a court will not enforce illegal agreements or agreements where the chosen law violates the forum state's fundamental policy.

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After examining the policy behind Lien Law § 34, the court in *Welsbach Electric Corp. v. Mastec North America, Inc.* determined that the policy against enforcing pay-if-paid clauses did not rise to the level of "fundamental public policy." Section 34 had been enacted in 1975 to reverse New York's longstanding allowance of lien right waivers. The law was enacted to protect New York subcontractors from the oppressive use of bargaining power. The Subcontractor here was not a New York entity, and both the Subcontractor and the General Contractor were sophisticated commercial entities that knowingly and voluntarily entered into the subcontract.

This case brings to mind a number of important issues that should be considered prior to contracting. (1) All participants in the construction industry should remember that laws vary from state, sometimes in significant ways. A party should apprise itself of the laws of the state before undertaking construction in a new location. (2) Parties are generally able to choose the law of a particular state to apply to their contracts. However, bear in mind that no matter what law is chosen, if the law violates the fundamental public policy of the forum state, it may not be applied. (3) In some states, such as Florida and Texas, statutes affect and even invalidate choice of law or choice of forum selections by the parties. Therefore, even when a contract contains a choice of law clause, make sure to also determine the law of the state of the project's location.

Additional Insured Entitled to Coverage and Settlement Costs

Turner Construction Co. obtained coverage for its defense and settlement costs, because it was an additional insured under the HVAC contractor's liability insurance policy. Turner was the construction manager on a renovation project at the Central Synagogue, a landmark in Manhattan, New York constructed in 1872. The synagogue roof had to be removed to allow installation of a new HVAC system. During roofing work performed by another contractor, a fire nearly destroyed the synagogue.

The synagogue had contracted with an HVAC contractor to install the new system. The HVAC contractor named Turner an additional insured under its liability policy pursuant to a requirement in the HVAC contractor's contract with the synagogue. A jury determined that Turner, the general contractor, the roofing subcontractor and the Synagogue were at fault in varying degrees for the fire damages. No fault was assigned to the HVAC contractor.

Ultimately, Turner settled with the synagogue and sued the insurance company for its refusal to provide a defense and coverage to Turner as an additional insured under the HVAC contractor's policy. The insurance company asserted that it did not owe a defense, because the named insured (HVAC contractor) was not at fault and the damages did not arise out of the HVAC work.

The New York federal district court disagreed in *Turner Construction Co. v. American Manufacturers Mutual Ins. Co.*, and determined that American owed Turner a defense and had to pay Turner's settlement with the synagogue. The court found that there was coverage, so long as Turner's liability arose out of the HVAC contractor's work. Because the roofing work that triggered the fire was performed to allow the new HVAC system to be installed, Turner's actions "arose out of" the HVAC work and Turner's liability was covered by the additional insured endorsement.

Under New York law, where an insurer improperly refuses to defend, the insured may make a reasonable settlement and thereafter be entitled to reimbursement from the insurer. Here, Turner received reimbursement for its settlement with the synagogue in addition to its defense costs.

No-Damage-For-Delay Clause Bars Recovery of Extra Work Costs Associated With the Delay

In July 2007, the New York Supreme Court (Appellate Division) in *Harrison & Burrows Bridge Constructors v. State of New York*, grappled with the application of a contractual provision (the so-called "no-damage-for-delay" clause) and whether such a clause extends to bar recovery of additional costs for extra work associated with a delay. The State of New York ("State") contracted with Harrison & Burrowes ("contractor") to rehabilitate and resurface various bridges in Delaware County, New York. Once the project was complete, the State refused to pay for costs incurred by the contractor for allegedly unanticipated cold weather protection. Specifically, the costs at issue were associated with curing concrete in the winter months instead of warmer months. According to the contractor, the curing was in the winter due to delays caused by the State. The State argued that the contract contained a no-damage-for-delay clause barring damages associated with delays and thus the additional concrete protection costs were non-recoverable. The trial court disagreed with the State and awarded the contractor judgment for the protection costs. The State appealed to the New York Supreme Court (Appellate Division).

Generally, courts enforce clauses that exculpate a party (in this case the State) from liability for damages resulting from delays in performance of the contract work. Although not raised in this case, there are recognized exceptions where exculpatory clauses are invalid, including, for examples, (1) delays caused by the exculpated party's bad faith or its willful, malicious, or grossly negligent conduct, (2) uncontemplated delays, (3) delays so unreasonable that they constitute an intentional abandonment of the contract by the

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exculpated party, and (4) delays resulting from the exculpated party's breach of a fundamental obligation of the contract. Although the exceptions are noteworthy (and not applied in every state), they are irrelevant to the case at hand. Here, the court only grappled with whether the asserted extra costs were "delay costs" or "extra work." If the costs could be termed as "extra work", the exculpatory clause would not bar recovery. On the other hand, if the costs were deemed "delay costs", the clause would bar their recoverability.

After an analysis of the facts, the trial court held that the State's delays in reviewing shop drawings delayed the project as a whole, and thus "extra costs" incurred by the contractor should be recoverable. The New York Appellate Court disagreed and gave a strict interpretation of the contract clause, holding that all costs associated in anyway with delays were barred under the clause. Therefore, the only remedy the contractor had for the State's delay was to seek a time extension.

Strict contract interpretation decisions like this one stress the importance of carefully evaluating contracts, especially public contracts when negotiations are rare. Contractors should balance whether the risk is worth the benefit and should always seek advice from counsel in advance as to the interpretation and application of "gotcha" clauses in their specific jurisdiction.

Arbitrator's Evident Partiality Overturns Arbitration Award

There are not many ways in which one can overturn a binding arbitration award. However, one federal appeals court has recently concluded that an arbitration award must be overturned where a reasonable person would have to conclude that an arbitrator was partial to one party, regardless of whether actual partiality is found.

The United States Court of Appeals for the Second Circuit (appeals court governing district courts in Connecticut, New York, and Vermont) in *Applied Industrial Materials Corp. v. Ovarlarmakine Ticaret VE Sanayi, A.S.*, overturned an arbitration award because it found that one of the arbitrators was disqualified when he knew that there was a potential conflict but failed to either investigate or disclose an intention not to investigate.

The arbitration agreement between AIMCOR and Ovalar provided that each party would select an arbitrator, and the two party-appointed arbitrators would then select a presiding officer. AIMCOR and Ovalar selected Charles Fabrikant as the third arbitrator and chairman of the panel. He was the Chairman, President and CEO of Seacor Holdings. Before the arbitration hearings started, Fabrikant sent an email to the parties stating that his St. Louis office had recently been engaged with AIMCOR's parent company about a contract for the carriage of petroleum coke and that Fabrikant had no knowledge of such conversations and that he did not plan to become involved in discussions should there be further conversations between the companies.

In a 2-1 decision the arbitration panel found Ovalar liable to AIMCOR for breach of contract. Ovalar wrote Fabrikant asking him to withdraw because it had conducted an investigation and concluded that a previously existing, inadequately disclosed commercial relationship existed between a division of Fabrikant's company and the parent of AIMCOR.

Fabrikant refused to withdraw from the panel and stated that he revealed when he was initially informed that his company was engaged in discussions with AIMCOR's parent company, that he told his company that he did not want to know anything about the conversations or be a party to information about the activities with the two companies. Fabrikant concluded that he had erected a wall to prevent his learning of any agreements between the companies and that he was unaware of the relationship.

The appeals court found that Fabrikant's failure to recuse himself violated the Federal Arbitration Act, which states that an order vacating may be made where there was evident partiality or corruption among the arbitrators or any one of them. The court found that the parties had a reasonable expectation on the part of the parties that they would be notified of any contractual relationship between the companies and that failing to tell the parties that he had insulated himself from the information, Fabrikant created an "appearance of partiality" when a nontrivial commercial relationship surfaced.

The court opined that arbitrators must take steps to ensure that parties are not misled into believing that no nontrivial conflict exists. Therefore, where an arbitrator has reason to believe that a nontrivial conflict exists, he must 1) investigate the conflict or 2) disclose his reasons for believing there might be a conflict and his intention not to investigate. The court emphasized that they were not establishing a duty to investigate but that when an arbitrator knows of a potential conflict, he must either investigate or disclose an intention not to investigate. Because Fabrikant failed to investigate the discussions between the companies (which if he had, would have uncovered an existing relationship that already had generated $275,000 in revenue) or disclose that he would make no further inquiries into the relationship, a reasonable person would have to conclude that evident partiality existed.

Arbitrators and parties should be keenly aware of a trend by parties to make after-award challenges to alleged inadequate pre-award disclosures by arbitrators.

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Bradley Arant Lawyer Activities:

Wally Sears was elected as a member of the American College of Construction Lawyers. The American Colleges are comprised of the preeminent practitioners in the applicable area of experience. ACCL membership is highly selective, comprising only one percent of lawyers in the construction practice area. Nick Gaede, recently retired from Bradley Arant, was a founder of ACCL. Mabry Rogers has been a member for sixteen years.

Rhonda Caviedes presented a seminar entitled "Managing Construction Projects in Alabama" on August 24, 2007 in Birmingham, Alabama. The seminar covered topics related to prime and subcontracts, document management, dispute resolution, and insurance.

Rhonda Caviedes, **David Hume**, **Arlan Lewis**, and **Mabry Rogers** presented a statewide seminar to an invited group of public officials on "Public Procurement in Alabama," focusing specifically on anticipated construction under recently approved bond measures for public education. The seminar was held on September 11, 2007.

Mabry Rogers presented an in-house client seminar entitled "DO's and DON'Ts for Construction Managers" on September 18, 2007 in San Francisco, California.

Mabry Rogers conducted a seminar in Arlington, Virginia for in-house counsel entitled "International Arbitration" on September 20, 2007.

Ed Everitt and **Mitch Mudano** presented a seminar to the National Association of Credit Managers on September 20, 2007. The seminar covered the subject of mechanics' liens. Approximately twenty companies attended the seminar, including some of the largest steel mills in the United States and Canada.

Kevin Newsom and **Harold Stephens** spoke at the Alabama Defense Attorney's Fall Meeting in Amelia Island, Florida on September 28, 2007. Harold spoke on the topic of mediation and Kevin's topic focused on appellate practice.

David Owen spoke at a National Business Institute seminar entitled "Managing Complex Construction Law Issues" in Birmingham, Alabama on October 3, 2007.

Arlan Lewis served as a panelist at the 2007 Associated Owners & Developers' National Conference East on the topic of "Dealing with Major Construction Defects" in Atlanta, Georgia on October 15, 2007.

Rhonda Caviedes and **Arlan Lewis** attended the American Bar Association's Construction Industry Forum Fall Meeting on October 24-26, 2007 in Newport, Rhode Island.

Rob Dodson, Will Manuel and **David Pharr** presented a seminar entitled "Practical Advice for Corporate Counsel" on October 30, 2007 at the Golden Moon Resort and Casino in Choctaw, Mississippi. The seminar is in conjunction with the Mississippi Corporate Counsel Association's 2nd Annual Scramble for Scholarships Golf Tournament.

Mabry Rogers presented on the topic of "Defective Specifications" on November 8th at The Thirty-Fifth Annual Symposium on Government Acquisition.

Rhonda Caviedes will speak on November 13th at a Policy Roundtable concerning "Alabama Environmental Law and Policy Affecting Green Building," sponsored by the Alabama Chapter of the U.S. Green Building Council.

Keith Covington will speak at a National Business Institute seminar on November 30, 2007, Birmingham, Alabama, on "Guarding Against Ethical Issues" and "10 Tips for Using Depositions to Win Your Case."

Michael Knapp, **Arlan Lewis**, **Mitch Mudano**, **Jeff Peters**, and **David Pugh** will present "The Fundamentals of Construction Contracts: Understanding the Issues" on December 5, 2007. This seminar will cover contract principles, dispute resolution, project delivery systems, and subcontracting issues.

David Hume will conduct a seminar on green building and its effects on the mechanical contracting industry in Atlanta, Georgia in December 2007.

Sabra Barnett, **Keith Covington**, **Rob Dodson** and **Eric Frechtel** will attend the Construction Superconference on December 12-14, 2007 in San Francisco.

Joel Brown, **Patrick Darby**, **Arlan Lewis**, and **David Pugh** will present a seminar entitled "Construction Insurance, Bonding and Liens in Alabama" on March 18, 2008.

For more information on any of these activities or speaking engagements, please contact Rebecca Harris at 205-521-8504.

NOTE: YOU CAN FIND THIS NEWSLETTER AND PAST NEWSLETTERS ON OUR WEBSITE. WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY GO TO WWW.BRADLEYARANT.COM/PG_CONSTRUCT.CFM OR CONTACT ANY ATTORNEY LISTED ON PAGE 8 OF THIS NEWSLETTER.

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The lawyers at Bradley Arant Rose & White LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

This newsletter is a periodic publication of Bradley Arant Rose & White LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact your lawyer or any of the lawyers in our group whose names, telephone numbers and E-mail addresses are listed below; or visit our web site at www.bradleyarant.com.

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BRADLEY ARANT ROSE & WHITE LLP **First Quarter 2008**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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In Order to Get Paid, Contractors Working on Federal Projects Need Express Authorization from the Contracting Officer (No One Else) for All Extra Work

In August 2007, the United States Court of Appeals for the Federal Circuit in *Winter v. Cath-dr/Balti Joint Venture* held that in order for a contractor to get paid for change orders, all changes for extra work must be expressly authorized from the Contracting Officer only. The Federal Circuit went on to note that this rule holds regardless of whether the contractor is told otherwise verbally by the government or a different arrangement is set out in the contract documents.

In *Winter v. Cath-dr/Balti Joint Venture*, the contractor ("Cath") and the Navy entered into a contract for external renovations of a historic dental research facility at the Great Lakes Naval Training Center in Illinois. The contract incorporated by reference many standard government clauses giving the Contracting Officer authority to grant change orders, modifications and equitable adjustments. Once the project started, the Navy informed Cath that a Project Manager had been assigned, and to direct all correspondence and Requests for Information to the Project Manager. Upon substantial completion, Cath submitted several adjustments to the Project Manager in accordance with the standard equitable adjustments provision in the contract. The requests were sent for review up to the Contracting Officer who determined that many of the submitted adjustments were inappropriate and denied them. Cath appealed the Contracting Officer's decision to the Armed Services Board of Contract Appeals ("ASBCA"), arguing that all adjustments were appropriate because they were authorized by the Project Manager, an agent of the Navy. The ASBCA agreed and held that the Project Manager had delegation of authority to resolve minor problems under the contract and, thus, his authorization of changes bound the government to provide an equitable adjustment. The Navy appealed the ASBCA decision to the Court of Appeals for the Federal Circuit.

Under general agency principles, an agent is authorized to bind a principal if apparent or actual authority exists. Actual authority is that which a principal expressly confers on an agent, while apparent authority is authority that a third party reasonably believes an agent has based on the party's dealings with the principal. Arguably, the Project Manager in this case had apparent authority to grant

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change orders and modifications. Cath was told to direct all correspondence to the Project Manager who held himself out as the head of the project. The Federal Circuit, however, confirmed that apparent authority is not enough to bind the government. The fact that the Project Manager held himself out as the Navy's agent, including Cath's reasonable reliance on this fact, was not enough. Express or implied actual authority must exist to bind the government. Express authority generally comes from the contract itself. With respect to contracts for supplies and services, the government only gives express authority to Contracting Officers. When clear express actual authority exists in the contract, like in this case, implied authority is irrelevant. The Federal Circuit held that although the Contracting Officer had made a limited delegation of authority to the Project Manager, this delegation of authority did not include contract modifications.

The Federal Circuit's decision confirms that a contractor must deal with the person having express authority. When in doubt, contractors operating under federal government contracts should always take the side of strict interpretation of the contract terms and seek advice from counsel before relying on the authority of a government agent who is not expressly authorized under the contract to take the action in question.

by Nick Voelker

Spearin Claims Requires Proof of Substantial Defects

In *Caddell Construction Co., Inc. v. U.S.*, the Court of Federal Claims considered a defective specification claim under the *Spearin* doctrine. Under the *Spearin* doctrine, the Government impliedly warrants that, if the contractor follows detailed specifications provided with the contract, the resulting project will not be defective or unsafe and that the contractor will achieve satisfactory contract performance. Where a design specification is defective, a Government contractor may recover costs incurred to overcome the specification, including damages suffered from delays attributable to the defective specification. To prevail on a defective specification claim, the contractor must show that that the Government's specification was a design specification and that the specification was "substantially deficient or unworkable." *Spearin* may not apply to purely performance specifications.

Caddell, the general contractor, sponsored a claim by its structural steel erector, Steel Service Corporation ("SSC"), arising from the construction of a VA hospital in Memphis, Tennessee. SSC claimed that the structural steel drawings provided by the VA were incomplete and contained conflicting information. As a result, SSC submitted over 300 requests for information ("RFIs") aimed at clarifying and correcting the allegedly defective structural steel design documents.

In response to SSC's claim, the Government first argued that the structural steel design was a performance specification to which *Spearin* did not apply. According to the Government, the specification allowed the contractor to utilize its own schedule and sequence for completing the structural steel work; therefore, it was not a detailed design specification. The Court rejected the Government's argument, however, reasoning that the nine-page specification for structural steel contained detailed instructions about how to erect the structural steel, including instructions about what types of bolts, washers, nuts, welds, finishes, and connections to be used. While sequencing and scheduling were left to the contractor, the Court concluded that the structural steel specifications were a detailed "road map" that the contractor was obligated to follow.

After finding that the structural steel specification was a design specification, the Court concluded that the specification was not defective. According to the Court, the contractor failed to meet its burden of proving that the specifications were "substantially deficient or unworkable." The Court rejected the notion that a substantial number of RFIs proves that a specification is defective. Unless the responses to the RFIs generate changes to the design or otherwise reveal that the design was fundamentally flawed, the mere fact that many RFIs were issued is not enough to support a defective specification claim under *Spearin.*

The Court noted that the general contractor did not immediately submit RFIs received from its subcontractor to the Government, instead waiting to "bundle" numerous RFIs into one large submission. According to the Court, this practice of bundling the RFIs resulted in signification delays to resolving the RFIs that were not attributable to the Government.

The *Caddell* case confirms that a contractor pursuing a design defect claim under *Spearin* must show that the design contained a fundamental flaw, or a collection of flaws, that required a major revision to the design and delays to the project. Conclusory allegations will not be sufficient to prevail.

by Jim Archibald

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Be Specific in Preparing Releases and Settlement Agreements

A recent decision from Florida provides a useful reminder to all in the construction industry to draft and review carefully settlement agreements and releases. Be wary of "boiler-plate" clauses, and ensure that the language describing the claims released is precise.

On March 14, 2000, the University of Central Florida contracted with Centex Rooney/Construct Two to construct student housing. Traveler's Casualty and Surety Company issued a payment bond for the use and benefit of claimants on the project. Centex entered into a subcontract with Progressive Plumbing, Inc. for Progressive to perform the plumbing work on the project. Progressive then hired The Plumbing Service Company to perform some of the plumbing work.

Plumbing Service stopped working on the project on or about February 1, 2001, because of a dispute between it and Progressive. Plumbing Service and Progressive met on February 14, 2001, and agreed upon the amount of money due Plumbing Service for the work it had performed. When Progressive failed to make the payment, Plumbing Service sued Traveler's on the payment bond. While the suit was pending, Plumbing Service filed a "Civil Remedy Notice of Insurer Violation" against Traveler's with the Department of Insurance, pursuant to section 624.155(2) of the Florida Statutes alleging, among other things, that Traveler's violated the statute by: (1) failing to acknowledge claims and act promptly; (2) denying claims without conducting a reasonable investigation; (3) not attempting in good faith to settle claims; and (4) failing to promptly settle claims.

On March 5, 2003, Plumbing Service, Traveler's and Progressive entered into a Settlement Agreement under which the parties agreed that Plumbing Service had a valid claim under the bond and was entitled to recover. Traveler's agreed to pay Plumbing Service a total of $76,566.40, representing principal, interest, court costs and attorney's fees. Plumbing Service, in turn, agreed to dismiss its lawsuit upon payment of all specified sums. The Settlement Agreement contained a mutual release. The two release clauses, however, differed in one significant aspect. Traveler's released Plumbing Service from "all causes of action whether known or unknown, . . . from the beginning of the world through the date hereof." Plumbing Service released Traveler's from "all causes of action whether known or unknown, . . . from the beginning of the world through February 14, 2001 . . . ."

Shortly after executing the Settlement Agreement, Plumbing Service filed a separate action alleging bad faith and asserting those claims contained in the "Civil Remedy Notice of Insurer Violation." Traveler's filed a motion to dismiss the complaint, affirmative defenses, and a motion for summary judgment relying in part on the release contained in the Settlement Agreement. The trial court granted the motion based on the language in the Settlement Agreement. Plumbing Service appealed the decision.

In *Plumbing Service Co. v. Traveler's Cas. & Sur. Co.*, the Florida Court of Appeals reviewed the Settlement Agreement language related to the scope of the release. As an initial matter, the court noted that the release failed to specifically mention which of Plumbing Service's claims Traveler's released because the release used general language, *e.g.* "all" claims. The court also noted that unlike the release language used in Traveler's release of Plumbing Service, the release as to Traveler's was limited by time to a date certain, February 14, 2001. As such, the court stated that Plumbing Service claims accruing after February 14, 2001 were unaffected by the release. The court then determined that based on the language of the statute governing Plumbing Service's bad faith claim, the claim did not accrue until after February 14, 2001. The court held that the release did not extinguish that claim. As a result, the Court reversed the trial court.

Parties to a written agreement have an affirmative duty to read and understand the written agreement before signing it. Moreover, courts interpreting a written agreement after the fact presume that the express language in the agreement is what the parties intended, and construe the agreement to mean what on its face it purports to mean. When drafting an agreement, ensure that you are precise. More importantly, it is imperative that you review any written agreement prior to execution.

by Mike Griffin

Florida Condo Law: Owner Awarded Damages for Defective Central Air Conditioning Unit, Despite Exclusion in Condominium Act

In a recent Florida case, a unit owner sued the developer of a residential condominium complex over problems with the air conditioning system. In *Turnberry Court Corp. v. Bellini*, the owner claimed several deficiencies in the system, and sued the developer for breach of implied warranty of fitness and merchantability under Fla. Stat. Section 718.203. After a jury verdict in favor of the owner, the developer appealed on the basis that

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the Florida Condominium Act specifically excluded warranty claims for "mechanical elements serving only one unit."

The appeals court analyzed Florida's Condominium Act. The court found that the condominium is a unique hybrid in property law. For example, a condo owner obtains title to a unit, as well as an undivided share in common elements. For this reason, the court found that condominiums are exclusively subject to the Florida Legislature's control and regulation.

Specifically, under Florida's Condominium Act, a developer grants to each unit owner an implied warranty of fitness and merchantability. Per the statute, the warranty includes six (6) classifications, including: (1) the unit; (2) the personal property transferred with each unit; (3) all other improvements for the use of unit owners; (4) all other personal property for the use of the unit owners; (5) the roof and structural components, and mechanical, electrical and plumbing elements serving a building (rather than a single unit); and (6) all other property conveyed with a unit. Each classification has a different warranty period. While subsections (1), (2) and (6) concern the unit itself, subsections (3), (4) and (5) relate to the common elements of the condo complex.

The Florida appeals court found that the clear objective of the statute is to cover the complete unit and all common elements. The court reasoned that the warranty already extended to such personal property transferred with the unit, such as refrigerators, stoves and ceiling fans. The court found that it was illogical to find that the Legislature purposely intended to exclude from the warranty such an important part of a condo as the central air conditioning system because it was a material mechanical element serving only one unit. For this reason, the court affirmed the verdict in favor of the condo unit owner against the developer. The result is not surprising considering the purpose of the Florida Condominium Act is to provide buyers with a warranty that the unit they are purchasing meets reasonable expectations, including an adequate air conditioning system.

by Mitch Mudano

Contractor Awarded Lost Future Profits as Damages

When a contractor or subcontractor is terminated from performance on a bonded job, it is likely that the termination will result in a loss of, or reduction in, bonding capacity, where the bonding company is notified of the termination and takes action following the termination. In such a case, contractors and subcontractors have long contended that a damage flowing from the termination is a loss of future profits on jobs that "would have been bid." There are numerous legal and common sense hurdles which must be cleared before a claim for lost profits on future work will be actually awarded (or negotiated), but Mehr Beglari, owner of BEGL Construction Co., Inc., was awarded such damages by a jury in California following BEGL's termination by the Los Angeles Unified School District. In August, 2007, the California intermediate appellate court in *BEGL Construction Co., Inc. v. Los Angeles Unified School Dist.*, sustained the award of lost future profits, as a component of what lawyers call "special" damages. The damages arose when BEGL was terminated from its right to proceed with a contract for work on a School District project. Following termination, the District called on the bonding company, F&D Company of Maryland, to complete the work. F&D did so, and sued BEGL. BEGL had obtained replacement bonding capacity, for a brief period, until its new bonding company learned of the dispute with F&D. As a result, BEGL's bonding capacity was reduced to 10% of what it had been prior to the termination. The trial and appellate court allowed evidence of the lost profits caused by the inability to bid the number of jobs BEGL had bid prior to the termination, and the jury awarded $506,000 to BEGL for its lost profits (on jobs it never bid), after the jury found, of course, that the District had wrongfully terminated BEGL's proceeding under its contract with the District.

In the appropriate case, where the loss of bonding capacity can be tied to a wrongful termination, BEGL is instructive as to some of the elements that may support, or defeat, such a claim arising out of a breach of a contract with a state or other related entity. For breaches of contract by the Federal government, lost profits on future contracts are difficult to recover, although there is no *per se* prohibition.

by Mabry Rogers

Indemnity for Your Own Negligence: Be Clear and Conspicuous or You'll Fail

In *Gilbane Bldg. Co. v. Keystone Structural Concrete, Ltd.*, the Texas Court of Appeals reiterated the requirement that indemnity provisions aimed at indemnifying one from its own negligence must be clear and conspicuous. In *Gilbane*, the contractor, Gilbane, contracted with Keystone for Keystone to act as subcontractor. During construction, an employee of Keystone suffered an injury and, due to a Texas law that limited his rights against Keystone to

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workers' compensation benefits, he brought suit alleging negligence against Gilbane only. Gilbane settled the suit for $2,000,000.

After the settlement, Gilbane filed suit against Keystone and Royal Insurance, Keystone's excess carrier, seeking to recover the funds it paid to settle the claim. Gilbane asserted, among other things, that Keystone was liable to Gilbane for breaching an indemnity agreement in the Gilbane-Keystone contract. The provision on which Gilbane relied stated as follows: "Keystone agrees to indemnify . . . Gilbane . . . from and against claims . . . arising out of or resulting from the performance . . . of Keystone's work under this Agreement provided that any such claim . . . is caused, in whole or in part, by any negligent act or omission of Keystone or anyone directly or indirectly employed by Keystone, or anyone for whose acts Keystone may be liable, regardless of whether caused in part by a party indemnified hereunder." Gilbane argued that it could establish that the employee's injuries were caused by the negligence of Keystone and not the negligence of Gilbane. Thus, in accordance with the contract, Keystone should have been required to indemnify Gilbane. Keystone responded that the provision was not enforceable because Gilbane was sued for its own negligence and, since the provision did not expressly indemnify Gilbane for its own negligence, the provision did not comply with Texas law.

In agreeing with Keystone, the court noted that because indemnity provisions seek to shift the risk of one party's negligence to the other, Texas applies an express negligence doctrine and the conspicuousness requirement to such provisions. Under the express negligence doctrine, the intent to indemnify a party from its own negligence must be specifically stated in the four corners of the document. The conspicuous requirement mandates that something on the face of the contract, such as larger type or contrasting colors, must attract the attention of a reasonable person. Since Gilbane was the only one sued for negligence and the Gilbane-Keystone contract did not expressly and conspicuously provide that Keystone would indemnify Gilbane for Gilbane's own negligence, the provision was deemed unenforceable. While Gilbane argued that it sought indemnity for Keystone's negligence and not its own, the court refused to allow Gilbane to recover because the allegations of negligence were made solely against Gilbane and Gilbane did not litigate the issue.

If a party intends to be indemnified for its own negligence, it must make sure that its contract with the indemnitor expressly and conspicuously indicates this requirement. Anything less than clear, concise, and noticeable language may not be enforced in many states.

by Mike Huff

Miller Act's Definition Of "Subcontractor" Expanded To Include Bankrupt First-Tier Supplier

The Third Circuit Court of Appeals recently ruled that a third-tier subcontractor on a construction project, whose only contractual relationship was with a steel fabricator used by the prime, was entitled to recover under the contractor's Miller Act payment bond. According to the court, the steel fabricator was a "subcontractor" for purposes of the Miller Act because it was tasked "to supply a specific and crucial part of the materials required by the original contract" and also had a "substantial and important" relationship with the prime contractor. *United States ex rel. E & H Steel Corp. v. C. Pyramid Enterprises*.

The dispute arose out of a contract awarded by the Army Corps of Engineers to Pyramid Enterprises for the design and construction of an airplane hangar. Pyramid issued a $2.23 million purchase order to Havens Design Build to provide the structural steel. Havens, in turn, hired E & H Steel Company to manufacture the steel as well as deliver it to the job site. Following delivery to the job site, Havens filed for bankruptcy. Although Pyramid had already paid Havens for the delivered steel, Havens had failed to pay approximately $500,000 of what was owed E & H. E & H brought a Miller Act suit against Pyramid and its payment bond surety, citing a United States Supreme Court decision, which held that recovery under a Miller Act payment bond is available to "subcontractors without an express or implied contract with the prime contractor, but with a direct contract with a subcontractor."

The District Court for New Jersey denied the claim, asserting that E & H did not have a "direct contract with a subcontractor" because Havens' role in the project was merely that of a material supplier, not a subcontractor. The Third Circuit reversed the district court's decision, finding that Havens qualified as a "subcontractor" under the Miller Act. In arriving at this conclusion, the Third Circuit explained its view that other, contrary court decisions had lost sight of "the purpose of the Act, the relationship between the parties, and the middleman's role in the project.'" The court then determined, in accordance with the Miller Act's intent to "protect persons who supply labor or materials for government construction projects," that Havens was indeed a subcontractor, and making E & H a second-tier subcontractor under the Act. If you are a

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supplier for a federal project, make sure you consult with counsel about all of your options to secure payment, including the possibility of pursuing a claim under the Miller Act.

by Steve Pozefsky

Colorado Passes New Anti-Indemnity Legislation

Construction contracts almost always include indemnity provisions, whereby parties agree to contractually transfer the risk of potential losses and damages that may arise out of a construction project. However, almost every state has passed legislation that aims to constrict the scope of indemnity provisions in the construction context. Colorado is the most recent state to pass such legislation which applies to virtually all construction contracts involving real property in the State that are executed after July 1, 2007.

Under Colorado's new statute, all broad and intermediate indemnity provisions are declared void and unenforceable. The statute provides:

> any provision in a construction agreement that requires a person to indemnify, insure, or defend another . . . for [damages or injuries] . . . caused by the negligence or fault of [that party or any other person] under the control or supervision of [that party] is void as against public policy and unenforceable.

The statute also voids contractual provisions which require the purchase of additional insured coverage for damages from acts or omissions that are not caused by the negligence or fault of the party providing such insurance.

In support of the statute, the Colorado General Assembly made several findings, including (1) it is in the best interests of the state its citizens and consumers to ensure that every construction business will be financially responsible for damages and/or losses that it causes; (2) the statute will promote competition and safety in the construction industry; (3) contract provisions that shift the financial responsibility for one's own negligence to another are in conflict with the intent of the law; and (4) if all businesses are responsible for their own actions, then construction companies will be able to obtain adequate insurance, the quality of construction will be improved, and workplace safety will be enhanced.

Colorado has joined the trend to eliminate indemnity and additional insured provisions that shift the responsibility for damages arising out of one's own negligence. Many form contracts and subcontracts will need to be compared to a particular jurisdiction's law to see if "broad" indemnity is enforceable.

by Ed Everitt

Bradley Arant Lawyer Activities:

Mabry Rogers presented on the topic of "Defective Specifications" on November 8, 2007 at The Thirty-Fifth Annual Symposium on Government Acquisition.

Rhonda Caviedes spoke on November 13, 2007 at a Policy Roundtable concerning "Alabama Environmental Law and Policy Affecting Green Building," sponsored by the Alabama Chapter of the U.S. Green Building Council.

Keith Covington spoke at a National Business Institute seminar on November 30, 2007 on "Guarding Against Ethical Issues" and "10 Tips for Using Depositions to Win Your Case."

Michael Knapp, **Arlan Lewis**, **Mitch Mudano**, **Jeff Peters**, and **David Pugh** presented a seminar entitled "The Fundamentals of Construction Contracts: Understanding the Issues" on December 5, 2007.

David Hume conducted a seminar on green building and its effects on the mechanical contracting industry in Atlanta, Georgia in December 2007.

Keith Covington, **Rob Dodson**, **Eric Frechtel**, and **David Owen** attended the 23rd Construction SuperConference held on December 12-14, 2007 in San Francisco, California.

Keith Covington recently published an article in *Alabama Construction News* entitled "Complying with Immigration Laws."

David Owen presented a seminar to the Alabama Society of Professional Engineers entitled "Professional Services Contracts and Risk Allocation" on January 15, 2008.

David Bashford and **Michael Knapp** attended the Carolinas AGC 87th Annual Convention on January 16, 2008 in Aventura, Florida.

David Pugh conducted a seminar on Building Codes on January 16, 2008.

The Construction Practice Group members attended a "Learning Day" on January 28, 2008 covering an in-depth review of "Defective Specifications."

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Michael Knapp and **Stanley Bynum** attended the ABA Forum on the Construction Industry's presentation covering "The 2007 AIA Documents: New Forms, New Issues, New Strategies" on January 31, 2008 in New York City.

David Pugh has been elected to serve as a member of the ABC Board of Directors for 2008.

Stanley Bynum will attend the American Bar Association Tort Trial and Insurance Practice Section's presentation entitled "The Butterfly Effect: How Surety and Fidelity Claims Handlers' Responses Shape Perceptions" on January 31, 2008 in New York.

Arlan Lewis will attend the ABA Forum on the Construction Industry's presentation covering "The 2007 AIA Documents: New Forms, New Issues, New Strategies," on February 7, 2008 in San Antonio, Texas.

Mabry Rogers will attend the annual meeting of the American College of Construction Lawyers on February 21-24, 2008 in San Antonio, Texas. Mabry will present a review of important insurance law decisions affecting the construction industry.

Wally Sears will be inducted as a new fellow in the American College of Construction Lawyers at the annual meeting on February 21-24, 2008 in San Antonio, Texas.

John Mark Goodman, **Jonathan Head**, **David Hume**, and **David Pugh** will participate in the 1st Annual Chili Cook-Off for the Alabama Chapter of the Associated Builders and Contractors at Sloss Furnaces on February 22, 2008.

Mabry Rogers will present a client seminar concerning "Common Sense Contract Negotiation and Administration" on February 28, 2008 in Palm Springs, California.

Rob Dodson, **Arlan Lewis**, **David Owen**, and **David Pugh** will present a seminar entitled "AIA Contracts" in Mobile, Alabama on March 25, 2008.

Michael Knapp, **David Bashford**, **Michael Griffin**, and **Nicholas J. Voelker** will be conducting a CLE seminar entitled "Condominium Construction Law Issues in The Carolinas" in Charlotte, North Carolina, on March 25, 2008, with **John Bond** as Moderator.

Joel Brown, **Patrick Darby**, **Arlan Lewis**, and **David Pugh** will present a seminar entitled "Construction Insurance, Bonding, and Liens in Alabama" on April 1, 2008 in Birmingham, Alabama. **Ed Everitt** will act as a moderator for the seminar.

Rhonda Caviedes, Michael Knapp and **Arlan Lewis** will attend the ABA Forum on the Construction Industry's Annual Meeting on April 24-25, 2008 in Palm Springs, California.

Rhonda Caviedes will co-present a workshop titled "Debate, Mitigate, or Wait: Addressing Unexpected Environmental Issues or Archaeological Features on the Construction Site" at the ABA Forum on the Construction Industry's Annual Meeting in Palm Springs, California, April 24-25, 2008. Ms. Caviedes will speak on the topic of unexpected environmental issues encountered on construction projects.

Sabra Barnett, **Joel Brown**, **Jonathan Head**, **Michael Knapp**, and **David Pugh** will present a seminar entitled "The Fundamentals of Construction Contracts in Alabama" scheduled for May 13, 2008. **Luke Martin** will act as a moderator for the seminar.

Rhonda Caviedes will speak at a seminar entitled "Current Issues in Stormwater Regulation" on May 30, 2008.

Sabra Barnett, **Keith Covington**, **Arlan Lewis**, **David Pugh**, and **Mabry Rogers** will present a seminar entitled "Construction Claims and Litigation/Arbitration" on June 13, 2008.

Jonathan Head and **David Bashford** are co-authoring a chapter on "Remedies" in the Second Edition of the *Construction Law Handbook* with Nick Gaede. The publication date is currently unknown.

For more information on any of these activities or speaking engagements, please contact Rebecca Harris at 205-521-8504.

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The lawyers at Bradley Arant Rose & White LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

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BRADLEY ARANT ROSE & WHITE LLP Second Quarter 2008

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Condominium Developers Beware: With Bad Real Estate Market Conditions Buyers Are Using Crafty Legal Arguments to Rescind Purchase Agreements

As recently as just two years ago, the condominium market was so hot and profitable that buyers rarely, if ever, attempted to rescind purchase agreements. Why would they? Many were making money immediately following the closing of the deal. As all of us are well aware, the real estate market has changed drastically in the last few years and now buyers are looking to crafty legal arguments to rescind purchase agreements they find themselves in under depressed market conditions.

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Lawsuits have started to pop up, especially in Florida, involving two main legal arguments: namely, (a) the use of the federal Interstate Land Sales Disclosure Act, and (b) an argument that changes made by developers during construction were "material and adverse" to what the parties agreed to at the time of purchase

The federal Interstate Land Sales Disclosure Act says that, within two years of executing purchase agreements, a developer must file property reports with the U.S. Department of Housing and Urban Development ("HUD") or agree to deliver units to owners within those two years. On projects where developers have failed to file with HUD and the project is two or more years late, buyers have attempted to use the federal statute to rescind purchase agreements because they claim they are in violation of federal law. Therefore, condominium developers should be cognizant of the exposure under this statute.

In addition, buyers are using the argument that changes made by the developer from the time of pre-construction purchase until substantial completion of the units are material and adverse. Rescission of contract is the appropriate remedy for buyers where they allegedly did not get what they bargained for. This approach raises the question of whether oral representations can be relied upon, or on the other hand, is the buyer strictly forced to rely only on the contract documents? In January 2008, a Miami developer promised to provide an "Olympic-style pool." The developer delivered a

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pool that was 2,500 sq. ft. An International Swimming Pool is defined as 13,500 sq. ft. Even though the condominium documents specifically stated that the pool would be 2,500 sq. ft., the buyers claim they relied upon the oral representation of an "Olympic-style pool" during pre-construction purchase. Although final judgment in this case has yet to be rendered, in a not so good sign to developers, the court has recently denied summary judgment for the Miami developer.

The lack of case law in these attempts by buyers to rescind purchase agreements should alarm developers, because there is little way of knowing which way various courts will go in these cases. Therefore, in order to avoid exposure in the current real estate market conditions, developers should always consult with counsel before they orally represent anything to a potential buyer. In addition, developers should file with HUD as soon as possible or at the very least, make sure their projects do not carry over the two year threshold set forth in the Interstate Sales Disclosure Act.

by Nick Voelker

Courts Continue to Find CGL Coverage for Construction Defects

Defective work is a fact of life on most construction projects and can often be absorbed by contingencies or bid allowances. However, when curing defective work places a contractor or subcontractor at a significant loss on a project, disputes often arise that cause parties to seek additional funds to finance the work. Although coverage for a contractor's self-performed work is very often excluded by a general liability policy, coverage is often and, based on the trends of state court cases, increasingly available for defective work performed by subcontractors. A recent case from the Supreme Court of South Carolina demonstrates that an upper-tier contractor may have potential insurance recoveries when a subcontractor performs defective work.

In *Auto Owners Insurance Company, Inc. v. Newman*, a homeowner sued its general contractor for moisture problems arising out of stucco installation. The homeowner alleged that the stucco was improperly applied and caused moisture damage to the substrate underlying the stucco. The insurer argued that it had no liability or, at the very least, liability only for the repair to the substrate that did not include the costs of removing and reapplying the stucco. The court disagreed.

To fall within the general liability policy's insuring agreement, the insured first has to prove an "occurrence," *i.e.*, that an unexpected event caused "property damage" or "bodily injury." The court found property damage to the substrate materials and that the removal of the stucco to get to them would further constitute property damage. The insurer raised a common exclusion, called the "Your Work" exclusion, which disallows coverage for a contractor's self-performed defective work. This type of liability is generally covered by a warranty and not by a general liability policy. However, the "Your Work" exclusion contains an exception for property damage caused by a subcontractor. Since the general contractor did not self-perform either the stucco or substrate work, the court found that the subcontractor exception applied and coverage was available. In reaching its coverage conclusion, the court stated in the following very broad language—probably broader than justified by the general liability policy language itself—that "a CGL policy in the home construction industry is designed to cover the risks faced by homebuilders when a homeowner asserts a post-construction claim against the builder for damage to the home caused by alleged construction defects." Though technically inaccurate because it does not draw the distinction between self-performed and subcontracted work, the court's quote is becoming more a reality as many general contractors self-perform little, if any, work themselves and courts are finding coverage within the subcontractor exception to the Your Work exclusion.

Our advice to those who subcontract work is to look for any subcontractor contribution to defective work when it arises. Quite often, general liability coverage is available to help offset a loss in these circumstances.

by Jonathan Head

Immigration Compliance: The DHS Issues Supplemental Proposed Rule on Social Security "No-Match" Responses, Increases Penalties for Immigration Violations

There are two recent developments regarding workplace immigration compliance about which all construction industry employers should be aware. First,

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on March 21, 2008, the Department of Homeland Security ("DHS") issued a Supplemental Proposed Rule on Social Security "no-match" responses which is intended to validate DHS's previously implemented employer "safe harbor" protocol and clear the way for the Social Security Administration ("SSA") to resume sending out "no-match" notices. Then, on March 28, 2008, DHS implemented a regulation which substantially increases the monetary penalties assessed against employers found to have committed immigration compliance violations.

The Supplemental Proposed "No-Match" Rule. For years employers have received no-match notices for employees whose W-2 information does not match the information in the SSA database. The stated purpose of the no-match notice is not immigration enforcement but to help ensure that employee social security allocations are correct. Nevertheless, employers justifiably are concerned that the notice could give rise to a finding that the employer had knowledge of an employee's unauthorized status and lead to liability under the federal immigration laws. This concern is heightened when the no-match notices identify, in large or disproportionate numbers, employees in ethnic groups associated with undocumented workers. Until last year, it was unclear how employers should respond to these no-match notices.

DHS provided some guidance in an August 10, 2007 Final Rule which expressly stated that a no-match notice could lead to a finding that the employer had "constructive knowledge" of an employee's unauthorized status. This August 2007 Final Rule also outlined a protocol (the "safe harbor") for employers to follow that would prevent the employer from being attributed constructive knowledge based on the no-match notice. The Final Rule also made clear that an employer who did not follow the safe harbor procedure faced an increased risk of liability under the immigration laws.

The safe harbor procedures require that an employer give a "mismatched" employee 90 days to clear up the discrepancy with SSA. If the employee cannot, the employer must then re-verify the employee's work authorization using documents other than those bearing the questionable social security number. If the employee cannot resolve the discrepancy with SSA and cannot produce alternative documents, the employer must terminate the employee or risk liability if the employee turns out to be unauthorized.

Although the Final Rule was to go into effect on September 14, 2007, a lawsuit in a federal court in California stopped it. *AFL-CIO, et al. v. Chertoff, et al.*, No. 07-4472-CRB, D.E. 135 (N.D. Cal. 2007). The plaintiffs argued that the August 2007 Final Rule was inconsistent with the federal immigration laws, gave DHS and SSA impermissible authority, and would lead to discrimination and result in the firing of lawful workers. On October 10, 2007, Judge Charles R. Breyer entered a preliminary injunction barring implementation of the August 2007 Final Rule. Judge Breyer found that the rule would cause immediate harm to both employees and employers and held that the plaintiffs had raised serious concerns about its legality. Judge Breyer concluded that a rule which used the SSA database (which contained numerous errors according to an SSA report) for firings would discriminate against tens of thousands of legal workers and place an unfair burden on employers. The judge also held that DHS had not provided a "reasoned analysis" for its change in position that an employer who receives a no-match notice now can be held liable, without any other evidence of illegality, under the immigration laws. DHS appealed Judge Breyer's ruling and indicated that it planned to issue a supplemental proposed rule to address the matters raised in the judge's preliminary injunction.

DHS issued the planned Supplemental Proposed Rule on March 21, 2008. The new Proposed Rule seeks to provide the "reasoned analysis" Judge Breyer found lacking and respond to several other concerns. Significantly, this Proposed Rule *does not* make any changes to the text of the August 2007 Final Rule. Thus, if the Supplemental Rule becomes final -- and survives further legal challenge -- the safe harbor procedures for responding to Social Security no-match notices would finally become operable.

The Proposed Rule rescinds language in the preamble to the Final Rule which had stated that an employer who follows the safe harbor procedures will not be found to have engaged in discrimination. This was in response to one of Judge Breyer's articulated concerns -- that the Final Rule encroached on the authority of the Department of Justice ("DOJ"), and it is DOJ, not DHS, which is charged with enforcing the federal immigration law's anti-discrimination provisions. However, DOJ has issued additional guidance stating that an employer will not be held liable for discrimination if it follows the safe harbor procedures

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and then terminates an employee in accordance with DHS's no-match rule, so long as the employer applies those same procedures uniformly to all employees and does not act with a purpose or intent to discriminate.

The Increased Penalties for Immigration Violations. On March 28, 2008, DHS issued a final regulation which increased by approximately 30% the civil penalties imposed on employers for worksite immigration violations. Now, an employer found to have knowingly hired or employed an unauthorized alien is subject to civil penalties, for a first offense, of not less than $375 but not more than $3,200 for each unauthorized alien. These civil penalties increase to a range of not less than $3,200 but not more than $6,500 per unauthorized alien for a second offense and to a range of not less than $4,300 but not more than $16,000 per unauthorized alien for a third offense and any subsequent offenses. Additionally, federal contractors remain subject to debarment if they are found guilty of knowingly employing unauthorized aliens. The initial period of debarment is one year and may be extended if the employer continues to be in violation of the immigration laws. Even if knowledge of unauthorized status is not established, an employer is subject to civil penalties of between $110 and $1,100 per individual if it fails to satisfy the Form I-9 verification and record-keeping requirements. Additionally, if an employer is found to have engaged in a "pattern and practice" of worksite immigration violations, it is subject to criminal penalties, including fines of up to $3,000 per unauthorized alien and imprisonment of up to six months.

by Keith Covington

License Reminder: Forecast When You Will Need It, Get It, Keep It Current

The lack of a professional license (engineer, architect, some specialty subcontractors), or of a contractor's (or subcontractor's) license in the appropriate amount (or specialty) can be costly. In some states, one cannot enforce one's contract if unlicensed, and in a subset of those states, the lack of a license cannot be "cured" or made retroactive. And the blade has but one edge: your contracting party has the right to enforce the contract against you or your company and, notwithstanding that lawsuit by the other party, you cannot assert your contract defenses (because, of course, you cannot enforce the contract). In a recent case from an intermediate appellate court in California, *Vestra Resources, Inc. v. Thompson*, the court ruled that the unlicensed professional could not enforce its contracts for professional fees. The appellate court thus overturned an arbitration award in favor of the designer--and overturned the arbitrator's finding that the failure to obtain a license defense had been waived by the owner. This case could be reversed on further appeal, but it is a reminder: get your license; keep it in effect. If you are expanding (and we hope you are and are doing so profitably), you should forecast the need for a license. In some states, it is a misdemeanor to bid on a project when you or your company is not properly licensed in the state in which you tender your bid or proposal, and it is a misdemeanor for the owner to consider your bid or proposal. To make it more complicated, the licensing exams are sometimes administered at set times only, so that forecasting work in a state--and thus the need for a license--must be done very early.

by Mabry Rogers

Expanded Review of Arbitration Awards Rejected by Supreme Court

In *Hall Street Associates, LLC v. Mattel, Inc.*, the U.S. Supreme Court ruled that the Federal Arbitration Act ("FAA") supplied the exclusive grounds for judicial review of an arbitration award, and that any attempt to provide for increased judicial review of an arbitration award by contract would not be enforced. The decision means that parties seeking to challenge an unfavorable arbitration award are limited to the narrow grounds set forth by the FAA even if they contracted for broader review. Attempts to provide for expanded review in future contracts likely will not be enforced.

Section 10 of the FAA provides that a court must confirm an arbitration award unless the award resulted from fraud, evident partiality by the arbitrators, arbitrator misconduct, or the arbitrators exceeding their powers. 9 U.S.C. § 10(a) (2000). These grounds for attacking an arbitration award rarely exist and are difficult to prove. As a result, arbitration awards are difficult to overturn, even where arbitrators mistakenly interpret disputed facts or misapply applicable law.

Some parties to arbitration agreements view finality as an advantage to arbitration. Once the arbitrators make their decision, such parties can avoid the

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protracted and expensive battle through the appellate courts that often follows a bench trial or jury trial. Not everyone favors this finality, however, and some parties have bargained for increased judicial review of an adverse arbitration award in their arbitration agreements.

In *Hall Street*, for example, the arbitration clause between Hall Street and Mattel provided that a court could vacate an award by the arbitrators if the arbitrator's findings of fact were "not supported by substantial evidence" or if the arbitrator's conclusions of law were "erroneous." As a result of this provision, Hall Street successfully vacated an arbitration award in favor of Mattel by convincing a federal district judge in Oregon that the arbitrator had reached an erroneous conclusion of law.

The Ninth Circuit Court of Appeals reversed the district judge, however, reasoning that parties could not provide for expanded judicial review in their arbitration agreement. Other federal circuit courts, including the First, Third, Fifth and Sixth Circuits, had reached the opposite result and had enforced arbitration clauses that provided for heightened review. The U.S. Supreme Court granted review to resolve the split among the circuits. The Court concluded that language used by Congress in the FAA precluded expanded judicial review of arbitration awards.

Parties seeking expanded judicial review of their arbitration awards have few options in the wake of this decision. One option may be to attempt to arbitrate under state law, instead of federal law, in a state that allows expanded judicial review of arbitration awards. If the transaction from which the arbitration arises involves interstate commerce, however, this option likely is not available because federal law will preempt state law.

A second option, discussed by the dissent, involves conducting the arbitration pursuant to an order entered by a federal district judge so that the judge retains jurisdiction to review the outcome of the arbitration. It is not clear whether other justices support the dissent's views concerning judicial review of a court-ordered arbitration.

by Jim Archibald

Another Statutory Victory for Subcontractors in North Carolina Will Challenge Prime Contractors to Make Up for Lost Leverage

Adding to a growing body of subcontractor-friendly construction law (including extensive mechanic's lien and public construction bond recovery rights), the North Carolina legislature recently approved revisions to Section 143-134.1 of the North Carolina General Statutes that greatly limits retainage rights down the contractual chain on non-Department of Transportation ("DOT") public projects.

The revisions to Section 143-134.1, which took effect January 1, 2008, initially act to limit retainage rights on *public* projects to five (5%) percent on payments otherwise due prime contractors and subcontractors. In addition, when the project is fifty (50%) percent complete, retainage from monthly payment applications will cease without some assertion of unsatisfactory performance by the applicant. While it can be argued that these provisions benefit both prime contractors and subcontractors, in practice it is the subcontracting community that will benefit the most from these new requirements.

Historically, it has been common for local governmental owners to hold ten percent (10%) retainage on prime contractors. However, many state public entities (including the State Construction Office and University of North Carolina System) have in recent years more commonly utilized five percent (5%) as the prime contractual rate. At least in part, this trend reflects North Carolina's statutory requirement that prime contractors furnish payment and performance bonds on large public projects. Through bonding of prime contractors, public owners have an alternative protection against costs associated with defective or incomplete performance by prime contractors, which makes reduced retainage less of a risk.

Unlike with prime contractors, bonding of subcontractors on North Carolina public projects is not statutorily required and most often is left to the discretion of the prime contractor. While prime contractors often require performance bonds from their major subcontracts, many prime contractors rely solely on withheld funds to ensure complete and compliant performance by mid to lower level subcontractors. With the recent revisions to Section 143-134.1, the amount of retainage held on subcontractors can be as low as two

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and a half percent (2.5%) for the subcontractor's final payment application. This represents a significant limitation on the financial pressure a prime contractor can assert against its subcontractors to complete their work.

In understanding the "real world" impact of this revision, it is critical to note that the final ten percent (10%) of a subcontractor's payment on a project is often what the subcontractor realizes in profit. Removing a prime contractor's ability to withhold such a large portion of its subcontractors' profit lessens the leverage that prime contractor has at the end of the project to get work corrected and completed. Conversely, this retainage limitation will benefit subcontractors by allowing them earlier access to more of their project profit as the job progresses.

A special group of subcontractors will see an even more beneficial impact from this recent amendment. For trades that have reached final completion on or before the time that the project as a whole is fifty (50%) percent complete, the prime contractor generally is now required to make full payment of all amounts due (including retainage) within sixty (60) days of that subcontractor's request. For those involved early in a project, e.g., structural steel, piling, caisson and demolition subcontractors, this new provision ensures that they will no long have to wait until completion of the project as a whole to recover withheld retainage.

As stated above, while these revisions to Section 143-134.1 allow for earlier recovery of withheld retainage for both prime contractors and subcontractors, the new law will predominantly benefit subcontractors. However, it will be prime contractors that are left with deciding the most economical way to compensate for the corresponding loss of leverage against their subcontractors. One likely result will be that prime contractors will find it necessary to obtain performance bonds for more of their subcontractors, as merely being able to hold five (5%) retainage or less will not provide the security prime contractors need to ensure lower tier trades correct and complete their work. Additional bonding necessarily means additional cost, which will be reflected in bidding on public projects going forward.

In summary, while the revisions to Section 143-134.1 appear positive for prime contractors and subcontractors on public projects, it is the subcontracting community that really will reap the benefits. Prime contractors, on the other hand, will be faced with the corresponding question of how to make up for minimizing of their retained leverage and ensure adequate and complete performance by their subcontractors.

by David Bashford

Bradley Arant Lawyer Activities:

David Pugh was installed as a 2008 Board member for the Alabama Chapter of the Associated Builders and Contractors.

David Hume and **Arlan Lewis** attended the ABA Forum on the Construction Industry's presentation covering "The 2007 AIA Documents: New Forms, New Issues, New Strategies," on February 7, 2008 in San Antonio, Texas.

Mabry Rogers attended the annual meeting of the American College of Construction Lawyers on February 21-24, 2008 in San Antonio, Texas. Mabry presented a review of important insurance law decisions affecting the construction industry.

Wally Sears was inducted as a new fellow in the American College of Construction Lawyers at the annual meeting on February 21-24, 2008 in San Antonio, Texas.

Mabry Rogers presented a client seminar concerning "Common Sense Contract Negotiation and Administration" on February 28, 2008 in Palm Springs, California.

Rob Dodson, **Arlan Lewis**, **David Owen**, and **David Pugh** presented a seminar entitled "AIA Contracts" in Mobile, Alabama on March 25, 2008.

David Hume's comments regarding possible legal issues surrounding green building were recently featured in the Spring 2008 edition of Alabama Construction News Magazine in an article entitled *Green Building Finally Comes of Age*.

Michael Knapp, **David Bashford**, **Michael Griffin**, and **Nicholas J. Voelker** conducted a CLE seminar entitled "Condominium Construction Law Issues in The Carolinas" in Charlotte, North Carolina, on March 25, 2008, with **John Bond** as Moderator.

Joel Brown, **Patrick Darby**, **Arlan Lewis**, and **David Pugh** presented a seminar entitled "Construction Insurance, Bonding, and Liens in Alabama" on April 1,

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2008 in Birmingham, Alabama. **Ed Everitt** was the moderator for the seminar.

Sabra Barnett and **Keith Covington** attended the Alabama Associated Builders and Contractors annual Day on the Hill in Montgomery, Alabama on April 2, 2008.

Jim Archibald, **Jonathan Head**, **David Hume**, **Luke Martin** and **David Pugh** competed in the 1st Annual Chili Cook-Off for the Alabama Chapter of the Associated Builders and Contractors at Sloss Furnace on April 4, 2008.

Mabry Rogers presented a client seminar in Las Vegas, Nevada on April 22, 2008. The seminar focused on practical job administration and schedule methodology.

Rhonda Caviedes, Michael Knapp and **Arlan Lewis** attended the ABA Forum on the Construction Industry's Annual Meeting on April 24-25, 2008 in Palm Springs, California.

Rhonda Caviedes co-presented a workshop entitled "Debate, Mitigate, or Wait: Addressing Unexpected Environmental Issues or Archaeological Features on the Construction Site" at the ABA Forum on the Construction Industry's Annual Meeting in Palm Springs, California. Ms. Caviedes spoke to over 150 members of the Forum on the topic of unexpected environmental issues encountered on construction projects.

Rob Dodson, **David Hume**, **Will Manuel**, **David Owen**, and **David Pugh** presented a Construction Law seminar to the Mississippi Associated Builders and Contractors on May 1, 2008 in Jackson Mississippi. The seminar included topics on insurance, bonding, green building, project management and hot topics surrounding the construction industry.

Sabra Barnett, **Joel Brown**, **Jonathan Head**, **Michael Knapp**, and **David Pugh** will present a seminar entitled "The Fundamentals of Construction Contracts in Alabama" scheduled for May 13, 2008 in Montgomery, Alabama. **Luke Martin** will act as a moderator for the seminar.

Wally Sears will speak at the Mealy's Construction Litigation Conference in Philadelphia, Pennsylvania on May 20-21, 2008. Wally will present on two topics: (1) proof of damages for delay and disruption, and (2) termination, default, and material breach.

Joel Brown will join three Bradley Arant partners in speaking to the Huntsville, Alabama Chamber of Commerce on May 29, 2008, regarding issues which impact government and private sector contractors.

Rhonda Caviedes will speak at a seminar entitled "Current Issues in Stormwater Regulation" on May 30, 2008 in Birmingham, Alabama.

Sabra Barnett, **Keith Covington**, **Arlan Lewis**, **David Pugh**, and **Mabry Rogers** will present a seminar entitled "Construction Claims and Litigation/ Arbitration" on June 13, 2008 in Birmingham, Alabama.

Rob Dodson will attend the Mississippi Associated Builders and Contractors annual convention on July 10-12, 2008 at the Grand Sandestin, in Sandestin, Florida.

Jonathan Head and **David Bashford** are co-authoring a chapter on "Remedies" in the Second Edition of the *Construction Law Handbook* with Nick Gaede. The publication date is currently unknown.

Mabry Rogers will speak on the topic of "International Dispute Resolution" at the Society of Construction Law's 2008 International Construction Law Conference in London, England on October 5-7, 2008.

The Governing Committee of the American Bar Association Form on the Construction Industry appointed **Rhonda Caviedes** as a member of the Steering Committee for Division 10 – Legislation & Environment at the Forum's annual meeting in LaQuinta, California.

For more information on any of these activities or speaking engagements, please contact **Rebecca Harris** at 205-521-8504.

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BRADLEY ARANT ROSE & WHITE LLP Third Quarter 2008

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Immigration Compliance: E-Verify

On June 6, 2008, President Bush amended Executive Order 12989 mandating that all federal contractors use E-Verify, an employment verification system, to check immigration status. On June 12, 2008, the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council issued a proposed rule to the Federal Acquisition Regulation (FAR) implementing the Executive Order. Comments on the proposed rule are due by August 11, 2008. The government will consider all comments before issuing the final rule. Accordingly, it will likely take several months before this requirement is actually "the law" for federal contracts.

Highlights of the proposed rule:

1. Once you are awarded a federal contract, you have 30 days to enroll in the E-Verify program. Once you are enrolled, you must use E-Verify within 30 days to verify the employment eligibility of all of your employees assigned to the contract at that time.

2. If you were already enrolled in E-Verify at the time of the contract award, you have 30 days to use E-Verify for your employees assigned to the contract.

3. You must use E-Verify for all employees you subsequently assign to or hire for the contract. You only have three days for each employee who is new to the contract, so you need to make sure you have procedures in place to verify quickly and accurately.

4. You must require all your subcontractors performing work exceeding $3000 for services or for construction to comply as well.

Effective Date. The Final Rule will apply to all contracts awarded after the effective date. It will not apply to federal contracts existing on the effective date. The proposed rule, however, directs contracting officers who have indefinite-delivery/indefinite-quantity contracts to seek amendments that would have E-Verify requirements for future orders if there is (1) at least six months still

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remaining on the contract and (2) a substantial amount of work expected to be performed.

Enrolling, Waivers, and Consequences of Non-Compliance. To participate in the E-Verify program, you must enter into a Memorandum of Understanding (MOU) with the Department of Homeland Security and the Social Security Administration. Under the MOU, you will agree to abide by legal hiring procedures and ensure that no employee will be unfairly discriminated against as a result of the E-Verify program. Participation in the E-Verify program does not exempt you from the responsibility to complete, retain, and make available Forms I-9, but participation in E-Verify will provide you with some deference of compliance upon inspection, such as a "good faith" exception to any civil or criminal liability.

The proposed rule provides for waivers of the E-Verify requirements only under "exceptional circumstances." You seek a waiver from the head of a contracting agency.

Compliance with the E-Verify rule will be a performance requirement for a federal contract. You will be required to release information relating to compliance to contracting officers or other officials. Failure to comply could result in the termination of the contract.

by Sabra Barnett and Keith Anderson

Immigration Compliance: State Immigration Rules

Recently, there has been much activity among state legislatures to pass their own versions of immigration reform, resulting in a hodgepodge of rules that have to be followed in addition to those prescribed by the federal government. Although a majority of this legislation regulates social programs provided to illegal immigrants, some states have gone so far as to create their own employment enforcement laws.

For those contractors doing business in various states, it is important to know the immigration compliance rules for those states. Below is a survey of employment-related legislation that has been implemented in the past several years. However, it is important that if contracting in these states, you check with your attorney about compliance. These laws are changing rapidly.

Arizona

- Prohibits employers from knowingly or intentionally hiring undocumented workers, and requires all employers to use the Basic Pilot program to determine employees' eligibility status. Penalties include the loss of a business license.

Arkansas

- Prohibits state agencies from contracting with businesses that employ undocumented immigrants. Contractors must certify that they do not employ or contract with undocumented workers. Contractors must obtain certification from all subcontractors. Penalties include the termination of the contract and actual damages.

Colorado

- Requires prospective state contractors to use E-Verify to confirm the employment eligibility of new hires. Penalties include the termination of the contract, actual, and consequential damages.
- Creates hiring requirements in addition to those required under the Federal Immigration Reform and Control Act. The Director of that department is authorized to conduct random audits of employers to obtain the documentation.

Georgia

- Requires state contractors to use E-Verify.

Iowa

- Businesses that receive state economic development grants must certify that all employees are authorized to work in the United States.

Louisiana

- Prohibits businesses from employing unauthorized workers. Establishes civil penalties for violations up to $1,000 for each unauthorized worker. Allows any state agency or department to conduct an investigation into an employer's hiring policies, provides for cease and desist orders, and subjects an employer to penalties up to $10,000 for violations.

Massachusetts

- Prohibits the use of undocumented workers on state contracts. Contractors are required to certify that they shall not knowingly use undocumented workers and shall verify the immigration status of all workers assigned to the state contract. Violation of the terms is a breach of contract, subjecting the

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contractor to monetary penalties, suspension, and/or termination of the contract.

Michigan

- Directs state agencies to consider a variety of factors when awarding or canceling contracts with private businesses including the immigration and residency status of persons employed by the contractor, and whether the use of non-citizen workers would be detrimental to state residents or the state economy.

Mississippi

- Requires all employers to use E-Verify. Creates cause of action against employers for terminating an authorized worker while employing an unauthorized worker. Penalties include loss of business license.

Missouri

- Prohibits employers from employing unauthorized workers. Requires E-Verify for state contractors. E-Verify is optional for private employers but is an affirmative defense to a charge that the employer knowingly hired an unauthorized worker. Provides for the revocation of business licenses and the termination of state contracts.

Minnesota

- Requires state contractors to use E-Verify.

Nevada

- Upon a finding by the U.S. Government that an employer has violated IRCA, the Nevada Tax Commission shall hold a hearing and fine the employer if found to have willfully, flagrantly or otherwise egregiously violated the law.

New Hampshire

- Prohibits the employment of unauthorized workers. Provides for penalties up to $2,500 for terminating an authorized worker while employing an unauthorized worker.

Oklahoma

- Requires public employers to use E-Verify. Creates cause of action against employers for terminating an authorized worker while employing an unauthorized worker.

Pennsylvania

- Prohibits employers from using illegal immigrants on projects financed by grants or loans from state government. Penalties include repayment of loan with interest.

Rhode Island

- Requires state contractors to use E-Verify.

South Carolina

- Employers must enroll in E-Verify or verify that the employee has a valid driver's license. Provides for a cause of action by fired workers if they are replaced with unauthorized workers. Felony offense for harboring an illegal immigrant. Employer in violation may lose business license.

Tennessee

- Prohibits employers from knowingly hiring illegal immigrants. Penalties include loss of business license. There is a safe harbor provision for employers using E-Verify.

Texas

- Requires employers receiving public subsidies to certify the legal status of its workers. Employers found in violation of this Act must repay the subsidy with interest.

Utah

- Requires public employers to use E-Verify. Creates a cause of action for the termination of a lawful employee while retaining an unauthorized alien in the same job category.

Virginia

- Suspends the business license of a company whose officers or directors are convicted under federal law for having a pattern or practice of employing unauthorized aliens in Virginia. Requires employers signing state contracts to state that they will not knowingly hire unauthorized aliens.

West Virginia

- Prohibits employers from employing unauthorized workers. Penalties include revocation of business licenses.

by Sabra Barnett

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Lien Preferences in Alabama

In *Ex parte Theresa Lawson d/b/a The Design Company*, the Alabama Supreme Court recently addressed the priority of mechanics liens and mortgages. It overturned a decision of the Court of Civil Appeals unfavorable to mechanics lien claimants.

Brian Homes built several homes on properties it owned in Madison County. Theresa Lawson was a subcontractor to Brian Homes. To finance construction, Brian Homes obtained a construction loan secured by a mortgage on the properties. After the homes were completed, but before Lawson filed her liens, the homes were sold to initial homeowners and the construction loan was paid in full. To obtain the money to purchase the homes, the homeowners mortgaged the properties to residential lenders. The residential lenders had no notice of Lawson's potential liens. Lawson recorded her mechanics liens after the residential mortgages were recorded.

The Court of Civil Appeals held that, even though Lawson commenced work before the residential mortgages were recorded, the residential mortgages had priority over her mechanics liens. It reasoned that the lenders had satisfied the construction mortgage without notice of Lawson's liens. Because they had no knowledge of Lawson's liens, they should be equitably subrogated to the rights of the construction lender, who filed its construction mortgage before Lawson commenced work. This would leave Lawson in the same position she occupied at the time she decided to perform the work. By subrogating the residential lenders to the rights of the construction lender, Lawson's priority would not change. She started in a subordinate position. The Alabama Mechanics Lien statute does not promise that mechanics liens will not be subject to equitable subrogation when equity requires it. Because the residential lenders had no notice of Lawson's potential liens and because the construction industry relies on lenders to finance construction and home ownership, the residential lenders were entitled to priority over Lawson, as subrogees to the priority position of the construction lender.

The Alabama Supreme Court reversed the Court of Civil Appeals. In doing so, it examined the Alabama Mechanics Lien statute and Alabama court decisions on the doctrine of equitable subrogation. Someone who claims equitable subrogation must meet five requirements: (1) the money was lent at the instance of the debtor to extinguish a prior encumbrance, (2) the new lender reasonably expected that it would enjoy the position of the old lender, (3) the whole debt was paid in full, (4) the new lender was ignorant of the lien, and (5) the lien claimant would not be "burdened or embarrassed." The court held that the residential lenders could not satisfy the first and fourth requirements. As to the first requirement, the loans were made at the request of the homeowners, not Brian Homes. As to the fourth requirement, the lenders could not claim they did not have notice of Lawson's potential mechanics liens. Section 35-11-211 of the Alabama Mechanics Lien statute provides that mechanics liens "shall have priority over all other liens, mortgages or encumbrances created subsequent to the commencement of work. . . ." Thus, by statute, the residential lenders were given constructive notice that a lien could be filed that would have priority over their interests. The plain words of the statute require that mechanics liens have priority over all other liens, mortgages or encumbrances created subsequent to the commencement of the work. Therefore, the constructive notice given by the mechanics lien statute defeated the lenders' claims of equitable subrogation.

The Court of Civil Appeals decision created uncertainty over the priority status of mechanics liens. Although a lien claimant could wait the statutory period to file its lien, it would be at risk of losing priority to subsequent claimants. Had the Alabama Supreme Court not overturned the lower court decision, mechanics lien claimants would have had difficulty determining exactly when to file a mechanics lien to avoid losing rights to persons coming after them claiming interests in the property.

by Axel Bolvig

"No Damage For Delay" Clause Is Enforceable Under California Law and Bars Subcontractor Pass-Through Claim for Delay Damages brought under the *Severin* Doctrine

The Court of Federal Claims has recently held that under California law, a contract with a clear "no damage for delay" clause is enforceable by a prime contractor in its subcontracts, and because this clause is an iron-bound bar to the subcontractor's claim, the United States was entitled to dismissal of the pass-through, delay claim brought under the *Severin* doctrine.

In *Harper/Nielsen-Dillingham v. U.S.*, the prime contractor, Harper, asserted claims against the U.S. on behalf of a subcontractor, KCI, for delay damages, as well as other claims. The contract between Harper and KCI contained a clear "no damage for delay" clause. Pursuant to the contract, if KCI experienced delays caused by Harper or the U.S., it was only entitled to additional time to

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complete the contract, not damages. The project experienced significant delays, and upon completion of its subcontract, KCI sued Harper under the Miller Act for the unpaid balance of its contract as well as $770,565.00 for delay damages. KCI and Harper later settled this lawsuit and executed a settlement agreement settling all claims between the parties except for KCI's claim for equitable adjustment from the U.S. with which Harper agreed to cooperate.

After the government's contracting officer denied KCI's equitable adjustment claim, Harper and KCI entered a second agreement titled "Claims Presentation and Prosecution Agreement" ("Claims Agreement"). In the Claims Agreement the parties acknowledged that Harper continued to be liable to KCI for any recovery which Harper might obtain from the U.S. as a result of KCI's claim. Harper was only liable to KCI if Harper recovered from the U.S.

Pursuant to the *Severin* doctrine, Harper brought suit against the United States on behalf of KCI asserting its claim for delay damages. The *Severin* doctrine allows a prime contract to assert claims of subcontractors as "pass through" claims, but only when the prime contractor remains potentially liable to the subcontractor for the claims. The subcontractor cannot sue the United States directly because, under the Tucker Act, the United States has only agreed to allow suits against it by parties who have a direct contractual relationship with the United States.

The government requested that the court dismiss the delay claims asserting that Harper had no potential liability to KCI because the subcontract in question contained a "no damage for delay" clause. Harper countered that under California law, which was applicable to the contract, a "no damage for delay" clause was not enforceable, and Harper was potentially liable to KCI for these damages.

The court examined California law as it applies to a "no damage for delay" clause and found that California enforces such contract provisions when they are clear and unambiguous. The court specifically considered whether the California statute governing contracts with state and local government agencies would apply to Harper's claims, and the court found no basis for applying this statute primarily because the United States did not meet the definition of a state or local government agency. The court also considered the plaintiff's argument for exceptions to the enforcement of "no damage for delay" clauses, and found that if such exceptions existed, the Plaintiff failed to present any evidence to support the application of any of the potential exceptions. Furthermore, the court specifically noted that California had not embraced any of the traditional exceptions to enforcement of a "no damages for delay" clause.

Because the court found that the "no damage for delay" clause was enforceable, KCI had no claim for delay damages against Harper from the inception of its subcontract. Understandably, the court held that because KCI never had a delay claim, the Claim Agreement entered by Harper and KCI could not be used to revive, or in this case, create a viable claim for purposes of the pass-through claim against the government.

Because the KCI subcontract contained an enforceable "no damage for delay" clause, the court found that Harper had an iron-bound bar to KCI's pass through claim, and consequently the delay claim was dismissed.

by Rob Dodson

North Carolina Lien Law: Subcontractors Win Crucial Subrogated Claim of Lien on Real Property Lien Law Hierarchy Issue

Recently, in *Carolina Building Services' Windows & Doors, Inc. v. Boardwalk, LLC*, the North Carolina Supreme Court took up issues pertaining to the lien law hierarchy for "Subrogated Liens on Real Property" created by the North Carolina General Statutes. The North Carolina Supreme Court held that a default judgment in favor of an owner of real property against its general contractor cannot extinguish a subcontractor's lien on real property.

Boardwalk, LLC ("Owner") entered into a contract with Miller Building Corporation ("Contractor") for the construction of a condominium project. Before completion, Contractor removed its personnel and equipment from the project site and failed to pay its subcontractors, including the plaintiff Carolina Building Services' Windows and Doors, Inc. ("Subcontractor").

In North Carolina, a subcontractor or supplier can acquire no better lien rights by subrogation than those of the general contractor and is bound by any defenses available to the owner against the general contractor. In this case, Subcontractor properly gave notice of its claim of lien upon funds, filed a subrogated lien, and filed suit against Owner and Contractor to perfect its lien rights. However, the Contractor failed to answer or appear, and the trial court entered a default judgment against Con-

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tractor. Subsequently, Owner filed a cross-claim against Contractor and also obtained a default judgment against Contractor. The trial court granted summary judgment to Owner on Subcontractor's lien claims based on the entry of the default judgment. The trial court held that because Owner established it owed no money to Contractor through default, Subcontractor could not have a claim of lien against the property.

The North Carolina Supreme Court reversed and found the default judgment could not limit Subcontractor's lien rights. In support of its decision, the North Carolina Supreme Court noted that, pursuant to N.C.G.S. 44A-23, "upon filing of a notice and claim of lien and the commencement of an action, no action of the contractor shall be effective to prejudice the rights of the subcontractor without his written consent." The Contractor's failure to answer or appear constituted an "action" by defining it broadly as "a thing done." Therefore, the Contractor's action had the effect of prejudicing Subcontractor in contravention of the North Carolina lien law statute, and, therefore, Subcontractor should have a right to present evidence concerning the merits of its claim of lien.

In many instances, subcontractor liens are the result of a "disappearing" general contractor, resulting in unpaid bills on a project. Prior to this decision, in North Carolina, owners could obtain a default judgment against the general contractor and use that default judgment as a quick and inexpensive way for refusing to pay the subcontractors subrogated lien claims. Now, that argument is no longer available to owners in North Carolina, who will now additionally be required to argue the merits of the subcontractor's lien claims.

by David Bashford and Nick Voelker

Alabama Supreme Court Rules on Relationship Between Letters of Credit and Arbitration

In today's economic environment, we are seeing more and more real estate deals and the construction projects affiliated with those deals go bad or run into financial problems. All parties involved -- developers, contractors, subcontractors, lenders and buyers -- need to remain vigilant in their knowledge of the terms of their deal before signing on the dotted line.

In *Holiday Isle, LLC v. Beth Adkins, et al.*, the Alabama Supreme Court reversed the decision of the trial court, but in so doing affirmed the Court's precedent in dealing with letters of credit issues and arbitration issues that often arise in a development project.

Holiday Isle, LLC was the developer of a condominium project. Beth Adkins was one of several purchasers ("the purchasers") who agreed to pre-purchase a condominium unit from Holiday Isle prior to construction. The purchasers all signed preconstruction purchase agreements and escrow agreements with Holiday Isle. The purchase agreements required an earnest money deposit, but allowed the purchasers to satisfy that obligation with cash or with a letter of credit issued in favor of Holiday Isle. All of the purchasers in this instance obtained letters of credit for their escrow. The purchase agreements said that if purchasers were to default, Holiday Isle "shall draw on the existing Letter of Credit . . . with said funds to be delivered to [Holiday Isle] as liquidated damages."

Holiday Isle had contracted with the purchasers to complete the condominiums within two years. Toward the end of the two years, a dispute arose over completion. On the one hand, the Town of Dauphin Island issued a certificate of occupancy on March 28, 2007, and the purchasers conducted a pre-closing inspection on April 2, 2007. On the other hand there were parts of the condominium units that the purchasers claimed were not complete within two years as they had been promised. As a result, the purchasers told Holiday Isle they were not closing and wanted their letters of credit back. Holiday Isle in response set a closing date, stating it had met its obligations.

The purchasers filed suit seeking a declaration of their rights under the purchase agreements with Holiday Isle and also seeking a Temporary Restraining Order ("TRO") preventing Holiday Isle from collecting on the Letters of Credit. Holiday Isle in response moved to compel arbitration pursuant to a clause in the purchase agreement.

On July 30, 2007, the trial court ordered the case to arbitration. On October 11, 2007, Holiday Isle filed an objection to the TRO arguing, among other things, that the trial court lacked jurisdiction to enter a TRO because the case had been ordered to arbitration. On October 18, 2007, the trial court appointed an arbitrator and issued a preliminary injunction preventing Holiday Isle from negotiating the letters of credit. The trial court entered the injunction stating that the letters of credit were inextricably intertwined with the arbitration issues and that nothing should happen to the letters of credit until the arbitration resolved the matter.

The Alabama Supreme Court first ruled that the trial Court had jurisdiction to enter a TRO after ordering the

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matter to arbitration. The Alabama Supreme Court then turned to the merits of whether the TRO should have been granted.

The Court first noted the purpose of letters of credit and stated that they exist independent of the underlying contract – in this instance the purchase agreement. The Court then analyzed the parties opposing views on how the independent letters of credit should be handled. To prevent an underlying dispute to preclude the drawing of a letter of credit, the Court reversed the trial court's injunction and allowed Holiday Isle to move forward with negotiating the letters of credit.

The Alabama Supreme Court's decision gives trial courts the option of ruling on certain matters outside the arbitration setting, if the contractual language of an agreement or the rules called for by the arbitration agreement provide for such leeway to the trial court or if they are needed to preserve the status quo. The Court also upholds the rights of beneficiaries to letters of credit to draw on those letters as the terms provide, regardless of any disputes in the underlying transaction (absent, of course, a showing of fraud by the beneficiary). Because the ruling focuses so heavily on the contractual agreements between the parties, developers, contractors and all persons involved in real estate development or construction contracts should pay close attention to the specifics of their agreements.

by Mike Brown

To Get or Not to Get: An Important Limitation on Qui Tam Lawsuits

To help enforce various prohibitions against false claims to the Federal government, Congress authorized private actions against anyone who knowingly "makes, use, or causes to be made or used, a false record or statement **to get** a false or fraudulent claim paid or approved by the Government." This has helped spawn a growing number of *qui tam* lawsuits where individuals, acting they say on behalf of the Federal government, sue contractors for submitting false claims. Sometimes the "relator" (the name for the person suing as a *qui tam* plaintiff) had a hand in creating the false claim.

In a recent case decided by the US Supreme Court, *Allison Engine Co., Inc. v. U.S.*, the "false claim" was a number of certifications that the second tier vendor had complied with the technical specifications in manufacturing the equipment and that various quality control procedures had been followed during manufacturing. These certifications had been given to the contractors up the chain and, so the plaintiffs alleged, the Government made progress payments based upon these documents. Because the plaintiffs said the manufacturing procedure was not so perfect as the certifications declared, a "false claim" had been made and the Government had paid based upon that claim. A jury agreed, but the trial court reversed the jury because the plaintiffs failed to show that a false or fraudulent claim was actually presented to the Government. They had shown that the Government paid the prime contractors, and that money was used to pay the allegedly fraudulent invoices coming from the second tier manufacturer.

The Supreme Court agreed with the trial court, stating that a *qui tam* plaintiff must show that the target defendant itself had an intent to present a false claim to the Government and that it intend that the Government pay for that false claim. This is a key reading of the statute, requiring "intent" by the alleged bad actor. The Supreme Court found this requirement of intent in the words "to get" above: "'To get' denotes purpose, and thus a person must have the purpose of getting a false or fraudulent claim" paid in order to be liable.

As the Supreme Court itself noted, this reading of "to get" is its natural reading, and it prevents the False Claims Act from having an almost boundless reach into everyday acts. A "false claim" would attach to a foreman's certifying the rebar was at 1 inch elevation, when it in fact was at 1 and 1/4 inches, so long as the General Contractor received some federal funds – maybe even on a different job.

by Mabry Rogers

Door-Closing Statutes

A recent decision from the Alabama Supreme Court, *TradeWinds Env. Rest., Inc. v. Brown Bros. Constr.,* demonstrates the importance of complying with state statutes and regulations regarding the certification to conduct business in foreign states. Be sure to qualify your business with the foreign state's Secretary of State, and any other required agencies, prior to executing an agreement and commencing performance.

TradeWinds Environmental Restoration, Inc. ("TradeWinds"), a New York-based company which performs post-disaster response, environmental remediation, and restorations services, filed suit against Brown Brothers Construction, LLC, ("BBC") an Alabama-based general con-

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tractor, Shoalwater Condominium Association ("Shoalwater"), and the Windward Condominium Association ("Windward") alleging that Windward owed it $210,024.75 and that Shoalwater owed it $188,814.25 for monies due under a contract. TradeWinds entered into the contract with BBC following Hurricane Ivan. The contract provided that TradeWinds would perform structural-drying services and restoration at a number of condominiums along the Gulf Coast, including the Shoalwater and Windward properties. TradeWinds alleged that it completed the work contemplated by the contract, but that BBC failed to pay it the amounts due under the contract.

BBC, Shoalwater and Windward moved for summary judgment on grounds that TradeWinds' claims were barred by Alabama Code § 10-2B-15.02, the Alabama "door closing" statute, because TradeWinds is a foreign corporation that had not qualified to do business in Alabama. The trial court granted the motion for summary judgment noting that in prior decisions, the Alabama Supreme Court interpreted the door-closing statute to bar lawsuits brought by an out-of-state, corporation who failed to obtain a certificate of authority to transact business from the secretary of state.

On appeal, TradeWinds argued the trial court erred when it entered summary judgment in favor of BBC, Shoalwater, and Windward because the contract at issue involved interstate commerce, and therefore, the door-closing statute was inapplicable to the action.

The Alabama Supreme Court affirmed the trial court decision. Although the Court agreed with TradeWinds' assertion that the Commerce Clause protects foreign corporations from the penal effects of the door-closing statute where the contract involves interstate commerce, the Court noted that TradeWinds failed to allege that its labor, materials, and service were incident to an interstate sale. Accordingly, the Court held that the contract at issue was intrastate, not interstate, in nature. The Court also rejected TradeWinds' equitable estoppel claim. The Court stated that even if the result were harsh, the door-closing statute prevents a non-qualified corporation from maintaining a proceeding in this state under any theory sounding in contract. The Court concluded that a foreign corporation cannot circumvent the door-closing statute by merely labeling the claim as something other than a contract claim.

Many states require foreign corporations to register with a state's Secretary of State in order to transact business in that state. Failure to comply with the relevant statutes and regulations may result in your contract being void and unenforceable. In certain states, the violation of these statutes may also involve criminal charges. Ensure that you qualify your business prior to executing an agreement or performing work to protect your rights to recover for your effort.

by Michael C. Griffin

Earth to General Contractors [or Contractors Beware]: Follow Bond Terms When Terminating Subcontractors

A Florida State appellate court recently ruled that multiple letters declaring a subcontractor in default were not enough to trigger the liability of a subcontractor's performance bond surety because these letters failed to follow the precise terms of the bond in notifying the surety of a default termination.

Even though the general contractor incurred over $600,000 in cost overruns to complete the defaulted subcontractor's work, and even though a jury found the original subcontractor breached its subcontract and was liable for these damages, the court in *Current Builders of Florida, Inc. v. First Sealord Surety, Inc.*, affirmed the lower court ruling that the performance bond surety could not be held liable.

The court's ruling was based on a strict reading of the terms of the performance bond default provisions. The performance bond at issue required that, in order to trigger the surety's obligations under the bond in the event of a default termination, the general contactor was required to: (1) "formally terminate the subcontractor's right to complete the contract"; and (2) "agree to pay the balance of the contract price, if any, to the surety."

The general contractor, during the course of the project, wrote numerous letters declaring the subcontractor in default, each of which was copied to the surety. However, none of these "notice of default" letters ever formally terminated the subcontractor. Several days after the last "notice of default" letter was sent, the general contractor informed the subcontractor and surety that it had removed the subcontractor from the job and hired a replacement subcontractor. At no time prior to announcing the termination of the subcontractor and hiring of a new subcontractor, did the general contractor formally invoke the terms of the bond, demand performance from the surety or offer to tender the remaining contract balance to the surety.

In affirming the lower court's ruling that the general contractor did not comply with the terms of the bond, the

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appellate court seized on the general contractor's failure to agree to pay the remainder of the contract price to the surety, or to a subcontractor selected by the surety, as the key factor in its holding. By failing to take this step, the court held that the general contractor "did not permit the surety to perform under the bond" which was "part of [the general contractor's] obligation."

With respect to the notice provided by the general contractor, the court also found persuasive the testimony of the surety's expert who opined that, to be effective, the default letter "would have had to have a declaration of default, a termination, and probably an agreement that they're going to release the remaining project funds to the surety." Because the letters by the general contractor merely declared the subcontractor in default, the court held that the notice given was insufficient to trigger the surety's obligations under the bond.

As the decision in *Current Builders of Florida* demonstrates, the safest practice in terminating a subcontractor is to precisely follow the terms of the performance bond and subcontract in both notifying the surety and arranging for replacement subcontractor.

by Thomas Lynch

Contractor Awarded Over $6.2 Million on Cumulative Impact Claim

The Court of Federal Claims recently awarded a general contractor approximately $6.2 Million for a cumulative impact and delay claim against the federal government. The case, *Bell BCI Co. v. United States*, arose out of the construction of a laboratory building at the National Institutes of Health (NIH) in Bethesda, Maryland. The building's original design called for five stories and a basement with a total price tag of $63.6 million. During construction, NIH issued over 200 contract modifications, including the decision to add a new floor. These changes caused the contract price to increase by 34% to a total cost of $85 million.

In its defense, the government mainly argued that Bell's cumulative impact claims were barred by the doctrine of accord and satisfaction. However, the court found the government's defense to be without merit. None of the contract modifications on the project included payments to Bell for the cumulative impact of NIH's changes nor did Bell ever expressly release its cumulative impact and labor inefficiency claims. The court also rejected the government's claim for liquidated damages.

In calculating the cumulative impact claim, Bell's expert found that approximately 25% of its total labor hours were due to lost productivity caused by NIH's changes on the project. The court adopted the expert's recommendation and found Bell was due approximately $2 million for its cumulative impact (or labor inefficiency) claim. In addition, the court awarded Bell $1.6 million in delay damages for its extended general conditions costs, 10% profit on the labor inefficiency and extended general conditions costs, $1.6 million for disputed extra work orders that had not been resolved, and Bell's unpaid balance for a total amount of approximately $6.2 million.

Bell also attempted to "pass through" claims of five subcontractors. The record incorporated all five subcontractors' underlying claims, but the court only granted the claim of the one subcontractor who actually testified at trial. While noting the other four subcontractors may have had viable claims, the court found that Bell failed to submit any specific evidence on their behalf and they did not present any witnesses at trial.

This case is a prime example of how numerous design changes can cause a construction project to get completely out of hand. The fact that Bell never expressly released its cumulative impact claims proved to be a key factor. The practical lesson of course is that you should try to avoid releasing a cumulative impact or labor inefficiency claim, especially where the owner has issued numerous design changes on a project. While contract modifications or change orders may compensate for the direct costs of an owner's changes, they usually do not reimburse for indirect costs that are difficult to ascertain at the time.

by Ed Everitt

Bradley Arant Lawyer Activities:

Rob Dodson, **David Hume**, **Will Manuel**, **David Owen**, and **David Pugh** presented a Construction Law seminar to the Mississippi Associated Builders and Contractors on May 1, 2008 in Jackson Mississippi. The seminar included topics on insurance, bonding, green building, project management and hot topics surrounding the construction industry.

Wally Sears spoke at the Mealy's Construction Litigation Conference in Philadelphia, Pennsylvania on May 20-21, 2008. Wally presented on two topics: (1) proof of damages for delay and disruption, and (2) termination, default, and material breach.

Sabra Barnett, **Joel Brown**, **Jonathan Head**, **Michael Knapp**, and **David Pugh** presented a seminar entitled "The

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Fundamentals of Construction Contracts in Alabama" scheduled for May 13, 2008 in Montgomery, Alabama. **Luke Martin** acted as a moderator for the seminar.

Sabra Barnett and **John Hargrove** spoke at a recent meeting of human resource professionals and risk managers regarding recent changes in the federal and state immigration laws on May 14 and 30, 2008.

Joel Brown joined three Bradley Arant partners in speaking to the Huntsville, Alabama Chamber of Commerce on May 29, 2008, regarding issues which impact government and private sector contractors.

Rhonda Caviedes presented a seminar entitled "Current Issues in Stormwater Regulation and Control" on May 30, 2008, in Birmingham, Alabama.

Rhonda Caviedes participated in a "LEED for New Construction and Major Renovations Workshop" presented by the U.S. Green Building Council on June 11, 2008, in Birmingham, Alabama.

Sabra Barnett, **Keith Covington**, **Arlan Lewis**, **David Pugh**, and **Mabry Rogers** presented a seminar entitled "Construction Claims and Litigation/Arbitration" on June 13, 2008 in Birmingham, Alabama.

Darrell Tucker attended the Alabama Associated General Contractors State Convention in Destin, Florida on June 19-22, 2008.

Rhonda Caviedes organized and chaired the Greater Birmingham Chapter of the National Association of Women in Construction's Annual Industry Appreciation Fundraiser and Banquet honoring construction industry businesses, partners, and members that support NAWIC's core purpose of enhancing the success of women in construction. The event was held in Birmingham, Alabama, on June 26, 2008.

Rob Dodson attended the Annual Meeting of the Associated General Contractors of Mississippi on June 26-28, 2008 in Gulf Shores, Alabama.

On June 27, **Jim Archibald** taught an in-house training seminar about key subcontract terms and project documentation for B.L. Harbert International project managers at the Associated General Contractors offices in Birmingham, Alabama.

Harold Stephens, a partner in the firm's Huntsville office, was elected as Vice President/President Elect at the recent annual meeting of the Alabama Defense Lawyers Association held in June at Sandestin, Florida. With almost 1200 members, ADLA is the fifth largest state lawyer defense organization in the nation.

Rob Dodson attended the Mississippi Associated Builders and Contractors annual convention on July 10-12, 2008 at the Grand Sandestin, in Sandestin, Florida.

Rhonda Caviedes was a panelist discussing recruiting, training, and retaining minorities and women in the construction workforce at the Southeast Manpower Tripartite Initiative ("SEMPTA") Meeting on "Tapping a Rich Resource: Recruiting Minority and Women Workers" held July 15-16, 2008, in Birmingham, Alabama.

Arlan Lewis attended the 2008 ALFA International Construction Practice Group meeting held in Chicago, Illinois on July 15-18, 2008.

Sabra Barnett spoke at a meeting of Huntsville human resource professionals on July 24, 2008 concerning recent changes to federal and state immigration laws.

Arlan Lewis served as a faculty member for the Hoar Construction, LLC's Mentoring Program "Contracting with Owners and Vendors" held on July 25, 2008.

Sabra Barnett will teach a segment of UAB's Construction Engineering Management Certificate Program being held in Cairo, Egypt from August 1-7, 2008. The Program focuses on providing graduate students with education that will enhance their ability to adapt to a rapidly changing global environment.

Rhonda Caviedes, Michael Knapp and **Arlan Lewis** will attend the ABA Forum on the Construction Industry's Fall Meeting "Winds of Change? The Consensus DOCS" on September 11-12, 2008 in Chicago, Illinois.

Mabry Rogers will speak on the topic of "International Dispute Resolution" at the Society of Construction Law's 2008 International Construction Law Conference in London, England on October 5-7, 2008.

Rhonda Caviedes, **Donna Crowe**, **Ed Everitt**, and **David Hume** will present a seminar on "Green or Sustainable Construction" in Birmingham, Alabama on November 13, 2008.

For more information on any of these activities or speaking engagements, please contact Rebecca Harris at 205-521-8504.

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BRADLEY ARANT ROSE & WHITE LLP **Fourth Quarter 2008**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Final FAR Rule Published on Contractor Code of Business Ethics and Conduct and Self-Disclosure Requirements for Criminal Violations

The final FAR Rule on Federal contractors' Code of Business Ethics and Conduct and self-disclosure requirements for criminal violations was published on November 12, 2008, and becomes effective December 12, 2008.

There are significant implications to this FAR Rule which require immediate and serious review by all contractors or subcontractors performing any Federal contract or subcontract, particularly those in excess of $5 million and lasting more than 120 days. Given the complexities of the new Rule, this Alert is intended only to provide you with a basic overview of the major issues presented by the changes. We strongly urge you to contact your lawyer to familiarize you with the many aspects of the new Rule.

The changes become effective on December 12, 2008, and apply to any contract awarded on or after that date. One portion of the changes also has a substantial impact on any federal contract that is presently in existence or that has been closed out within the three year period immediately preceding December 12, 2008.

Effective December 12, 2008, the FAR will be amended to require Government contractors to:

1. Establish and maintain specific internal controls to detect and prevent improper conduct in connection with the award or performance of *any* Government contract or subcontract.

These internal controls require the establishment of an ongoing business ethics and compliance program to be implemented within 90 days after contract award. The requirement affects all contractors (and subcontractors) awarded contracts valued at more than $5 million and expected to last more than 120 days, with the exception of small businesses and contracts for commercial items (who are only required

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to have a written code of business ethics and conduct, and make a copy of that written code available to each employee engaged in performance of the contract). The ongoing business ethics and compliance program will require training at both the prime and sub-contractor level and implementation of an internal control system. The internal control system is required to "establish standards and procedures to facilitate timely discovery of improper conduct in connection with Government contracts; and ensure corrective measures are promptly instituted and carried out." Additionally, the new Rule lists far-ranging and comprehensive measures that must be included in the internal control system as a minimum requirement.

2. Timely disclose to the agency Office of the Inspector General, with a copy to the contracting officer, whenever, in connection with the award, performance, or closeout of a Government contract performed by the contractor or a subcontract awarded thereunder, the contractor has credible evidence of a violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity prohibitions found in Title 18 of the United States Code; or a violation of the civil False Claims Act (31 U.S.C. 3729–3733).

This self disclosure requirement applies to any contract awarded to any contractor (or subcontractor) valued at more than $5 million and expected to last more than 120 days. There are no exceptions. The reporting requirement is limited to each contract (and awarded subcontracts, at all tiers) in which the amended clause (FAR 52.203-13) is included and is limited to the types of violations listed. The reporting requirement remains in effect throughout the performance period and until three years after the contract has been closed out. If the contract in question is a Government-wide acquisition contract, multi-agency contract, or a multiple award schedule contract, then disclosure must be made to the OIG of the ordering agency and the OIG of the agency responsible for the basic contract. A knowing failure to disclose can result in suspension or debarment.

3. The Rule also provides as cause for suspension or debarment, knowing failure by a principal, until three years after final payment on any Government contract awarded to the contractor, to timely disclose to the Government, in connection with the award, performance, or closeout of the contract or a sub-contract thereunder, credible evidence of (a) violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity prohibitions found in Title 18 of the United States Code; (b) violation of the civil False Claims Act; or (c) significant overpayment(s) on the contract, other than overpayments resulting from contract financing payments as defined in FAR 32.001, Definitions.

This provision for suspension or debarment applies to **all contracts and subcontracts of any size and duration**. There are no exceptions. While a contractor awarded a contract for less than $5 million or with a performance period of less than 120 days is not required to self-disclose criminal violations under the new FAR 52.203-13, under these new provisions that contractor still runs the risk of suspension or debarment if it knowingly fails to disclose. Thus, as a practical matter, all federal contractors, even if exempted from self-disclosure regulations elsewhere or not required to have ongoing ethics compliance programs, are required to disclose criminal violations or risk suspension or debarment. Additionally, this provision applies to any federal contract that is presently in existence or that has been closed out within the three year period immediately preceding December 12, 2008. The cause for suspension or debarment is not the underlying violation of law, but is the failure to disclose the violation.

The new FAR Rule contains a great number of inter-related definitions, policy guidelines, and requirements too numerous to list in this Alert. Again, given the many complexities of the new Rule, this Alert is intended only to provide you with a basic overview of the major issues presented by the changes. We strongly urge you to contact a lawyer to familiarize you with the many aspects of the new Rule.

by Jeremy Becker-Welts

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Subcontract Form Lien Waiver Unenforceable In Nevada

Most general contractors (and owners) use standard form contracts which contain a prospective waiver of lien rights. Such provisions should always be carefully reviewed with your lawyer before undue reliance is placed on them. *Lehrer McGovern Bovis, Inc. v. Bullock Insulation, Inc.*, a recent case from Nevada, illustrates the point. Lehrer McGovern Bovis, as CM, entered into a subcontract with the firestopping sub; that subcontract incorporated by reference the CM's general conditions in its contract with the owner (Venetian Sands). Those general conditions had the effect of a promise, before any payment was made to the sub, by the sub "not [to] suffer or permit any lien or other encumbrance to be filed" against the project. The Nevada Supreme Court agreed with the trial court that the provision was against public policy and could not be enforced. The Court also agreed with the trial court that the "pay if paid" clause, too, was unenforceable because it violated the sub's statutory right to a mechanic's lien.

In some jurisdictions, if an Owner files an action to have a job declared a "no lien" job, and then spreads that finding on the public record, an advance lien waiver is enforceable. However, many states reach the conclusion stated above by the Nevada Supreme Court as to a prospective lien waiver, before any payments have been made.

This case does *not* involve the enforceability of a lien waiver signed with a monthly pay application, where presumably there is a payment to the sub or the GC. The analysis of the effect of the lien waiver in that circumstance is different because there is a payment.

In the case of each kind of waiver, some states have enacted statutes addressing the enforceability of lien waivers. When there is a statute addressing the point in a given state, the statute sometimes prescribes a form for a lien waiver to be enforceable. Hence, it may be advisable to have your lawyer advise you about this issue before entering a project in a state where you are not familiar with the particular laws applicable to construction contracts.

by Mabry Rogers

Contractual Provisions Matter: Insurer "Stuck Holding the ($6.2 million) Bag" Pursuant to Its Insured's Waiver of Subrogation Clause

In the recent case of *Lexington Insurance Company v. Entrex Communications Services, Inc.*, the Supreme Court of Nebraska affirmed the dismissal of an insurer's claims against a contractor pursuant to a contractual waiver of subrogation clause in the contract between the owner and the contractor. In *Lexington*, a television broadcast tower constructed by the contractor collapsed, causing approximately $6.2 million in damage to the tower and the owner's transmission building. Pursuant to the contractual provision requiring the owner to obtain property insurance, the owner had relied upon its existing, "all risk" property insurance policies rather than obtaining a specific insurance policy to cover the project. One of the owner's "all risk" insurers compensated the owner for the damage. The owner and the insurer then attempted to recover the money paid from the contractor, alleging that the contractor was grossly negligent in constructing the tower. The trial court dismissed both the owner's and the insurer's claims against the contractor. The insurer appealed the trial court's decision.

On appeal, the insurer argued 1) that enforcing a waiver of subrogation clause to bar a claim of gross negligence was against public policy and 2) that, even if not against public policy, the waiver applied only to "Work" property (as defined in the contract between the owner and the contractor). The Supreme Court of Nebraska disagreed. First, it held that it was not against public policy to bar a gross negligence claim, pursuant to a waiver of subrogation clause, because there was no risk that an injured party would be left uncompensated, a reason which has provided the basis for other courts to decline to enforce other contractual provisions (e.g., exculpatory and limitation of damage clauses). Moreover, the court found that enforcing the waiver clause served the important social goals of encouraging parties to anticipate risks and to procure insurance, thereby avoiding litigation (regarding

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whether a party was grossly negligent) and the disruption of projects.

Second, the court, adopting the approach taken by a majority of courts, held that the waiver applied to both "Work" and "non-Work" property. The court found that this approach was more consistent with the parties' agreement and that it furthered the purpose of the waiver clause (i.e., preventing litigation and the disruption of the project). Additionally, the court found that the approach taken by the minority of courts, which distinguishes between "Work" and "non-Work" property in construing a scope of the waiver of subrogation clause, was not reasonable because it was inconsistent with the waiver's purpose (i.e., it encourages, rather than discourages, litigation regarding whether "non-Work" or "Work" property was damaged) and it could produce different results depending on whether the owner purchased two policies or relied on one policy that covered both "Work" and "non-Work" property.

Aside from the result (the insurer was stuck paying the $6.2 million notwithstanding any actual negligence of the contractor), this case illustrates the importance of the provisions in a construction contract and how they affect the rights of not only the parties to the contract, but also related third parties, including insurance companies. Moreover, it reinforces the importance of carefully reviewing contractual provisions, including waiver of subrogation clauses, during contract negotiations.

by Darrell Tucker

South Carolina: Missing One Payment under a Construction Installment Contract Constitutes a Substantial Breach

Recently, the South Carolina Court of Appeals in *Silver v. Aabstract Pools & Spas* held that regardless of homeowners' frustrations with a contractor, refusal to pay one installment under the terms of a construction contract constituted homeowners' substantial breach of the contract.

Homeowners and contractor entered into a contract for the construction and installation of an in-ground swimming pool and spa. The construction contract specifically required five installment payments by homeowners to contractor at certain stages of construction. Homeowners paid the first three installments (one of which was the initial deposit) without objection. At the time the fourth installment payment became due, homeowners refused to pay the contractor because it had only completed 20% of the work. Homeowners argued that the installment payment schedule did not account for the percentage completed on the job and was an ambiguous term. The lower court found: (1) the contract installment terms were ambiguous and ambiguities are read against the contractor as drafter of the contract; and (2) accordingly, the contractor breached the contract when it stopped work and removed its equipment from the project.

On appeal, the South Carolina Court of Appeals reversed and found in the contractor's favor. The Court of Appeals held that it was improper for the trial court to look beyond the four corners of the document in evaluating the terms of the contract, and that on its face, the contract was not ambiguous. In addition, the Court of Appeals stated that homeowners could not change the terms of the contract because homeowners became unhappy with the terms, or progress of the work. The homeowners are subject to the terms bargained for in the contract. Therefore, homeowners' refusal to pay the installment payment was a substantial breach of the contract and as such, the contractor had the right to cease work and recover the value of the work already performed. The Court of Appeals also held that the first party to breach bears the liability of non-performance. The Court of Appeals awarded the contractor damages, court costs and attorneys' fees.

Many times contractors and owners become frustrated with each other during the progress of a job. The initial response by a frustrated party is to withhold payment or to lay down its tools. However, as this case demonstrates, failure to abide by the terms of the contract could result in a substantial breach and costly litigation.

by Nicholas Voelker

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Pay Your Company's Subs . . . or, Be Forced To Pay Them Out of Your Own Wallet

In *Walter v. Atlantic Builders Group Inc.*, a general contractor ("ABG") entered into a contract with a subcontractor ("United"), whereby United agreed to supply wall panels and curtainwalls for a library project. United entered into two purchase order agreements with two different suppliers, Alply and X-Clad, for the provision of supplies for the work.

United allegedly breached its agreement with ABG, and ABG filed suit against both United and the individual who served as United's managing agent ("Agent") in his individual capacity, for breach of contract, and an action under Maryland's Construction Trust Statute. The Maryland Construction Trust Statute is a law under which money paid by a commercial contractor to a subcontractor is considered to be held in trust. The Statute also provides in pertinent part:

> "Any officer, director, or managing agent of any contractor or subcontractor, who knowingly retains or uses moneys held in trust under [The Maryland Construction Trust Statute] for any purpose other than to pay those subcontractors for whom the moneys are held in trust, shall be personally liable to any person damaged by the action."

Therefore, under Maryland law, any individual officer of a contractor at any tier may be personally liable as a trustee if money earmarked for a subcontractor is misused.

The trial court entered summary judgment against United, but conducted a trial on the case against Agent in his individual capacity. The trial court found that Agent had violated the Maryland Construction Trust Statute by misappropriating funds that had been paid by ABG to United that were due to be paid to Suppliers. The trial court entered judgment against Agent in the amount of $146,533.

Agent appealed, but the Court of Special Appeals of Maryland affirmed the judgment. The appellate court noted that Agent was vice president of United and had control of United's disbursements. The appellate court further noted that Agent testified that he paid "$140,000 and change" to Alply out of the $250,950 that ABG had paid to United for Alply's materials, and that he paid $16,394 to X-Clad out of slightly over $77,000 that ABG had paid to United for X-Clad's materials. Accordingly, the appellate court held that "[t]o the extent that monies were received by [United] for subcontractors, and not paid to them, the evidence permitted a finding that appellant had actual knowledge of the money flow." Thus, the appellate court determined that the trial court properly found Agent personally liable under the terms of the Maryland Construction Trust Statute.

This case serves as a cautionary tale for individual officers of contractors who think they have individual immunity for their actions as officers. In Maryland, and in any states with statutes similar to Maryland, if an agent of the company does not make payments to subcontractors in accordance with the terms of the payment, not only does that agent put the assets of the company on the line, but he or she may also be putting his or her personal assets on the line.

by Jeff Peters

Turnover of Condominium Association Tolls Limitation for Florida Construction Defects

An intermediate appellate court in Florida recently addressed the analysis of when condominium owners may bring actions for construction defects in Florida. In *Saltponds Condominium Ass'n, Inc. v. Walbridge Aldinger Co.,* the court provided a contractor with what appeared to be a clear statute of limitations argument. On August 1, 2002, the developer turned over control of the condominium association to its owners. Subsequently, on or shortly after August 17, 2005, the owners served a notice of claim on the contractor, the developer, and the architect. After unsuccessful attempts at informal resolution, the owners filed suit on August 21, 2006. Citing the statutory three-year warranty "from the date of completion of construction of a building or improvement" for major building elements, the contractor argued that the claim fell outside the three-year period because the date of completion (which the court implied, but did not state, preceded the date of the condominium association turnover) was more than three years before the notice of claim.

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The court noted that there was a difference between the warranty period and the limitations period, a distinction it had made in previous cases. It further noted that the latter existed in Florida's general statute of limitations and repose for actions involving real property. While Florida has an overall fifteen-year statute of repose that bars all actions, it has a two-part statute of limitations that may bar actions before the statute of repose runs. The first part of the statute of limitations is a simple four-year period calculated from the latest of four discrete project events (actual possession, issuance of a CO, abandonment of construction, or completion/termination of the engineering or building contract). In this case, the first part of the limitation period was undisputedly up on August 1, 2006. However, the second part of the statute of limitation contains a discovery period running from the date "the defect is discovered or should have been discovered with the exercise of due diligence." Because the complaint pleaded facts regarding latent construction defects, the court held that it was error for the trial court to dismiss the complaint using only the first part of the statute of limitations.

Due to the intersection of warranty periods, limitations periods, and repose periods, it is often confusing when causes of action accrue exactly and when they are no longer valid. Of course, in all cases, it is best to bring an action as early as possible to avoid prejudicing one's rights. However, especially when working in Florida, pleading facts about latent defects when they are available and well-founded may serve to avoid a time bar on legitimate actions for construction defects.

by Jonathan Head

Contractor Not Always Responsible for Subcontractor's Work

Many states have implied warranties associated with the sale of new homes and other construction. In South Carolina, the implied warranty of habitability and workmanship extends from a home builder to the original purchasers and subsequent purchasers for a reasonable period of time after construction of the home. However, the contractor may not be responsible for its subcontractor's breach of that warranty.

In *Fields v. J. Haynes Waters Builders, Inc.*, the court ruled that a contractor is not automatically responsible for its subcontractor's failure to satisfy the implied warranty of workmanlike service. This case dealt with subsequent purchasers of a residence who discovered problems associated with the exterior insulation and finish system (EIFS). The purchasers sued the original builder on multiple counts, including breach of the implied warranty of workmanship. The homeowner could not sue on a breach of contract theory because it had no contract with the original contractor.

The court found that a contractor may perform its duties in a workmanlike manner and not necessarily be responsible for its subcontractor's failure to perform its services in a workmanlike manner.

Though usually associated with home construction, the law of implied warranties and its applicability varies among the states.

by David Owen

Bradley Arant Lawyer Activities:

James F. Archibald III, Axel Bolvig III, Douglas L. Patin, J. David Pugh, E. Mabry Rogers, and **Walter J. Sears III** were listed in *Best Lawyers in America 2009*. Overall, eighty-four Bradley Arant attorneys are listed in this highly selective and regarded publication.

Sabra Barnett taught a segment of UAB's Construction Engineering Management Certificate Program held in Cairo, Egypt from August 1-7, 2008. The Program focused on providing graduate students with education that enhances their ability to adapt to a rapidly changing global environment.

Rhonda Caviedes, Michael Knapp and **Arlan Lewis** attended the ABA Forum on the Construction Industry's Fall Meeting "Winds of Change? The Consensus DOCS" on September 11-12, 2008 in Chicago, Illinois.

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Mabry Rogers spoke to the Construction Law Society (of the Commonwealth countries) regarding International Arbitration from a U.S. practitioner's perspective in London on October 5, 2008, and attended the meetings on October 6-7.

Rhonda Caviedes, **Donna Crowe**, **Bryan Thomas**, and **David Hume** presented a seminar on "Green or Sustainable Construction" on November 13, 2008. This seminar focused on the various aspects of green building and the policies, legal processes, and regulations that shape them.

William R. Purdy and **Ralph B. Germany, Jr.** recently joined Bradley Arant's Construction and Procurement Practice Group. Ralph and Bill are located in the Jackson, Mississippi office.

David W. Owen was recently named to the Associated Builders and Contractors of Alabama Advisory Board.

DeShanna Greenhill serves on the Board of Directors of the Alabama Association of Paralegals, Inc. as the Student School Liaison Chairperson. DeShanna's leadership role involves the education, communication, and coordination of paralegals and paralegal students throughout Alabama, as well as with the numerous institutions providing paralegal education.

Jonathan Head attended the two-week Jonah Program at the Avraham Y. Goldratt Institute during the weeks of October 6th and October 20th.

Arlan Lewis taught a seminar entitled "Construction Law Overview" on October 16, 2008 to the Birmingham Construction Industry Authority (BCIA).

Keith Covington and **Abdul Kallon**, of Bradley Arant's labor group, recently spoke at in-house Lunch and Learn on E-Verify: Federal Developments and State Requirements.

Michael Griffin completed the Marine Corps Marathon on October 26, 2008. He raised $7,500 for the injured Marine Semper Fund. Bradley Arant employees and friends accounted for approximately 65-75% of the donations.

Robert J. Symon and Eric A. Frechtel presented a Federal Government Contracts Seminar on October 28, 2008 at The Pacific Club in Honolulu, Hawaii. The seminar topics included "Critical FAR Contract Clauses" and "Ethics in Federal Contracting."

Michael W. Knapp attended the Comprehensive Construction Defect Claims and Coverage Super-Conference in Las Vegas, Nevada on November 5-7, 2008.

Rob Dodson spoke on "Making Changes and Resolving Disputes During the Construction Process" at a seminar in Jackson, MS entitled Construction Law for Architects, Engineers and Contractors on November 20, 2008.

Keith Covington will attend the Associated Builders and Contractors Attorneys Conference in Washington on December 4-5, 2008.

Mabry Rogers will give a client seminar on Federal Government Administration in December, 2008 in Las Vegas, Nevada.

Michael Knapp, **Arlan Lewis**, **Mitch Mudano**, **Jeff Peters**, and **David Pugh** will present "The Fundamentals of Construction Contracts: Understanding the Issues" in Birmingham, Alabama on December 5, 2008. This seminar will cover contract principles, dispute resolution, project delivery systems, and subcontracting issues.

For more information on any of these activities or speaking engagements, please contact Rebecca Harris at 205-521-8504.

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CONSTRUCTION AND PROCUREMENT LAW NEWS

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BULLETIN

Proposed EPA Rule Would Establish Effluent Guidelines for Discharges From the Construction and Development Industry

On November 28, 2008, the United States Environmental Protection Agency ("EPA") published a *proposed* rule to address stormwater runoff from construction sites. *The comment period on the proposed rule runs through February 26, 2009.* The proposed rule, if finally adopted by EPA, would establish technology-based Effluent Limitation Guidelines ("ELGs") and New Source Performance Standards ("NSPSs") to control the discharge of pollutants from construction sites. The proposed rule would work in concert with existing state and local programs, and would add nationwide minimum requirements; where a state's requirements are below the minimum, the new guidelines will replace them.

EPA initially proposed a rule to address storm-water discharges from the construction and development industry in June 2002. EPA withdrew the rulemaking in April 2004, and the withdrawal was challenged in court. In September 2009, the Ninth Circuit Court of Appeals affirmed a lower court's order compelling EPA to propose and take final action with respect to ELGs and NSPSs for the construction and development industry no later than December 1, 2009.

EPA's proposed rule would require most significant construction sites to implement a range of erosion and sediment best management practices to reduce pollutants in stormwater discharges. Some construction sites may be required to meet a numeric limit on the allowable level of turbidity depending

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upon the acreage of the site and its location. Chemical treatment and filtration of stormwater discharges may be necessary for stormwater discharges containing clays and fine silts that cannot be effectively removed by conventional storm water best management practices such as sediment basins.

Full text of the proposed rule as published in the Federal Register and information about how to submit comments to EPA may be found on the EPA website: http://www.epa.gov/waterscience/guide/construction/. This site can be consulted for questions such as size and type of projects to be covered. One particular concern is the applicability of the rule to existing permits, particularly if, after the effective date of the rule, a permit must be amended for some reason. Any such concern should be expressed prior to the comment closure deadline, currently February 26.

Bradley Arant Boult Cummings and industry groups such as the Associated General Contractors of America and Associated Builders and Contractors continue to monitor progress on this proposed rule. Further information can be found on their websites. Links to these websites are available on Bradley Arant Boult Cumming's online version of this newsletter.

by Rhonda Caviedes

Responding to Claims under the AIA A312 Payment Bond – *45 Days Might Really Mean 45 Days*

Contractors on projects utilizing American Institute of Architects (AIA) A312 Payment Bonds should be aware of recent state court decisions holding that a surety's failure to answer a subcontractor's claim within 45 days results in a waiver of the surety's defenses to the claim, even if the general contractor itself has valid defenses. Several surety companies have reacted to these decisions by refusing to issue A312 bonds without modifications, and the AIA has since issued an interim amendment to the bond form which provides that a surety does not waive its defenses by failing to respond in a timely manner. For projects utilizing an unmodified A312 Payment Bond, contractors must be attentive and work with their sureties to ensure that the surety responds to the claimant within 45 days of its receipt of the claim so that valid defenses are not waived.

Under the A312 Payment Bond form, the claims process generally follows three steps. First, a claimant provides notice that it is making a claim under the bond, setting forth the amount of the claim with substantial accuracy. Second, the surety "answers" the claim and asserts any defenses. Third, the surety pays any portion of the claim that is undisputed. With respect to the second prong, the A312 Payment Bond states, in part, that the Surety shall "Send an answer to the Claimant, with a copy to the Owner, within 45 days after receipt of the claim, *stating the amounts that are undisputed and the basis for challenging any amounts that are disputed*." Recent court decisions have interpreted this provision literally and strictly – rejecting arguments that a general reservation of rights letter issued within 45 days satisfies the bond's response requirements.

In *National Union Fire Ins. Co. of Pittsburg, PA v. David Bramble*, the Maryland Court of Appeals held that a surety that fails to answer a claim with a response delineating which portions of the claim are disputed and the basis therefore within 45 days cannot dispute the claim and the surety is liable for the amount claimed.

In *Casey Industrial, Inc. v. Seaboard Surety Co*, the surety responded to a payment bond claim within 45 days after receipt of the claim, and identified certain bases for disputing the claim. When the subcontractor subsequently filed suit, the surety attempted to raise new factual defenses. The Virginia federal district court, adopting the reasoning from *Bramble*, held that the surety had waived factual defenses not raised within the 45 day period and was precluded from raising new factual defenses in the subsequent litigation. However, the court also held that the surety was not precluded from asserting legal defenses (*e.g.*, statute of limitations).

The most recent published decision comes from Florida. In *J.C. Gibson Plastering Co., Inc. v. XL Specialty Insurance Co.*, a surety responded to a subcontractor's bond claim notice by requesting that the subcontractor submit supporting cost records and

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complete a proof of loss form. The surety also advised the subcontractor that it was contacting its bond principal to elicit its position on the claim. On summary judgment, the Florida court held that the 45 day response period is triggered upon the surety's receipt of the bond claim notice. The Court rejected the surety's contention that the 45 day period only begins to run after the surety receives the completed proof of loss form and supporting documentation.

As these cases make clear, on projects with an unmodified A312 Payment Bond in place, bond principals (which have indemnity agreements with their sureties) must be prompt in providing their bond sureties sufficient information to permit the surety to respond with any applicable defenses within the 45 day window and must insist that the surety comply with the 45 day requirement. If the surety cannot assert defenses because the bonded principal does not provide the requisite information in a timely manner, the bond principal may be responsible to the surety for any resulting loss under its indemnity obligations. By the same token, if the surety, notwithstanding the principal's actions to prompt the surety to comply, fails to comply with the limit, it may provide a defense to the principal on a claim by the surety under the indemnity agreement.

These principles apply to the Payment Bond claim. The Performance Bond has different deadlines and procedures, and the case law has treated the Performance Bond deadlines with different results depending on the jurisdiction. The proverbial word to the wise: to the extent feasible, comply with the notice and other procedural requirements of each form.

by Michael Koplan

Compliance with Licensing and Notice Laws Protects Payment Rights

The recession continues to ripple through the United States economy. As a result, many contractors and subcontractors find themselves unable to obtain timely payment for the labor and materials they have supplied. With margins tighter, non-payment of a few significant invoices could lead to business failures for even established businesses. Mechanics liens and lawsuits are the ultimate remedies to secure payment for labor and materials. Contractors, subcontractors, and suppliers must be vigilant about protecting their rights to enforce these remedies because they may not be available if the contractor, subcontractor, or supplier fails to comply with specific legal requirements, like maintaining a proper contracting license and providing proper pre-lien notices. While complying with these legal "technicalities" may be frustrating and time-consuming, two recent court decisions demonstrate that the failure to do so can be fatal to otherwise valid claims for payment.

In *JR Construction/Electric, LLC v. Ordner Construction Co.,* the Georgia Court of Appeals ruled that an unpaid electrical subcontractor could not recover payments from the general contractor or enforce a mechanics lien against the owner's property where the subcontractor failed to maintain a proper, valid license to perform electrical work in Georgia. By statute in Georgia and in many other states, a contract is void and cannot be enforced in court where one of the parties fails to maintain a proper license.

Some subcontractors working in multiple states attempt to comply with licensing statutes by forming loose joint ventures or affiliations with local construction firms. The local firm does little more than supply a license to help obtain a permit; work is performed by electricians from the unlicensed national company. The *JR Construction/Electric* Court rejected this practice, reasoning that the work must be performed or supervised by the licensed firm. The Court demanded evidence that the local firm had done more than supply the license at the permit application stage. When the subcontractor could not show that the licensed firm had performed or supervised the work, the Court concluded that the subcontract work was performed by an unlicensed firm. As a result, the subcontract was void, the subcontractor not entitled to payment, and the lien was invalid. This result underscores the importance of complying with state licensing statutes carefully. It is risky to rely entirely upon associating with a local licensed firm; such shortcuts may be found unacceptable. Contractors and subcontractors must research and consider carefully all licensing issues before work begins to assure that you do not suffer the same fate as JR

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Construction/Electric. Licensing links to most jurisdictions may be found under the Construction and Procurement Practice Group tab of our website.

Similarly, in *Wallboard, Inc. v. St. Cloud Mall, LLC*, the Minnesota Court of Appeals ruled that a drywall supplier could not assert a lien against a shopping mall because it failed to give proper pre-lien notice before filing its lien. The lien process in this case was complicated by the fact that the supplier had a purchase order with a subcontractor, who had a subcontract with a general contractor, who contracted with a store leasing space from the mall, who had a lease agreement with the owner of the mall. While the subcontractor advanced several creative and equitable arguments in support of its right to claim a lien, the Court insisted upon strict compliance with the lien statute's notice requirements.

Most state lien laws require notice by subcontractors and material suppliers who wish to claim a lien, often in a very specific form. Sometimes, notice must be given before work begins or materials are supplied. In addition, it may be necessary to give notice to lenders, owners, and lessors to properly claim and perfect the lien. As with licensing statutes, contractors and subcontractors should be sure to comply with lien statutes before beginning and while performing work. Failure to do so could result in losing security for payment of a valid claim. In this economy, construction firms cannot afford to lose out on otherwise valid claims for payment due to missed technicalities.

by Jim Archibald

The Employee "Free Choice" Act

The Employee Free Choice Act ("EFCA") presents one of the most significant changes to federal labor law since the Taft Hartley Act in 1947 and a significant challenge for employers addressing union activities. The EFCA passed the U.S. House of Representatives in March 2007, but stalled in the Senate despite majority support. President Obama was a sponsor of this legislation, and with a few more votes the EFCA may pass the Senate and become law. If it passes without modification, it will impose a number of changes to the current law. Here are the two main changes:

Card Check Authorization Rather Than Secret Ballot. Under the EFCA, the National Labor Relations Board (NLRB) would certify a union as the exclusive bargaining representative for employees if (1) the majority of employees have signed authorization cards that designate the union as its representative and (2) no other labor organization has been certified or recognized as the employees' exclusive representative. This "card check" provision drastically changes current law.

Currently, if a majority of the employees sign authorization cards, the employer has the option either to voluntarily recognize a union or to request a secret ballot election (the more common practice). What then follows is an NLRB-supervised "campaign" during which pros and cons of organization are discussed and debated by all. The NLRB then holds a secret-ballot election. Not every employee who signs an authorization card ends up voting for the union - after the campaign period and in the secrecy of the voting booth, card signers often vote against the union.

This legislation would do away with the secret ballot. Without secret ballot protections, employees may be intimidated by union organizers and pro-union coworkers, whether in the locker room, the parking lot, or at the local restaurant. Further, employees will be forced to make their "choice" in full view of coworkers who are attempting to obtain their signature. To compound matters, employers will no longer have the opportunity to present their side of the unionization story through formal discourse and debate. Some have said that the bill will turn every day into a campaign day. Clearly, the "free choice" bill may actually lead to social or workplace coercion.

No More Bargaining to Impasse. The EFCA also guarantees workers a contract when they form a new union. Current law allows the parties to negotiate a contract until they settle on the terms, so long as they negotiate in good faith. If they fail to agree, the union may call a strike, and the employer may implement its last offer or even lock out workers.

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This good faith negotiation and use of economic weapons is the essence of voluntary collective bargaining currently available under the NLRA.

Under the EFCA, however, if parties do not meet fixed negotiation deadlines, the terms of their agreement will be supplied by an arbitrator. Specifically, the EFCA provides that if an employer and a union are bargaining for their first contract, but are unable to reach an agreement in 90 days, either party may refer the dispute to the Federal Mediation and Conciliation Service for mediation. If mediation does not produce a contract after 30 days, the dispute will go to binding arbitration. The resulting contract will bind the parties for two years. Accordingly, under the EFCA, the parties will be subject to the strict 90-day negotiating/30-day mediation deadlines unless they agree otherwise. Effectively, if the parties do not form an agreement within 120 days, an arbitrator will impose a contract. The EFCA therefore supplants the parties' right to voluntary collective bargaining with a government-imposed contract. This may have a dramatic impact on small and new employers, because there is no "small business" exemption in the NLRA, the overarching labor act.

The bill in its present form could be described as a benefit to unions who have pushed for years to do away with secret ballot elections. If the bill becomes law, employers may need to make plans for informing employees of the issues involving unionization on a regular basis and even before there is any specific known overture from a union.

by John Hargrove

Contractors Successful in Suits Against Municipalities in Wyoming and in Mississippi

Suits against municipalities face hurdles similar to suits against any owner; two recent decisions from the Supreme Courts of Wyoming and Mississippi provide a survey of the issues presented to the contractor which seeks recovery from a public owner. Each is instructive in that the notice requirement in the contract was found to have been waived or that actual notice was sufficient to satisfy the notice requirement.

In Wyoming, Hladky Construction sought $1,000,000+ from the City of Gillette, Wyoming, for extra work and delay arising from what the Contractor viewed as the City's improper application of a certification requirement to the precast supplier. The Wyoming Supreme Court affirmed a substantial award (and attorney fees) to the Contractor, primarily relying on the duty of good faith and fair dealing which is an implied term of every contract in Wyoming (and in most other states). Because the City had actual notice of the Contractor's claim, the court disagreed with the City's argument that the contractual notice was inadequate. Finally, the court agreed with the trial court that the Contractor's damages, based on the total cost method, were appropriately considered by the jury because the nature of the loss made it highly impracticable to determine damages with a reasonable degree of accuracy, the Contractor's bid or estimate was realistic, its actual costs were reasonable, and it was not responsible for the added expenses. The case represents a significant win for the Contractor, but also illustrates the principle that compliance with contract notice provisions of a municipal contract (or any contract) is always desirable.

The Mississippi case arose in a different posture. The Contractor, Gray Corporation, sued the City of Tupelo for indemnity from a lawsuit brought against the Contractor by its subcontractor for delays. The Contractor's theory against the City was that the delay arose from defective plans and specifications issued by the City, so that the City should reimburse the Contractor for any amounts it was held to owe the sub. The three-way nature of the litigation embodies a concept usually captured in "pass-through" or "liquidating" agreements frequently used by a Contractor to collect and present the claims of its subcontractors to the Owner. The jury awarded the subcontractor a substantial amount, based on total cost damages. The Mississippi Courts agreed, finding the Contractor's argument that the sub had not complied with the contractual notice requirement unpersuasive, in part because the Contractor sponsored the subcontractor's claim in a letter to the Owner. The more unusual result was the indemnity verdict against the City. The Court agreed that the City owed indemnity if its plans and specifications caused the damage to the

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subcontractor, through the Contractor. The Court also refused to apply a "no damages for delay" clause in the City-Contractor contract because the jury had reasonably concluded that the exceptions to the clause's enforcement applied. While the case represents a significant win for the Contractor, vis-à-vis the City, as a practical matter, the Contractor (a) did not get full indemnity—the jury concluded some of the subcontractor's damages were caused by the Contractor—and (b) the Contractor had to pay the sub's attorney's fees, but the City did not have to pay the Contractor's attorney's fees.

The cases illustrate the pitfalls of suits against municipalities, the fact that such suits can be successful, and, ultimately, the conclusion that such suits should, whenever possible, be avoided in favor of a negotiated settlement.

by Mabry Rogers

Statute of Limitations for Subcontractor Breach of Contract Starts to Run on the Last Date of Labor

In *Harmony at Madrona Park Owners Association v. Madison Harmony Development,* the Washington Court of Appeals considered whether the statute of limitations for breach of contract began to run when the subcontractor stopped its work or when the project as a whole reached substantial completion. The case involved the construction of a twenty-five building condominium complex in Bellevue, Washington. Well after construction was completed, the condominium association sued the developer alleging construction defects. The developer in turn sued the general contractor, Ledcor. The developer and Ledcor settled, and Ledcor subsequently filed a claim for breach of contract and indemnification against its subcontractor, Serock. Serock was responsible for completing the exterior trim on thirteen buildings in Phase 1 of the project.

Serock argued that Ledcor's breach of contract claims were barred by Washington's six-year statute of limitations for breach of contract. Serock last provided labor and materials on the jobsite in May of 1998, and Ledcor filed its complaint in November of 2004, more than six years after Serock left the project. Ledcor countered that the statute of limitations did not begin to run until substantial completion of the project as a whole, not completion of Serock's work, and under this interpretation Ledcor had filed its claims within the six-year limitations period.

The Washington Court of Appeals held that the six-year statute of limitations began to run no later than Serock's last date of labor on the project. Ledcor argued that a statute of repose, which provided a limitation of six years from the date of substantial completion of the project as whole for any claim to arise, extended the time within which Ledcor could assert claims against Serock. The Court rejected this argument, finding that Ledcor's claims were extinguished at the expiration of (a) the six-year limitations period based upon the subcontractor's last date of labor or (b) the six-year statute of repose based upon the project's substantial completion, *whichever came first*.

However, the Court found that Ledcor's claims based upon the contractual indemnity provision in its subcontract with Serock, which included many of the same damages asserted in the breach of contract claims, were *not* barred by the statute of limitations because the time period for the indemnity claims did not begin to run until Ledcor's settlement with the developer, which triggered Serock's liability for indemnity. Thus, Ledcor was able to recover similar damages based upon the indemnity provisions, despite the fact that its breach of contract claims were barred as untimely.

As demonstrated in the *Harmony* case, the statute of limitations for claims by or against subcontractors can begin to run, and potentially expire, before substantial completion of the project as a whole. While claims for breach of contract may be barred by expiration of the statute of limitations, similar claims for indemnity may be valid even after the breach of contract claims have been extinguished. Understanding the length and manner for calculating the applicable limitations period is a complicated and oftentimes confusing endeavor. As a proactive matter, consulting counsel on this issue early in a project may be quite helpful.

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by David Hill Bashford & Nick Voelker

Throw Mama from the E-Discovery Train

Companies with significant litigation realize the cost and burden that e-discovery places on the dispute resolution process. Notwithstanding the attempts of the federal judiciary to rein in and better define e-discovery practice by passage of new rules, courts continue to require both parties and third parties to subject themselves to onerous and intrusive inspections of their electronically stored information (ESI). A recent case from the federal court for the Eastern District of Louisiana illustrates this point.

As part of an employment contract dispute, the plaintiff's former employer learned that plaintiff had sent emails to and from his mother's and best friend's computers during the course of his employment. The plaintiff had also used his mother's laptop computer for business-related work. The defendant served subpoenas on the plaintiff's mother and best friend, and the plaintiff (but not the mother or best friend) moved to quash the subpoenas. Although the court ordered protective protocols for personal and privileged information, which were to be agreed on by the parties, it refused to quash the subpoena and ordered the production of the actual hardware in the mother's laptop computer. One potentially significant fact in the judge's decision is that the defendant agreed to bear all of the costs associated with the forensic examination of the ESI.

While this case may be somewhat humorous, modern reality is that a "borrowed" computer may have information reasonably related to litigation. Because one of the defining characteristics of ESI is that it can almost always be recovered, people need to be careful and consider the potential burden they may be placing on third parties when using another computer or sending documents to them. Also, if your company is affected by a subpoena on a third party who does not wish to object to it, you might be well-advised to obtain counsel for that third party who could raise the objection and alleviate the burden on the third party, hopefully avoiding undue costs of e-discovery.

by Jonathan Head

Changes to Labor and Employment Landscape Likely

Now that President Obama has taken office and the new Congress seated, employers should expect significant changes on a number of labor and employment issues. Organized labor provided crucial support and financial backing for President Obama's 2008 Campaign and is now pushing a very aggressive, pro-union agenda. The nation's economic slowdown may force more deliberate change in some areas, but employers must be prepared for a new labor and employment environment, which will likely include these developments:

Pay Discrimination – The Lilly Ledbetter Fair Pay Act was enacted January 29, 2009. This new law amends Title VII, the Age Discrimination in Employment Act, and the Americans with Disabilities Act, to overturn a 2007 U. S. Supreme Court decision which rejected as untimely the pay discrimination claims brought by Lilly Ledbetter, a long-time employee at Goodyear's Gadsden, Alabama plant. This new law will make it easier for employees to assert pay claims by clarifying that the time period for filing such a claim begins to run anew each time an employee receives a paycheck, no matter how long the employee has been receiving pay on a discriminatory basis. A second piece of legislation, known as the Paycheck Fairness Act, would amend the Equal Pay Act by making it more difficult for employers to justify legitimate pay differentials among its male and female employees and by allowing aggrieved employees to sue for unlimited compensatory and punitive damages. This legislation has also received early consideration in Congress and passage is considered likely.

RESPECT Act – Organized labor is promoting enactment of the Re-Empowerment of Skills and Professional Employees and Construction Tradeworkers (RESPECT) Act. If passed, this legislation would amend the National Labor Relations Act by narrowing the definition of "supervisor" to include only those individuals who have authority over rank and file employees *for a* majority *of the supervisor's*

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work time. This Act would expand the universe of employees eligible to unionize and have a particularly important impact in the construction industry where the use of leadmen and working foremen is common.

New NLRB Appointments – There are currently three vacant positions on the five-member National Labor Relations Board (NLRB), the quasi-judicial body which decides labor relations cases and sets precedent under the National Labor Relations Act. President Obama will likely fill these positions with appointees who favor organized labor. This is likely to have a significant effect on construction industry employers because the NLRB is expected to address a number of hot-button topics such as bannering, the use of company e-mail to conduct union activities and issues relating to union decertification petitions.

Project Labor Agreements – Most observers expect that one of President Obama's first acts will be to rescind Executive Order 13202, signed by President Bush in 2001. That Executive Order prohibits agencies from requiring project labor agreements (PLA's) on federally financed construction projects. This move, which requires no legislative action, would permit PLA's just in time for the federal infrastructure projects expected under the President's proposed stimulus package. It is not clear whether President Obama will support new policies that require PLA's on federal projects.

Independent Contractors – Under the Independent Contractor Proper Classification Act, which was first proposed by President Obama when he was in the Senate, the IRS would be allowed to reclassify workers incorrectly classified as independent contractors by their employer even when the misclassification results from a long-standing practice in the employer's industry. This legislation would also require the IRS to implement procedures through which workers could challenge their classification as independent contractors. Additionally, employers would be forced to inform workers classified as independent contractors about their federal tax obligations as well as their right to challenge their classification with the IRS.

Arbitration Fairness Act – Many employers have implemented pre-dispute arbitration policies which require their employees to arbitrate discrimination and other employment based claims. Over the past decade, the courts have displayed an increasing willingness to enforce these policies even though they typically prevent employees from having their claims adjudicated in a jury trial. However, these pre-dispute arbitration policies would be rendered invalid under the Arbitration Fairness Act of 2007, which will likely be re-introduced in 2009 and has previously received the support of President Obama. Under this legislation, pre-dispute agreements requiring arbitration of individual employment disputes or disputes arising under any law intended to protect civil rights would no longer be enforceable. Standard arbitration provisions contained in collective bargaining agreements, however, would not be affected.

Amendments to the Family Medical Leave Act (FMLA) – As a Senator, President Obama supported amendments to the FMLA that would reduce the coverage threshold from 50 to 25 employees and require employers to provide leave for certain reasons not now mandated by law. Legislation to make these and perhaps other changes to the FMLA will likely be re-introduced in 2009 and will have a significant chance at passage.

Employee Free Choice Act (EFCA) – This legislation, which is the top priority of organized labor, is addressed in detail elsewhere in this newsletter. President Obama consistently voiced support for the EFCA during his 2008 Campaign and most Washington observers predict a contentious battle over passage this year, probably early in the Congressional term.

Attorneys at Bradley Arant Boult Cummings maintain a wealth of knowledge and offer a broad range of services beyond the construction industry. For example, our government affairs practice group and labor and employment law practice group are available to serve you in responding to these and other proposed and already-enacted laws which may impact your business.

by Keith Covington

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Bradley Arant Lawyer Activities:

Michael Knapp attended the Comprehensive Construction Defect Claims and Coverage SuperConference in Las Vegas, Nevada on November 5-7, 2008.

Rhonda Caviedes, **Donna Crowe**, **David Hume**, **Sarah Katherine Nichols**, and **Bryan Thomas** presented a seminar entitled "Green or Sustainable Building: Understanding the Issues" on November 13, 2008 in Birmingham, Alabama.

Rob Dodson and **Ed Everitt** spoke on "Making Changes and Resolving Disputes During the Construction Process" at a seminar in Jackson, MS entitled Construction Law for Architects, Engineers and Contractors on November 20, 2008.

Mabry Rogers attended the celebration of the opening of Stewart/Perry's new offices, which are spectacularly built around a lake on 4855 Overton Road, Birmingham, Alabama on November 20, 2008.

David Taylor spoke in Orlando at the Annual International Counsel of Shopping Center Legal Conference on "Arbitrating vs. Litigating Construction Disputes" in November, 2008.

Keith Covington attended the Associated Builders and Contractors Attorney's Conference in Washington D.C. on December 3-5, 2008.

Michael Knapp, **Arlan Lewis**, **Mitch Mudano**, **Jeff Peters**, and **David Pugh** presented "The Fundamentals of Construction Contracts: Understanding the Issues" in Birmingham, Alabama on December 5, 2008. This seminar covered contract principles, dispute resolution, project delivery systems, and subcontracting issues.

Mabry Rogers gave a client seminar on Documentation and Change Management on Veterans Administration jobs in Las Vegas, Nevada on December 12, 2008.

David Owen attended the 23rd Annual Construction SuperConference in December, 2008 in San Francisco, California.

David Taylor spoke on "Design Issues" for the Tennessee Chapter of the American Subcontractors Association on January 3, 2009.

David Taylor spoke on "Retainage and Lien Law" for the Tennessee Association of Roofing Contractors on January 9, 2009.

Michael Knapp attended the Carolinas AGC Annual Conference in West Palm Beach, Florida on January 14–18, 2009.

Rhonda Caviedes, Donna Crowe, Arlan Lewis and **Luke Martin** attended ABA Forum Mid-Winter Meeting January 16, 2009 in Bonita Springs, Florida.

The BABC Construction Practice Group held its annual "Learning day" on January 22, 2009. The presentation was entitled "Stix and Brix" and focused on practical construction methods and technologies. The speakers included Dr. Dan Brown – Geotechnical (formerly of Auburn University), Professor Michael Hein – Concrete (Auburn University), Bill Gibson – MEP (Shaw Power Group), David Hare – Building Envelope (B.L. Harbert International), and Keith Andrews – Road Construction (RaCON, Inc.).

Keith Covington spoke on the proposed Employee Free Choice Act at the Legislative Summit for the construction industry held at Associated Builders and Contractors in Homewood on January 23, 2009.

David Taylor, as Chair of the Tennessee Bar Association Construction Section, coordinated and spoke at a one day seminar entitled Tennessee Construction Law, A-Z.

Rhonda Caviedes presented a Client Seminar for Regions on January 29, 2009.

Eric Frechtel attended the ABA/TIPS/FSLC seminar focusing on public-private partnerships in New York in January, 2009.

Mabry Rogers and **Wally Sears** will attend the annual meeting of the ACCL in Amelia Island, Florida on February 19-22, 2009. Wally will be presenting on Discovery in International Arbitration, along with Nick Gaede.

David Taylor will coordinate and speak at the National meeting of the American Subcontractors Association in Nashville, Tennessee on "Legal Protections in a Volatile Economy" on March 6, 2009.

Mabry Rogers will present a client seminar of Federal procurement on February 10, and on project

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management to a construction team in San Antonio, Texas in March 16, 2009.

Jonathan Head will speak at the ABA Litigation Section annual meeting on how to deal with inadvertent waiver of privilege in e-discovery in Atlanta, Georgia in April.

David Taylor, Joel Brown and Doug Patin will present a complimentary legal seminar and breakfast entitled "Qualifying, Bidding, Obtaining and Managing Federal Construction Work" on March 3, 2009 at our Nashville office.

Keith Covington, **Chris Glenos**, **Arlan Lewis**, and **David Pugh** will present a seminar entitled "Construction Insurance, Bonding, and Liens in Alabama" on April 22, 2009 in Birmingham, Alabama.

Jim Archibald, Axel Bolvig, Doug Patin, David Pugh, Mabry Rogers, Wally Sears and David Taylor have been selected for inclusion in the 2009 edition of *The Best Lawyers in America* in the specialty of Construction Law.

Axel Bolvig, Mabry Rogers and Wally Sears have been selected for inclusion in the 2009 edition of *Alabama Super Lawyers, Corporate Counsel* edition in the field of Construction Litigation.

Bill Purdy has been selected for inclusion in the 2009 edition of *Mississippi Super Lawyers, Corporate Counsel* edition in the field of Construction Surety/ Construction Litigation

Fred Humbracht has been selected for inclusion in the 2009 edition of *Tennessee Super Lawyers, Corporate Counsel* edition in the field of Construction Litigation

Doug Patin has been selected for inclusion in the 2009 edition of *Washington D.C. Super Lawyers, Corporate Counsel* edition in the field of Construction Litigation

David Hume will participate on the ABC Cares committee for the Alabama Chapter of the Associated Builders and Contractors.

David Hume will also participate in the Associated Builders and Contractors' Future Leaders in Construction 101 training program in 2009.

In late 2008, Several BABC Construction Practice Group attorneys wrote portions of the recently published *Alabama Construction Law Manual* (West 2008). The authors included **Jim Archibald**, **Keith Covington**, **Ed Everitt**, **David Hume**, **Arlan Lewis**, **Luke Martin**, **David Owen**, and **Wally Sears**. Several other BABC attorneys authored other portions of the Manual, including **Helen Ball**, **Charlie Beavers**, **Patrick Darby**, **Chris Grissom**, **Rod Kanter**, and **David Roth**.

For more information on any of these activities or speaking engagements, please contact Rebecca Harris at 205-521-8504.

As of January 1, 2009, Bradley Arant Rose & White LLP and Nashville's well-respected Boult, Cummings, Conners & Berry PLC merged to form Bradley Arant Boult Cummings LLP. Our new firm has more than 350 attorneys in seven offices strategically located in Tennessee, Alabama, Mississippi, North Carolina and the District of Columbia. Together, we will offer you or your clients a talented legal team with not only expanded areas of service and enhanced industry knowledge, but also the continued dedication to excellence in client service you have come to expect from our firms.

Editor's Note:

In December 2008, the former editor of this newsletter, Sabra Barnett, left Bradley Arant to take a position as Legislative Director for the President Pro Tem of the Alabama Senate. We would like to thank Sabra for her efforts as editor and for her years of exceptional service at Bradley Arant. We congratulate her on her new endeavor, and welcome Luke Martin and Bryan Thomas as the new co-editors of our quarterly newsletter.

NOTE: YOU CAN FIND THIS NEWSLETTER AND PAST NEWSLETTERS ON OUR WEBSITE. IF YOU ACCESS THIS NEWSLETTER ON OUR WEBSITE, CASE-LINKS WILL BE AVAILABLE UNTIL THE NEXT NEWSLETTER IS PUBLISHED. WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY GO TO WWW.BA-BOULT.COM/PG_CONSTRUCT.CFM OR CONTACT ANY ATTORNEY LISTED ON PAGE 8 OF THIS NEWSLETTER.

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The lawyers at Bradley Arant Boult Cummings LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

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BRADLEY ARANT BOULT CUMMINGS LLP **Second Quarter 2009**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Owners and Contractors Beware: Tennessee Retainage Law has Changed

Recently enacted bills in Tennessee limit retainage to 5% for all construction contracts, set strict time limits for the release of retainage and tie the failure to create a Retainage Account to severe penalties under the Prompt Pay Act. These requirements cannot be waived by contract.

Tennessee has enacted new legislation that substantially changes the law regarding withholding of retainage on Tennessee projects. The new law limits the amount of retainage an owner or contractor can withhold from any contract (public or private) to 5% of the contract amount. This new legislation applies if the prime contract is equal to or more than $500,000. The retainage that is withheld "shall" be placed in an interest bearing escrow account and the monies, when funded, become the "property" of the contractor or subcontractor. This funding requirement applies no matter how small the subcontract amount, as long as the prime contract meets the $500,000 dollar threshold. The release of the funds must be accomplished within ninety (90) days of completion of the work (which impacts early completion subcontractors) or substantial completion of the project, whichever occurs first. Contractors must release any retainage due to subcontractors for their completed scope of work within ten (10) days of owner payment and subcontractors must pay sub-subcontractors or vendors within ten (10) days of payment by the subcontractor. The interest earned on such an account is also required to be paid to the subcontractors.

The other primary change in the law is that failure to comply with these retainage requirements is now a violation of Tennessee's Prompt Pay Act. In essence, the old retainage law, which had been almost universally ignored, has been given teeth. Specifically, the Prompt Pay Act not only allows for recovery of attorneys' fees and injunctive relief, it also makes violations a misdemeanor criminal offense and subject to daily penalties of as much as $2,500 a day. This stands in stark contrast to prior law, which provided little penalty for failure to adhere to these requirements other than the allowance of claims for lost interest.

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Some have questioned whether the new law requires a prime contractor to set up multiple retainage accounts for its many subcontractors, positing that in most instances, if an account is set up, it is formally only between the owner, prime contractor and escrow agent. If multiple accounts are required, this could severely impact a prime contractor's cash flow, potentially tying up 5% of the prime contractor's earned monies in the owner's escrow account, and another 5% in an escrow account for its many subcontractors. While no judge has ruled on this issue, it is believed that given that the statute describes the monies as the property of the company to whom they are owed, the "one" account required "by law" contains retainage owed to subcontractors. The interesting development will be when there is a dispute between an owner (or surety) and a prime contractor involving, for example, a potential roof defect, and the non-impacted subcontractors demand payment of their retainage out of the account.

The 5% requirement is also slowly filtering its way to lenders. Traditionally lenders have allowed an owner 90% of the construction loan proceeds (based on 10% retainage). Loan agreements are not construction contracts and thus this new 5% limitation does not apply to their loan agreements. This can cause issues with project funding unless all parties involved (lender, owner and prime contractor) are aware of the new limits. There have been instances where banks have refused to release the additional 5% to an owner after the project has begun, causing project funding problems with the potential to derail projects.

This change in Tennessee retainage law should remind owners and contractors in all states to be aware of applicable statutory requirements regarding payment. These laws vary from state to state and, as can be seen above, can have serious consequences for the uninformed.

by David Taylor

Eighth Circuit Revives OSHA's Multi-Employer Worksite Policy For "Controlling Employers"

On February 26, 2009, the United States Court of Appeals for the Eighth Circuit issued its long-awaited decision in *Solis v. Summit Contractors, Inc.*, overturning a 2007 decision of the OSHA Review Commission and reviving the so-called multi-employer worksite policy for "controlling employers." Under this policy, a general contractor with supervisory control over the worksite may be cited for a safety hazard even though it did not create the hazard and even though none of its own employees were exposed to it. This policy had resulted in thousands of OSHA citations issued against general contractors for violations committed by subcontractors before the policy was declared invalid by the OSHA Review Commission in 2007.

Summit Contractors was the general contractor for the construction of a college dormitory in Little Rock, Arkansas. During the course of the project, Summit's masonry subcontractor failed to ensure that its employees were utilizing fall protection as required by OSHA's standards. After conducting a worksite inspection, OSHA cited Summit as the "controlling employer," alleging that Summit had failed to detect the hazard and see that it was remediated by the subcontractor. Summit argued that OSHA had acted improperly because it had no authority to cite a general contractor whose own employees were never exposed to the safety hazard. After an Administrative Law Judge ("ALJ") ruled in favor of OSHA and upheld the longstanding multi-employer citation policy, Summit appealed.

The OSHA Review Commission reversed the ALJ's decision and vacated the citation against Summit. The Review Commission based its decision on 29 C.F.R. Section 1910.12(a), a regulation issued by the Secretary of Labor shortly after the OSH Act was enacted in 1970. That regulation states that each construction industry employer is required to "protect the employment and places of employment of each of his employees engaged in construction work by complying with the appropriate [OSHA] standards. . . ." The Review Commission examined the language of the regulation and interpreted it to require a construction contractor to comply with OSHA's safety standards only as to its own employees. The Review Commission found that OSHA's citation of a general contractor under the "controlling employer" doctrine was incompatible with this regulation and, therefore, improper.

In *Solis v. Summit Contractors, Inc.*, a three-judge panel of the Eighth Circuit, voting 2-1, disagreed with the OSHA Review Commission and found that the language of 29 C.F.R. §1910.12(a) "is unambiguous in that *it does not preclude* OSHA from issuing citations to employers for violations when their own employees are not exposed to any hazards related to the violations." The Eighth Circuit panel vacated the Review Commission's ruling, holding that the Review Commission

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had "abused its discretion in determining that the controlling employer citation policy conflicted with §1910.12(a)."

While the Eighth Circuit's decision clearly will have an important impact on construction contractors, it does not foreclose the possibility of other legal challenges to the multi-employer citation policy. The Court addressed the meaning of 29 C.F.R. § 1910.12(a), but did not engage in an analysis of the overall policy. At one point, the Court noted that the multi-employer citation policy had not been adopted through the informal rulemaking process of the Administrative Procedures Act and suggested that such rulemaking might be required for OSHA to continue to use the policy in its enforcement efforts. The Court, however, declined to address this issue directly because it had been raised only by the *amici* for Summit Contractors and not by the parties. As always, contractors should stay tuned to developments on this and other decisions regarding workplace safety that may have similar serious ramifications, and contractors should regularly revisit and update their workplace safety practices.

By Keith Covington

Contractors Beware – Violation of State Construction Lien Law Could Result in Criminal Liability

Wisconsin's construction lien statute, like the lien statutes in many other states, safeguards against the misappropriation of construction project funds by creating trust funds for the benefit of owners, subcontractors, and suppliers. The purpose of the "trust fund" is to pay claims for labor and materials used for improvements to real property. The statute prohibits prime contractors from using the money in the trust fund for any purpose other than for payment of claims, until such claims are paid in full. Also, in the event that the prime contractor does not have sufficient funds to pay all subcontractors in full, the prime contractor must pay subcontractor claims proportionally. Violation of the payment provisions of this statute constitutes theft by the prime contractor and, as confirmed in a recent decision interpreting the statute, *State v. Keyes*, subjects the prime contractor to criminal penalties.

In *Keyes*, the defendants, two individuals conducting business as a residential home builder and prime contractor for the project, received seven draws from the owner's loan account for a residential building project. Based on lien releases filed by certain subcontractors, it appeared the defendants paid certain of the subcontractors' claims. The owners later learned that certain other subcontractors on the project were not being paid, and that one of the individual defendants performed some of the project work purportedly as a subcontractor. Ultimately, the owner denied the defendant's request for an eighth draw and requested that its certified public accountant investigate project finances. The accountant's analysis revealed that the defendants failed to pay certain of the subcontractors on the project. As a result, the owners filed a criminal complaint against the defendants for felony theft by a prime contractor pursuant to the construction lien statute.

The defendants filed a motion to dismiss the criminal complaint, which was denied. On appeal, the Wisconsin Supreme Court affirmed the decision. The Court stated that the Wisconsin construction lien statute creates a trust and, as such, payments made to a prime contractor are not owned by the prime contractor. The Court stated that use of the trust fund money "for any other purpose until all claims . . . have been paid in full or proportionally in cases of a deficiency, is theft by the prime contractor. . . ." The Court found that after the final draw from the construction account, there was not enough money to pay the claims due third-party subcontractors and also pay the defendants the full amount for materials. The Court concluded that this was a case of deficiency, and the defendants were to compensate the unpaid subcontractors proportionally. Based on the defendants' failure to compensate the subcontractors proportionally and the amount at issue, the Court held that the defendants' actions constituted a violation of the state construction lien statute and a Class G felony.

It is important to note that pursuant to the Wisconsin statute, theft by a prime contractor in cases where the prime contractor is a corporation, limited liability company or other legal entity other than a sole proprietorship is also deemed theft by any officers, directors, members, partners, or agents of the prime contractor responsible for the misappropriation. New York, Illinois, Michigan and Maryland have enacted construction lien law statutes similar to that in Wisconsin. Michigan courts have also held prime contractors liable for both civil and criminal penalties. It is imperative for companies acting as a prime contractor to understand the applicable state construction lien statutes, because violation of these statutes may result in corporate and individual civil and criminal liability.

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By Michael Griffin

Wrongfully Terminated Contractor Entitled to Lost Profits Due to Impaired Bonding Capacity

When a contractor is terminated for default and a claim is filed with its surety, it is certainly foreseeable that the surety would reduce that contractor's bonding capacity. Consequently, the contractor's ability to bid on projects requiring a bond (such as public works projects) will be limited if not prevented altogether. But what if the contractor is wrongfully terminated? Can the contractor recover lost profits from the wrongfully terminating party as damages? In a recent case, *Denny Construction, Inc. v. City & County of Denver*, the Supreme Court of Colorado ruled that a general contractor was entitled to lost profits after losing its bonding capacity as a result of a wrongful termination.

The case involved an established general contractor (Denny) who contracted to construct a new headquarters for the City of Denver's Board of Water Commissioners, a political subdivision of the State of Colorado, for $3.5 Million. In over thirty years of business, Denny had never been declared in default, and at the time of the project half of Denny's revenue came from public works projects.

During the project, Denny requested numerous time extensions due to weather delays; the Board only granted some of the extensions. Because of the delays, Denny failed to meet the project completion deadline, and the Board refused to pay because of unfinished work. Ultimately, the Board declared Denny in default and filed a claim with Denny's surety. Within four months of this default, Denny's surety stopped underwriting bonds for Denny altogether. Denny attempted to obtain bonds from at least three other sureties but was unsuccessful. As a result, Denny was prevented from bidding on any public works projects.

After a subcontractor filed suit to recover its unpaid balance, Denny and the Board filed breach of contract claims against each other. After a trial, the jury found that the Board, not Denny, breached the contract. Therefore, Denny should have never been declared in default. As an element of damages, the jury awarded Denny lost profits due to its impaired bonding capacity. The Colorado Supreme Court eventually upheld the jury's award, holding that lost profits due to a contractor's impaired bonding capacity are recoverable (1) as long as they can be proven with reasonable certainty and (2) are foreseeable at the time the contract is made.

While the facts of this case involve an owner and a general contractor, the same rule could be applied where a general contractor wrongfully terminates its subcontractor. This case demonstrates the need to use caution before terminating a contractor for default. Such an action is drastic and will almost certainly lead to litigation, with a careful review of the terminating parties' actions. Serious consequences await a party found guilty of wrongful termination.

By Ed Everitt

Will Contract Clauses Limiting Liability Be Enforced?

Recently, two state courts have taken up the issue of the enforceability of a contractual limitation-of-liability provision in a subcontract capping damages owed by a subcontractor at the amount of fees paid to it by the general contractor. In *Octillo, LLC v. the WLB Group, Inc.*, the Arizona Court of Appeals held that Arizona public policy did not prohibit the enforcement of such provisions and, therefore, they are valid under Arizona law. However, in *Lanier at McEver, L.P. v. Planners and Engineers Collaborative, Inc.,* the Supreme Court of Georgia held that such provisions are in direct violation of Georgia's Anti-Indemnity statute and public policy and are void.

In the Arizona case, Octillo, a real estate developer, brought an action against WLB, a surveyor, for an erroneous survey conducted on a townhouse project in Phoenix. The limitation-of-liability provision capped damages owed by WLB at the total amount of fees paid by Octillo to WLB on the project. Octillo paid WLB $14,242 for services performed on the project and WLB argued that this was the highest amount of damages it could be liable for under the Subcontract. The trial court granted WLB'S motion for Summary Judgment stating that the contract provision did not violate Arizona public policy and was valid. The Arizona appellate court recognized that although parties in commercial settings are free to contract over which party bears the risk, if such a provision directly violates public policy (e.g. a statute), it is invalid under Arizona law. The appellate court looked at whether such provisions were in violation of the Arizona Anti-Indemnity statute. Because this case was one of first impression in Arizona, Octillo argued that the reasoning set forth in an Alaska

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case, *City of Dillingham v. CH2M Hill*, should apply. Namely, that an Anti-Indemnity statute, one that prohibits a party to a construction contract from enforcing a provision purporting to indemnify that party for its own negligence, made such a limitation-of-liability provision against public policy. The Court of Appeals disagreed and held that such a provision is not an indemnity provision and, therefore, the maximum amount of damages Octillo could recoup from WLB was $14,242.

In the Georgia case, Lanier, a property developer, brought an action against Planners and Engineers for the negligent construction of a storm water drainage system on a 220-unit apartment complex outside of Atlanta. After completion of the apartment building, Lanier discovered erosion and other physical damage caused by Planners and Engineers totaling roughly $500,000. Planners and Engineers argued that because it was paid $80,514 on the project, and because the limitation-of liability provision in the Subcontract limited its liability to that amount, its liability was capped at $80,514. The trial and appellate courts both found that the provision did not violate any Georgia law, was not a violation of public policy, upheld the provision, and capped damages at $80,514. However, the Georgia Supreme Court disagreed and overturned the lower courts' decisions. The Court held that because the provision was a complete avoidance of liability for a third party's sole negligence in a building contract, it was in direct violation of the Georgia Anti-Indemnity statute.

Due to the conflicting state law pertaining to these types of Subcontract limitation-of-liability provisions, parties involved in construction projects should contact counsel to confirm whether such provisions are valid in the state where their project is located prior to negotiating for such provisions. Otherwise, the party may have bargained for a provision that is not only invalid, but also carries the possibility of unanticipated exposure.

By David Hill Bashford & Nick Voelker

Stimulus Package (ARRA): The Buy American Provision: Get Ready Now!

Among the lesser noticed provisions of the American Recovery and Reinvestment Act of 2009 (ARRA) is the Buy American provision, which took effect February 17, 2009. It requires that all of the iron and steel and "manufactured goods" used in ARRA-funded projects for construction, alteration, maintenance or repair of a "public building or public work" be "produced in the US."

Regulations to implement this provision, as they relate solely to construction materials, have been published at FAR Subpart 25.6, and provide some guidance. They do not, however, define what is a "public building or public work," what are "manufactured goods," and they are not entirely clear as to what constitutes material "produced in the US."

Oddly, it is not clear that this applies only to construction projects. What is the impact on development of a wireless network system? A purchase solely of equipment? Other procurements not involving construction type efforts (food service contracts, as an example)? And is the ARRA applicable only to federal procurements, as is the Buy American Act of 1933? Finally, does the rule follow the dollars, such that a grantee is subject to it, a state, a private entity which then use the dollars to buy iron, steel, or manufactured goods?

As to "manufactured goods," must they be linked to a public building or public work? What if it's the purchase of lawnmowers for routine maintenance? Is an intellectual property (shop drawings, software) a "manufactured good?" The FAR addresses manufactured construction materials, but does not distinguish them from manufactured goods. What if the "manufactured good" is not made of iron or steel? If a manufactured good is partly made of iron or steel, must all of its iron or steel be produced in the US?

What about "produced in the US?" Which test will the government or the courts apply, the "substantial transformation test" (*i.e.,* it is produced in the US if it is "substantially transformed into a new and different article of commerce" in the US) or the "cost of domestic components test" (*i.e.,* more than 50% is US produced, and some additional manufacturing process takes place in US). Even if one solves the test problem, does it apply to the final product (a heating and cooling system in an office building) or to each component? The FAR provides that "steel or iron used as components or subcomponents of other manufactured construction material" is exempt from the "produced in the US" requirement, but fails to define where something becomes a component or subcomponent.

There are important exceptions to the application of this provision—for example, certain foreign trade agree-

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ments granting exceptions to country of origin preferences – so one will want to consult your lawyer about the exceptions and whether they apply (or, in the case of a prospective procurement, can be lobbied to apply). Moreover, even if it does not apply, one will still need to analyze whether the Buy American Act applies.

Companies that hope to participate in the ARRA funding need to prepare to examine these issues for any effect on procurement decisions. Quick and accurate action may repay the prepared company. Moreover, one will be better able to assess whether a competitor's bid or proposal can be protested on ARRA "Buy American" grounds.

By Mabry Rogers

Despite Being Unlicensed, Contractor Allowed to Retain Payments

States have licensing requirements of all kinds, for real estate agents, architects, contractors, even lawyers. Most of those statutes provide that those practicing their trade without a license cannot enforce contracts made while unlicensed. That is, those without licenses cannot sue to get paid. Alabama's licensing provision for contractors provides exactly that. The Alabama Supreme Court recently addressed a related, but clearly different, issue. Does an unlicensed Contractor have to return payments that had already been made?

In *Fausnight v. Perkins* the Alabama Supreme Court addressed whether an owner could sue his contractor to recover payments already made solely because the owner learned that the contractor was not licensed under Alabama law. The trial court ruled that the owner could recover the money. The trial court's reasoning was based upon the public policy behind the licensing statute which was to protect the public from unlicensed contractors. The trial court concluded that if the state legislature passed a statute that does not allow a contractor to sue to obtain money owed to him, surely the legislature also meant that a contractor could not retain money voluntarily paid to him by an owner when the owner did not know that the contractor was unlicensed.

The Alabama Supreme Court disagreed. In ruling that the contractor could keep money already paid, it first emphasized that the licensing statute was very penal. The home at issue in the case was already built and occupied by the owner. The money paid by the owner resulted in a home of value which the contractor had provided. Second, in addition to being quite penal, the statute was a change to the common law which would not have barred the unlicensed contractor from bringing suit to enforce his contract. Therefore, the statute needed to be "narrowly construed." In other words, if the statute did not say specifically that the contractor could not retain payments voluntarily made, then the courts did not have the authority to "write in" that provision simply based upon what the legislative intent appeared to be. The Supreme Court further noted that the statute was very specific. In addition to preventing an unlicensed contractor from filing a lawsuit, it provided for criminal penalties (fines) for unlicensed contracting. Clearly, the legislature could have included a provision which also would have prevented an unlicensed contractor from retaining payments voluntarily made, but the legislature did not do that.

Despite the *Fausnight* ruling, contracting without a license in any state is risky business, whether it is home building or work in some other regulated trade or profession. Had the payments in this case been made before the work had been completed for the owner or if the money had been used improperly in some way, the result in the case might well have been different. Moreover, the law in many other states is not as favorable to contractors. A New Mexico case, for example, came out the opposite way on the *Fausnight* issue, and many state licensing statutes (California for one) contain the very provision about refund of voluntary payments that the *Fausnight* Court noted was not included by the Alabama legislature in this case.

By John Hargrove

Bradley Arant Lawyer Activities:

In late 2008, Several BABC Construction Practice Group attorneys wrote portions of the recently published Alabama Construction Law Manual (West 2008). The authors included **Jim Archibald**, **Keith Covington**, **Ed Everitt**, **David Hume**, **Arlan Lewis**, **Luke Martin**, **David Owen**, and **Wally Sears**. Several other BABC attorneys authored other portions of the Manual, including **Helen Ball**, **Charlie Beavers**, **Patrick Darby**, **Chris Grissom**, **Rod Kanter**, and **David Roth**.

Keith Covington spoke on the proposed Employee Free Choice Act at the Legislative Summit for the construction industry held at Associated Builders and Contractors in Homewood on January 23, 2009.

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Mabry Rogers and **Wally Sears** attended the annual meeting of the ACCL in Amelia Island, Florida on February 19-22, 2009. Wally presented on Discovery in International Arbitration, along with Nick Gaede.

John Bond, Kay Bains, and David Taylor spoke on a panel at the National Conference of the American Subcontractors Association Annual Meeting in Nashville on March 5, 2009.

David Taylor coordinated and spoke at the National meeting of the American Subcontractors Association in Nashville, Tennessee on "Legal Protections in a Volatile Economy" on March 6, 2009.

Mabry Rogers presented a client seminar on project management to a construction team in San Antonio, Texas on March 16, 2009.

Michael Koplan and Robert Symon presented an in-house Risk Management Seminar for a client on March 19, 2009.

Jonathan Head spoke at the ABA Litigation Section annual meeting on how to deal with inadvertent waiver of privilege in e-discovery in Atlanta, Georgia in April.

Keith Covington, **Chris Glenos**, **Arlan Lewis**, and **David Hume** presented a seminar entitled "Construction Insurance, Bonding, and Liens in Alabama" on April 22, 2009 in Birmingham, Alabama.

David Hume participated and completed the Future Leaders in Construction 101 Program organized by the Alabama Chapter of the Associated Builders and Contractor. **David** is currently participating in the second phase of the program, FLIC 102, which will be complete at the end of May 2009.

Michael Koplan wrote an article on mechanic's lien and change order releases for a client newsletter on April 15, 2009.

Rhonda Caviedes, Ed Everitt, and Arlan Lewis attended the ABA Forum on the Construction Industry Annual Conference held in New Orleans from April 16-18. The program was entitled "Talking Green Blues: Energy, Sustainability, and Green Building Challenges Affecting the Construction Industry."

Ralph Germany presented a construction law update to Barksdale Bonding and Insurance Company on April 20, 2009.

David Hume attended the 2009 Building Science Awards Banquet, Career Expo and Golf Tournament at Auburn University on April 23, 2009.

David Taylor spoke on "Arbitration" at the firm's Litigation Section's In-House Counsel Seminar entitled "Controlling Legal Costs" in Nashville on April 23, 2009.

David Taylor spoke at the Tennessee Association of Construction Counsel's Spring Meeting on "Opening Statements in Mediations" in Memphis on April 24, 2009.

David Hume coordinated and spoke at the 1st Annual FLIC Blind Wine Tasting benefiting the ACE Mentor Program on April 30, 2009. ACE is a nonprofit organization that mentors high school students in the architectural, construction, and engineering sciences for future careers in the industry.

Joel Brown and **David Hume** will participate in the Lorman seminar "Public Contracts and Procurement Regulations" to be held in Huntsville, Alabama on May 6, 2009. Several other BABC attorneys will participate as well, including Hall Bryant, Frank Caprio, Stephen Hall, Warne Heath, and Harold Stephens.

Jeremy Becker-Welts, Axel Bolvig, Joel Brown, Ralph Germany, Arlan Lewis, Doug Patin, William Purdy, and Robert Symon will present a seminar entitled "Federal Construction Projects: Finding, Pricing, and Managing the Work" in Birmingham, Alabama on May 21, 2009 and Jackson, Mississippi on June 4, 2009.

Keith Covington has presented several seminars at ABC regarding unions.

For more information on any of these activities or speaking engagements, please contact Rebecca Harris at 205-521-8504.

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The lawyers at Bradley Arant Boult Cummings LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

This newsletter is a periodic publication of Bradley Arant Boult Cummings LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact your lawyer or any of the lawyers in our group whose names, telephone numbers and E-mail addresses are listed below; or visit our web site at www.babc.com.

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BRADLEY ARANT BOULT CUMMINGS LLP Third Quarter 2009

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Mandatory E-Verify for Federal Contractors Appears Likely

Two separate developments, both occurring on July 8, 2009, point strongly to the prospect that mandatory E-Verify for federal contractors will soon become a reality. Companies doing or expecting to do work for the federal government should stay tuned.

First, Department of Homeland Security Secretary Janet Napolitano announced that the Obama Administration would move forward with implementation of the regulation that requires federal contractors to use E-Verify to check the immigration status of their employees. This regulation, which was developed by the Bush Administration, was issued in November 2008 and was initially set to go into effect on January 15, 2009. The effective date, however, was most recently postponed until September 8, 2009. Prior to the July 8 announcement, the Obama Administration had been mum on its intentions about the regulation, saying only that it needed additional time to review the regulation and its impact.

This E-Verify regulation amends the Federal Acquisition Regulations to require contracting officers to include in federal contracts exceeding $100,000 a clause mandating a contractor's use of E-Verify to confirm the employment eligibility of (1) all the contractor's new hires and (2) all the contractor's employees—existing and new—who are assigned to the federal contract. Certain existing indefinite-delivery/indefinite-quantity contracts must also be amended to include the E-Verify clause for future orders. If a federal contract is covered by the E-Verify regulation, the contractor must include the E-Verify clause in subcontracts having a value of more than $3,000. There are some contracts excepted from the regulation, including contracts with a performance period of less than 120 days and contracts for commercially available off-the-shelf items.

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Also on July 8, the U. S. Senate passed its version of the 2010 Homeland Security appropriations bill. This Senate bill includes an amendment which permanently authorizes E-Verify and makes the E-Verify system mandatory for federal contractors. The E-Verify program has previously been authorized and funded by Congress as a "pilot program," is completely voluntary for all employers, and is currently set to expire in September 2009. The 2010 Homeland Security appropriations measure passed by the House of Representatives reauthorizes E-Verify for only two additional years and does not include a provision making E-Verify mandatory for federal contractors. Because of these differences, a joint conference committee must reconcile the Senate's version of the bill with the version passed by the House. This committee will meet within a matter of weeks and many observers expect the Senate amendments to be included in the final version of the legislation.

A federal lawsuit challenging the regulation mandating E-Verify for federal contractors is currently pending and the outcome of that litigation is unclear. The principal basis for this legal challenge is that the regulation's imposition of mandatory E-Verify conflicts with the existing immigration laws enacted by Congress. If the current Congress passes legislation that specifically requires federal contractors to use E-Verify, the lawsuit may become moot. Even if the Senate amendment is not included in the final version of the 2010 appropriations bill, there is no guarantee that the lawsuit challenging the regulation will be successful. Now that the E-Verify regulation has the backing of the Obama Administration, federal contractors and those anticipating federal work should prepare for the likelihood that they will soon be required to adhere to the mandatory E-Verify rules.

by Keith Covington

Public Bid Law: Bidders that Fail to Comply with Bid Specifications May Have their Bids Ignored

In a recent appellate decision from New Jersey, a county agency was found to have properly exercised its discretion when it refused to consider bids from contractors who failed to comply with certain bid requirements. Specifically, the contractors at issue failed to list all of their subcontractors, and failed to provide business registration certificates (BRCs) for all of the subcontractors that were listed.

The county agency advertised for bids on a project for improvements to the county justice complex. The bid specs required each bidder to list its subcontractors if it planned to use subcontractors for a particular trade. The bid specs further required that bidders provide a BRC for each subcontractor listed in the bid.

The low prime mechanical bidder failed to list all of its subcontractors and failed to provide BRCs for all of the subcontractors it did list. In addition, the signature of the company president on the bid was not attested, and there was a math error in the bid. The second lowest bidder's bid was rejected for failure to provide BRCs for three of its subcontractors. Both contractors challenged the county agency's award of the mechanical contract to the third lowest bidder. The trial court rejected their challenges, and on appeal, the appellate court affirmed the trial court's ruling that the bids were properly rejected.

The thrust of the trial court's ruling was that even though the public bid law did not require these specific bid items, the county agency had the right and authority to require them. Furthermore, the court found that the county agency had the authority to make the requirements mandatory if it chose to designate them as mandatory in the bid specifications.

The appeals court agreed that the specific provision of the public bid law at issue did not limit a public entity's discretion to require lists of sub-contractors and to deem those lists mandatory and non-waivable. In fact, the court emphasized that the importance of strict compliance with bid requirements is to prevent contractors from bid shopping.

The practice pointer is that if you submit a bid for public work, ALWAYS comply with ALL of the bid specifications.

By Mitch Mudano

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Statute Setting Race-Based Participation Goal Ruled Unconstitutional

In *Rothe Development Corp. v. Department of Defense*, the United States Court of Appeals for the Federal Circuit rejected as unconstitutional a statute setting a goal that 5% of the total dollar value let for certain groups of contracts be awarded to "socially and economically disadvantaged" groups.

The statute, 10 U.S.C. § 2323, dealt with certain contracts awarded by the Department of Defense, the Coast Guard, and NASA. The statute used racial classifications to define those who were socially and economically disadvantaged. The statute and its related regulations allowed up to a 10% adjustment in bid prices in favor of bidders deemed socially and economically disadvantaged.

Rothe Development Corporation bid $5.57 million on a project at the Columbus Air Force Base in Mississippi. A company owned by a Korean-American couple bid $5.75 million. Rothe's bid was adjusted upwards to $6.1 million for bid evaluation purposes. Rothe sued after the job was awarded to the other company.

The Court recognized that race-based remedial programs to cure the problems of past discrimination are acceptable. However, before Congress (or any other governmental entity) can enact such statutes, it must first demonstrate a need for that remedial program because of proven past discrimination. In this case, the record surrounding Congress' enactment of that particular statute did not contain a "strong basis in evidence" of past discrimination, thus the statute was unconstitutional.

It must be noted that the Court ruled solely on 10 U.S.C. § 2323. The Court did not rule on any other federal, state, or local enactments setting minority participation goals. At this point, it is unclear whether other programs will be found to be unconstitutional based on this rationale, but each bidder may want to consult its lawyer, if an RFB/IFB contains explicit race-based criteria.

By Ralph Germany

Does She or Doesn't She? Authority to Bind the Government

Fundamentals of contracting require that the person making the contract have the authority to bind the party for whom or which he or she works. This principle is true in public and private contracts. We hammer on this point in all of our client seminars. The point bears repeating once more.

In *Southwestern Security Services, Inc. v. Dept of HS*, Southwestern Security Services entered into a unit price contract, before Katrina, to provide security forces in southern Louisiana. When Katrina hit squarely in Southwestern's service area, Southwestern received a call to provide security services for a number of federal installations. The person calling: the Contracting Officer's Technical Representative. The 'agreement': that the government would pay certain expenses above those allowed in the contract. The government's answer to Southwestern's later request for payment: No.

Why this result? Southwestern argued the contract was an "implied in fact" new contract, outside the existing contract. But the Technical Representative did not have authority to bind the government outside the contract. Southwestern argued the Technical Representative could bind the government under the contract. But the contract expressly stated that only the Contracting Officer could bind the government under the contract. Southwestern argued that the Contracting Officer ratified the Technical Representative's actions. But the Contracting Officer, when he first learned of the contractor's alleged agreement with the Technical Representative, stated that it was not, and had not been, authorized.

The lesson is one that is worth re-visiting each year: know the authority of the person who orders you to do extra work. On public jobs, it is usually a matter of asking the person for his or her authority. On private jobs, it can be more sensitive, but one must investigate. If the contract states that the architect cannot make a change in money or time, and if a mark-up of a shop drawing by the architect would be such a change, then the contractor should not act on

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the mark-up until it has given notice to the owner that the change to the shop drawing is a change and received a directive from the owner's project manager to proceed.

By Mabry Rogers

No-Damage-For-Delay Provision Held Invalid in Virginia

In April, the Supreme Court of Virginia in *Martin Bros. Contractors, Inc. v. Virginia Military Institute* upheld a statute prohibiting no-damage-for-delay provisions, which purport to make a time extension the sole and exclusive remedy available to a contractor for owner-caused delay.

Martin Bros. (Martin), a contractor, entered into a public construction contract with the Virginia Military Institute (VMI) for the renovation of its main dining facility, Crozet Hall. Due to changes in the project requested by VMI, completion of the project was delayed by 270 days. VMI was entirely responsible for the delays. The contract contained a provision that, in the event of delay, only certain categories of site direct overhead damages were recoverable, and which also barred any recovery of home office overhead damages. Relying on the limitations, VMI refused to pay any site damages beyond $99,646.20, which VMI determined to be allowable site direct overhead, and refused to pay any home office overhead damages.

Martin filed suit against VMI, arguing that Virginia law made the damage limitation relied upon unenforceable as against public policy and, therefore, it could not be used to limit Martin's recovery for owner-caused delay. VMI insisted that the limitation was an enforceable liquidated damages provision. The lower court agreed with VMI and under freedom of contract principles granted its motion for summary judgment, dismissing Martin's complaint and limiting its damages.

On appeal, the Virginia Supreme Court reversed. The high court ruled that any provision in a public contract that purports to limit or restrict a contractor's right to recover delay damages is void as against public policy (subject to certain exceptions). Refuting VMI's position that the provision involved liquidated damages, the court reasoned that it was not an agreed formula for the calculation of delay damages and, therefore, was not a liquidated damages provision. Instead, the contract acted as an absolute bar to legitimate delay damages incurred by Martin and, therefore, was void and unenforceable under Virginia law.

Individual jurisdictions are split as to the enforceability of so-called no-damage-for-delay provisions, making it critical that contractors and subcontractors confirm whether such provisions are effective in each state. This case demonstrates that where such provisions are deemed void, creative attempts to circumvent the prohibition by limiting or liquidating the available damages may also be rejected. Moreover, courts may find "limited" damages-for-delay provisions like the one in this case to be just as unenforceable as those purporting to bar all damages for delay.

By David Hill Bashford and Nick Voelker

"I Didn't Sign Up For That—Knowing the Limits of your Guarantee Obligations"

In *Builders Supply Co., Inc. v. Czerwinski*, the Supreme Court of Nebraska reminded the construction industry of the potential for surprise liability in guarantee agreements. When a guarantor failed to explicitly limit her liability to a cap agreed to under an earlier credit agreement, the court interpreted the language of an absolute guarantee strictly against the guarantor.

The case involved four parties common to 'Mom and Pop' small commercial construction: Mom, Pop, their Company, and the Supply House. The basic facts are that Company entered into a credit agreement with Supply House and collateralized the credit agreement with a deed of trust on Company's office building. The credit agreement was limited to an amount of $525,000. Later, Mom and Pop executed an absolute and unlimited guarantee in favor of Supply House, which did not reference the $525,000 limitation of liability in the earlier credit agreement.

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A few years later, Pop requested that Supply House release the deed of trust, which it did, arguably without Mom's knowledge. Company continued to use its credit line, but Pop died and Company filed bankruptcy. Supply House sued Mom under the absolute guarantee, but Mom raised two defenses. She said that Supply House impaired the collateral that was available to pay the debt and that she owed nothing; alternatively, Mom argued that her liability was limited to $525,000.

The court ruled against Mom, dispatching her first argument on the basis that after Supply House had released the deed of trust, Mom had issued numerous subsequent deeds of trust on Company's office building. The court said explicitly that Mom, not Supply House, impaired the collateral. Mom's second argument failed because the court, while acknowledging that multiple documents part of the same transaction may be read together as one contract, found that the guarantee agreement was independent from the underlying credit agreement. A lack of any cross-referencing between the two contracts made it unnecessary to read the $525,000 limitation of liability into the otherwise plain language of the absolute guarantee.

Guarantee agreements – such as personal indemnity agreements to bonding companies – should always be entered into carefully. If a guarantor intends to rely on collateral to satisfy any part of the debt, the guarantor should require that it be given notice of the disposition of any collateral in the guarantee agreement itself and should further take no steps that would impair the collateral, independently from the principal's actions. Additionally, if the guarantor wants to rely on any part of an earlier transaction or course of dealing between the principal and the obligee, it should make sure all pertinent terms from those earlier dealings are embodied in the guarantee agreement itself. Following these prudent practices will help avoid surprise and allow guarantors to make accurate business decisions based on the amount of exposure and risk they are willing to accept.

By Jonathan Head

Bradley Arant Lawyer Activities:

Jim Archibald, **Axel Bolvig**, **Doug Patin**, **David Pugh**, **Bill Purdy**, **Mabry Rogers**, **Wally Sears**, and **David Taylor** are named in the 2009 edition of *The Best Lawyers in America* in the specialty of Construction Law.

In late 2008, several BABC Construction Practice Group attorneys wrote portions of the recently published *Alabama Construction Law Manual* (West 2008). The authors included **Jim Archibald**, **Keith Covington**, **Ed Everitt**, **David Hume**, **Arlan Lewis**, **Luke Martin**, **David Owen**, and **Wally Sears**. Several other BABC attorneys authored other portions of the Manual, including **Helen Ball**, **Charlie Beavers**, **Patrick Darby**, **Chris Grissom**, **Rod Kanter**, and **David Roth**. This Manual has been recently updated by **Jim Archibald, Keith Covington,** and **Jeff Peters**.

Jim Archibald and **Wally Sears** recently updated the Alabama section of the *State-by-State Guide to Construction Contracts and Claims.*

David Hume recently updated the Alabama section of the *50 State Lien Law Handbook*.

Jeremy Becker-Welts, Axel Bolvig, and **Joel Brown** presented "Federal Construction Projects: Finding, Pricing, and Managing the Work" in Birmingham on May 21, 2009.

Jeremy Becker-Welts, Bill Purdy, and **Joel Brown** presented "Federal Construction Projects: Finding, Pricing, and Managing the Work" in Jackson on June 4, 2009.

David Taylor spoke in June at the Construction Specifications Institute's "Construct2009" national convention in Indianapolis on "Who Owns the Float." He also spoke in June at the Tennessee CSI Convention of the American Subcontractors Association on "Retainage and Enforcing Lien Rights."

Jeremy Becker-Welts, Joel Brown, and **David Pugh** presented a seminar in conjunction with the ABC in

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Birmingham on July 16, 2009, entitled “Finding and Building Federal Projects”

Joel Brown spoke at the Independent Electrical Council Meeting in Birmingham on August 10, 2009 about “Finding, Bidding, and Managing Federal Projects”

Michael Knapp taught a course entitled, “Advance Topics in Engineering Law” at Misr University of Science and Technology in Cairo, Egypt from August 8-12. The course is a master’s level course in conjunction with the University of Alabama-Birmingham.

Frank Caprio and **Doug Patin** will be presenting a seminar entitled “Competing for U.S. Government Contracts in the United States” on September 22 and 23 in London, England.

David Taylor recently published an article which will appear in the upcoming volume of the Institute of Real Estate Management Magazine: "Myths and Realities of Payment and Performance Bonds"

Arlan Lewis will be speaking at the ABA National Conference for the Minority Lawyer in Philadelphia, PA on September 24-25, 2009. The session in which Arlan will participate is entitled “The New New Deal: Transactional Skills for a Changing Environment” and is being jointly presented by the ABA Forum on the Construction Industry and the ABA Business Law Section.

Bryan Thomas completed the Bibb Allen Trial Academy sponsored by the Alabama Defense Lawyers Association.

Arlan Lewis and Rhonda Caviedes will be attending the 2009 Fall Meeting of the ABA Forum on the Construction Industry on October 15-16, 2009 in Philadelphia, PA.

It is with mixed emotions that we report that **Donna Crowe** and **David Hume** have left Bradley Arant Boult Cummings to take in house positions in two respected construction industry participants. We would like to thank Donna and David for their years of service and for the time each dedicated to the firm and its construction clients. We wish each the best of luck in their new endeavors.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

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Robert J. Symon (d.c.)
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Darrell Clay Tucker, II
D. Bryan Thomas
Nicholas J. Voelker (c)

Don't Forfeit Future Claims in a Contract Modification

The United States Court of Appeals for the Federal Circuit recently reversed a trial court's award of damages to a contractor who signed a release of liability. At issue in the case was whether a contractor, who released the government from "any and all" liability upon an initial contract modification, was later entitled to damages for cumulative impact attributable to the modification.

In *Bell BCI Co. v. United States*, the contractor agreed to build a five-story laboratory building for the government. Several months into the construction, the government expanded the plans to include a sixth floor. The contractor agreed to a daily liquidated damages amount and also agreed to meet fourteen revised substantial completion milestones. In exchange, the government paid the contractor an additional $2.2 million as a full and equitable adjustment for all delays stemming from the modification. The modification included a release whereby the contractor released the government from "any and all liability" under the contract attributable to the modification at issue.

After missing thirteen of the fourteen milestone dates, the contractor requested an equitable adjustment for cumulative impacts. At trial, the court drew a distinction between a "delay" claim and a "cumulative impact" claim and stated that the release language in the modification did not address cumulative impact damages. Accordingly, the trial court awarded the contractor more than $6 million in damages on its cumulative impact claim. The appellate court reversed this decision on the grounds that the language in the modification was sufficiently broad to encompass cumulative impact damages.

The Court of Appeals did not question the trial court's finding that the contractor suffered a cumulative impact. Rather, the appellate court considered whether the contractor had released the government

Inside:

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from liability for that impact. The court determined that the modification language releasing the government from "any and all liability" was unambiguous and that the Contractor's claims for cumulative impact were barred by this modification. The appellate court noted that if the parties plan to leave some issues open and unsettled, their intent should be made clear.

The practical implication of this holding is simple: be mindful of the scope of the releases or waivers that you sign. If possible, do not sign a release that waives all claims when in the midst of construction, as unforeseeable issues could arise. If you must sign a release, to the extent possible you should carve out exceptions in this release for unknown cumulative impact along with any known claims. This is achievable in Federal contracts; in other public contracts, and in private contracts, a reservation of rights can be very difficult to negotiate. If you always remember that a release may be viewed as a binding contract which may have serious consequences on your ability to recover in the future, you will more likely treat a release as you would any other significant contract document.

By Jonathan Cobb

Arbitration: Alabama Adds Another Advantage

Arbitration clauses are common in construction contracts. Generally, arbitration allows parties to have disputes heard more quickly, on average, than in a courtroom. It is meant to offer a cost-effective alternative to litigation. It provides an opportunity to select an arbitrator(s) with specific experience in construction issues, which can simplify the sometimes difficult task of explaining complex construction disputes.

The Alabama Supreme Court recently confirmed the power of arbitral bodies to determine whether a party has satisfied all prerequisites for arbitration. Specifically, the Court held that the arbitrator, not the court, is to determine whether a party has done everything required by the arbitration clause in the parties' contract as a condition to arbitration.

The dispute in *Brasfield & Gorrie, LLC v. Soho Partners*, LLC, involved a claim for amounts owed to the general contractor by the owner under a construction contract. The prime contract contained provisions requiring a party seeking arbitration to submit the dispute to the architect and to mediate the dispute before pursuing a claim in arbitration. The contractor submitted a demand for arbitration, and the owner filed a lawsuit to stop the arbitration based on the contractor's alleged failure to submit the claim to the architect and to mediate before demanding arbitration. In response, the contractor argued that the question of whether it had satisfied all pre-conditions to arbitration was one for the arbitrator to make. The trial court rejected the contractor's argument and stopped the arbitration.

The contractor appealed the trial court's decision to the Alabama Supreme Court, which reversed the trial court's opinion. The Court held that the question of whether the contractor had complied with all contractual provisions was a decision for the arbitrator, not the court. The *Brasfield & Gorrie* decision shows an increasing willingness by the courts to enforce arbitration clauses as written in construction contracts by the parties. It further demonstrates that when parties agree to arbitration, the courts are going to defer to the arbitrator's decision on as many issues as possible, including, as in this case, questions regarding whether a party has the right to pursue its claim in arbitration.

By Darrell Tucker

South Carolina Modifies Its Lien Law

To perfect and enforce a mechanic's lien in South Carolina, the person asserting the lien (1) must serve upon the owner or person in possession and file with the register of deeds or clerk of court a notice or certificate of lien containing the lien amount, a description of the real property, and other required information "within ninety days after he ceases to labor on or furnish labor or materials for such building or structure"; (2) must commence a lawsuit seeking to enforce the lien within six months after ceasing to provide labor or materials for such real property; and (3) must file a notice of the pending action within six

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months after ceasing to provide labor or materials for such real property.

In June 2009, the South Carolina legislature amended various portions of the South Carolina lien law, including adding a provision allowing landscape service providers to take advantage of the lien statute's protection. The new law also includes a new requirement for a lien claimant to provide the Clerk of Court or Register of Deeds proof that it is licensed or registered, if required by law to be licensed or registered. The revised statute also provides a penalty for the filing of a frivolous lien of up to $5,000, the loss of contractor registration or license, or both. In addition, the revised statute provides procedures to dissolve a mechanic's lien when the party asserting the lien fails to perfect its lien by filing suit.

The new legislation affects other code sections as well. It is now a misdemeanor to engage in the business of residential building or residential specialty contracting without registering with the commission or procuring a license from the commission, or to file false information to the commission in order to obtain a license. Additionally, a party who is required by law to be licensed, but that has not filed for a license or registered with the commission, may not file a mechanic's lien or bring an action at law or in equity to enforce the provisions of a construction contract.

As is true in each jurisdiction, if you do work in South Carolina, you should be aware of the general lien requirements to ensure compliance with lien deadlines or filing requirements. Moreover, an owner or developer doing business in South Carolina should be aware of the changes as they may provide additional defenses to contractor lien claims.

By Nick Voelker

Government Contractors Beware: Certify Carefully

In *Daewoo Engineering and Construction Co., Ltd. v. United States*, the U.S. Court of Appeals for the Federal Circuit loudly proclaimed, again, that certifying claims on federal projects is very serious business. The claim at issue arose on an $89 million contract with the U.S. Government to build a fifty-three mile road around the island of Babeldaob in the Republic of Palau in the Northern Pacific. After experiencing significant delays during the first year of performance, the Contractor submitted a certified claim under the Contract Disputes Act for $64 million, including $13.4 million for additional costs previously incurred and $50.6 million for additional anticipated costs to complete the work. As required, the Contractor certified that the claim was made in good faith; that the supporting data were accurate and complete; and that the amount requested accurately reflected the contract adjustment for which the Contractor believed the Government was liable. After trial, the U.S. Court of Federal Claims concluded that the claim was submitted simply as a "negotiating ploy" and that the Contractor did not honestly believe that the Government was liable for the amounts stated. In particular, the Court determined that the portion of the claim relating to future costs of $50.6 million was fraudulent for various reasons, including: the amount assumed, without analysis, that the Government was responsible for all project delay; the Contractor computed the claim amount without the assistance of outside experts; the Contractor failed at trial to justify or explain the amount and its expert witnesses virtually ignored it; and the individual who had certified the claim gave false testimony.

On appeal, the appeals court upheld these findings and rejected the Contractor's argument that a claim is fraudulent only if it is based on false facts. The court held instead that a claim that rests on a baseless calculation is a fraudulent claim. The consequences were brutal: (1) an award for the Government and against the Contractor of $50.6 million (the entire amount of the fraudulent portion of the claim) for violating the anti-fraud provision of the Contract Disputes Act; (2) an award for the Government and against the Contractor of $10,000 as a penalty for violating the False Claims Act; and (3) a forfeiture, under a third federal law, of the Contractor's entire $64 million claim by virtue of containing a fraudulent component. Lesson learned: Certify carefully because the consequences of a fraudulent claim are severe.

By Eric Frechtel

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Where Does the Obligation to Indemnify End?

Construction contracts often contain broad indemnity language, such as a subcontract which requires a subcontractor to defend and indemnify the general contractor and others (owner, design professional, etc.) from claims arising out of the subcontractor's negligence. But what happens when the general contractor agrees to indemnify a different contractor on the project? Is the general contractor allowed to pass its own indemnity obligation on to the subcontractor when a claim arises, in part, because of the subcontractor's negligence? The Alabama Supreme Court recently addressed this issue in *Doster Construction Co. v. Marathon Electric Contractors, Inc.*, and found that the general contractor could hold the subcontractor responsible for the third-parties claim.

In this case, Doster (the general contractor) subcontracted with Marathon Electric. The subcontract contained broad indemnity language obligating Marathon to indemnify Doster from all claims arising out of Marathon's negligence. Doster also subcontracted with Steel City for crane and equipment support services on the project. While unclear from the facts provided in the Court's opinion, it appears Doster unintentionally agreed to indemnify Steel City when one of Doster's employees signed a Steel City invoice for overtime work containing form indemnity language.

During the course of the project, one of Marathon's employees was injured after falling from a scissor lift when the crane he was repairing collided with the scissor lift, knocking it over. The employee sued Doster and Steel City for damages. Pursuant to the subcontract, Marathon was obligated to defend and indemnify Doster from this claim. Under the form indemnity language on the overtime invoice, Steel City tendered defense of the employee's claim against Steel City to Doster. Doster refused to honor the indemnity demand, and Steel City sued Doster alleging breach of the indemnity obligation. Doster, in turn, tendered Steel City's indemnity claim to Marathon under the indemnity obligation of their subcontract, but Marathon refused, contending its obligation to indemnify was fulfilled by defending the original claim brought against Doster. Doster then brought a third party claim against Marathon for indemnity, resulting in the decision.

Marathon eventually obtained summary judgment on Doster's demand for Marathon to indemnify the Steel City claim. Doster appealed, and the Alabama Supreme Court overturned the trial court's ruling, holding that because Steel City's claim arose because of Marathon's negligence (Marathon's employee had been found to be partially negligent), Marathon was obligated to indemnify Doster from Steel City's claim.

While the facts of this case deal with indemnity arising from a subcontract, the court's holding should have broad application. Those who agree to indemnify another pursuant to broad indemnity language should remember that the obligation to indemnify may extend to other claims for indemnity, unless, of course, there is a specific exclusion of such claims. Appropriate attention to the indemnity language may limit such claims.

By Ed Everitt

Problems With Collecting Liquidated Damages For Contract Cancellation

A recent Missouri case demonstrates the difficulty contractors, particularly storm or accident repair contractors, may have in enforcing cancellation fees in their contracts. At root, the court in *Repair Masters Const., Inc. v. Gary* could not approve a percentage-based cancellation fee when the total amount of the work, and thus the potential cancellation fee, was unknown at the time of contracting.

A homeowner whose house burned hired a contractor to board up the house until permanent repairs could be made. The contractor presented the homeowner with a contract, within hours of the accident, containing the following provision: "Purchaser further agrees to pay Contractor an amount equal to 15% of the total contract price should Purchaser cancel this contract for any reason prior to the initiation of work on the Purchaser's roof." The homeowner signed the contract.

As is common following a casualty loss, the insurer, contractor, and homeowner's adjuster nego-

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tiated over the amount of the loss over an extended period. As is also common, the insurer did not agree to pay the amount that the contractor said was necessary to do the job. Faced with a shortfall in insurance funds, the homeowner canceled the contract with the repair contractor and hired another company to make the repairs at the insurer's price. The contractor sued the homeowner on the cancellation provision.

The homeowner argued successfully that the cancellation provision was unenforceable as applied. The Court's result reflects a belief that the contingent cancellation fee penalized the homeowner unfairly.

Contractors who have good business reasons for including cancellation fees in their contracts should avoid uncertainty in those fees. The court suggested that the fee might have been acceptable had it been tied to a fixed estimate of costs at the time of contracting. Perhaps a remediation or renovation contractor, *i.e.*, those who very often do not know the final scope of the work at the time of contract, should consider a contract that commits the homeowner to an initial scope but allows for later addenda, including appropriate cancellation fees, as the scope grows.

By Jonathan Head

Bradley Arant Lawyer Activities:

Jim Archibald, **Axel Bolvig**, **Doug Patin**, **David Pugh**, **Bill Purdy**, **Mabry Rogers**, **Wally Sears**, and **David Taylor** are named in the 2009 edition of *The Best Lawyers in America* in the specialty of Construction Law.

In late 2008, Several BABC Construction Practice Group attorneys wrote portions of the recently published *Alabama Construction Law Manual* (West 2008). The authors included **Jim Archibald**, **Keith Covington**, **Ed Everitt**, **Arlan Lewis**, **Luke Martin**, **David Owen**, and **Wally Sears**. Several other BABC attorneys authored other portions of the *Manual*, including **Helen Ball**, **Charlie Beavers**, **Patrick Darby**, **Chris Grissom**, **Rod Kanter**, and **David Roth**. The *Manual* has been recently updated by **Jim Archibald, Keith Covington,** and **Jeff Peters**.

Jim Archibald and **Wally Sears** recently updated the Alabama section of the *State-by-State Guide to Construction Contracts and Claims*.

David Taylor's article on Payment and Performance bonds, "Myths and Realities," was published in the October, 2009, *Journal of Real Estate Management*.

Keith Covington published an article entitled "Court Revives OSHA's Multi-employer Citation Policy" in the October/November 2009 edition of the *Alabama Construction News*.

Keith Covington was also published in the November 2009 edition of the *Construction Business Owner*. The article is entitled "E-Verify Now Required for Federal Contractors."

Jeremy Becker-Welts, Joel Brown, and **David Pugh** presented a seminar in conjunction with the ABC on July 16, 2009, entitled "Finding and Building Federal Projects."

Joel Brown spoke at the Independent Electrical Council Meeting on August 10, 2009 about "Finding, Bidding, and Managing Federal Projects."

Michael Knapp taught a course entitled, "Advanced Topics in Engineering Law" at Misr University of Science and Technology in Cairo, Egypt from August 8-12. The course was a master's level course in conjunction with the University of Alabama-Birmingham.

Jeff Peters made a presentation entitled "Navigating Troubled Waters: Development & Leasing Issues in a Challenging Economy, Mechanic's Liens and Other Construction Related Issues" to the N.A.I.O.P.--Commercial Real Estate Association and C.C.I.M. in September.

Joel Brown presented a federal contracting seminar to the Middle Tennessee branch of the Society for Estimating Engineers on September 2, 2009 in Nashville.

Joel Brown and **Doug Patin** presented a federal contracting seminar in Nashville on September 15, 2009 for the Tennessee AGC.

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David Taylor delivered a presentation to Pinnacle Bank and SunTrust Bank concerning lien law and its impact on bankers in Nashville.

Frank Caprio and **Doug Patin** presented a seminar entitled "Competing for U.S. Government Contracts in the United States" on September 22 and 23 in London, England.

Arlan Lewis spoke at the ABA National Conference for the Minority Lawyer in Philadelphia, PA on September 24-25, 2009. The session was entitled "The New New Deal: Transactional Skills for a Changing Environment" and was jointly presented by the ABA Forum on the Construction Industry and the ABA Business Law Section.

Jonathan Head taught a seminar concerning e-discovery on September 25, 2009.

Arlan Lewis, Rhonda Caviedes, and **Stanley Bynum** attended the 2009 Fall Meeting of the ABA Forum on the Construction Industry on October 15-16, 2009 in Philadelphia, PA.

BABC co-hosted the ABC Economic Forecast seminar, titled "2010 Economic Forecast: Where the Projects Are" on October 22, 2009.

Mabry Rogers Attended Princeton University Symposium, "Managing the Challenges of Scarcity: The Critical Path for Global Construction," on November 5-6, 2009.

Keith Covington spoke on November 6, 2009 at the Home Builders Association of Alabama Conference concerning 'Chinese Drywall'.

David Taylor has been selected to facilitate a 'Construction Financing' meeting of bankers, developers, subcontractors, and general contractors in Nashville on November 12, 2009.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

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CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Your Work Stinks! – Insurance Coverage for Odor Remediation as "Physical Injury to Property"

An insurer has two principal duties arising from a Commercial General Liability (CGL) policy. The first is the duty to provide a defense for its insured (duty to defend) and the second is the duty to pay for covered losses (duty to indemnify). Generally, courts require an insurer to defend cases where a reasonable view of the facts alleged could render the insurer responsible, even if the facts necessary to prove coverage are not known when the insured is sued. The practical effect of a broad duty to defend, coupled with a narrower duty to indemnify, is that insurance companies often end up paying for losses where coverage is questionable when the cost of the defense would be close to or higher than the amount of the alleged loss.

The United States Court of Appeals for the First Circuit – one of the eleven circuit courts just below the U. S. Supreme Court in the federal system – recently held that an odor allegedly caused by defective carpeting in a building could constitute "physical injury to property" such that an insurer has a duty to defend under the terms of a CGL policy. The impact of this ruling is that CGL insurance carriers faced with similar allegations must provide a defense, though not necessarily indemnity for the underlying damages, to their policy holders.

In *Essex Insurance Company v. Bloom South Flooring Corporation*, a general contractor was an additional insured on its subcontractor's CGL policy. The subcontractor was responsible for installing carpet in an office building, which required testing and cleaning an existing concrete floor prior to installation. The occupants of the building noticed a foul odor and instructed the general contractor to fix the problem. The general contractor removed the installed carpet and its adhesive, and re-carpeted the floor. This effort did not fix the problem and actually

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made it worse. After disputing the cause of the odors with the subcontractor, the general contractor incurred $1.4 million in remediation costs and sued the subcontractor to recover them. During the course of the remediation, the general contractor demanded a defense from its insurer based on the owner's demands for remediation and indemnity for the costs it incurred. The insurer refused. The general contractor also sued the subcontractor, which again demanded a defense from the insurer. The insurer filed a declaratory judgment action, asking the court to determine it has no duty to defend its insured.

The court began by finding that the odor, which was alleged to have permeated the building, constituted "physical injury" under the policy. Thus, the alleged damage was within the scope of the insured's coverage. Next, the court turned to the business risk exclusions of the CGL policy. It held that the odor damaged the existing concrete floor, which was real estate rather than the subcontractor's "work" or "product." Because the property damage could not be remedied by "the repair, replacement, adjustment or removal" of the insured's work – special air venting was required to remove the odor, in addition to repairs – the "impaired property" exclusion did not apply. These holdings placed the damage arguably within the coverage clause and arguably outside the exclusions, which was all that was necessary to require the insurer to defend its insureds.

When issues arise on a construction project, owners, contractors, subcontractors, and others involved should consider each of their insurance policies and whether damages could be covered by one of the parties' policies. Insurance policies and their exclusions are often complex and are governed by laws which may vary from state to state. Thus, it is always advisable to contact counsel for advice regarding coverage. If there is any possibility of coverage, it is worth putting the insurer on notice to initiate an insured's duty to defend.

By Jonathan Head

Termination for Convenience Clauses: Why They May Be Inconvenient and How to Use Them Effectively

Termination for convenience clauses have become popular provisions in many construction contracts. They allow an owner or contractor to terminate obligations under a contract without alleging any fault. A typical termination for convenience clause might read "Owner may at any time and for any reason terminate the contract at Owner's convenience. At such time, Contractor must cease all activities under the contract." As these clauses have become more common in the construction industry, courts have struggled over their effect and scope. Generally, courts have been unwilling to interpret these clauses as providing an owner carte-blanche power to terminate the contract. Instead, some courts have required a showing of good faith before enforcing a termination for convenience clause. However, few courts have explained the extent of this good faith obligation.

In *Questar Builders, Inc. v. CB Flooring, LLC,* the Court of Appeals in Maryland confronted this issue. The court found that the duty of good faith which the court held was implied in termination for convenience clauses afforded owners discretion to terminate a contract so long as termination followed the reasonable expectations of the contractor.

In this case, a general contractor for a luxury apartment project subcontracted the flooring installation. The subcontract included a termination for convenience clause. Before the subcontractor started its work, the general contractor terminated the subcontractor citing the convenience clause. In response, the subcontractor filed suit for breach of contract. One of the general contractor's primary defenses focused on the validity of the termination for convenience clause.

The court considered whether the general contractor had exercised good faith such that it had a right to invoke the termination for convenience clause. Specifically, it considered the behavior of the contractor in the weeks prior to termination. This gave the judge serious pause because the general contractor contacted another business to organize a proposal for

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the floor installation and failed to express any concerns regarding performance to the subcontractor before doing so. The judge determined that the convenience clause did not provide a limitless power to terminate and awarded damages to the subcontractor for the general contractor's breach of contract.

On appeal, the general contractor claimed that the trial court did not provide an adequate explanation of its reading of the convenience clause. The court of appeals agreed and responded by reading a duty of good faith into all termination for convenience clauses. In explaining its rationale, the court looked to the widespread use of the good faith standard across the country. According to the court, a termination for convenience clause affords a general contractor discretion to terminate in the event of some change in circumstances that makes a project economically unfeasible like, for instance, a rapid change in market conditions. However, such discretion must be exercised in accordance with the reasonable expectations of the subcontractor or other party.

As a practical matter, owners and contractors should ensure that they are acting reasonably before terminating another party based on a termination for convenience clause. Otherwise, they may face lawsuits for lost profits and other damages by the terminated party. Attempts by owners or contractors to "shop around" after executing a contract will not be tolerated. Thus, to avoid liability for breach of contract, owners and contractors should be cautious when exercising their right to terminate under a convenience clause.

By Aman Kahlon

Even Minor Defects in Liens Can Result in Contractors Losing Their Lien Rights

Many areas of the law provide a party who makes an error, whether procedural or substantive, with relief to correct the error, generally under principles of fairness and equity. States' lien laws are often not so forgiving. A defect in a lien, even a minor one, can render a lien invalid. Most state courts strictly interpret statutory procedural requirements for liens. Contractors should be aware that the deadline to file a lien is strict, that a lien with a defect will often not be enforced, and that a defective lien cannot be cured once the deadline has passed.

Because of this strict enforcement, attorneys who notice such defects will wait until after the contractor's lien deadline expires and then move to dismiss the lien. Two recent state court cases, one from Illinois and the other from Kansas, remind us that this scenario can happen in residential and commercial projects involving minor defects in liens.

In *Weydert Homes, Inc. v. Kammes*, a general contractor filed an action to enforce a lien on real property for work and materials performed on the construction of a residence in Sycamore, Illinois. Illinois lien statutes require that before any monies are to be paid on a project, "a contractor must provide to the owner a statement in writing, under oath or verified by affidavit, of the names and addresses of all parties furnishing labor, services, material, fixtures, apparatus or machinery, forms or form work and of the amounts due or to become due." In *Weydert*, the owner requested, and the general contractor provided, such a statement. However, the contractor statement was not verified or given under oath (i.e., notarized). The owner argued that because the Illinois lien statutes are strictly construed, this error, regardless how minor, rendered the lien invalid. The trial court agreed and granted the owner's motion for summary judgment as to the lien claim. On appeal, the Illinois Court of Appeals affirmed, holding that the Illinois lien statutes are to be strictly construed and, therefore, because the contractor's statement was not in strict compliance with the statute, the lien filed by the general contractor was invalid.

The same strict compliance lien requirements are evident in commercial projects. In *National Restoration Co. v. Merit General Contractors, Inc.*, a general contractor on a commercial project in Overland Park, Kansas moved for summary judgment dismissing its supplier's lien because the supplier's lien mistakenly noted the general contractor as "Merit Construction Company, Inc." The general contractor's correct corporate name was "Merit General Contractors, Inc." The trial court granted the general contractor's motion for summary judgment as to the lien claim, and the supplier appealed. The Kansas

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Court of Appeals affirmed and held that the supplier had notice of the correct corporate name of the general contractor and, therefore, because Kansas law strictly construes its lien law, the supplier's lien was invalid. Because the supplier's time to file a lien had expired, it was unable to amend its lien, and it lost its lien rights entirely.

Contractors beware – before the start of construction review the relevant lien law and pay close attention to the details to ensure that you preserve your rights. Some states like Illinois and Ohio even require pre-construction notice, and the failure to review the lien law and recognize these requirements prior to project commencement can be fatal. In this economy, with many entities filing bankruptcy and many others in financial distress, a valid lien can determine whether or not you will ever receive payment. Moreover, an invalid lien can be the lever for an owner to argue that a contractor or subcontractor has improperly clouded the owner's title, giving the owner a claim against the lien claimant. Because the risk of filing an invalid lien is significant, contractors should seek advice from a construction attorney before starting construction in a new state and should seek assistance when filing liens to ensure compliance with each state's individual nuances.

By Nick Voelker

Not in the Contract, Not Part of the Deal

A recent case out of New York is a good reminder to all contracting parties to pay particular attention to what is (and what is not) included in the final, executed version of their contracts. Contractors and owners should not rely on documents presented and discussed during negotiations when these documents are not included in the signed contract.

In *Century-Maxim Construction Corp. v. One Bryant Park, LLC,* the concrete trade contractor on a skyscraper project in midtown Manhattan sued the developer and construction manager for acceleration damages. The contractor claimed that the construction manager represented at various pre- and post-bid discussions that the work would be completed in three separate phases. It claimed that the construction manager had presented a schedule which reflected this staged plan for construction. According to the contractor, this schedule showed that concrete work would take between 24-27 months, and it showed sufficient float as well as sufficient periods of slowed or suspended steel erection to allow the contractor to keep pace with steel erection, as it was required to do by New York City code.

The contractor claimed that from the outset of the project, the schedule was delayed six months through no fault of its own. As a result, the schedule was compressed and the periods of slowed or suspended steel erection were removed from the schedule. The concrete contractor claimed that it was forced to accelerate its work to keep pace with the steel contractor. It sought $22 million in acceleration damages.

In response, the construction manager and developer argued that the schedule upon which the contractor relied was not referenced in the contract documents. The contract contained a clause stating that the parties were not relying on any previous conversations, agreements, or documents, other than those specifically mentioned (a merger clause). It also contained provisions which directly contradicted the concrete contractor's allegations regarding the schedule. So, the construction manager and developer argued that this alleged schedule could not be the basis for an acceleration claim.

The concrete contractor's acceleration claims were dismissed. The court held that the contractor was not entitled to rely on a document which was not referenced or incorporated into the contract, especially in the situation where the contractor's allegations regarding this schedule were directly contrary to the plain terms of the contract. This should be a reminder to all owners and contractors to be sure to base your price and plan for construction on the documents which are included in the executed contract. It is a risky proposition indeed to rely on representations made during negotiations of a contract, especially when these representations are not included in the final, executed contract.

By Luke Martin

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Site Inspection Clauses: Preventing Loss for Those Unexpected Conditions

Many owners attempt to shift the risk (and extra costs) associated with unexpected project conditions to the general contractor by inserting site inspection clauses in their contracts. Typically, owners provide contractors a preliminary report of the site conditions in bid packages, but include a clause in the subsequent contract stating that the contractor has reviewed and familiarized itself with the project site, is aware of project conditions, and that it assumes full responsibility for any site conditions it may encounter. If there is no "differing site condition" clause in the contract, this provision attempts to push the risk of unknown site conditions to the contractor. The enforcement of these risk shifting clauses has been called into question by a recent case in Texas.

In *Mastec North America v. El Paso Services*, the general contractor who installed a gas pipeline (Mastec) sued the owner (El Paso) for the extra construction costs it incurred because of an excessive number of pipeline crossings These pipeline crossings did not appear on the drawings the owner provided with the bid package and resulted in almost five million dollars in extra costs. The owner defended the lawsuit by relying on clauses it included in the contract with the contractor which stated that the contractor was familiar with the pipeline route, including all subsurface conditions, and that the contractor agreed to construct the pipeline for a lump sum price regardless of the conditions it encountered. The trial court agreed with the owner and dismissed the case because the contractor had assumed the risk of subsurface conditions and therefore was not entitled to be reimbursed for the cost associated with the pipeline crossings.

The appellate court took a broader view and focused on the owner's representation that it had exercised due diligence to locate any pipeline crossings in the bid documents, which, in actuality, grossly misrepresented the number and location of pipeline crossings. The court also made the determination that the owner was in a much better position to determine the number and location of pipeline crossings. Thus, it reversed the trial court and ordered the owner to reimburse the contractor for the extra installation costs it incurred, despite the risk shifting site inspection clause. The court also indicated that it may be willing to take its logic a step further in the future and find that risk shifting site inspection clauses may not protect the owner when the bid documents misrepresent the nature and amount of the work to be performed.

Risk shifting site inspection clause will likely remain a contentious point between contractors and owners. Special attention should be given to such clauses and hidden conditions to proactively limit the potential problems for both owners and contractors. However, problems will arise because of site conditions and when they do, remember that a risk shifting site inspection clause may not provide the final answer, particularly where the owner makes an affirmative representation, in the contract itself, about a condition or fact which is material to the contract.

By Bryan Thomas

Bradley Arant Lawyer Activities:

Jim Archibald, **Axel Bolvig**, **Doug Patin**, **David Pugh**, **Bill Purdy**, **Mabry Rogers**, **Wally Sears**, and **David Taylor** are named in the 2010 edition of *The Best Lawyers in America* in the specialty of Construction Law.

Axel Bolvig, **Rick Humbracht**, **David Hymer**, **Joe Mays**, **Doug Patin**, **Bill Purdy**, **Mabry Rogers, Wally Sears**, and **David Taylor** have been selected as Super Lawyers 2010 for Construction.

Jim Archibald and **Wally Sears** recently updated the Alabama section of the *State-by-State Guide to Construction Contracts and Claims*.

Keith Covington published an article entitled "Court Revives OSHA's Multi-employer Citation Policy" in the October/November 2009 edition of the *Alabama Construction News*.

Keith Covington was also published in the November 2009 edition of the *Construction Business Owner*.

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The article is entitled "E-Verify Now Required for Federal Contractors."

David Taylor's article on Tennessee's retainage law, "Tennessee Retainage Law: Ignore at Your Peril," was published in the January edition of Tennessee Bankers Magazine.

David Taylor's article on dispute resolution entitled "Arbitrating and Mediating Real Estate Disputes" will be published in the March edition of the Institute of Real Estate Management Magazine.

BABC co-hosted the ABC Economic Forecast seminar, titled "2010 Economic Forecast: Where the Projects Are" on October 22, 2009.

Mabry Rogers Attended Princeton University Symposium, "Managing the Challenges of Scarcity: The Critical Path for Global Construction," on November 5-6, 2009.

Keith Covington spoke on November 6, 2009 at the Home Builders Association of Alabama Conference concerning 'Chinese Drywall'.

David Taylor facilitated a 'Construction Financing' meeting of bankers, developers, subcontractors, and general contractors in Nashville on November 12, 2009.

David Taylor recently chaired and spoke at a Tennessee Bar Association seminar entitled "Arbitrating and Mediating Construction Disputes".

Arlan Lewis, Rhonda Caviedes, and **Ed Everitt** recently participated in the ABA Forum on the Construction Industry's mid-winter conference in San Francisco entitled "Government Construction Contracting."

Ed Everitt's article "Mississippi Lien and Bond Law; Make Sure You Know Your Rights," was published in the First Quarter 2010 edition of Construction Mississippi, a special publication of the Mississippi Business Journal.

Bill Purdy, **Wally Sears**, and **Mabry Rogers** attended the annual meeting of the American College of Construction lawyers in San Diego in February. Bill is Program Chair for the meeting to be held in February, 2011.

David Taylor and **Bryan Thomas** will be presenting a session entitled "The Great Debate: Do You Arbitrate" at the national CONSTRUCT 2010 meeting in Philadelphia in May 2010.

It is with mixed emotions that we report that **Jeremy Becker-Welts** and **Mitch Mudano** have left Bradley Arant Boult Cummings. We would like to thank Jeremy and Mitch for their years of service and for the time they dedicated to the firm and its construction clients. We wish both of them the best of luck in their new endeavors.

We would also like to welcome **Aman Kahlon and Avery Simmons** to the firm's construction practice Group. Aman is practicing in our Birmingham office and Avery is practicing in our Charlotte office.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

NOTE: YOU CAN FIND THIS NEWSLETTER AND PAST NEWSLETTERS ON OUR WEBSITE. IF YOU ACCESS THIS NEWSLETTER ON OUR WEBSITE, CASE-LINKS WILL BE AVAILABLE UNTIL THE NEXT NEWSLETTER IS PUBLISHED. WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY GO TO WWW.BABC.COM/PG_CONSTRUCT.CFM OR CONTACT ANY ATTORNEY LISTED ON PAGE 8 OF THIS NEWSLETTER.

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NOTES

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CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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CGL Policies Cover Subcontractor Defects in Mississippi

The Mississippi Supreme Court recently settled a significant question regarding insurance coverage on construction projects in Mississippi. In *Architex Association, Inc. v. Scottsdale Insurance Co.*, the court ruled that a general contractor's Commercial General Liability (CGL) policy provides coverage for property damage caused by a subcontractor's defective work, thus bringing Mississippi in line with a growing majority of states which recognize that defective construction may constitute an 'occurrence' under a CGL insurance policy.

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The case arose out of the construction of a Country Inn and Suites in Pearl, Mississippi by Architex Association, Inc. (Architex), the general contractor. Architex hired various subcontractors to perform different aspects of the work. A dispute arose at the end of the project between Architex and the owner, with the owner withholding payment and alleging that Architex and its subcontractors caused property damage by knocking off a false chimney during construction (causing water damage) and failing to install adequate rebar in the foundation concrete. Architex notified its CGL carrier, Scottsdale, of the owner's claims, but Scottsdale declined to provide a defense or coverage under the policy, stating that there had not been an 'occurrence' which would trigger coverage. Architex then filed a third party complaint against Scottsdale for its failure to defend and indemnify under the CGL policy.

In Architex's suit against Scottsdale, the trial court granted summary judgment to Scottsdale, finding that there had been no 'occurrence' under the policy language because Architex's intentional act of hiring subcontractors set in motion the chain of events that led to the defective work. Previous Mississippi cases interpreting CGL policy language (not in the construction defect context) held that an 'occurrence' does not exist where the insured intentionally sets in motion the chain of events that lead to the property

damage. In the construction context, however, this rule can lead to inconsistent and confusing results, as it did in this case. Certainly the act of hiring a subcontractor should not preclude the possibility for CGL coverage. In many instances, hiring a subcontractor is absolutely necessary due to the need for a contractor with specialized knowledge and skill in a specific area, such as an insulator or an electrician.

The Mississippi Supreme Court reversed the trial court. The Court started its analysis by recognizing the purpose of a CGL policy—it is "designed to provide liability protection for the general contractor and [its] subcontractors for accidental, inadvertent acts which breach accepted duties and proximately cause damage to a person or property." The Court decided that an interpretation of Architex's CGL policy that precluded coverage for a subcontractor's defects would undermine the plain language and purpose of the CGL policy altogether. Accordingly, the Court held that the policy covered property damage caused by a subcontractor's defects.

Architex is a win for the entire construction industry because it makes clear that the hiring of subcontractors on a project will not negate coverage under a CGL policy. It makes clear that a claim of defective work by a subcontractor falls within the broad grant of coverage initially afforded by a CGL policy. However, it is important to note that the ruling does not address whether or not such coverage might be excluded under one of the CGL policy exclusions. The fact pattern of every case is different and ultimately must be evaluated in light of the applicable policy language and exclusions to determine whether coverage exists.

By Ed Everitt

Contractor Loses Big on Hurricane – *Force Majeure*

The federal appeals court which supervises the trial courts in Georgia, Florida, and Alabama has ruled—as a matter of law (thus, no trial, no discovery)—that a contractor could not win in its efforts to obtain compensation for *force majeure,* labor shortage, and contract interference claims. The appeals court extended its ruling in an earlier case involving the construction of a Marriott Hotel in south Florida, in applying very harsh risk-shifting provisions of the owner-contractor contract.

The case, *S&B/Bibb Hines PB 3 Joint Venture v. Progress Energy Florida, Inc.,* involved two power plants in Polk County, FL. During the project, four hurricanes struck the job. The contractor finished on time, but sought compensation for the impacts from these hurricanes. It argued that the hurricanes created job shortages and other damages that entitled it to extra compensation.

The court disagreed, citing the *force majeure* clause as expressly disallowing any compensation for such events, and reinforced its decision by citing the "no damages for delay" provision as shifting the risk of delay to the contractor. The court was clear that the owner could have allowed a change order for the hurricanes to the contractor but had no obligation to do so. Because the Owner did not have an obligation to issue a change order, the owner could not be in violation of its implied obligation to act in good faith in administering the contract.

The decision underscores the willingness (and enthusiasm) with which the particular appeals court applies typical risk-shifting clauses in Florida construction contracts, and applies them favorably to owners and against contractors. As the court put it in this case (and in several earlier Florida law cases), "[the contractor] could have increased its prices to reflect the risks it was assuming."

By E. Mabry Rogers

Failure to File a Timely Lawsuit Results in Contractor's Loss

The law requires that claims be brought in a timely manner. The failure to do has a harsh result – no recovery. The specific time period for bringing a claim varies. Because of a misunderstanding of the applicable time limitation and despite a potentially valid claim against the engineer, a Georgia contractor recently suffered this result when it waited more than four years to file a lawsuit against the engineer.

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The Georgia Court of Appeals took up the issue of whether a four (4) year statute of limitations for professional malpractice or a six (6) year statute of limitations for breach of contract applied to an owner's breach of contract claim against an engineer for failure to provide competent, professional design and engineering services. In *Jordan Jones and Goulding, Inc. v. Newell Recycling of Atlanta, Inc.*, the Georgia Court held that, although the owner's ("Newell"), claim was couched as one for breach of contract, it was actually a claim for professional malpractice based upon the engineer's ("JJ&G") alleged breach of its contractual duties to provide competent, professional design and engineering services. Therefore, the four (4) year statute of limitations for professional malpractice, not the six (6) year statute of limitations for breach of contract, applied to bar Newell's action against JJ&G.

Newell purchases and processes scrap metal, which it then resells. In 1997, Newell contacted JJ&G regarding design and engineering services for a new automobile shredding facility it wanted to build. Work was completed on the project in September 1999, and in May 2000, Newell informed JJ&G that the pavement around the shredding machine was cracking. In August 2004, Newell sued JJ&G, claiming that JJ&G failed to perform its services with that degree of care, skill, and ability ordinarily expected of a prudent design professional and engineers of similar circumstances.

JJ&G argued that Newell's Complaint asserted a claim for professional negligence, breach of an oral contract or breach of a contract partly written, all of which have a four (4) year statute of limitations in Georgia. The trial court disagreed.

The Court of Appeals reversed, reasoning that the Complaint demonstrated a professional malpractice claim, and all such malpractice claims are governed by the four (4) year statute of limitations.

Each state has its own statute of limitations periods for various causes of action, including case law that may interpret which limitations period applies to a particular set of facts. For this reason, consult an attorney early on to determine when the deadline expires to bring claim under the applicable state law. By failing to do so, you could end up like Newell in this case and be time-barred from bringing an action.

By David Hill Bashford & Nick Voelker

GC's Stinky Sinkhole Indemnity Claim Fails

The Tennessee Court of Appeals recently addressed a not uncommon liability scenario for a construction defect. The owner sued the general contractor, and the general contractor sued the supplier. Unfortunately for the GC, the third-party claim was barred by contractual limitations in the supply contract. The court in *Baptist Memorial Hospital v. Argo Construction v. Hanson Pipe and Products South* thus held that the GC was on its own with its smelly sinkhole problem.

The owner-hospital discovered a sinkhole in its parking lot after the completion of a sewage drainage project. It sued the GC which in turn sued the pipe supplier because it discovered that the internal steel reinforcement for the concrete pipe used in the project was incorrectly positioned. The supplier successfully based its refusal to indemnify upon the express limitations in its supply contract. The GC sued the supplier for *implied* or *equitable* indemnity. In other words, the GC's claim was not based upon the supply contract. The GC maintained that the time period for asserting the implied indemnity claim began to run when the defect was discovered – that is, when the sinkhole started to smell. The supplier argued instead that its supply contract stated that the supplier provided a one-year warranty from delivery only, and that the warranty provided for repair, replacement, or refund only. The supplier thus could not be liable for a general damages claim brought by the owner-hospital outside of one year.

In upholding judgment for the supplier, the Tennessee Court of Appeals first held that the GC could not bypass the supply contract's limitations by simply asserting an implied or equitable (noncontractual) indemnity claim rather than asserting a claim for indemnity under the contract itself. Second, it upheld the remedy provision in the supply contract (the one-year warranty), finding the provision did not "fail in its essential purpose" simply because a defect might

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not be discovered within the one-year warranty period (as occurred in this case).

The *Baptist* case emphasizes the need for careful review of supply contracts. Ordinarily, one should be wary of an "exclusive" remedy provision in the warranty clause. In situations in which a product failure reasonably cannot be discovered for a time period well beyond the date of delivery, a contractor should consider and negotiate for the express warranty as an additional remedy, in order to obtain a less stinky result than what the GC received here.

By John Hargrove

Major Provisions of the Patient Protection and Affordable Care Act and their Impact on the Construction Industry

The Patient Protection and Affordable Care Act passed by the current Congress and signed into law by President Obama will reportedly cost $940 billion over the next ten years; will expand coverage to 32 million Americans who do not currently have coverage; and may bring some hospital expansion projects across the country to a screeching halt.

Many of the effects of the health care reform legislation impact the construction industry just like other industries. Construction companies with more than 50 employees will be mandated to provide health insurance coverage or pay a fine in most cases, and construction company owners and employees will be subjected to the same tax increases as other Americans.

The first impact of the new law will be felt by small employers, who will begin receiving a tax credit for insurance costs. Companies with ten or fewer employees making $20,000 or less on average will be eligible for a 50% tax credit on health insurance costs. The credit is phased out for employers who do not meet the size and income thresholds by a formula which takes into account both factors. The credit is completely phased out for employers with more than 25 employees or whose employees' average annual wages exceed $40,000.

In order to facilitate the provision of additional health insurance coverage to millions of Americans, the new law requires that by 2014, all 50 states will have to set up Small Business Health Options Programs or "SHOP Exchanges." These organizations will be used to allow employers with less than 100 employees to pool together to buy insurance. The intent is to reduce costs for coverage by spreading the risk within larger groups. Until the SHOP Exchanges are established, tax credits are available for some small businesses.

Beginning June 21, 2010, individual and group health insurance plans will no longer be able to exclude pre-existing conditions from coverage. Also beginning June 21, 2010, the government will begin a temporary program to reinsure the cost of providing health insurance to early retirees (ages 55 to 64) and their families.

Beginning September 23, 2010, the law will prohibit limitations of the amount of coverage available to an individual in a single year or for a lifetime.

In 2011, the law requires that all W-2's report the value of the health insurance coverage provided to each employee. This will not result in additional tax to the employer or employee at that time, but the reporting requirement may offer a step to taxing health insurance benefits provided by employers.

Specific to the construction and healthcare industries, the health care reform legislation will affect physician-owned hospital projects that are either currently underway or planned for the future.

At present, there are approximately 260 physician-owned hospitals in the United States, and approximately 58 have expansion plans either under construction or on the books. The new laws restrict physician-owned hospitals from adding beds, procedure rooms, or operating rooms. The legislation also reduces Medicare reimbursement for physician-owned hospitals. The congressional reasoning for this prohibition is to prevent doctors from referring the "better" patients to their hospitals or steering them away from public hospitals.

The legislation includes a narrow exception allowing the Secretary of Health and Human Services to

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establish a process to apply for an exception to the new law. The community in which the hospital is located must be given input in that exception process. While an exception to this rule is good news, the Secretary is not required to develop and implement the process to obtain an exception until August 1, 2011. The new legislation offers no clear answers for physician-owned hospitals with ongoing expansion projects and has reportedly caused the abandonment of 60 additional community hospitals which will no longer be built, an ironic result of legislation intended to increase access to healthcare.

If you have a construction project affected by the effective hold, you may want to consult your lawyer regarding the exception above, how to apply for it, and whether the process can be expedited.

By Rob Dodson

Contingent Payment Clauses: Know Your State's Policy

A contingent payment clause (sometimes known as a "pay-when-paid" or "pay-if-paid" clause) is a clause which conditions downstream payment to a subcontractor or sub-subcontractor on receipt of payment from the upstream contractor or owner. Thus, in the typical owner-contractor-subcontractor relationship, if a contractor has not been paid by the owner for work performed by the subcontractor, the contractor has no obligation to pay its subcontractor. The interpretation and enforceability of such "contingent payment" clauses varies from state to state. Recently, The United States Court of Appeals for the Fourth Circuit confirmed that, in Virginia, unambiguous pay-when-paid clauses are valid conditions to payment to lower-tier contractors.

In *Universal Concrete Products Corp. v. Turner Construction Company*, the general contractor included an *express* pay-when-paid clause in its subcontract with its concrete subcontractor. This clause made payment from the owner to the general contractor an *express* "condition precedent" to payment from the general to its subcontractor.

When the subcontractor substantially completed its work in March, 2008, the real estate market had soured. The owner did not pay the general contractor, and, as a result, the general contractor did not pay the subcontractor. When the subcontractor sought payment for its work, the general contractor refused, citing the pay-when-paid provision in the subcontract.

The subcontractor sued alleging that the pay-when-paid clause was ambiguous and therefore should only be interpreted as setting the time for payment (a concept adopted by some state courts). The Court rejected this argument, reasoning that the pay-when-paid clause was unambiguous and, because it is the policy of Virginia courts to allow parties to form contracts without government interference, the clause was to be enforced, barring the subcontractor from recovery from the general contractor.

The court's decision is good news for general contractors in Virginia and bad news for lower tier subcontractors. For those outside Virginia, the court's decision is a reminder to general contractors and subcontractors to perform due diligence prior to contract negotiations. General contractors which want to include contingent payment clauses in their contracts should determine beforehand how the respective state's courts interpret and enforce such provisions. Some states require specific "condition precedent" language in the clause before they will enforce the clause as written; some interpret the clause as a timing mechanism requiring payment after a reasonable time, even if the owner does not pay the general contractor; others will not enforce contingent payment clauses at all. Likewise, subcontractors should be aware of the implications of contingent payment provisions, especially in this market where owners are facing difficulties obtaining financing for their projects.

By Jonathan Cobb

Bradley Arant Lawyer Activities:

Jim Archibald, **Axel Bolvig**, **Doug Patin**, **David Pugh**, **Bill Purdy**, **Mabry Rogers**, **Wally Sears**, and **David Taylor** are named in the 2009 edition of *The Best Lawyers in America* in the specialty of Construction Law.

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Jim Archibald and **Wally Sears** recently updated the Alabama section of the *State-by-State Guide to Construction Contracts and Claims*.

David Taylor's article on dispute resolution entitled "Arbitrating and Mediating Real Estate Disputes" was published in the March edition of the Institute of Real Estate Management Magazine.

Jim Smith hosted a seminar on February 26, 2010 sponsored by the Mecklenburg County Bar Association entitled "Technology in the Courtroom: Making Your Case Come Alive."

Bob Symon recently conducted five Seminars on the Federal Acquisition Regulation (FAR). On March 5, 2010 he presented in Washington, DC; on March 9, 2010 he presented in San Diego, CA; on March 11, 2010 and March 26, 2010 he presented in Rockville, MD; and on May 5, 2010 he presented in Brentwood, TN.

Joel Brown presented a teleconference on March 12, 2010 entitled "AIA Doc. A401 Subcontract Doc. (Intellectual Property Rights)."

Mabry Rogers and **David Bashford** have recently presented risk management seminars in Raton, NM, Boulder City, NV, and Tempe, AZ, and **Mabry** presented recently an overview of federal contracts seminar in Ft. Lauderdale, FL.

Joel Brown and **David Taylor** presented a seminar entitled "Bidding Requirements in Federal Contracting" on March 25 for the Tennessee ABC in Nashville, TN

David Taylor presented a "Legal Issues for Management" training class on April 1 for the Tennessee ABC

Stanley Bynum attended the ABA International Law Spring Meeting April 14th -17th in New York, NY.

David Taylor presented a seminar entitled "Tennessee Retainage Laws" on April 7 for the Tennessee AGC in Nashville, TN

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David Pugh, Michael Knapp, Arlan Lewis, Luke Martin, Ed Everitt and Jonathan Cobb will present a seminar entitled "Fundamentals of Construction Contracts" on June 24, 2010 in Birmingham, AL.

David Taylor recently authored an article entitled "Road to Resolution – How ADR can Help Avoid Conflict Disputes" which was published in the March/April edition of Journal of Property Management

Arlan Lewis, Rhonda Caviedes, and **Ed Everitt** participated in the ABA Forum on the Construction Industry's mid-winter conference in San Francisco entitled "Government Construction Contracting."

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

NOTE: YOU CAN FIND THIS NEWSLETTER AND PAST NEWSLETTERS ON OUR WEBSITE. IF YOU ACCESS THIS NEWSLETTER ON OUR WEBSITE, CASE-LINKS WILL BE AVAILABLE UNTIL THE NEXT NEWSLETTER IS PUBLISHED. WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY GO TO WWW.BABC.COM/PG_CONSTRUCT.CFM OR CONTACT ANY ATTORNEY LISTED ON PAGE 8 OF THIS NEWSLETTER.

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NOTES

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The lawyers at Bradley Arant Boult Cummings LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

This newsletter is a periodic publication of Bradley Arant Boult Cummings LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact your lawyer or any of the lawyers in our group whose names, telephone numbers and E-mail addresses are listed below; or visit our web site at www.babc.com.

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BRADLEY ARANT BOULT CUMMINGS LLP **Third Quarter 2010**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Nicholas J. Voelker (c)

Federal Circuit Raises the Stakes for Contract Disputes Act Claims

The federal appeals court that supervises all contract claims against the United States recently expanded the risk of failing to properly seek a formal extension of time under the Contract Disputes Act ("CDA"). In *M. Maropakis Carpentry, Inc. v. United States*, the Court of Appeals for the Federal Circuit held that a contractor's failure to submit a valid CDA claim for a time extension not only prevented the contractor from pursuing a contract modification but also barred the contractor from presenting factual defenses to the government's claim for liquidated damages.

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In *Maropakis*, the contractor failed to complete the renovation of a U.S. Navy facility in accordance with the terms of the contract and argued that the government caused the bulk of the 467 day delay. Three months after completing the project, the contractor sent a letter to the contracting officer ("CO") requesting a contract modification for an extension of time due to the government's delays. The CO rejected the claim, asked for additional information, and specifically stated that the rejection was not a Final Decision. The contractor did not submit additional information. Ten months later the CO again wrote to the contractor, pointed out that the contractor never provided additional information in support of the extension request, and stated that due to the delay, the government was entitled to over $300,000 in liquidated damages. The parties exchanged letters again without the contractor providing any additional information to support its excusable delay claim. Subsequently, the CO issued his Final Decision on the liquidated damages assessment. The contractor then filed suit seeking a time extension due to government delays and seeking elimination of the liquidated damages assessment. The government counterclaimed for liquidated damages.

The court ruled for the government on all counts. First, the court held that the contractor never submitted a valid CDA claim seeking time extensions. While there is no specific format for a CDA claim, a valid claim requires

notice of the basis for the claim, the amount of the claim, and a request for a final decision from the contracting officer. Because the contractor never provided this information to the CO in support of its claim for a time extension, it never submitted a valid CDA claim. Thus, the court held that it did not have the legal authority to consider the contractor's claim seeking a contract modification for an extension of time.

The scope of the court's rejection of Maropakis' CDA claim went far beyond rejecting its affirmative claim. The court also held that because it could not consider the contractor's claim for the time extension, the contractor could not present any factual evidence of the government's delays in defense of the government's counterclaim for liquidated damages.

The implications of this far-reaching opinion are significant. Now, in all contract disputes before the Court of Federal Claims or the Boards of Contract Appeals, a contractor can be deemed to have waived its ability to present certain factual defenses by failing to recast and properly submit these facts in a formal CDA claim. At a minimum, if a contractor believes that the government may pursue liquidated damages and it if believes it has valid grounds for a time extension (compensable or excusable), it must submit a proper CDA claim for a time extension to preserve the right to present evidence of government delays in any future court proceedings.

By Lewis Rhodes

Prime Contractors on Federal Projects Beware: Big Penalties for Providing False or Inaccurate Certified Payrolls to the Government

The federal government recently was awarded $1,661,423.13 in damages against a prime contractor who submitted false certified payrolls to the government on a federal project. In *United States of America v. Circle Construction, LLC*, the federal trial court held that because Circle Construction, LLC ("Circle"), the prime contractor, submitted false certified payrolls in violation of the Davis Bacon Wage Act and False Claims Act, the government was entitled to three (3) times the amount it would not have paid Circle had it known about the false certified payrolls.

The case arose from the construction of various buildings on the Fort Campbell military facility in Clarksville, Tennessee. Circle subcontracted with Phase Tech for the electrical work on the Project. After the Project was complete, an employee of Phase Tech filed an action alleging that Circle submitted false certified payrolls to the government throughout the Project.

Circle's prime contract with the government, and applicable federal law, obligated Circle to pay electricians according to the wage determinations in the contract, submit payroll certifications to the government as a condition for payment, and ensure that all subcontractors on the Project submit complete and accurate certified payrolls. After an extensive investigation by the government, it was discovered that Circle provided roughly 62 false or inaccurate certified payrolls throughout the Project, many of which failed to list any Phase Tech employees. Moreover, the government found that Phase Tech employees were paid significantly less than the wage determination Circle agreed to in the prime contract. The Court noted that the Davis-Bacon Wage Act certified payroll requirement is designed to give local laborers and contractors fair opportunity to participate in federal projects and protect local wage standards by preventing contractors from basing their bids on wages lower than the prevailing wage in that area. The Court concluded that Circle's conduct was a direct attempt to pay a lower wage to Phase Tech employees than the prevailing wage in that area. The Court ruled that the contractor's false statement only needed to be material to the government's payment decision. In this case the Court reasoned that the government would not have paid Circle had it known Circle was submitting false certified payrolls.

Prime contractors on federal projects must ensure that any subcontractors on the project are submitting accurate certified payrolls. As this case demonstrates, if a prime contractor fails to do so the penalties for submitting false or inaccurate certified payrolls could be significant.

By Nick Voelker

"No Damage for Delay" Clause Means No Problem for Government

In *Harper/Neilsen-Dillingham, Builders, Inc. v. United States*, the United States Court of Federal Claims recently held that "no damage for delay" clauses contained in contacts between subcontractors and prime contractors bar pass-through delay claims to the government (under the so-called 'Severin Doctrine'), provided the clause is enforceable against the subcontractor under applicable state law.

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Harper was one of several prime contractors performing work to construct residential housing for the government. Harper was delayed in commencing its work, and had to perform its work out of sequence because other prime contractors were late in completing their work. This had the effect of forcing Harper's subcontractor, KCI, to perform its landscaping work during the winter and to encounter severe weather delays.

However, when KCI and Harper executed the subcontract, KCI was already aware that the work would have to be performed in the winter. Therefore, in the Court's words, "the delays complained of in this case occurred prior to the subcontract award and were therefore within the contemplation of the parties at the time they entered into the subcontract." Moreover, the subcontract contained a standard no damages for delay clause: "In the event of any delays, entailed as a result of fault of Contractor or Owner, then Contractor shall grant Subcontractor an extension of time equal to the delay and Subcontractor shall be entitled to no other or further damages against Contractor or Owner."

In eventually holding that the pass-through claim was barred, the Court first recited the rule that, to succeed on a pass-through claim against the government, the prime contractor must show that it is liable or potentially liable to the claiming subcontractor vendor. The Court further held that to defeat such a claim, the government must show "an *iron-bound release or contract provision immunizing the prime contractor completely from any liability to the sub.*" Under California law, the Court found that the no damages for delay clause was sufficient to defeat the subcontractor's delay claim. In addition, the Court held that even assuming that the "no damages for delay" clause did not bar the subcontractor's delay claim, the prime contractor still did not have any liability to the subcontractor because the delays were in the contemplation of the parties at the time of contracting.

In summary, while the holding of *Harper* may provide broad protection for the government against pass-through liability for claims barred under relevant subcontract provisions, it leaves some room for future pass-through claims seeking damages for delay, even where the subcontract includes a "no damages for delay clause." Specifically, any state law exceptions to the enforceability of such clauses, if properly supported by the requisite facts, would allow the prime contractor to pass through the subcontractor claim. Additionally, *Harper* did not rule out the possibility that a properly drafted liquidation agreement could solve the problem at issue in *Harper*. Finally, it remains to be seen if the breadth of the clause at issue, which is a bit unusual in that it included the "owner" in the protection of the "no damages for delay" clause, may prove to be a distinguishing factor.

By Tom Lynch

The Importance of Reviewing and Understanding Governmental Permitting Documents and Pursuing Administrative Remedies

The Supreme Court of Indiana recently issued a decision which highlights the importance of carefully reviewing – and fully grasping the implications of – governmental permitting documents. In *Carter v. Nugent Sand Company*, the court ruled that a lawsuit filed by a sand and gravel stockpiling and transporting company (Nugent Sand) was due to be dismissed because the company failed to exhaust certain administrative remedies as required under certificates of regulatory approval obtained from the Indiana Department of Natural Resources (IDNR). As a result, Nugent Sand was left with no way to challenge IDNR's stance that a man-made lake used for the company's operations and a channel excavated by the company to connect the lake with the Ohio River were open to full use by the general public.

As part of its commercial barge operation, Nugent Sand leased 156 acres of land adjoining the Ohio River in Utica, Indiana. This land included a fifty acre man-made lake which stood approximately 200 feet inland from the river. In 2000, Nugent Sand obtained the required governmental permits, including the certificates of regulatory approval from the IDNR. Nugent Sand then spent substantial sums of money excavating a channel so that the lake and channel could be navigated by tugboats and barges up to 195 feet long and 35 feet wide. The company also constructed a dock in the man-made lake for unloading the barges.

Recreational boaters began using the lake through the excavated channel, creating traffic problems and safety hazards for Nugent Sand's operations. Nugent Sand turned to IDNR for assistance, complaining that the recreational boating was interfering with its operations, driving up its costs, and jeopardizing the safety of its employees and the public-at large. IDNR took the position that the lake and the channel were public, refused to take action, and even provided statements that the waters were public in response to public inquiries.

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Nugent Sand filed a lawsuit against IDNR, seeking a declaration that the channel and the lake were private property and an injunction to prevent IDNR from issuing statements that the waters were open to the public. The trial court entered a permanent injunction in Nugent Sand's favor.

The Indiana Supreme Court reversed the trial court because Nugent Sand had not properly exhausted its administrative remedies as set forth in the excavation permit. The Supreme Court noted that "the terms imposed by IDNR, 'requiring all additional waters created by this project be dedicated to the public as required under IC-14-29-4,' were explicitly set forth in the 'Special Conditions' section of the approval documents" issued by IDNR prior to the channel excavation. The Court also pointed out that the approval documents contained provisions notifying Nugent Sand about the administrative procedures under which it could appeal any condition on the excavation contained in the permits. Those procedures specifically gave Nugent Sand the right to request IDNR "to interpret a statute or rule administered by the [IDNR] as applicable to a specific factual circumstance" and, if aggrieved by the response, to file a petition for administrative review under provisions of the Indiana Code. Because Nugent Sand had not exhausted its administrative remedies under those provisions to challenge the public access condition in the excavation permits, it was not entitled later to seek judicial relief.

The obvious reminder: review and understand the conditions in governmental permitting documents. The failure to see and appreciate the traps that may exist in these permits can result in unanticipated costs, negative operational impacts, and (as this case demonstrates) even the inability to seek legal relief.

By Keith Covington

Modified Total Cost Recovery and Owner's Warranty of the Plans and Specifications

For construction of the Hyperion Wastewater Treatment Plant, the City of Los Angeles obtained millions of dollars worth of construction from Dillingham-Ray Wilson (DRW) and its subcontractor, CBI Services, that it did not want to pay for. When the city was sued for failure to pay for this work, the trial judge excluded from the jury's consideration $25 million of damages, and the jury awarded the contractor $12.4 million for the claims and damages it was allowed to consider, in addition to $23 million in interest, prompt payment penalties, and lawyers' fees ($6.6 million total in lawyers' fees). On March 18, 2010, an intermediate appellate court in California affirmed the jury's verdict, and reversed the trial court as to excluding the $25 million of damages from the jury's consideration. It made two important rulings of general interest to the construction industry.

First, the trial court excluded the $25 million because DRW and CBI were not prepared at trial to show the "actual costs" of the changes. DRW and CBI argued that the City ordered them to proceed on disputed change orders and made it impossible to keep up with the "actual costs" of the changes. Moreover, they pointed out that the City at times agreed to certain change orders based upon the City's "engineering estimates" of what work should have cost, as opposed to actual costs. Based upon this showing, the intermediate court concluded that the trial court was wrong to exclude DRW's and CBI's cost evidence. The case was remanded to allow them to prove the costs of the change orders through engineering estimates or through the "modified total cost" method of pricing, so long as those are the "best evidence of damages available." In memorable language that is often overlooked by parties opposing damage claims, the court stated: "When it is clear that a party suffered damages, the fact that the amount of damage may not be susceptible of exact proof or may be uncertain, contingent or difficult of ascertainment does not bar recovery."

Second, the trial court also refused to allow DRW and CBI to proceed using a breach by Los Angeles of the implied warranty of the correctness of the plans and specifications (a concept often referred to as the *Spearin* doctrine). Again, the appellate court reversed, concluding that California law recognized such claims.

While the DRW case may be appealed yet again, it nevertheless is a reminder that Contract damages may be proved in less than precise methods, if the fact of damage is clear. Moreover, where there are numerous changes during construction, the entity ordering the changes (owner, general contractor, or subcontractor) may be liable to the claiming tier below based upon not only the changes clause (what is sometimes called "under the contract") but also upon the theory that the ordering entity breached the implied warranty of the adequacy of the plans and specifications ("arising out of the contract"). Of course, regardless of the theory, the claiming entity is entitled to be paid only once for the same damages.

By Mabry Rogers

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New "Transparency Act" Reporting Requirements under the FAR

On July 8, 2010, the FAR Council created a new rule implementing the requirements of the Transparency Act. The purpose of this rule is to disclose information regarding subcontracts and salaries of certain employees. These new regulations can be found in FAR 4.41 and FAR Clause 52.204-10. These are completely new rules. There was an existing pilot program established in 2008 that was limited to contracts over $500,000,000 and subcontracts greater than $1,000,000. The new requirements are much broader and eventually will attach to ALL contracts and subcontracts $25,000 or higher.

FAR clause 52.204-10 requires that by the end of the month following the month of the award, ALL first-tier subcontracts with a value of $25,000 be reported at www.fsrs.gov according to the procedures laid out in FAR Clause 52.204-10(c)(1). Furthermore, by the end of the month after the prime contract award – *and annually afterwards* – the contractor has to report the total compensation of each of the five most highly compensated executives for the contractor's most recently completed fiscal year, but only if:

1) The contractor received 80% or more of its annual gross revenues from Federal Contracts; AND
2) $25,000,000 or more gross revenue from Federal Contracts; AND
3) The contractor is not a publicly traded company publishing this info under the security acts.

The contractor must also report the five highest paid employees of its first-tier subcontractors if the subcontractor meets all of these same three requirements.

This rule making creates a new clause that will be inserted into NEW contracts; however, the rule requires existing ID/IQ contracts to be modified to include the new reporting clause. We have also seen at least one instance where the contracting officer modified an existing contract to include FAR Clause 52.204-10. This modification is a unilateral modification and does not need to be signed by the contractor. Thus, contractors need to be on the lookout for a modification adding this clause.

This rule is both an interim rule and a proposed rule making. Under the first phase, from now until September 30, 2010, only prime contracts $20,000,000 and higher are required to follow the reporting procedures in FAR Clause 52.204-10. Beginning October 1, 2010, all prime contracts of $550,000 or higher have to report the required sub-contract and salary information. Beginning March 1, 2011, absent a change in the rule, all contracts $25,000 and higher will be governed by the reporting rules.

The FAR Council is accepting comments on the rule until September 7, 2010. Information on how to comment on this rule is available at www.regulations.gov by entering "FAR Case 2008-039" as the keyword. For further information about this proposed rule or about commenting on this rule, feel free to contact one of the government contracts lawyers at Bradley Arant Boult Cummings.

By Lewis Rhodes

Bradley Arant Lawyer Activities:

Mabry Rogers has been named in the International Who's Who of Construction Lawyers 2010. This is published by the ABA Section of International Law.

Jim Archibald and **Wally Sears** recently updated the Alabama section of the *State-by-State Guide to Construction Contracts and Claims*.

Mabry Rogers and **David Bashford** recently presented contract and risk management seminars in Raton, NM, Boulder City, NV, Sarnia, Ontario and Tempe, AZ, among others.

David Taylor presented a seminar entitled "Tennessee Retainage Laws" on April 7 for the Tennessee AGC in Nashville, TN

Stanley Bynum attended the ABA International Law Spring Meeting April 14th - 17th in New York, NY.

David Taylor presented a seminar entitled "What to do When Your Commercial Contractor Stops Working" as part of Bradley Arant Boult Cumming's 9th Annual Commercial Real Estate Seminar on May 9 in Nashville, TN

Joel Brown presented a seminar in Huntsville, AL on May 13, 2010 for the Defense Acquisition University concerning government contracts and intellectual property rights.

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David Taylor and **Bryan Thomas** presented a session entitled "The Great Debate: Do You Arbitrate" at the national CONSTRUCT 2010 meeting in Philadelphia, PA on May 14, 2010.

Jonathan Head co-presented a national webcast on June 3, 2010 for DRI regarding privilege and its effect on major litigation.

David Pugh, Michael Knapp, Arlan Lewis, Luke Martin, Ed Everitt and Jonathan Cobb presented a seminar entitled "Fundamentals of Construction Contracts" on June 24, 2010 in Birmingham, AL.

Jonathan Head participated in a panel discussion at the Alabama State Bar annual conference on July 16, 2010 about Alabama's new electronic discovery rules and responses to common problems in electronic discovery.

Michael Knapp taught a course entitled "International Construction Contracts and Law" at Misr University of Science and Technology in Cairo, Egypt from July 24 to July 28th to graduate level engineering students**.**

David Taylor presented at an annual project managers meeting regarding "Dispute Avoidance" on August 4, 2010

Bob Symon will be presenting seminars on the Federal Acquisition Regulation (FAR) in Rockville, MD and Huntsville, AL

David Taylor spoke regarding the Tennessee Retainage and Prompt Pay Act to the Tennessee Professional Estimators Association on August 6, 2010.

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Arlan Lewis, Rhonda Caviedes, and **Michael Knapp** will be participating in the ABA Forum on the Construction Industry's conference entitled "We Won't Get Fooled Again: Lessons Learned in the Economic Downturn" on September 2-3, 2010.

John Bond recently accepted a position as President and Chief Operating Officer for a client of the firm. We thank John for his years of service and wish him well in this outstanding opportunity.

Bradley Arant attorneys have recently presented training sessions to a number of clients regarding Contract Administration and regarding Mandatory Written Ethics Compliance Programs for Federal Government Contracts. If you are interested in either of these seminars for your company, please contact one of the attorneys listed on page 8 of this newsletter.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

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BRADLEY ARANT BOULT CUMMINGS LLP **Fourth Quarter 2010**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Axel Bolvig, III
Joel E. Brown
Stanley D. Bynum
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David K. Taylor (n)
Darrell Clay Tucker, II
D. Bryan Thomas
Nicholas J. Voelker (c)
James Warmoth (c)

Owner May Be Liable to Contractor for Failure to Disclose Material Information

The industry uses bid/build delivery systems as a staple. An owner decides what its program is, and hires a designer to put the program into drawings and specifications from which bidders may establish a lump sum price for the work. Is an owner liable to the contractor where the owner knows of a condition but fails to disclose it to the bidders? In many jurisdictions, the answer is yes, if the information is material and if the owner willfully withholds the information. But what if the owner simply is negligent in withholding its superior knowledge? Is there an avenue for a contractor to seek financial redress?

The answer will vary from jurisdiction to jurisdiction. In California recently a public owner (the Los Angeles Unified School District) was held liable to a take-over contractor for negligent failure to disclose superior information. After defaulting its original contractor, the school district issued the original plans and specifications, along with a hundred plus page "pre-punchlist" of items which were incomplete or unsatisfactory from the defaulted contractor's work. On the "pre-punchlist" and in the request for completion bids, the school district stated that the take-over contractor would be liable for all defects in the defaulted contractor's work. As sometimes happens, the specific spot repairs to plaster noted on the "pre-punchlist" in fact required removal of all the plaster on the exterior of the building and repair of the substrate. Likewise, the spot repairs to tile required removal of all of the tile and its substrate in order to obtain a satisfactory tile product. Neither of these was evident from the take-over contractor's pre-bid walk; both were known, or knowable, to the school district at the time it sought the replacement contractor bids.

In a case of first impression, the Supreme Court of California held that a public owner in California is liable to a contractor for resulting cost overruns and damages and that the contractor need not prove an affirmative fraudulent intent to conceal. Rather – with the qualifications stated below – a public entity in California may be required to

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provide extra compensation if it knew, but failed to disclose, material facts that would affect the contractor's bid or performance. Because public entities do not insure contractors against their own negligence, relief for non-disclosure will be allowed in California only when (1) the contractor submitted its bid or undertook to perform without material information that affected performance costs; (2) the public entity was in possession of the information and was aware the contractor had no knowledge of, nor any reason to obtain, such information; (3) any contract specifications or other information furnished by the public entity to the contractor misled the contractor or did not put it on notice to inquire; and (4) the public entity failed to provide the relevant information.

The court itself cautioned that an owner is not liable for *any* failure to disclose. Instead, it explained that the circumstances affecting recovery may include (but are not limited to) positive warranties or disclaimers made by either party, the information provided by the plans and specifications and related documents, the difficulty of detecting the condition in question, any time constraints the public entity imposed on proposed bidders, and any unwarranted assumptions made by the contractor. The public entity likely will not be held liable for failing to disclose information a reasonable contractor in like circumstances would or should have discovered on its own, but may be found liable when the totality of the circumstances is such that the public entity knows, or has reason to know, that a responsible contractor acting diligently would be unlikely to discover the condition that materially increased the cost of performance.

While the case is couched as one involving a public owner, its teaching may be used by a subcontractor (or a takeover surety) against a general contractor in the appropriate context. Whether a given jurisdiction will in fact provide relief, notwithstanding the lack of willful suppression, is a matter that you should carefully consider with the aid of your lawyer.

By Mabry Rogers

Protecting Other Men's Wives: Controlling Employer Liability on the Jobsite

Occupational Safety and Health Administration ("OSHA") regulations long have stated that construction industry standards apply "to every place of employment of every employee engaged in construction work" and that every contractor "shall protect … places of employment of each of its employees." OSHA took the position for many years that a general contractor could be liable for safety violations under these provisions *even if* the general contractor did not cause the hazard and *even if* its own employees were not exposed to it. In other words, a general contractor could be liable for a subcontractor's violation which only affected the subcontractor's own employees. This was called the "controlling employer" doctrine.

Under the previous administration, the controlling employer doctrine was abrogated in an administrative proceeding. That case held that the language above meant that a contractor only had responsibility for protecting its own employees against jobsite hazards, noting that laws about husbands and wives apply only to one's own wife and not everyone else's. OSHA thus would not cite a general contractor for violations that it did not cause or which did not affect the general contractor's employees. That was in 2007.

Controlling employer liability is back. This past August, the original 2007 decision was overturned by the federal Occupational Safety and Health Review Commission. General contractors again face OSHA liability for any and all hazards on a jobsite so long as they have control of the jobsite and so long as they have at least one employee on the site. According to the new decision, the focus is on the language in the regulation, "places of employment." In the Commission's view, that language requires contractors to protect their employees in those places even if only one employee is there and even if the hazard is created by another entity: owner, subcontractor, or anyone else.

General contractors of course want to be vigilant in correcting workplace hazards; this decision may extend that vigilance to hazards that they might not otherwise even see. General contractors may be required to take steps to identify and to correct hazards even if those hazards were created by someone else.

The general contractor respondent in the case likely will appeal. There is a lengthy and well-reasoned dissenting opinion that provides a roadmap for such an appeal. If the decision is reversed, a split in the circuits will occur, as controlling employer liability already has been affirmed in some circuits.

By John W. Hargrove

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Recent Revisions to AIA A312 Payment and Performance Bond Forms

The American Institute of Architects ("AIA") maintains over 100 contract document forms in use throughout the construction industry. These contract documents are utilized by owners, architects, contractors, subcontractors, sureties, and other industry participants to define the roles and responsibilities of the parties on design and construction projects.

Periodically, the AIA revises its forms in response to court decisions or to comments from industry participants. One such revision recently occurred with regard to the AIA A312 Payment and Performance Bond forms. The prior (1984) edition of the AIA A312 Payment Bond form provided that the surety had 45 days to respond to a Claim and to state the basis for challenging any amounts that were disputed. Several courts held that the surety's failure to state the basis for challenging disputed amounts within this 45-day period amounted to a waiver by the surety of any challenge to these amounts.

The 2010 revisions to the A312 Payment Bond form address this issue. First, the 2010 revision extends the Surety's response time to 60 days. It then adds an entirely new section which provides that a failure to dispute the Claim within the 60-day period does not constitute a waiver of defenses. This change is in direct response to the court cases which held that a surety's failure to respond within 45 days amounted to a waiver of all defenses.

The revised A312 form does include an impetus for the surety to respond. If the surety does not respond within 60 days, the surety becomes liable to the Claimant to reimburse it for attorney fees "the Claimant incurs thereafter to recover any sums found to be due and owing to the Claimant." These fees are recoverable from the surety even if, when coupled with the amount of the Claim, they exceed the penal sum of bond.

There are other significant changes to the A312 Payment Bond form. The 2010 revision of the Payment Bond form adds a requirement that a Claimant submit a "Claim" and provides that the surety's obligations do not arise until it has received that Claim. This "Claim" is different from the "Notice of Claim" required under previous versions of the A312 form. It is more detailed and includes eight categories of information that must be included. The specific requirements for a proper "Claim" are found at § 16.1 of the revised bond form.

The new requirement for submission of a "Claim" as opposed to a "Notice of Claim" also affects the time in which a Claimant must file suit. Under § 12, the Claimant must file suit within the earlier of one year after the date it submits its Claim or one year after it last performed work on the project. Thus, suit may be required earlier than one year after completion of the work *if* the Claim is filed while work is still ongoing.

Finally, the 2010 revision to the Payment Bond form expands the number of potential Claimants. Previous versions of the Payment Bond form restricted Claimants to first and second tier subcontractors. The revised form broadens the scope of potential Claimants to anyone who may assert a mechanic's lien.

The AIA has also issued important revisions to the A312 Performance Bond form. These revisions deal mainly with the process for making a Claim on the basis of Contractor Default, and with the process for defaulting a non-performing Surety. The process under the new form is less administrative and thus far more streamlined.

Owners, contractors and subcontractors should be on the lookout for these revised forms. Always consider carefully any contract document before signing. After work has begun on a project, be sure to abide by whatever requirements are set forth in the applicable surety bond when making claim under these bonds.

By Luke Martin

No Home-Office Overhead Recovery for Government Contractor Absent Government-Imposed Standby

In a recent case, the Florida Court of Appeals reexamined and left unchanged the law in Florida regarding a government contractor's ability to recover "home-office overhead" as part of its delay damages. In *Martin County v. Polivka Paving, Inc.*, the Florida Court of Appeals held that, although the government contractor was entitled to extended "field-office overhead" and other damages arising out of a delay caused by differing site conditions, the contractor could not recover home-office overhead because it was not the case that the "government imposed delay required [it] to indefinitely standby to the point that [it] was effectively suspended and unable to take on additional work."

The parties to the case, Martin County, Florida ("Martin County"), and Polivka Paving ("Polivka"),

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entered into a contract under which Polivka constructed soccer fields and related improvements at a Martin County park. Early in the project, Polivka discovered inaccuracies in the county-provided elevation information on which it based its bid. Predictably, this necessitated the placement of significantly more fill material than Polivka had accounted for in its bid, increasing the project cost and lengthening the project schedule. Although the parties agreed to change orders to account for these discrepancies, Martin County eventually refused to pay for the additional work.

At trial, Polivka argued that it was entitled to home-office overhead costs because, in its view, home-office overhead costs are simply those "costs associated with the home office that are funded by the projects which the company is performing." The trial court allowed the jury to consider these damages, and the jury awarded Polivka, among other damages, $275,251.00 for home office overhead.

Martin County appealed and the Court of Appeals reversed the home office overhead portion of the damages, relying upon a series of previous Florida cases which examined and adopted the law developed in various federal appellate courts. Specifically, entitlement to home office overhead damages requires proof of three elements: (1) a government-imposed delay occurred; (2) the government required the contractor to "standby" during the delay; and (3) while "standing by," the contractor was unable to take on additional work.

The Court of Appeals extensively examined the "stand-by" requirement and held that, because Polivka had other ongoing jobs which contributed to paying the contractor's home office overhead, it would have incurred the individual cost components of the home office overhead whether or not it ever undertook the Martin County park project.

Contractors who are experiencing government-caused delay on a project should be cognizant of this "standby" gloss as a potential hurdle to recovery of home office overhead costs. As evidenced by this case, when the delay does not stifle the contractor's ability to maintain ongoing work or obtain new work, it may be difficult in some jurisdictions to recover for home-office overhead. On the other hand, if the government requires the contractor to stand by on the project such that it is difficult for the contractor to use its resources elsewhere, or the delay is so uncertain in duration as to make bidding on other work impractical, the contractor may have an eventual claim for extended home-office overhead, and should thoroughly document both the causes of these extended costs and the costs themselves.

By Nick Voelker and James Warmoth

Make Sure You Protect Your Rights

In a recent case, the Armed Services Board of Contract Appeals (the "ASBCA") granted summary judgment – that is, it found that there was no real factual dispute – over 90% of a Contract Disputes Act claim brought by the contractor. The basis for the ASBCA's holding was that the contractor (Whiting-Turner) released all of its rights to claims related to almost all of its contract modifications.

In July 2008, Whiting-Turner entered into a contract to perform new construction and renovation of the U.S. Military resort at Walt Disney World. Over the next 18 months, the parties agreed to 46 bilateral contract modifications. At the end of the project, Whiting-Turner submitted a Request for Equitable Adjustment ("REA") of nearly $4 million on behalf of itself and some of its subcontractors. The contracting officer denied the claims. Litigation followed.

The ASBCA held that in 18 of the 21 disputed modifications Whiting-Turner gave up all of its rights to any additional claims. Each of these 18 modifications stated that the adjusted contract price "constituted a complete and equitable adjustment" and that the modification "resolved any and all costs, impact effect, and … delays and disruptions." Additionally, and to the ASBCA "significantly," not one of these modifications contained any reservation of rights language. Therefore the ASBCA granted summary judgment for the government on all of Whiting-Turner's claims relating to these 18 modifications on the basis that all of these claims were resolved by accord and satisfaction, meaning that because Whiting-Turner accepted the payment amount in the modification, it accepted the terms of the modification. Conversely, the three modifications that the ASBCA allowed to continue to trial had reservation of rights language and reflected that they only addressed a partial recovery.

The lesson here is that modifications need to be read and analyzed carefully. If possible, proposed modifications should be reviewed by in-house or outside counsel. As this case demonstrates, a small, overlooked sentence or phrase in a modification can have significant long term repercussions.

By Lewis Rhodes

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"Inconvenience and Discomfort" Damages Available for Mold Infestation

In *Mayer v. Chicago Mechanical Services, Inc.*, an Illinois Appellate Court established that, in Illinois, damages for inconvenience and discomfort are available to an occupant of a home that has been damaged by defective construction, even when the occupant subsequently moves out of the home.

Chicago Mechanical, a contractor, improperly installed the HVAC system in plaintiffs' condominiums which led to a mold infestation. When plaintiffs were forced to move to substitute housing, they sued for inconvenience and discomfort damages. Plaintiffs argued that being displaced caused feelings of homelessness and dissatisfaction – they could not sleep in their own bed, bathe in their own bathroom, or cook in their own kitchen.

The court held that even though inconvenience and discomfort damages typically would be available in this fact scenario, these particular plaintiffs were not entitled to any money because their grievances were vague and subjective, focusing principally on the abstract sense of satisfaction from the comfort of their home. The home owners would have prevailed had they argued tangible damages such as inadequate amenities in the substitute housing, longer travel times to work or school, and any particular nuisances associated with the substitute housing (like having to live in tighter quarters or being exposed to road noise).

The majority of state courts hold, like *Chicago Mechanical*, that inconvenience and discomfort damages are available to plaintiffs whose homes have been negligently damaged. *Chicago Mechanical* provides an argument against such damages for construction industry participants that become involved in such litigation. If a plaintiff argues his theory of damages in a sentimental, abstract manner ("a feeling of homelessness and dissatisfaction") without the support of concrete, factual statements ("driving an additional 6 miles to work each day"), a builder or contractor may have a defense based on the generality of the allegations.

By Vesco Petrov

Bradley Arant Lawyer Activities:

Bradley Arant Boult Cummings' construction practice group was recognized as a Tier 1 national practice group by *U.S. News and World Report* in its first ever ranking of law firm practice groups. This ranking was based on the comments of clients and industry participants, and was performed in conjunction with Best Lawyers, a company which performs a highly-regarded semi-annual ranking of law firms. This recognition is client-driven, and we hope to continue in the future to deliver the services that win this respect.

Mabry Rogers was named "Lawyer of the Year" in the area of Construction Law for Birmingham, AL.

Jonathan Head co-presented a national webcast on June 3, 2010 for Defense Research Institute regarding privilege and its effect on major litigation.

David Pugh, Michael Knapp, Arlan Lewis, Luke Martin, Ed Everitt and Jonathan Cobb presented a seminar entitled "Fundamentals of Construction Contracts" on June 24, 2010 in Birmingham, AL.

Jonathan Head participated in a panel discussion at the Alabama State Bar annual conference on July 16, 2010 about Alabama's new electronic discovery rules and responses to common problems in electronic discovery.

Michael Knapp taught a course entitled "International Construction Contracts and Law" at Misr University of Science and Technology in Cairo, Egypt from July 24 to July 28th to graduate level engineering students.

David Taylor presented at an annual project managers meeting regarding "Dispute Avoidance" on August 4, 2010.

David Taylor spoke regarding the Tennessee Retainage and Prompt Pay Act to the Tennessee Professional Estimators Association on August 6, 2010.

Bob Symon spoke at the Mid-Atlantic Build Expo in Washington, DC on August 18-19, 2010.

David Taylor spoke regarding the Tennessee Prompt Pay Act and Retainage to the Tennessee Association for Professional Engineers on August 23, 2010.

Bob Symon and **Joel Brown** presented a Bid Protest discussion to Government Contractors in Huntsville, Alabama on August 26, 2010.

Jim Archibald, Sid Trant, Joe Gibbs, Nick Landau and **Rhonda Caviedes** spoke regarding emerging

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regulation and incentives in areas of construction, environmental and tax law at the Green Building Focus Conference & Expo in Birmingham, AL on August 26, 2010. Bradley Arant was a sponsor of this event.

Bob Symon presented a FAR seminar to a government contractor in Huntsville, Alabama on August 27, 2010.

Rhonda Caviedes was appointed to serve on the ABA Forum on the Construction Industry Marketing Committee and thereafter attended this committee meeting on September 1, 2010, Miami Beach, FL.

Arlan Lewis, Rhonda Caviedes, and **Michael Knapp** attended the ABA Forum on the Construction Industry's conference entitled "We Won't Get Fooled Again: Lessons Learned in the Economic Downturn" on September 2-3, 2010.

Arlan Lewis was a featured speaker at the American Bar Association Forum on Construction Industry 2010 Fall Meeting in Miami Beach, FL on the topic of "*Dangers and Dilemmas Associated with Waiving Subrogation Rights in the Construction Contract*."

David Taylor and **Chuck Mataya** led a "2010 Legal Update for Subcontractors" workshop at the September 23, 2010 meeting of the American Subcontractors Association of Tennessee.

Keith Covington wrote an article entitled "Military Leave Under ESERRA: Know Your Obligations" for the October/November 2010 edition of the Alabama Construction News.

David Taylor presented a seminar entitled "Legal Aspects of Construction Claims" to the Tennessee Association of CPAs on September 27, 2010.

Bob Symon provided a client seminar regarding Certified Payrolls and the Davis-Bacon Act in Rockville, Maryland on October 20, 2010.

Keith Covington attended the Defense Research Institute's Annual Meeting in San Diego, California from October 20-22.

David Pugh will serve as emcee at the November 4, 2010 ABC Excellence in Construction Awards Banquet in Birmingham, AL.

Rhonda Caviedes will be attending the 30th IRMI Construction Risk Management Conference on November 14-18 in Orlando, FL.

Jonathan Head and **David Deusner** will be speaking regarding e-discovery at a seminar in our Birmingham, AL offices on November 16, 2010.

Michael Knapp will present a session entitled "Drafting Effective, Enforceable Consulting Agreements to Protect and Maintain Privileges at Various Stages of Project/Litigation" at the 2011 Annual Meeting for the ABA Construction Forum in Scottsdale, Arizona, which is scheduled for April 14-16, 2011.

David Taylor has been named to the Legal Advisory Panel for the Tennessee Association of General Contractors.

Bradley Arant attorneys have recently presented training sessions to a number of clients regarding various topics, including Contract Administration, Risk Analysis and Management, and Mandatory Written Ethics Compliance Programs for Federal Government Contracts. If you are interested in these or similar seminars for your company, please contact one of the attorneys listed on page 8 of this newsletter.

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This newsletter is a periodic publication of Bradley Arant Boult Cummings LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact your lawyer or any of the lawyers in our group whose names, telephone numbers and E-mail addresses are listed below; or visit our web site at www.babc.com.

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Note: The following language is required pursuant to Rule 7.2 Alabama Rules of Professional Conduct: *No representation is made that the quality of the legal services to be performed is greater than the quality of the legal services performed by other lawyers.*

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READER RESPONSES

If you have any comments or suggestions, please complete the appropriate part of this section of the *Construction & Procurement Law News* and return it to us by folding and stapling this page which is preaddressed.

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  We are in the process of developing new seminar topics and would like to get input from you. What seminar topics would you be interested in?

  ____

  If the seminars were available on-line, would you be interested in participating? ☐ Yes ☐ No

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BRADLEY ARANT BOULT CUMMINGS LLP First Quarter 2011

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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No Immunity Under FHA and ADA

Under Federal Law, developers and owners are charged with designing and constructing housing projects that comply with the Fair Housing Act ("FHA") and the Americans with Disabilities Act ("ADA"). Owners, developers, contractors, subcontractors, and designers must all recognize that each bears a duty to comply with these laws. Construction contracts often include carefully negotiated provisions to apportion risk between these parties and to insure against the consequences of the risks accordingly. Industry participants and their lawyers should be aware that certain federal requirements may preempt state laws and contract provisions dependent on state law for enforcement.

The Fourth Circuit Court of Appeals (the federal court overseeing trial courts in Maryland, West Virginia, Virginia, North and South Carolina) recently ruled that a developer could not recover damages from an architect based on express indemnity, implied indemnity, breach of contract, or professional negligence, where the architect allegedly failed to design a project in compliance with FHA and ADA requirements. The Court reasoned that compliance with FHA and ADA requirements cannot be delegated to designers and contractors by owners and developers – all parties are responsible for meeting FHA and ADA standards.

In *Equal Rights Center v. Niles Bolton Associates*, the developer was sued by disability advocacy groups, charging that the design of its housing project failed to meet FHA and ADA requirements for accessibility to persons with disabilities. The developer ultimately entered into a consent decree under which the developer spent approximately $2.5 million dollars to retrofit its development and bring it into compliance with the FHA and ADA. The original architect for the project was not a party to the settlement but later entered into a separate settlement with the same plaintiffs that sued the developer.

The developer sought indemnity from the architect for the cost it incurred to retrofit the units designed by the architect. The district court granted the architect's motion for summary judgment and the Fourth Circuit affirmed. Both courts concluded that the FHA and ADA contained no right to indemnification. The courts further reasoned that allowing indemnification under state law would be antithetical to the purposes of the FHA and ADA. Thus,

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the developer could not recover the costs incurred to retrofit its housing project from the architect.

According to the Fourth Circuit, the doctrine of "obstacle preemption" enables Federal Courts to find state-law claims preempted where the state law claim might interfere with the accomplishment and execution of a federal statute. If owners could insulate themselves from ADA or FHA liability through contractual indemnity clauses, the Fourth Circuit reasoned, then FHA and ADA goals would be undermined. Hence, the state law claims asserted by the developer against the architect were pre-empted.

The decision potentially leaves open one avenue by which an owner might obtain relief from a contactor or designer. The owner initially failed to assert a common law claim for contribution. (While an indemnification claim seeks to transfer all of the liability from one party to another, a contribution claim seeks to apportion liability between parties based on their respective fault.) Ultimately, on the eve of trial, the owner attempted to add a claim for contribution. The District Court rejected the claim as untimely. The Fourth Circuit agreed. Both courts indicated, however, that the outcome of the case probably would not have been different even if the contribution claim were allowed.

Owners and developers expecting to protect their rights through indemnity clauses must recognize that not all risks can be transferred to other parties by contract. Many states interpret indemnity clauses narrowly. Moreover, certain federal statutes, including the ADA and FHA, may preempt state law claims for breach of contract and indemnity. Hence, owners and developers, at least in the states included in the Fourth Circuit, have an independent and non-delegable duty to evaluate whether their projects comply with these requirements.

By Jim Archibald

Implied Warranties: Does Your Contract Contain Terms in Addition to the Express Terms?

The Armed Services Board of Contractor Appeals recently ruled in the case of *Appeals of J.E. McAmis, Inc.*, that a contract warranty need not be expressly stated in the contract but, instead, may be implied from contract language and surrounding circumstances. For such a warranty to be valid, the contractor must prove that (1) the owner assured contractor of the existence of a fact; (2) the owner intended to relieve the contractor of the duty to ascertain the existence of the fact; and (3) the owner's assurance turned out to be untrue. The decision demonstrates that, by understanding both the letter and intent of contract documents, a contractor may be able to find relief from unanticipated changes and costs.

J.E. McAmis, Inc. contracted with the Army Corps of Engineers on a riverbed gradient facility project. The federal government provided contract drawings and specifications, which laid out the available routes for hauling rock and other materials to the site. Additionally, a note on these drawings stated that the construction site "SHALL BE ACCESSED ONLY BY ROADS DESIGNATED ON THE DRAWING." The contractor relied on the drawings in preparing an estimate for the hauling rates for the project. Also, in compliance with the terms of the contract, the contractor properly investigated the designated haul routes to ensure that they were indeed available for use under applicable county, local and state laws.

Subsequent to the signing of the contract, the local county government implemented an Urgency Ordinance that limited the weight of vehicles on the designated hauling routes and effectively eliminated the contractor's ability to deliver rock to a large portion of the project. Eventually, the federal government reached an agreement with the local county to reopen the hauling route to the contractor's use, but not before the contractor incurred substantial delay and disruption costs associated with having to re-sequence its work and re-route its hauling operations at an increased rate.

Ruling in favor of the contractor, the Board explained that the contractor validly demonstrated the existence of an implied warranty. According to the Board, the contractor established (1) that the government assured the contractor of the existence of specific unrestricted haul routes in the contract drawings; (2) by specifying haul routes, the government intended the contractor to be able to proceed with the project without establishing or negotiating its own haul routes; and (3) the government's assurance of the availability of the haul routes proved untrue. The Board concluded by awarding the contractor all of its claimed damages.

Injured parties should always consider whether the contract and the surrounding circumstances create an "implied" term in the contract. One that is well established in all jurisdictions is the implied duty not to hinder performance by the other party to a contract.

By Aman Kahlon

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Clear Pay-If-Paid Clauses Enforced in Alabama

Contractors and subcontractors expect to be paid; and "Pay-if-Paid" and "Pay-when-Paid" clauses play a critical role in determining payment when an entity in the contracting chain either becomes insolvent or simply disputes payment. A recent case, *Lemoine Company of Alabama v. HLH Constructors,* confirms that careful review of payment terms is key. Slight differences in the wording of a payment clause can be the difference between no payment and payment in full.

Lemoine was the general contractor for a condominium project in Baldwin County, Alabama. It subcontracted with HLH to perform the plumbing work. The project progressed as expected, and the owner paid Lemoine each of its payment applications. Lemoine, in turn, paid each of HLH's payment applications. A dispute arose when the owner failed to pay Lemoine its final payment application (retainage), and Lemoine contended that it did not have to pay HLH's final payment application (retainage) because of the owner's failure to pay. HLH disagreed and sued Lemoine for payment. The dispute ultimately made it to the Alabama Supreme Court which focused on the wording of two very important payment terms contained in the subcontract.

First, the court analyzed a clause which stated that the HLH would be paid by Lemoine *when* Lemoine received payment from the owner. Such a provision is known as a Pay-when-Paid clause. Alabama and many other state courts have construed such Pay-when-Paid clauses to mean that payment is not due to the subcontractor until the general contractor receives payment from the owner, *but if the general contractor is not paid by the owner within a reasonable time, the general contractor is still obligated to pay the subcontractor.*

Second, the court considered a clause stating that retainage would be withheld from each of HLH's progress payments, that payment of Lemoine's retainage by the owner was a condition precedent to the payment of HLH's retainage, and that HLH expressly assumed the risk of nonpayment by the Owner. Such clauses are known as Pay-if-Paid clauses and differ from Pay-when-Paid clauses in that the general contractor's obligation to pay a subcontractor never arises unless the general contractor is paid by the owner.

Considering these two payment terms in the subcontract, the Alabama Supreme Court reversed a lower Court and held that the Pay-if-Paid clause was enforceable with regard to the retainage; thus, Lemoine did not owe HLH its retainage. The court reached this conclusion even though it observed that Pay-if-Paid clauses are strongly disfavored and will only be enforced when a payment provision is clear that payment from the owner is a condition precedent to payment to the subcontractor and that the subcontractor assumes the risk of an owner's failure to pay.

States differ on the enforcement of Pay-when-Paid and Pay-if-Paid Clauses. Those states that recognize the two clauses and enforce the theoretical distinction focus heavily on the language included in the relevant contract. Considering the differing state law and risk of nonpayment from a defaulting contract party in the current economy, it is wise to consult a lawyer to draft or review payment terms before executing a construction contract.

By Bryan Thomas

Claim for Additional Work Barred for Failing to Provide Timely Written Notice

The recent case of *Weigland Construction Co. v. Stephens Fabrication, Inc.* underscores the importance of complying with notice requirements in construction contracts, even when those requirements are incorporated into the contract via a flow down provision. In *Weigland*, an intermediate appellate court in Indiana barred a subcontractor's claim seeking payment for additional work beause the subcontractor failed to provide timely written notice of the claim in accordance with the notice provisions incorporated into the subcontract by reference to the prime contract.

Weigland, the general contractor, subcontracted with Stephens, a structural steel fabricator, on a building project at Ball State University. The subcontract was in the form of a purchase order, which apparently contained no claim provisions of its own, but did include a flow down provision that incorporated the terms and conditions of the prime contract into the purchase order. The prime contract contained a claim provision providing that written notice of a claim must be provided within 21 days after "occurrence of the event giving rise to such Claim or within 21 days after the claimant first recognized the condition giving rise to the Claim, whichever is later." The claim provision also provided that notice of a claim for an increase in the contract value must be given before the party proceeds with executing that work.

After Stephens was awarded the steel fabrication subcontract, the owner's architect made several changes to the project's steel design. Weigland passed these changes on to Stephens, who provided them to its sub-consultant de-

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tailer and engineer. Stephens' detailer and engineer realized that the design changes would require substantial changes to their design; however, this concern was not immediately communicated to Weigland. It was not until 10 months after receiving the design changes that a Stephens employee orally informed a Weigland employee that the steel design changes would cause Stephens to perform extra work. Another month passed before Stephens sent Weigland written notice of its claim. The owner ultimately denied Stephens' claim at the project level for failure to provide timely notice under the contract.

Stephens filed suit against Weigland to recover the costs of the additional work, and prevailed in the trial court. On appeal, the trial court's ruling was reversed, and Stephens' claim for additional costs associated with the extra work was barred because Stephens failed to comply with the notice requirements of the prime contract. Stephens neither gave written notice within 21 days of the "occurrence" or from the moment Stephens "first recognized the condition" giving rise to its claim, nor did Stephens provide notice before it proceeded with a portion of the extra work (detailing and engineering). The court accordingly found Stephens failed to comply with the contract's notice requirements, and its claim for additional work was barred. The court's ruling also implicitly approved of the flow down provision in the purchase order, and even suggested that Stephens should have included a similar provision in its own subcontracts. Finally, the court found that Weigland had not waived the notice requirements by encouraging Stephens to submit its claim after the time had passed.

The *Weigland* case emphasizes the importance of complying with contractual notice requirements. By failing to provide timely written notice, the subcontractor in this case forfeited its right to be compensated for additional work that it performed over and above the original subcontract scope. Make sure you understand all obligations in your contracts, including those flow-down obligations in other referenced agreements.

By Ed Everitt

"Waiver of Subrogation" Means What it Says

The Appeals Court of Massachusetts recently considered the extent of the waiver of subrogation contained in the AIA standard form construction contracts. The Court concluded that the clause was not limited to either the type of policy or by when the policy was purchased.

A "waiver of subrogation" clause is a clause by which parties attempt to allocate the risks of certain types of losses which may be experienced in the performance of a contract. Subrogation is the right of an insurance company to "step into the shoes" of its insured and attempt to pursue recovery from another person or entity, any amounts it paid to its insured for a loss. Parties to a contract sometimes waive the right to make claims against each other for certain types of accidental or fortuitous losses, choosing instead to purchase insurance to cover such a loss. For example, an owner and a contractor may not want to sue each other in the event of a fire which results in a loss to a construction project in progress even if the negligence of one or both of them caused or contributed to the fire. Instead, they purchase a builders risk policy for such losses during construction and the owner purchases permanent property insurance for such risks after construction is completed. The parties then waive the rights of subrogation each has against the other and agree to look solely to the insurance company to bear the loss.

In the Massachusetts case, a fire severely damaged an apartment complex approximately two years after construction was completed. The owner's property insurer paid $4,744,150.14 to repair the damage and then sued the architect, general contractor and fire suppression subcontractor in a subrogation action to recover the money it had paid the owner. The defendants obtained summary judgment from the trial court relying on the waiver of subrogation language in the standard form AIA A201 General Conditions. The owner's insurer appealed arguing that the waiver of subrogation only applied to insurance purchased during the construction of the building and not for a loss after completion.

The intermediate appellate court concluded there was no such limitation. The waiver of subrogation applied to any subrogation claim based on the performance of the parties' duties under the construction contract whether it was during construction or after completion. Likewise, the waiver applied whether it was pursuant to a builders' risk policy purchased for losses during construction or permanent property insurance for losses after completion.

Waiving the right of subrogation can be an effective risk management tool in the construction industry. When negotiating contracts, owners, contractors, and subcontractors should all be aware of the potential long term impact of such waivers and should consult a knowledgeable risk manager to ensure that such mutual waivers will not void or limit the coverage under your respective policies.

By David Pugh

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E-Discovery: The Production of Metadata

Judge Shira Scheindlin wrote the seminal *Zubulake* case that ushered in the modern era of e-discovery. She recently ruled on another significant e-discovery issue for companies who file Freedom of Information Act (FOIA) requests with the federal government. The case resolved whether the government must produce metadata — information describing how the government had kept its electronic files before producing them to the requester — in response to a FOIA request. Judge Scheindlin writes, "[C]ertain metadata is an integral or intrinsic part of an electronic record. As a result, such metadata is 'readily reproducible' in the FOIA context. . . . [M]etadata maintained by the agency as part of an electronic record is presumptively producible under the FOIA. . . ."

The government produced documents in PDF format, without any metadata. The government created unsearchable PDF files, separated attached files from emails, and combined documents into a few large files. The requester had specified the format it wanted the records produced in. (It cleverly based its request on format demands made by government agencies in other litigation.) The government never agreed or objected to the requested forms of production.

The court rejected the government's argument that the FOIA and the Federal Rules of Civil Procedure conflicted, since the FOIA was "silent with respect to form of production." Because "common sense dictates that parties incorporate the spirit, if not the letter, of the discovery rules" in FOIA litigation, the federal government must include metadata in its FOIA productions. Judge Scheindlin also held that "certain metadata is an integral . . . part of an electronic record."

The court did not make the government reproduce all the requested records, but the government had to meet the requester's original specification. For all electronic productions, the court required disclosure of each file's location within the government's information systems, the custodian of the file, and last date the government modified the files. For email productions, the court required additional production of all sender and recipient information, the date and time the email was sent and received, the subject of the email, and the identification of any attachments to the email.

Judge Scheindlin's reasoning springs from the principles that "metadata is generally considered to be an integral part of an electronic record" and "production of a collection of [unsearchable] static images . . . is an inappropriate downgrading" of electronically stored information. By calling this metadata production "basic," this case sets a standard for other federal courts to follow. Construction industry beware, Judge Scheindlin has likely raised the standard of e-discovery practice again.

Do you have a document retention policy in place that covers electronic data and metadata that will allow you to comply with the new elevated standard? If not and you think you might need a hand, call one of the BABC lawyers (or your own lawyer) to discuss the services that may be in order.

By Jonathan Head

Bradley Arant Lawyer Activities:

Mabry Rogers was named "Lawyer of the Year" by the Best Lawyers survey firm in the area of Construction Law for Birmingham, AL.

Mabry Rogers is one of 318 lawyers recently named to a group of highly service-oriented lawyers in the United States. The BTI Client Service All-Stars are a group of attorneys whom clients recognize for superior client service. The only path to becoming a *BTI Client Service All-Star* is for corporate counsel and corporate-level executives to single out an attorney by name in an unprompted manner as part of independent research conducted by BTI Consulting. BTI specializes in providing high-impact client service and strategic market research regarding law firms and lawyers.

Keith Covington wrote an article entitled "Military Leave Under ESERRA: Know Your Obligations" for the October/November 2010 edition of the Alabama Construction News.

David Taylor presented a seminar entitled "Legal Aspects of Construction Claims" to the Tennessee Association of CPAs on September 27, 2010.

Bob Symon provided a client seminar regarding Certified Payrolls and the Davis-Bacon Act in Rockville, Maryland on October 20, 2010.

Keith Covington attended the Defense Research Institute's Annual Meeting in San Diego, California from October 20-22.

David Pugh served as emcee at the November 4, 2010 ABC Excellence in Construction Awards Banquet in Birmingham, AL.

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Rhonda Caviedes attended the 30th IRMI Construction Risk Management Conference on November 14-18 in Orlando, FL.

Jonathan Head and **David Deusner** spoke on e-discovery at a seminar on November 16, 2010.

Doug Patin and **David Owen** attended Construction SuperConference 2010 in San Francisco, California in December.

David Taylor and **Bryan Thomas** Spoke in Nashville, TN on January 14, 2011 as part of the Tennessee Bar Association Seminar "Tennessee Construction Law: A – Z: What You Do NOT Know Can Hurt You."

Stanley Bynum, Walter Sears, Arlan Lewis and **Rhonda Caviedes** attended the ABA Forum on Construction Industry's Midwinter Joint meeting with the TIPS Fidelity and Surety Law Committee entitled "Do You Think it's Alright: Pushing the ADR Envelope" in New York City on January 20-21, 2010.

Arlan Lewis has been selected to serve as one of four judges for the ABA Forum on the Construction Industry's inaugural Law Student Writing Competition. The competition is national in scope and the winning entry will be published in one of the Forum's publications. The award will be presented in April during the Forum's 2011 Annual Meeting in Scottsdale, Arizona.

Nick Voelker and **James Warmoth** published an article entitled "'Buy American' Primer" for the South Carolina Bar's Construction Law Section in its Winter 2011 Edition.

Mabry Rogers and **David Bashford** presented client seminars on risk management in the operations and maintenance, engineering, and construction management power plant environments at several locations in the southwest in February.

Mabry Rogers, Wally Sears, and **Bill Purdy**, attended the American College of Construction Lawyers annual meeting in February 2011. Bill was in charge of the programming for this event.

David Pugh participated in Associated Builders and Contractors' BizCon 2011 in Orlando, Florida on February 23-25, 2011

Joel Brown presented via teleconference a seminar entitled AID Document A401 on March 2, 2011

Michael Knapp will present a session entitled "Drafting Effective, Enforceable Consulting Agreements to Protect and Maintain Privileges at Various Stages of Project/Litigation" at the 2011 Annual Meeting for the ABA Construction Forum in Scottsdale, Arizona, which is scheduled for April 14-16, 2011.

Bill Purdy will make three national presentations to NISH (redesignation for the National Institute for the Severely Handicapped) which administers hundreds of millions in federal government set-asides under the Javits-Wagner-O'Day Act. On March 23, 2011, he will present to high ranking NISH officials and NISH-associated non-profit agency executives on "Top 10 Risks in Subcontracting on Federal Projects" at two locations in the Washington, D.C. area. On May 25, 2011, he will present a lecture entitled "Managing Relationships with Contracting Partners" at the 2011 NISH National Training and Achievement Conference in Orlando, FL. Lastly, he will present three two-day seminars and workshops in Atlanta on April 26-27, in Chicago on June 28-29, and in Los Angeles on November 2-3, all entitled "Subcontracting of Federal Projects".

David Taylor and **Bryan Thomas** will be presenting a session at the CONSTRUCT2011 Seminar in Chicago, Illinois on September 16, 2011.

Bradley Arant Boult Cummings' construction practice group was recognized as a Tier 1 national practice group by the U.S. News and World Report in its first ever ranking of law firm practice groups. This ranking was based on the comments of clients and industry participants, and was performed in conjunction with Best Lawyers, a company which performs a highly-regarded semi-annual ranking of law firms. We are grateful for this recognition, and we look forward to continued success in providing practical and quality legal services to each of our clients.

Bradley Arant attorneys have recently presented training sessions to a number of clients regarding Contract Administration and regarding Mandatory Written Ethics Compliance Programs for Federal Government Contracts. If you are interested in either of these seminars for your company, please contact one of the attorneys listed on page 8 of this newsletter.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

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The lawyers at Bradley Arant Boult Cummings LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

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Note: The following language is required pursuant to Rule 7.2 Alabama Rules of Professional Conduct: *No representation is made that the quality of the legal services to be performed is greater than the quality of the legal services performed by other lawyers.*

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BRADLEY ARANT BOULT CUMMINGS LLP Second Quarter 2011

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

F. Wendell Allen
James F. Archibald, III
David H. Bashford (c)
Ryan Beaver (c)
Axel Bolvig, III
Joel E. Brown
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Robert J. Symon (d.c.)
David K. Taylor (n)
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Darrell Clay Tucker, II
D. Bryan Thomas
Paul S. Ware
James Warmoth (c)

Teaming Arrangements for Small Businesses

The Small Business Administration (SBA) and Department of Defense (DoD) provide several teaming arrangements for small business contractors to compete for federal construction contracts set aside for small business entities. The term "team arrangement" generally refers to the types of strategic alliances contractors have formed to enhance efficiencies, exploit complementary capabilities, and increase competitiveness in the federal contracting marketplace. The major types of team arrangements include teaming agreements, joint ventures and mentor-protégé arrangements. The federal government recognizes the integrity and validity of these contractor team arrangements as long as the arrangements are identified and company relationships are fully disclosed in a competitive proposal or, for arrangements entered into after submission of a competitive proposal, before the teaming arrangement becomes effective.

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<u>Teaming Agreement</u>

The prevailing federal teaming business model, as it relates to small business, is one in which large businesses are motivated to seek out small businesses as team members. These team members act as subcontractors if the team is awarded a contract. A teaming agreement is not a subcontract for the performance of work under a prime contract. Rather, it is an agreement to work together to pursue a prime contract with the promise to work together (in good faith) to negotiate appropriate subcontracts with the team members if the team is successful in winning a contract award.

Key elements of successful teaming agreements include:

- Clearly defined proposal preparation responsibilities of all team members.
- Statement-of-work tasks clearly divided among team members.
- Protection of competition-sensitive proprietary information of all team members.

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- Exclusivity provisions to ensure that team members cannot be easily replaced and that team members will not team with other firms on the same procurement proposal.
- Clear event or condition that ends the teaming agreement.

When the team members are successful in their procurement pursuit and the proposed prime contractor is awarded a contract, the team members must then negotiate in good faith to enter into appropriate subcontracts with team members acting as a subcontractor to the prime.

There are occasions when "teams" become the prime contractor—often called a "consortium." Like the Joint Venture arrangement discussed below, a consortium is a partnership, such that, to third parties, each individual entity in the "team" or the "joint venture" has complete liability for all of the team's or joint venture's debts.

Joint Venture Arrangements

Another type of team arrangement is a joint venture. A joint venture is an association of two or more individuals or entities formed to undertake a particular project. Members of the joint venture share in the profits or losses of the project, generally in proportion to each entity's contributions to the project or venture. The joint venture members may but are not required to organize and operate a separate joint venture entity. Also, the SBA may view some teaming arrangements between prime and subcontractors as constituting joint ventures and conclude that the entities are affiliated.

The joint venture itself (which includes all the members of the joint venture) contracts directly with the government. If any member of the joint venture fails to adhere to the terms and conditions of the contract, the entire joint venture entity – and not solely the joint venture member at fault – will be held responsible. For this reason, it is advisable for joint venture members to include indemnification provisions in the joint venture agreement.

In addition, the joint venture agreement should clearly define the roles of each member of the joint venture. The joint venture agreement should indicate that the members are individually and severally liable for contract performance. In addition, the joint venture agreement should indicate how profits and losses are to be distributed.

Key elements of joint ventures are as follows:

- The contract is in the name of the joint venture entity.
- The joint venture entity is responsible for contract performance.
- Joint venture members contract directly with the government.
- Joint venture members are individually and equally liable for contract performance.
- Joint venture members share profits and risk of loss.
- Indemnification provisions protect the joint venture from the negligent actions or inactions of a joint venture member.
- The agreement must have clear decision making mechanisms in the event of an impasse, to avoid an inability to act.
- The agreement must provide for "capital" assessments of JV members, to provide working capital.

Mentor-Protégé Arrangements

A third type of teaming arrangement is the mentor-protégé arrangement. A small business can enter into a mentor-protégé arrangement with a more experienced business to pursue procurement opportunities as a joint venture. Mentor-protégé programs are designed to encourage more-established businesses to provide developmental assistance to small businesses to enhance their capabilities in performing federal procurement contracts. The objectives of mentor-protégé programs include fostering long-term relationships between the more established business and the small businesses and increasing the viability of the small business entities receiving federal contracts.

There are two types of mentor-protégé programs: the SBA Mentor-Protégé Program and the DoD Mentor-Protégé Program. The SBA Mentor-Protégé Program enables businesses certified as small disadvantage businesses (SDBs) under Section 8(a) of the Small Business Act to form a joint venture with a mentor firm (either a large or small business) in pursuit of federal procurement contracts. As long as the Section 8(a) protégé qualifies as small for the procurement, the joint venture itself will be deemed small without regard to the size of the mentor.

Unlike the SBA Mentor-Protégé Program, which permits protégés to form a joint venture with mentors, the

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DoD Mentor-Protégé Program contemplates that the mentor will provide subcontracting opportunities to the protégé. A mentor firm must have at least one active, approved subcontracting plan negotiated either with DoD or another federal agency and be eligible for federal contracts. Protégé firms may be an SBA-certified SDB, SBA-certified SDB owned and controlled either by an Indian tribe or a Native Hawaiian Organization, a qualified organization employing the severely disabled, woman-owned small business, SBA-certified HUBZone small business, or a service-disabled veteran owned small business.

The DoD mentor-protégé arrangement is designed to provide mutual benefit both to the small business and to the more established mentor business. The protégé business receives invaluable technical, managerial, financial, or other types of developmental assistance from the mentor business, enabling the small business to improve contract performance, while the mentor firm is eligible to receive either direct reimbursement for allowable costs of developmental assistance or credit toward the performance of subcontracting goals for acquisitions that require the submission of a subcontracting plan. Costs incurred by a mentor firm in assisting a protégé firm are allowable to the extent they are incurred in the performance of a contract identified in a mentor-protégé agreement, or are otherwise allowable in accordance with applicable cost principles.

Small businesses can form numerous types of team arrangements—teaming agreements, mentor-protégé agreements and various types of joint ventures—to pursue new or consolidated procurements. These various team arrangements enable small businesses to marshal complementary capabilities, enhance bondability, and, ultimately, to increase competitiveness in the federal procurement marketplace. If you have any questions about the teaming arrangement discussed above, please contact the authors or any member of our construction practice group or you own lawyer.

By Paul Ware and Frederic Smith

Multiple Schedules Lead to a Disastrous Result

In the recent case of *Bast Hatfield, Inc. v. Joseph R. Wunderlich, Inc.*, a general contractor was held to have wrongfully terminated one of its subcontractors when the general contractor tried to manage a job to two different schedules. Bast Hatfield, Inc. ("Bast") contracted to build a Lowe's Home Improvement Center in Albany County, New York. The prime contract included an October 21, 2003 substantial completion date with liquidated damages assessed after that date. The overall Project schedule, however, was expressly dependent upon the Owner's timely demolition and removal of several existing structures on the Project site.

Bast subcontracted a portion of the work to Joseph R. Wunderlich, Inc. ("Wunderlich"). The subcontract included a "time is of the essence" provision and set forth a substantial completion date of October 31, 2003 along with a final completion date of November 15, 2003. The subcontract also required Wunderlich to "coordinate its work so as to be completed by the date indicated on Bast's progress schedule in support of the overall completion date."

The owner failed to demolish the existing buildings on time and delayed the overall project completion. In addition, Wunderlich encountered numerous other delays and obstacles after work began in August 2003, which Wunderlich contended were attributable to Bast or the owner or both of them. In spite of the delays, Bast attempted to hold Wunderlich to the original substantial completion date in the subcontract and sent Wunderlich a "Notice to Cure" threatening termination for default unless certain issues were cured, including timely completion of its work. Undisputed evidence at trial indicated that Wunderlich cured some, if not all, of the issues cited by Bast, except for the timely completion of the project. Yet, Bast partially terminated Wunderlich for default shortly after the original completion date. Wunderlich responded with a mechanic's lien demanding to be paid its contract balance and other damages. Bast sued Wunderlich alleging that Wunderlich defaulted on its subcontract by not timely completing its work.

The trial court noted that Bast had been given extensions of time because of the owner delays and that Bast's overall Project schedules showed much later completion dates than the completion date in the subontract with Wunderlich. Thus, the trial court held that Wunderlich had been wrongfully terminated and was entitled to be paid by Bast. In reaching its decision, the court noted that all the provisions of a contract must be read together in construing its meaning. While the subcontract stated a specific substantial completion date, it also expressly referenced the overall Project schedule and obligated Wunderlich to coordinate its work to support the overall *Project substantial completion date,* as adjusted.

By David Pugh

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Court Allows Local Regulation of Jobsite Air Pollution

Before you enter an unfamiliar jurisdiction, review the local laws and regulations affecting construction. In *National Association of Home Builders v. San Joaquin Valley Unified Air Pollution District*, the Ninth Circuit Court of Appeals upheld a local rule regulating air pollution emanating from construction sites. The rule was aimed at reducing air pollution generated by off-road construction equipment, an area of regulation usually reserved to the federal EPA that normally has only an indirect effect on construction costs.

The local rule required developers, or their contractors, to file an Air Impact Assessment ("AIA") as a condition to approval of a project. The AIA required the applicant to use an approved computer model to determine the baseline amount of pollutants and particulates that would ordinarily be generated by the project, assuming no mitigation. The rule then required the applicant to reduce certain pollutants by 20% and certain particulates by 45%, through the use of new equipment or extraordinary measures, or else pay "fees" for the right to exceed the reduced amounts.

Hence, a local entity passed regulations treating a jobsite as a "facility" and a source of air pollution. This approach fills the gap between state regulation of stationary sources of emissions and federal regulation of emissions from vehicles and other mobile sources. It is somewhat analogous to the approach taken by Clean Water Act regulation of construction sites. Consider local laws such as these when evaluating or estimating your next project in an unfamiliar jurisdiction.

By Axel Bolvig

Alabama State and Local Sales and Use Tax Issues for Contractors

Contractors doing business in Alabama face a variety of unique state and local tax issues. This article briefly summarizes recent efforts to reinstate the government contractor exemption from sales and use taxes and an alternative arrangement that allows a contractor to utilize a tax-exempt status of an owner to purchase materials tax-free if certain procedures are followed.

Repealed Government Contractor Exemption – Recent Developments

In 2000, the Alabama Legislature created a sales and use tax exemption for contractors that purchased or used materials to be incorporated into realty pursuant to a contract with a government entity. The exemption was effectively repealed in 2004, and recent efforts to reinstate the exemption have failed. However, legislation has been introduced this session (House Bill 284 / Senate Bill 200) that would allow the Department of Revenue (the "Department") to issue certificates of exemption from sales and use tax to licensed contractors and subcontractors to purchase building materials and construction materials to be used in the construction of a building or other project for a governmental entity which is exempt from Alabama sales and use tax. Both proposals are still pending committee action in their respective houses of origin, and need to move quickly if they are going to pass this session.

Purchasing Agent Appointment Form

Since the repeal of the exemption discussed above, in most (but not all) instances government contractors are allowed to purchase building and construction materials tax-free only if they have a valid purchasing agency relationship authorizing the contractor to make purchases on behalf of the governmental entity. The Department will recognize an agency relationship if there is a *written contract* between the exempt owner and the contractor-agent establishing that:

- the appointment was made prior to the purchase of materials;
- the purchasing agent has the authority to bind the exempt entity contractually for the purchase of tangible personal property necessary to carry out the entity's contractual obligations;
- title to all materials and supplies purchased pursuant to such appointment shall immediately vest in the exempt entity at the point of delivery, and
- the agent is required to notify all vendors and suppliers of the agency relationship and make it clear to such vendors and suppliers that the obligation for payment is that of the exempt entity and not the contractor-agent.

The Department has created a form agreement that may be used to satisfy the above requirements. That form is available on the Department's website at http://www.revenue.alabama.gov/salestax/ST_PAA1.pdf. Please note that most purchase orders must be amended to comply with the regulatory requirements outlined above.

These forms are widely used, with variations, in many jurisdictions as well as Alabama. Please do not hesitate to

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contact the authors, any member of our State and Local Tax Practice Group, or your lawyer if you have any questions regarding the above issues.

By James E. Long, Jr. and William T. Thistle

Elevated Water Level in Dam-Controlled Lake May Constitute a Type II Differing Site Condition

In *Virginia v. AMEC Civil, L.L.C.*, AMEC contracted with the Virginia Department of Transportation ("VDOT") to construct a bridge across a dam-controlled lake. The U.S. Army Corps of Engineers regulated the lake's water levels. As such, the water levels routinely fluctuated throughout the course of the year. The contract required AMEC to study the Corps' historical records on the lake's water levels and use the information to account for days in AMEC's project schedule when water levels would prevent work on the bridge.

AMEC adhered to the terms of the contract and planned to do other work in its scope during the periods where forecasted high water levels would prevent work on the bridge. However, during the project, AMEC experi-nced sustained high water levels for six months, a period greatly exceeding the amount forecasted. The VDOT construction manager, a lifelong resident of the area, testified that (1) the lake had never been at such a high level for that long a period, (2) the high water levels were an unusual occurrence, and (3) he did not expect the water levels to remain that high for that length of time when he began the project. VDOT granted AMEC a schedule extension for the delays caused by the high water levels but did not award compensation. AMEC sought relief in a Virginia circuit court. On appeal, the Supreme Court of Virginia addressed, among a number of other issues, whether or not the sustained high water levels experienced by AMEC constituted a differing site condition.

The "differing site conditions" clause of the contract provided for compensation to AMEC "when either (1) subsurface or latent physical conditions encountered during the work differed materially from those indicated in the contract (Type I condition) or (2) unknown physical conditions of an unusual nature, differing materially from those ordinarily encountered and generally recognized as inherent in the work provided for in the contract are encountered (Type II condition)." The Court held that the abnormally elevated water level constituted a Type II condition.

According to the Court, a contractor can demonstrate a Type II condition by showing "(1) [the contractor] did not know about the physical condition, (2) [the contractor] could not have reasonably anticipated the condition from inspection or general experience, and (3) the condition varied from the norm in similar contracting work." The Court concluded, based on the "ample evidence" regarding the unusual duration and circumstances of the high water levels, that the elevated water levels constituted a Type II differing site condition. The elevated water levels were an "unknown physical condition of an unusual nature, which differed materially from those ordinarily encountered and recognized as inherent in the work." Further, AMEC could not have anticipated the duration of the high water levels from its study of the contract, the Corps' historical records, inspection of the site, or general experience as a contractor in the area.

The Virginia Supreme Court noted that the purpose of the "differing site conditions" clause is to produce competent low bids on construction projects by shifting the risk of unknown conditions to the Government. The decision demonstrates that courts will uphold this risk allocation device even when a contract accounts for fluctuations in site conditions, if that accounting mechanism later turns out to be inaccurate due to government action.

By Aman Kahlon

Subcontractor's Insurer Liable to General Contractor for Defective Work on Condominium

In a case involving the construction of a condominium complex in Louisiana, the general contractor was covered by the subcontractor's completed operations insurance, at least for damage resulting from the subcontractor's poor workmanship. In *Carinder v. BASF Corporation, and others,* an intermediate state appellate court in Louisiana decided two points: (1) Although it had concluded in an earlier suit by the same general contractor against the same subcontractor that the sub's insurance did **not** protect the general contractor for the general contractor's costs of making repairs to the sub's defective work, it held, in the second lawsuit, that the prior lawsuit did not bar the general contractor's new claim against the subcontractor, which resulted from claims by the condominium owners for "resulting damage" to their units arising from the leaky synthetic stucco; and (2) the court ruled that the "resulting damage" was covered by the subcontractor's completed

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operations insurance, because "resulting damage" was not excluded by the "your work" provision in the policy.

Most courts, like the Louisiana court in this case, have decided that the exclusion for damage to "your work" does **not** exclude coverage for property damage to other work, such as interior drywall, floors, rugs, and similar items. The case is a reminder of our oft-repeated observation that general contractors and subcontractors should always check their own insurance coverage, as well as coverage at each lower tier, for possible protection when there is damage arising from defective work.

By Mabry Rogers

Virginia Court Applies Anti-Indemnity Statute to Void Indemnification Provision

In *Uniwest Construction, Inc. v. Amtech Elevator Services, Inc.*, the Supreme Court of Virginia held that an indemnification provision violated public policy because, in addition to indemnifying the general contractor for injuries resulting from the subcontractor's negligence, it also required the subcontractor to indemnify the general contractor for damages caused by the general contractor's own negligence.

Uniwest involved a contract between a general contractor and a subcontractor in which the subcontractor agreed to indemnify the general contractor from all claims, even those resulting from the general contractor's own negligence. Virginia statute, however, expressly voids any provision in which a contractor agrees to indemnify the other party in the contract against liability caused by the negligence of the other party.

The dispute arose after two of the subcontractor's employees were injured on the project. The injured employees sued the general contractor and the subcontractor. The general contractor turned to the subcontractor for indemnification, but the trial court held that the indemnification provision was void as contrary to public policy.

On appeal, the general contractor argued that statute was not implicated because the accident was not the result of the general contractor's sole negligence but was, at least partially, due to the negligence of the subcontractor. The Court, however, stated that it did not matter if the subcontractor was at fault or if the provision encompassed the negligence of other parties. Because the provision was so broad that it indemnified the general contractor from its own negligence, the entire indemnification provision was void and unenforceable.

Here, the Court's holding hinged upon the existence of the Virginia statute, and not all states have similar legislation. This is an excellent example of why contractors at all tiers should be mindful ofthe law of the particular jurisdiction during the negotiation process. Just because the party across the table will agree to a provision does not mean the courts will enforce it; you should check with your lawyer or one of our lawyers when you are entering a new jurisdiction to get some feel for the enforceability of certain significant clauses.

By Jonathan Cobb

Bradley Arant Lawyer Activities:

Jim Archibald, Axel Bolvig, Mabry Rogers, and **Wally Sears** were named Alabama Super Lawyers for 2011 in the area of Construction Litigation.

Mabry Rogers was named "Lawyer of the Year" in the area of Construction Law for Birmingham, AL.

Arlan Lewis was named an Alabama Rising Star for 2011 in the area of Construction/Surety.

Mabry Rogers is one of 318 lawyers recently named to a group of highly service-oriented lawyers in the United States. The BTI Client Service All-Stars are a group of attorneys whom clients recognize for superior client service. The only path to becoming a *BTI Client Service All-Star* is for corporate counsel and corporate-level executives to single out an attorney by name in an unprompted manner as part of independent research conducted by BTI Consulting. BTI specializes in providing high-impact client service and strategic market research regarding law firms and lawyers.

Doug Patin and **David Owen** attended Construction SuperConference 2010 in San Francisco, California in December.

David Taylor and **Bryan Thomas** spoke in Nashville, TN on January 14, 2011 as part of the Tennessee Bar Association Seminar "Tennessee Construction Law: A – Z: What You Do NOT Know Can Hurt You."

Stanley Bynum, Walter Sears, Arlan Lewis and **Rhonda Marshall** attended the ABA Forum on Construction Industry's Midwinter Joint meeting with the TIPS Fidelity and Surety Law Committee entitled "Do You Think it's

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Alright: Pushing the ADR Envelope" in New York City on January 20-21, 2010.

Arlan Lewis was selected to serve as one of four judges for the ABA Forum on the Construction Industry's inaugural Law Student Writing Competition. The competition is national in scope and the winning entry will be published in one of the Forum's publications.

Nick Voelker and **James Warmoth** published an article entitled "'Buy American' Primer" for the South Carolina Bar's Construction Law Section in its Winter 2011 Edition.

Mabry Rogers, Wally Sears, and **Bill Purdy** attended the American College of Construction Lawyers annual event in February 2011. Bill was in charge of the programming for this event.

David Pugh participated in Associated Builders and Contractors' BizCon 2011 in Orlando, Florida on February 23-25, 2011.

Joel Brown presented a teleconference seminar entitled AID Document A401 on March 2, 2011.

Michael Knapp, Arlan Lewis, Rhonda Marshall, and David Deusner attended the 2011 Annual Meeting for the ABA Construction Forum in Scottsdale, Arizona. Michael Knapp presented a session entitled "Drafting Effective, Enforceable Consulting Agreements to Protect and Maintain Privileges at Various Stages of Project/Litigation."

David Pugh, Wally Sears, and **Matt Lonergan** attended the ABC Region IV Conference in Charlotte, NC on March 31 and April 1. David Pugh coordinated the programming, Wally Sears spoke on Risk Management and Allocation, and Matt Lonergan spoke on Recent Labor Law developments.

Mabry Rogers and **David Bashford** are presenting client seminars on risk management in the operations and maintenance, engineering, and construction management of power plant environments in May.

David Taylor spoke to the Tennessee Association of Construction Counsel on May 6, 2011 at their Spring meeting in Oxford Mississippi on "Innovative Arbitration Techniques."

David Taylor, David Pugh, Ralph Germany, David Bashford, Bryan Thomas, and **Ryan Beaver** are collectively presenting the "2011 Construction Contract: Legal 101 Seminar" in Nashville, TN on May 13, 2011, Birmingham, AL on May 19, 2011, and Charlotte, NC on May 26, 2011 The seminar is open to the firm's clients, and there is still room available for the Charlotte seminar on May 26. Contact any of the lawyers on the list below to learn more.

David Pugh and **Bob Symon** will present a seminar on the Pitfalls of Federal Contracting at the joint ABC/AIA Joint Conference in Sandestin, FL on June 9, 2011.

David Taylor and **Bryan Thomas** will present a session at the CONSTRUCT2011 Seminar in Chicago, Illinois on September 16, 2011.

It is with mixed emotions that we report that **Ed Everitt** has left Bradley Arant Boult Cummings to take an in house position with a firm client and a major entity in the construction industry. We are grateful for his years of service and for the time he dedicated to the firm and its construction clients. We wish him the best of luck in his new endeavors.

On Monday evening, June 13, 2011, Bradley Arant will host a cocktail reception at its Washington, D.C. office for those attending the Associated Builders & Contractors Legislative Conference 2011.

Bradley Arant attorneys have recently presented training sessions to a number of clients regarding Contract Administration and regarding Mandatory Written Ethics Compliance Programs for Federal Government Contracts. If you are interested in either of these seminars for your company, please contact one of the attorneys listed on page 8 of this newsletter.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

NOTE: YOU CAN FIND THIS NEWSLETTER AND PAST NEWSLETTERS ON OUR WEBSITE. IF YOU ACCESS THIS NEWSLETTER ON OUR WEBSITE, CASE-LINKS WILL BE AVAILABLE UNTIL THE NEXT NEWSLETTER IS PUBLISHED. WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY GO TO WWW.BABC.COM/PG_CONSTRUCT.CFM OR CONTACT ANY ATTORNEY LISTED ON PAGE 8 OF THIS NEWSLETTER.

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The lawyers at Bradley Arant Boult Cummings LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

This newsletter is a periodic publication of Bradley Arant Boult Cummings LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact your lawyer or any of the lawyers in our group whose names, telephone numbers and E-mail addresses are listed below; or visit our web site at www.babc.com.

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BRADLEY ARANT BOULT CUMMINGS LLP **Third Quarter 2011**

CONSTRUCTION AND PROCUREMENT LAW NEWS

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Fundamentals of a Performance or Payment Bond

How many times have you or your company been reminded to read the bond (performance or payment) before you make a substantial alteration to a subcontract? Advice like this is fundamental, and it applies most pointedly when a bonded subcontractor is in, or may be close to, default. A recent case supplies a reminder from New York. The construction manager (not at risk) defaulted the sub in January 2007 and, by April, had executed a MOU (Memorandum of Understanding) extending substantial completion and withdrawing the default. The surety (Federal) participated in the negotiations leading to the April MOU. By August, the construction manager learned that its customer had not obtained payment authorization for the subcontractor from NYC, which was the ultimate source of the payments to the subcontractor. A superseding MOU was negotiated in August, where the subcontractor agreed to submit the paperwork to get registered with NYC, and, in the meantime, would work without pay (some $8 to $12,000,000, depending on how one reads the court opinion) and receive additional extensions of time. The surety was NOT involved in the new MOU, nor was it even informed of it; an email suggested the parties had decided expressly against telling the surety. When the sub defaulted a month later, the construction manager demanded that the surety perform, attaching the August MOU. The surety immediately objected, stating that the change to the payment terms was a material change to its obligations under the bond. The City funded the replacement contractor's costs, and the City and construction manager sued the surety for the overrun.

The federal trial court ruled in the surety's favor: the bond was materially changed when the subcontractor was asked to, and agreed to, work for free pending submission of paperwork to NYC. The court found that approval of the sub by NYC had not been an express part of its contract with the

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construction manager, so that waiting for that approval (and working for free in the meantime) was a material change to the subcontract and thus to the surety's obligation under the bonds. Because of the change, the surety was released of its obligation to perform (or pay) under the bonds.

This case serves as yet another reminder. Read the bond. Keep the surety in the loop, particularly on changes to the subcontract. And, follow any default procedures called for in the bond, as well as those in the subcontract. These fundamentals of construction contracting are simple, yet extremely important. Here, they were worth $8,000,000 to $12,000,000.

By Mabry Rogers

Alabama's 2011 Legislative Session Update

The most recent legislative session saw a number of bills passed which affect construction, and which are similar to legislation in other states, following the elections in November 2010. The design and construction industry is closely watching developments regarding Alabama's new Immigration Reform law, also passed this session, as it is likely to have an adverse impact on the industry.

Immigration Reform

The most dramatic new law is, of course, Alabama's new Immigration Reform law. While its stated purpose is to help the State combat illegal immigration, the bill could have serious adverse effects on the ability to carry on a construction business in Alabama. In addition to the immediate reduction in the available pool of skilled workers, the bill imposes several new record keeping and fact finding burdens on individuals and businesses that hire or may hire undocumented workers and also imposes potential criminal liability for violations of the bill's provisions. Many feel that the bill places too heavy a burden on an industry which is already weakened by the severe economic downturn.

Since the passage of the bill, lawsuits have been filed seeking either to enjoin the law from taking effect or to have the law declared unconstitutional or both. Several of those lawsuits have been consolidated in a proceeding pending in federal court in Birmingham. On August 29, 2011, the trial judge entered an Order enjoining the new law from taking effect for at least thirty days, at which time she has announced she will issue a more detailed ruling and opinion. Should the current litigation efforts fail to bring about changes to the law, many believe that additional legislative efforts to modify the bill will follow in next spring's 2012 session.

Statute of Repose

Another notable development was a dramatic reduction in the Statute of Repose. A statute of repose statutorily establishes a time after which no cause of action may be brought, regardless of when the basis for the cause of action is discovered. For years, Alabama has had a 13-year statute of repose with a 2-year "discovery" or statute of limitations period for filing claims against contractors for defective work and against designers for defective design. In other words, no one could sue a contractor or designer after the building was 13 years old. The only exception was for a claim which was discovered prior to the expiration of the 13-year period, in which case the claimant had up to two years after "discovery" in which to file a lawsuit, resulting in a total time period of 14 years, 364 days to file. The new law has only a 7-year statute of repose and a 2-year "discovery" period resulting in a 9-year total time in which to file a lawsuit.

Retainage

A new Alabama law limits parties to holding retainage in the amount of 10% up until a project is 50% complete with no additional retainage withheld thereafter. This results in a net total retainage of 5% for the Project. This was already the law on public projects in Alabama and now applies to private projects as well.

Post Judgment Interest Rate

For years, the post judgment interest rate in Alabama has been 12%. Economic changes which have resulted in essentially two decades of very low market interest rates resulted in this rate becoming

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punitive. The new Alabama law reduces the rate from 12% to 7.5%.

Expert Witness Testimony Standards

For some time, the federal courts, and other states as well, have been imposing more strict standards on expert witnesses. These standards were intended to safeguard trials from what has been referred to as "junk science." This year, Alabama adopted the federal standards for scientific expert witness testimony which is intended to have a deterrent effect on what are otherwise "frivolous" lawsuits.

Product Liability Reform

Alabama also adopted stricter standards for suing retailers, wholesalers and distributors in a product liability lawsuit when those entities have nothing to do with the design or manufacture of the product but are passive participants in the distribution chain. The former practice was thought to be too liberal in allowing a plaintiff to name such entities as defendants even though the true target defendant was clearly the manufacturer. The impact on construction is unknown, in terms of how it may affect a claim against a subcontractor for, say, the installation of defective couplings.

By David Pugh

Government Liable When it Imposed Use of Particular Means and Method

In *Singleton Enterprises-GMT Mechanical v. Department of Veterans Affairs*, the Department of Veterans' Affairs ("VA") was held liable for its direction to a contractor to use a particular means and method to attach roofing insulation instead of allowing the contractor the opportunity to pursue whether it could use an alternative approach and still meet the warranty requirements.

The contract called for a polyisobutylene roofing system. The contract contained conflicting terms regarding how the contractor could attach the insulation to the roof deck. In one section the contract described how asphalt could be used to attach the insulation to the roof deck. In other sections the contract addressed the use of adhesives. No particular polyisobutylene roofing system manufacturer was specified, but the evidence showed that the VA expected a Republic Powdered Metals, Inc. ("RPM"), product to be used. In fact, the contractor at bid time planned to use RPM's product. But, RPM would not issue the contractually required 20-year warranty if asphalt were used to attach the insulation to the roof deck, insisting instead on RPM's own special adhesives.

The contractor provided its submittals, which included an asphalt submittal, and advised the VA that use of the RPM adhesives, to obtain the RPM warranty, would result in additional costs.

The VA eventually rejected the contractor's asphalt submittal. Further, the VA issued a directive as follows: "The adhesive to be used to secure the roofing insulation shall be RPM Insulation Primer and RPM Insulation Adhesive as manufactured by Republic Metals, Inc. Asphalt shall not be used to secure insulation to the roof deck."

The contractor filed a claim for its additional costs for using adhesives instead of asphalt. The Civilian Board of Contract Appeals awarded in favor of the contractor. The Board ruled that the contract allowed the contractor the opportunity to use either asphalt or the adhesives, so long as the contractor could ultimately provide the 20-year warranty. The Board ruled that instead of directing the contractor to use the RPM adhesives, the VA should have directed the contractor to investigate whether there was a way to use asphalt and still provide the 20-year warranty, such as by using a different manufacturer's polyisobutylene roofing system. Since the VA did not allow the contractor that opportunity, but instead directed the use of the RPM adhesives, the VA's action constituted a change to the contract that entitled the contractor to recover its additional costs for using the adhesives.

A contractor is generally permitted to determine its own means and methods unless the contract contains a specific requirement to the contrary. Where an owner, whether public or private, directs a contractor, after contract award, to use specific means and methods, the contractor is generally entitled to a

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change for the increased costs incurred due to this direction.

By Ralph Germany

Will You Pay Out-Of-Pocket For Your Employees' Personal Injury?

Contractors can find themselves on the uninsured hook for injuries to employees when they fail to coordinate their indemnity obligations with their insurance coverage.

In *Transcontinental Contracting, Inc. v. Burlington Ins. Co.,* a contractor was awarded a state contract to perform work on the St. George Ferry Terminal on Staten Island. The construction contract incorporated a typical indemnification provision, by which the contractor indemnified the owner from any liability arising out of the actions, omissions, or negligence of the contractor and its subs, agents, employees and suppliers. Two of the contractor's employees were seriously injured – one by falling from scaffolding and another by a falling wrench – and sued the owner for their injuries. The owner sought indemnity from the contractor pursuant to the contractual indemnification clause and the contractor turned to its insurance company to cover the costs. When the insurance company refused coverage, the contractor sued.

Presumably because of the unusual degree of risk presented by the project, the contractor had obtained three successive one-year surplus lines of insurance policies. Each policy contained identical Cross-Liability Exclusions which stated that the insurance did not apply to personal injury to "[a] present, former, future or prospective partner, officer, director, stockholder or employee of any insured…" The contractor argued that the insurance contract was ambiguous and against public policy, but the court rejected both of these views and held that the language expressly and clearly excluded from coverage personal injury to the contractor's employees.

There are a few important points to note from this case. First, you should always read your insurance policy (while this should be obvious, the contractor in this case seemed oblivious to the Exclusion). Second, you should always coordinate indemnity provisions in a construction contract with exclusions from an insurance policy so as to make sure you have coverage for personal injury to your own employees. One way to do this is to draft a contract that only indemnifies the owner from liabilities to *third parties*, and excludes your own employees from the definition of "third party." If the contract in this case was so drafted, the owner (and its carrier) might have remained on the hook for the personal injuries because the contractor's employees would not have been third parties. Practically speaking, many owners might not agree to this because it puts them at risk if the contractor's employees get injured on the job. Another way to avoid the result in *Burlington* is to negotiate an insurance policy that covers indemnity obligations for personal injury to your own employees (CGL policies always exclude coverage for direct actions by one's own employees, as that is a worker compensation issue). Courts will not find violations of public policy and rule against the plain language of an insurance agreement just because it is a surplus policy with seemingly unfair provisions. Businesses need to be aware of gaps in their indemnity agreements and tailor their insurance policies to close those gaps – and *vice versa*.

By Vesco Petrov

School District Properly Rejected a Low Bid Where the District Perceived the Low Bidder to be Litigious

In *Triton Services, Inc. v. Talawanda City School Dist.*, an intermediate appellate court in Ohio recently affirmed a trial court's denial of a construction contractor's motion for preliminary injunction against an Ohio school district. The contractor brought the action against the school district, seeking to enjoin it from awarding a contract to another bidder, after the school district rejected the contractor's responsive low bid because it apparently perceived the contractor to be litigious and thus as non-responsible.

Evidence was presented at a hearing before the trial court that the contractor sued the same school district in 2007 after the parties disputed the scope of the work that the contractor was to perform under a contract for the construction of an elementary school.

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That particular dispute was ultimately settled by the parties. The contractor presented testimony before the trial court that it received "about 90 percent" of what it sought in the lawsuit related to the construction of the elementary school, and therefore, the litigation was not frivolous.

The contractor asserted that it was not litigious and explained the reasoning behind, and resolution of, previous lawsuits it filed involving public projects. The contractor also complained that it was the only bidder on the project that had its history of litigation closely scrutinized and that the school district developed a "scheme" to reject its bid.

The school district presented testimony that school officials were concerned when they learned that the contractor had failed to account for certain costs in its bid, which a witness for the school district estimated would add approximately $75,000 to the cost. School officials indicated they were particularly concerned about the omission because the previous litigation between the parties involved a dispute over the scope of the work that the contractor was to perform.

According to the Ohio appellate court, the trial court heard evidence that was "both favorable and unfavorable to the relationship between [the contractor] and [the school district]." After reviewing the record, however, the Court of Appeals of Ohio found that the trial court did not abuse its discretion when it denied the contractor's motion for a preliminary injunction.

This is an important reminder of three issues in public contracting: 1. Responsibility determinations include a review of a contractor's litigation history; 2. Many public owners are using a "pre qualification" procedure, where allowed by state law, which often requests litigation information; and 3. A suit to enjoin the award of a contract is a long shot, and you and your legal advisor must carefully assess the likelihood of success of a challenge before investing the legal and management costs in one.

By Aron Beezley

Bradley Arant Lawyer Activities:

Our pride and prayers follow one of our lawyers, Lt. Col. **Lewis Rhodes**, in our Washington, D.C. office, who is currently on active duty in Afghanistan.

U.S. News and World Reports' "Best Law Firms 2010" gave the **BABC Construction Group** a National Tier One Ranking in the area of Construction.

Chambers 2011 is an important recognition for the firm because it is derived independently by a London-based group. **BABC** is listed in many categories in several of the states in which it is located; below we highlight those most pertinent to our practice.

BABC is listed as Band 1 for litigation (in Alabama), and **Mabry Rogers** is listed under Litigation generally and then as a "Leading Individual" in the Construction section.

BABC is listed by Chambers as Band 1 for construction in DC, and **Doug Patin** and **Bob Symon** are listed as "leading individuals" for construction in DC.

In Mississippi, **BABC** is listed in Band 1 for litigation, and **Bill Purdy** is featured as a "leading individual."

In Tennessee, the firm is listed as a "leading firm" in litigation. (There are no separate listings for construction in Mississippi or Tennessee)

Mabry Rogers, **Doug Patin**, **Bill Purdy**, **David Pugh**, **Axel Bolvig**, **Jim Archibald**, **Fred Humbracht, Wally Sears** and **David Taylor** were among the 153 **BABC** lawyers recognized in *The Best Lawyers in America* for 2011.

Jim Archibald, Axel Bolvig, Mabry Rogers, and **Wally Sears** were named Alabama Super Lawyers for 2011 in the area of Construction Litigation.

Mabry Rogers was named "Lawyer of the Year" in the area of Construction Law for Birmingham, AL.

Arlan Lewis was named an Alabama Rising Star for 2011 in the area of Construction/Surety.

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Mabry Rogers is one of 318 lawyers recently named to a group of highly service-oriented lawyers in the United States. The BTI Client Service All-Stars are a group of attorneys whom clients recognize for superior client service. The only path to becoming a *BTI Client Service All-Star* is for corporate counsel and corporate-level executives to single out an attorney by name in an unprompted manner as part of independent research conducted by BTI Consulting. BTI specializes in providing high-impact client service and strategic market research regarding law firms and lawyers.

David Taylor has been named to the legal advisory committee of the AGC of Tennessee.

Mabry Rogers, Wally Sears, and **David Bashford** presented client seminars on risk management in the operations and maintenance, engineering, and construction management of power plant environments in May, June, and July in different areas of the country.

David Taylor spoke to the Tennessee Association of Construction Counsel on May 6, 2011 at their Spring meeting in Oxford Mississippi on "Innovative Arbitration Techniques".

David Taylor, David Pugh, Ralph Germany, Bryan Thomas, and **Ryan Beaver** presented the "2011 Construction Contract: Legal 101 Seminar" in Nashville, TN on May 13, 2011, Birmingham, AL on May 19, 2011, and Charlotte, NC on May 26, 2011.

David Pugh and **Bob Symon** presented a seminar on the Pitfalls of Federal Contracting at the joint ABC/AIA Joint Conference in Sandestin, FL on June 9, 2011.

Michael Knapp taught a class on the Advanced Topics of Engineering Law as a visiting professor to UAB's Engineering Department.

John Hargrove spoke in Montgomery, Alabama on August 17, 2011 at a seminar devoted to Alabama's new immigration law. The seminar was sponsored by Associated Builders and Contractors and Alabama Employers for Immigration Reform.

Keith Covington spoke on Alabama's new immigration law on a number of recent occasions. He spoke on this issue throughout Alabama on July 25, 2011, August 3, and August 31. Keith's talks were sponsored in part by the Associated Builders and Contractors of Alabama, underscoring the concern about the law, which we address in the text.

David Taylor and **Bryan Thomas** will present a session on construction specifications at the CONSTRUCT2011 Seminar in Chicago, Illinois on September 16, 2011.

David Taylor is teaching a session for the AAA in Nashville, TN on September 20, 2011 entitled Advanced Arbitrator Training.

Ryan Beaver will be presenting at the October meeting of the Charlotte Chapter of the Construction Financial Management Association on calculating and documenting construction damages.

Bob Symon will be speaking at the Construction SuperConference in San Francisco on December 15th on Terminations of Government Contracts.

David Bashford and **Ryan Beaver** will also be presenting at the Construction SuperConference in San Francisco on December 15th on "What Can You Get? The State of Damage Law Today."

Bradley Arant attorneys have recently presented training sessions to a number of clients regarding Contract Administration and regarding Mandatory Written Ethics Compliance Programs for Federal Government Contracts. If you are interested in either of these seminars for your company, please contact one of the attorneys listed on page 8 of this newsletter.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

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BRADLEY ARANT BOULT CUMMINGS LLP Fourth Quarter 2011

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

James F. Archibald, III
Sabra Barnett
David H. Bashford (c)
Charlie Baxley
Ryan Beaver (c)
Aron Beezley (d.c.)
Axel Bolvig, III
Joel E. Brown
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F. Keith Covington
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Ralph Germany (j)
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James Warmoth (c)
Monica Wilson (c)

Proposed Legislation Gives Teeth to Small Business Self-Performance Requirements

On September 21, 2011, the U.S. Senate passed the Small Business Contracting Fraud Prevention Act of 2011. While this bill has several hurdles to clear before it becomes law, this proposed legislation nonetheless is noteworthy because, as currently written, it contains several provisions that could have a significant impact on small and disadvantaged federal contractors.

One aspect of the proposed legislation that has received remarkably little attention is that the bill provides that each payment application submitted by a contractor or subcontractor to the Government will be deemed a certification of compliance with applicable self-performance requirements on contracts managed by the Small Business Administration. If implemented, this aspect of the proposed legislation would broaden the "deemed certification" provision in the Small Business Jobs Act of 2010, which provides, among other things, that submission of a bid or proposal for a federal contract is deemed to be "affirmative, willful, and intentional certification of small business size and status." Under the September 21, 2011 version of the proposed legislation, contractors and subcontractors who violate applicable self-performance requirements could be subject to the following penalties and remedies:

- A fine up to $500,000 or imprisonment of up to ten years, or both;
- Administrative remedies under the Program Fraud Civil Remedies Act of 1986;
- Suspension and debarment per FAR subpart 9.4; and
- Ineligibility for participation in various small business programs for a period not to exceed three years.

Specifically, the proposed legislation provides that a person shall be subject to the foregoing penalties and remedies if the person:

- Uses the services of a business other than the business awarded the contract or subcontract to

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perform a greater percentage of work under a contract than is permitted by regulations issued by the Small Business Administration; or

- Willfully participates in a scheme to circumvent regulations issued by the Small Business Administration governing the percentage of work that a contractor is required to perform on a contract.

This proposed legislation gives the Government a clear-cut way to penalize contractors and subcontractors who violate the self-performance requirements of SBA regulations - authority that did not previously exist. And the penalties are very substantial. We will continue to monitor this important piece of legislation.

By Eric A. Frechtel and Aron C. Beezley

Developer's Label of Residential Project as 'Condominium' Proves Disastrous Due to Contractor's CGL Policy Exclusion

A recent case in California proves a useful reminder that the decisions made during the planning and development phase of a project can have a substantial, and sometimes negative, impact on later phases of the project. As seen in *California Traditions, Inc. v. Claremont Liability Ins., Co.,* the failure to coordinate such decisions can result in potential liability without the protection of indemnity.

California Traditions, Inc. was the developer and general contractor of a housing development. California Traditions contracted with Ja-Con Systems, Inc. to perform the rough framing for thirty residential units in phases six through eight of the development. Ja-Con was insured under comprehensive general liability (CGL) policies in effect during the time Ja-Con performed its work.

The CGL policy provided coverage for amounts the insured became legally obligated to pay because of property damage or bodily injury arising out of the insured's work. However, the policy contained an exclusion for "work product or products that are incorporated into a condominium . . . or townhouse project."

Despite the fact that the 146 residential units within the development were freestanding units with no shared walls, roofs, halls, or utility lines, California Traditions chose to develop, market, and sell the housing development as a condominium. This was principally due to the less restrictive "set-back" requirements applicable to condominiums, which allowed California Traditions to build a higher density development.

In August 1999 California Traditions sold one of the units to the Wood family (the "Homeowner"). Both the purchase documents and the grant deed described the unit as a condominium. In August 2003 the Homeowner filed a complaint against California Traditions alleging property damage and bodily injury caused by the defective construction of the unit. California Traditions then brought Ja-Con into the suit to defend and indemnify it against the Homeowner's claims. However, the CGL insurer denied Ja-Con coverage because of the exclusion.

Generally, the interpretation of an insurance policy is a question of law decided by the court. While insurance contracts have special features, they are still contracts and therefore the basic rules of contract law apply. The court's ultimate goal in construing a parties' agreement is to give effect to the mutual intention of the parties. The court will infer such intent, if possible, solely from the written provisions of the contract. Therefore, clear and unambiguous language will govern.

California Traditions argued that there was ambiguity in the CGL policy because the term 'condominium' was not defined. After examining the CGL policy at issue, the court concluded that the only reasonable interpretation of the exclusion language was that it did not cover liability arising from work incorporated into a condominium project. The court granted the CGL Insurer judgment on the argument, without allowing a jury to hear the evidence, leaving California Traditions solely responsible for any damages awarded to the Homeowner.

California Traditions serves as a good reminder that parties involved in the planning and development phase of a project should communicate with those charged with construction of that project. Additionally, it highlights the importance of reviewing the insurance program of those performing work on a project before construction. We recommend review of the policy itself and not only the certificate of insurance.

By Charlie G. Baxley

Exceptions to the Preclusive Effect of Broad Release Language in Contract Modifications

In July 2011, the U.S. Civilian Board of Contract Appeals (CBCA) issued an important decision in *Walsh/Davis Joint Venture v. General Services Administration* reaffirming certain exceptions to clear release

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language in contract modifications on federal procurements. This is a very instructive decision, particularly in light of the 2009 *Bell BCI Co. v. United States* decision in which the Federal Circuit rejected cumulative impact claims as having been waived under broad release language in an earlier contract modification. A summary of the 2009 decision can be found in our Fourth Quarter 2009 newsletter, found at the 'Construction and Procurement Newsletters' link on the Construction Practice Group homepage, www.babc.com/construction.

In *Walsh/Davis*, the CBCA considered whether general contractor Walsh/Davis Joint Venture (WDJV) could prosecute subcontractor Freestate's pass-through inefficiency claim based on the cumulative impact of General Services Administration ("Government") directed changes, even though WDJV and the Government had signed contract modifications for changes affecting Freestate's work that included the following language: "Settlement of this change includes all costs, direct, indirect, and impact and delay associated with this change." Agreeing with the Government that differences between such language and the release language in the pertinent modification in *Bell BCI* were immaterial, the Board stated: "If nothing more were at issue here, we would follow in the course of the many board of contract appeals decisions – both before and after *Bell BCI* – which have enforced similarly-phrased releases." But, the CBCA continued its analysis, citing precedent that there are "special and limited situations" in which a contractor may prosecute claims despite broad releases, including (a) where neither party intended a release to cover certain claims and the use of broad language suggesting otherwise was simply a "mutual mistake," and (b) where the conduct of the parties in continuing to consider claims after the execution of a release demonstrates that they did not intend the language in the release to preclude such claims. Finding evidence supporting both of these exceptions, the CBCA denied the Government's motion for summary relief. Among other evidence, the CBCA noted that Freestate had included reservation-of-rights language in every change order proposal and cover letter, and that WDJV and the Government had continued to negotiate – and even settle – subcontractor inefficiency claims despite the earlier modifications containing the broad release language.

The CBCA's decision seems to contradict the typical refusal of courts and boards to consider evidence of the parties' intentions if a contract, including a modification or even a separate release, contains clear and unambiguous language. Indeed, *Bell BCI* stands for that very proposition. In any event, the *Walsh/Davis* decision is very instructive, reinforcing that contractors must: (a) consider, for each change, whether one or more subs are, or could allege they are, affected, directly or indirectly; (b) seek to reserve their rights in writing; (c) document their negotiations with the Government, especially concerning claims that the Government might argue later were waived; and (d),when involved in litigation, search for ways to prosecute valid claims despite broad language in prior modifications or releases, because there are exceptions to the enforceability of such language.

By Eric A. Frechtel

Conduct Constituted Waiver of Change Order Requirement

In *Tripoli Management, LLC v. Waste Connections of Kansas, Inc.*, the federal trial court for Kansas held that a contractor could pursue a claim for extra work despite the contractor's failure to obtain a written change order prior to performance as required by the contract.

The prime contract in this case, as is common, stated that a written change order must be obtained for the contractor to be paid for extra work. The contractor never obtained a written change order for the work at issue. The contractor did send some e-mail notices regarding its potential claims, but those e-mails were largely met with denials. Despite those denials, the contractor nevertheless proceeded with the extra work. At one point the contractor attempted to bill for the extra work despite the absence of a written change order.

When the contractor filed suit to collect for the extra work, the owner filed a motion to dismiss the claims based on the lack of a written change order. The contractor countered by arguing that the owner knew the work was being done and that the contractor thought it was entitled to additional payment for this work. However, the court focused on evidence presented by the contractor showing that the custom and practice had been to work out change orders after the fact. The court found that the right to insist on written change orders had potentially been waived or otherwise modified out of the contract by the parties' course of conduct in handling change order issues. Therefore, the court allowed the contractor to continue pursuit of its claims, where a jury would hear the claims (and damages) on the merits.

It must be emphasized that this decision was based on the particular facts involved in the *Tripoli* case. The court found a sufficient number of instances in which the written change order requirement had been ignored to justify

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finding a waiver or modification of the change order requirement. The court in *Tripoli* acknowledged prior caselaw where the facts of other cases had not established a sufficient history of ignoring the written change order requirements to constitute waiver. The *Tripoli* court distinguished the earlier cases, emphasizing instead the central role the facts will play in determining whether there has been enough conduct to justify a finding that the written change order requirement has been waived.

What are the lessons from this case? One cannot assume that the written contract terms regarding change orders will necessarily control the outcome. What the parties do after the contract has been signed can render contract language ineffective. Further, one should not assume that "enough" has been done to waive the change order requirement because, as the *Tripoli* case recognized, this is a subjective determination based on the facts of the particular case.

By Ralph Germany

Beware Joint-Check Agreements: When a Sub Sues an Owner for Breach of Contract

Joint-check agreements have become common in today's construction market. For the subcontractor, joint checks are useful tools to ensure payment when the general contractor appears financially unstable. For the general contractor or owner, joint checks can be useful to ensure proper payment to lower-tier contractors.

However, owners and contractors should be aware that joint checks may also expose them to increased liability. A recent opinion issued by the United States Court of Federal Claims demonstrates the danger (or advantage, for subcontractors) of joint-check agreements creating an intended third-party beneficiary relationship between the owner and subcontractor. In *FloorPro v. United States*, a subcontractor (FloorPro) completed flooring work on a military base pursuant to a contract with the general contractor. During the project, the financial situation of the general contractor began to deteriorate. FloorPro's work was completed on time and under budget, but FloorPro remained unpaid.

FloorPro notified the contracting officer of its outstanding invoice, and the contracting officer suggested that the government and the general contractor agree to a two-party check to FloorPro and the general contractor. The general contractor agreed and entered into a contract modification with the government in which the government promised to issue payment jointly to FloorPro and the general contractor. However, the government failed to do so, and instead paid the general contractor directly.

FloorPro sued the government for breach of contract, claiming the contract modification was directly intended to benefit FloorPro and thus made FloorPro a third-party beneficiary entitled to bring an action based on the contract. The government argued that FloorPro could not sue for breach of contract because a contract modification intended to benefit a third party must be a condition precedent to further performance (and FloorPro's work on the project was completed at the time of the contract modification).

The court agreed with FloorPro. It held that the government entered into the contract modification with the intent to benefit FloorPro, and that the modification resulted in a direct benefit to FloorPro. Therefore, FloorPro was a third-party beneficiary entitled to bring an action under the contract. The government breached the contract by paying the general contractor directly, and FloorPro was damaged by the government's breach.

FloorPro v. United States serves as an important reminder to the construction industry that joint-check agreements may do more than simply ensure payment to a subcontractor. They may also create a direct relationship between the party issuing the joint check and the party to receive payment under the joint check agreement. Owners and general contractors should use caution when entering into joint-check agreements, because a subcontractor promised payment by joint check may be able to bring an action as a third-party beneficiary for breach of the agreement.

By Monica L. Wilson

Read and Follow Your Contract Carefully

When deciding to terminate a contractor or sub-contractor, read your contract carefully. A recent case from the Court of Appeals of Indiana, *Town of Plainfield v. Paden Engineering Co., Inc.*, reminds us that it is critical to follow all requirements in a termination clause.

In July, 2002, the Town of Plainfield contracted with Paden Engineering, Co. Paden provided an AIA A312 Performance Bond, which was expressly incorporated by reference in the contract. The contract's termination clause required seven days written notice to the contractor and a certification by the architect stating sufficient cause existed to justify termination. The contract included an example architect's certificate. The performance bond also incor-

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porated certain conditions precedent before the surety's obligations arose, providing the surety with options for exercising its obligations.

Although Plainfield produced an email from the architect whereby the architect raised concerns about Paden's work and alluded to termination, the court found that the email did not constitute a "rendering" of an architect's certificate. The appeals court held that public policy favors the enforcement of contracts and therefore requires conditions precedent to be performed. The court rejected Plainfield's argument that by enforcing the condition precedent, the court was denying Plainfield its common law rights under breach of contract claims. Instead, the court stated that once an owner contractually agrees to comply with specified requirements for termination, its failure to abide by those requirements prevents it from rescinding the contract and taking charge of the work unless it abides by those requirements.

Further, Plainfield's failure to provide written notice to the surety or permit the surety to elect which of its contractual options would be exercised prevented Plainfield from collecting from the surety for Paden's default. In light of this decision, it is important to remember that you are bound by the terms of your contract and must satisfy all conditions precedent in order to collect for a breach by your contractor or subcontractor. If you have any questions about whether you can terminate, it is extremely important to check your contract and make sure that you have complied. In a termination situation, where a bond is involved, you must read the bond carefully to comply with its terms if you plan to call on the surety to perform or pay.

By Sabra M. Barnett

Bid Protests on the Rise in Current Economic Climate

The number of federal government related bid protests being filed at the Government Accountability Office (GAO) and the U.S. Court of Federal Claims (COFC) has been on the rise. The growing number of bid protests reflects the convergence of two realities: federal government contract spending generally has increased, while the economy generally has declined. In the past, companies were reluctant to file bid protests due to customer relation concerns, but today contractors are recognizing that not pursuing their protest rights can have long term, negative effects, especially as federal agencies seek to meet their needs through multiple award contracts that can last several years. Contractors are also realizing the importance of the federal bid protest system as a tool to maintain the integrity of the federal procurement process.

Bradley Arant has experienced first-hand this upward trend in the filing of bid protests. With this upward trend, we have encountered an extraordinary success rate for our clients – a success rate which far surpasses the average success rate for bid protests as reflected in published statistics. Indeed, in several consecutive protests recently filed on behalf of our clients, the procuring agency took corrective action in response to the protest grounds. For example, we recently challenged a "best value" analysis conducted by the U.S. Marine Corps Logistic Command. In response, the Marine Corps took corrective action and canceled the contract award, modified the solicitation, and re-evaluated proposals. The award result is pending. We also recently challenged the National Oceanic and Atmospheric Administration's (NOAA) elimination of a client from the competition and failure to refer its effective non-responsibility determination to the Small Business Administration (SBA). Again, the agency recognized the errors of its way and took corrective action. In this particular case, NOAA cancelled the award, reinstated our client in the competition, conducted discussions, and then re-evaluated offerors' proposal. While the client in this protest did not end up with the award, the fact remains that it was able to obtain a "second bite at the apple." But for exercising statutory and regulatory rights to protest, a second chance to be fairly evaluated and compete for the award is not possible.

Contractors should also recognize the importance of intervening in bid protests lodged by their competitors. The importance of intervening in protests cannot be understated, as this ensures that awardee-companies' interests are adequately represented and that their contract award is vigorously defended. Intervenor's counsel can make sure that agencies stay the course regarding original award decisions and do not simply take corrective action to avoid the lengthy protest process thereby subjecting the awardee to a different evaluation result.

The two primary forums that decide bid protests are GAO and the COFC. An advantage of pursuing a bid protest at GAO is the automatic stay of contract performance required by the Competition in Contracting Act (CICA). This law prohibits the procuring agency from awarding a contract or continuing performance pending resolution of a timely filed protest. In contrast to the automatic stay at GAO, if a protester files its protest at the COFC, it must meet the standards for a preliminary injunction to obtain a stay. Often, this is a very costly

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process so most contractors seek to assert their protests at the GAO.

While an advantage to filing a bid protest at GAO is the CICA stay, GAO's timing requirements for filing bid protests are very strict. GAO's bid protest regulations require that protests based upon "alleged improprieties in a solicitation which are apparent prior to bid opening or the time set for receipt of initial proposals" must be filed prior to bid opening or the time set for receipt of initial proposals. A protest based on improprieties in a solicitation that is filed prior to bid opening or the time set for receipt of initial proposals is timely regardless of how long the protester was aware of the improprieties. Any other protest must be filed "not later than 10 days after the basis of protest is known or should have been known (whichever is earlier)." In the case of negotiated procurements, unsuccessful offerors must timely request a debriefing before protesting. Once this debriefing is conducted, the offeror has ten (10) days after the date on which the debriefing is held to file a timely protest. However, more germane to an effective remedy is the CICA stay. In the case of negotiated procurements, the protest must be filed within five (5) days of the debriefing in order for the protester to obtain an automatic stay of contract performance pending GAO's protest decision. Thus, it is critical in the cases of negotiated procurements to file the protest within five (5) calendar days of the debriefing in order to obtain an effective remedy. Otherwise, the agency has no legal obligation to suspend performance of the awarded contract even if the protest is timely filed between six and ten days after the debrief. The lesson here to remember is that under negotiated procurements, the contractor really only has five (5) days from the date of deadline to file a protest at GAO and guaranty an effective remedy if successful.

The COFC, on the other hand, generally has less stringent filing deadlines than are imposed in GAO protests. For example, GAO's ten (10) day filing requirement does not exist at the COFC. However, the U.S. Court of Appeals for the Federal Circuit (the COFC's appellate court), essentially has adopted GAO's timeliness rule for a COFC protest of errors apparent on the face of a solicitation so that such errors must be protested at the COFC prior to the closing date for receipt of proposals. And, in terms of complaints over evaluation errors, delaying a protest for an extended period will likely impact your ability to obtain injunctive relief and stop the procurement from proceeding. Remember, the automatic stay of performance does not apply to protests filed at the COFC.

Whether considering a protest or defending a contract award – and regardless of the bid protest forum – having knowledgeable and experienced legal counsel is essential. Bradley Arant Boult Cummings LLP has an active bid protest team (on federal and state procurements) which offers advice to increase the likelihood of a successful outcome whether you are protesting or defending an award.

By Robert J. Symon and Aron C. Beezley

Bradley Arant Lawyer Activities:

Bob Symon will be speaking at the Construction SuperConference in San Francisco on December 15th on Terminations of Government Contracts.

David Bashford and **Ryan Beavers** will also be presenting at the Construction SuperConference on "What Can You Get? The State of Damage Law Today."

Arlan Lewis co-authored an article featured in the Fall 2011 issue of *The Construction Lawyer* entitled "Subrogation Waivers."

Bill Purdy, **Mabry Rogers**, and **Wally Sears** are members of the American College of Construction Lawyers.

David Taylor spoke in Phoenix on October 27th at the International Council of Shopping Centers Legal Conference on "Using Arbitration and Mediation to Resolve Construction Disputes."

Jim Archibald, Axel Bolvig, Frederick Humbracht, Doug Patin, David Pugh, Bill Purdy, Mabry Rogers, **Wally Sears** and **David Taylor** were recognized in *The Best Lawyers in America* for 2011.

David Taylor and **Bryan Thomas** spoke on September 16th in Chicago at the National Construction Specifications Institute annual meeting on "Using Mediation to Resolve Disputes" and jointly presented a mock mediation on an actual case involving a performance versus design specification dispute.

Jim Archibald, Axel Bolvig, Mabry Rogers, John Hargrove, Joe Mays, and **Wally Sears** were named Alabama Super Lawyers for 2011 in the area of Construction Litigation.

David Taylor has been named a vice-president of the Tennessee Association of Construction Counsel.

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Mabry Rogers was named "Lawyer of the Year" in the area of Construction Law for Birmingham, AL.

Ryan Beavers presented at the October meeting of the Charlotte Chapter of the Construction Financial Management Association on calculating and documenting construction damages.

David Taylor has been named to the Legal Advisory Council for AGC of Tennessee

David Taylor will speak in Nashville on December 1st at the firm's latest In-House Counsel Seminar on "Using Arbitration to Resolve Disputes." **Ralph Germany** will also speak at the event on "How to Avoid Turning Arbitration into Litigation."

Mabry Rogers and **Bill Purdy** were recognized in *Chambers 2011* edition in the area of Construction Litigation, while **Doug Patin** and **Bob Symon** were recognized in the area of Construction.

David Taylor and **Bryan Thomas** attended the Tennessee Association of Construction Counsel Annual Meeting on November 11, 2011.

Arlan Lewis was named an Alabama Rising Star for 2011 in the area of Construction/Surety.

David Taylor taught an Advanced Construction Arbitrator Training seminar for the American Arbitration Association in Nashville on September 20th.

David Taylor will present a webinar on December 2nd for the Construction Specifications Institute on Arbitration

David Pugh spoke in Birmingham on November 4th at the ABA Forum on the Construction Industry's regional program entitled *"The Construction Contracts Program: Understanding and Negotiating the Critical Clauses in the Industry Form Documents*" on contract termination, claims handling, and dispute resolution. **Arlan Lewis** served as the regional coordinator for the program.

Keith Covington spoke on the new Alabama Immigration Act at the September 20, 2011 meeting of the Birmingham Chapter of the Construction Financial Management Association (CFMA).

Bob Symon sat on a panel as a part of a presentation for the ABA Contract Claims and Dispute Resolutions Committee entitled "Claims Preparation and the Calculation of Damages" on October 12th in Washington, D.C.

Chambers 2011 recognized Bradley Arant Boult Cummings' **District of Columbia Construction Practice Group** as a Leading Firm (Band One).

U.S. News and World Report's "Best Law Firms 2010" gave the **Bradley Arant Boult Cummings Construction Practice Group** a National Tier One Ranking in the area of Construction.

Charlie Baxley was sworn in as a licensed attorney by the Supreme Court of Alabama.

Bradley Arant attorneys have recently presented training sessions to a number of clients regarding Contract Administration and regarding Mandatory Written Ethics Compliance Programs for Federal Government Contracts. If you are interested in either of these seminars for your company, please contact one of the attorneys listed on page 8 of this newsletter.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

NOTE: YOU CAN FIND THIS NEWSLETTER AND PAST NEWSLETTERS ON OUR WEBSITE. IF YOU ACCESS THIS NEWSLETTER ON OUR WEBSITE, CASE-LINKS WILL BE AVAILABLE UNTIL THE NEXT NEWSLETTER IS PUBLISHED. WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY GO TO WWW.BABC.COM/PG_CONSTRUCT.CFM OR CONTACT ANY ATTORNEY LISTED ON PAGE 8 OF THIS NEWSLETTER.

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The lawyers at Bradley Arant Boult Cummings LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

This newsletter is a periodic publication of Bradley Arant Boult Cummings LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact your lawyer or any of the lawyers in our group whose names, telephone numbers and E-mail addresses are listed below; or visit our web site at www.babc.com.

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BRADLEY ARANT BOULT CUMMINGS LLP **First Quarter 2012**

CONSTRUCTION AND PROCUREMENT LAW NEWS

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Pennsylvania "No Damages for Delay" Doctrine Held Not to Foreclose Contractor's Delay Claim

In a recent case, the federal trial court for the Western District of Pennsylvania disposed of a number of the Pittsburgh Airport Authority's (Owner) arguments against G&T Conveyor's (Contractor) delay claim arising from testing of a newly installed baggage handling and bomb detection system. The case presented the judge—unfamiliar with key construction principles—with a difficult and common array of arguments to place the risk of delay on the contractor, and it is a well-researched, though densely written, opinion.

The court held that the contractor was not liable for testing delays because the testing criteria were actually changed during the test by the Owner's testing agency. The contract contained a "no damages for delay" clause, but the court found that the Owner's active interference rendered the clause inapplicable. Specifically, the court found the Owner's change of the testing specification and supply of defective PLC's for the Contractor to install constituted active interference.

The Owner argued that the duty of the Contractor to "cooperate" with the Owner's testing agency placed the risk of delay on the Contractor. The court found that "cooperate" does not mean "take the risk of." The Owner argued that the prime contract's "turnkey" requirement placed all risk of delay on the Contractor. The court found that "turnkey" does not mean "take the risk of" delay caused by the Owner or those for whom the Owner was responsible.

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The case is not a landmark, as there are cases like it in many jurisdictions and in the Court of Federal Claims. Instead, it is a reminder to contractors, owners, and subcontractors to examine closely so-called "risk shifting" clauses to determine if they apply. In particular, clauses which purport to shift the risk of delay completely to the contractor (or subcontractor) must be examined in light of the applicable law and in light of the facts causing the delay.

By Mabry Rogers

Subcontractor Required to Pay "Expectation" Damages after Refusing to Honor Bid

In *Dynalectric Co. of Nevada, Inc. v. Clark & Sullivan Constructors, Inc.*, the Supreme Court of Nevada recently affirmed a trial court's judgment granting a general contractor, Clark and Sullivan Constructors, Inc. (C&S), "expectation" damages after its prospective subcontractor, Dynalectric Company of Nevada, Inc., refused to honor its bid.

The case arose from a dispute between C & S and Dynalectric on the expansion of the University Medical Center (UMC) in Las Vegas. In 2004, UMC solicited bids for the project. C&S, interested in serving as general contractor for the project, sought bids from subcontractors. Dynalectric submitted a bid to C&S to perform the electrical work for the project and "repeatedly assured" C&S of the accuracy of its bid. C&S relied on Dynalectric's bid in developing its bid for the general contract. C&S was the low bidder, and UMC awarded it the general contract. Thereafter, Dynalectric repudiated its bid and refused to negotiate with C&S. C&S contracted with three other subcontractors to perform the electrical work for the project.

C&S sued Dynalectric in district court under various theories of liability, including the legal doctrine of promissory estoppel. The doctrine of promissory estoppel provides that if a party changes its position substantially in reliance on a promise, then that party can enforce the promise although the essential elements of a contract are not present.

Following a trial, the district court entered judgment for C&S on its promissory estoppel claim and rejected each of Dynalectric's counterclaims. The district court awarded C&S the difference between Dynalectric's bid and the amount C&S paid the three replacement contractors to complete the work. This measure of damages placed C&S in the same position that it would have occupied if Dynalectric had performed as promised, and thus, it constituted "expectation" damages.

Dynalectric appealed to the Supreme Court of Nevada, where it argued that the lower court applied the incorrect measure of damages in awarding C&S "expectation" damages. The Supreme Court disagreed, finding that the modern trend is to tailor the damages to the requirements of justice, and to ensure that the damages are reasonably certain and foreseeable. According to the Supreme Court of Nevada, it was plain that justice required that C&S be awarded "expectation" damages and that the damages the district court awarded were reasonably certain and foreseeable.

Contractors and subcontractors should continue to use care when submitting bids on projects. While a bid may not be a formal contract, it carries with it an expectation of reliance that could subject the submitting party to liability if the contractor or subcontractor later decides not to honor the bid.

By Aron Beezley

Bad-Faith Mechanic's Liens: How to Make a Bad Situation Worse

Indiana, in a ruling by the Indiana Court of Appeals in *Walsh & Kelly, Inc. v. International Contractors, Inc.*, joined a list of jurisdictions which hold that owners may seek damages, including attorney fees, against contractors who refuse to remove an invalid mechanic's lien after being made aware that it is legally invalid.

The lien claimant in *Walsh-Kelly*, working as subcontractor, performed paving and road work on a residential subdivision owned by a developer. Following a payment default by the general contractor, the claimant, without consulting legal counsel, filed a lien

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against several unsold lots on which it performed no work. The owner notified the subcontractor in writing that the lien was invalid because the subcontractor performed no work on the lots in question and because the owner had paid the general contractor, a complete defense under Indiana law. The subcontractor refused to remove the lien and instead filed suit to enforce the lien. The owner responded by asserting a counterclaim for slander of title and requested as damages its attorney's fees incurred in defending the frivolous lien. The Indiana Court of Appeals held that the trial court was correct in dismissing the mechanic's lien and awarding attorney's fees to the owner.

The Indiana Court of Appeals ruled in favor of the owner despite a high standard required by Indiana law. The law required the owner to prove that the lien contained a "false" or "malicious" statement which was "made knowingly or with reckless disregard" to its falsity. While the subcontractor was unaware of the legal reasons that the mechanic's lien was invalid, the court reasoned that once it was made aware of its possible invalidity, it had a duty to investigate the legality of the lien and remove it. The subcontractor's failure to do so constituted a "reckless disregard" for the falsity of the lien, regardless of whether the subcontractor had any legal understanding of the reason the lien was invalid.

Walsh & Kelly reminds us how seriously the courts take the effects of an invalid mechanic's lien on a property owner. It is extremely important that an owner give notice of and reasons for the invalidity of a lien; once notified, the contractor (or subcontractor) must investigate the validity of a lien. Furthermore, as illustrated in this case, the contractor must take steps to have the lien removed once it has been determined to be invalid.

By Thomas Lynch

Changes To The Rules Governing SBA's 8(a) Program

Within the last year, comprehensive changes to the Small Business Administration ("SBA") regulations went into effect. These new rules are wide-ranging and will significantly impact SBA's 8(a) Business Development ("BD") program, SBA's mentor-protégé program, and SBA's joint venture regulations. The final rule can be found at: http://edocket.access.gpo.gov/2011/pdf/2011-2581.pdf.

Especially noteworthy are the new rules as they relate to SBA's joint venture regulations. Firms seeking to joint venture with 8(a) contractors for set-aside work under any of the designated regulations should now be aware that the 8(a) partner to the joint venture agreement is no longer required to receive 51% of the profits. Instead, under the new rules, "the 8(a) Participant(s) must receive profits from the joint venture commensurate with the work performed by the 8(a) Participant(s)." 13 CFR § 124.513(c)(4). Under 13 CFR § 124(d), "[f]or an unpopulated joint venture or a joint venture populated only with one or more administrative personnel, the 8(a) partner(s) to the joint venture must perform at least 40% of the work performed by the joint venture." Therefore, the 8(a) contractor can now be limited to 40% of the profits under the joint venture agreement if it performs only 40% of the work. In its comments to the final rule, SBA clarified this change and the reasons for it:

> [T]he majority of commenters supported the proposal that 8(a) Participant(s) to an 8(a) joint venture must receive profits from the joint venture commensurate with the work they performed. Those in support believed that this provision makes sense in light of the change specifying that the 8(a) partner(s) to a joint venture must perform at least 40% of the work performed by the joint venture. In a situation where the joint venture performs 100% of the contract, 40% by an 8(a) Participant and 60% by a non 8(a) firm, these commenters believed that it was not reasonable for the 8(a) firm to receive 51% of the profits when it performed only 40% of the work. SBA continues to agree. SBA believes that requiring an 8(a) firm to receive 51% of the profits in all instances could discourage legitimate non-8(a) firms from participating as joint venture partners in the 8(a) BD program, or encourage creative accounting practices in which a significant amount of revenues

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> flowing to a non-8(a) joint venture partner would be counted as costs to the contract instead of profits in order to meet the SBA requirement. SBA does not believe that either of those outcomes is positive. As such, this provision is retained in this final rule.

Federal Register, Vol. 76 No. 29, at p. 8243 (February 11, 2011)

It is important to be mindful, however, that this change applies only to a joint venture that has not been formed as a separate legal entity. In the case of a joint venture between an 8(a) contractor and its non-8(a) partner that is formed as a separate legal entity, the 8(a) contractor is still required to own at least 51% of the joint venture entity. 13 CFR § 124.513(c)(3). In this case, the profits received by the 8(a) contractor need not be commensurate with the percentage of work performed by that 8(a) contractor but, rather, must be "commensurate with [the 8(a) contractor's] ownership interests in the joint venture" – *i.e.*, the 8(a) contractor will receive at least 51% of the profits regardless of the percentage of work it performs for the separate legal entity joint venture. 13 CFR § 124.513(c)(4). Therefore, a firm seeking to joint venture with an 8(a) contractor for set-aside work needs to be aware that if it elects to construct the joint venture as a separate legal entity, then it can only receive up to 49% of the profits of the joint venture – regardless of whether the 8(a) contractor only performs 40% of the work.

Firms seeking to joint venture with an 8(a) contractor also need to familiarize themselves with the self-performance requirements under the new rules. In order to seek a full or partial small business set-aside construction contract or an 8(a) construction contract under a joint venture agreement, the 8(a) contractor or the 8(a) concern must "perform at least 15 percent of the cost of the contract with its own employees (not including the costs of materials)." 13 CFR § 125.6(a)(3). The phrase "cost of the contract" means "[a]ll allowable direct and indirect costs allocable to the contract, excluding profit or fees." 13 CFR § 125.6(e)(1).

To illustrate this self-performance requirement, consider the example of a large business and its small 8(a) partner who have an SBA-approved written mentor-protégé agreement and are seeking to joint venture together to perform an 8(a) contract. Assuming their joint venture agreement for the particular contract is approved by SBA, then the joint venture taken as a whole will be considered an 8(a) concern for that contract (provided that the 8(a) protégé "qualifies as small for the size standard corresponding to the NAICS code assigned to the procurement and has not reached the dollar limit set forth in [13 CFR] § 124.519."). 13 CFR § 124.513(b)(ii)(B)(3). This means that the protégé firm and its approved mentor firm *together* must perform at least 15% of the cost of the contract with their own employees. Keep in mind, however, that the 8(a) protégé firm still must perform 40% of the total work being performed by the joint venture.

It should be remembered that joint venture eligibility and self-performance requirements for construction contracts are different with respect to other SBA programs. For example, with respect to SBA's Service-Disabled Veteran-Owned Small Business ("SDVO SBC") Program, an SDVO SBC seeking a service-disabled veteran-owned small business set-aside construction contract must agree that "at least 15 percent of the cost of the contract performance incurred for personnel will be spent on the [SDVO SBC's] employees or the employees of other service-disabled veteran-owned small business concerns." This standard – *i.e.*, "15% of the cost of the contract performance incurred for personnel" – is the same standard for HUBZone small business concerns in SBA's HUBZone Program.

The rules are complex, and this is an area of great interest to non-qualifying firms. You must be cautious in approaching these joint ventures.

By Eric Frechtel, Steven Pozefsky & Aron Beezley

OSHA's Multi-Employer Liability Policy Enforced by the D.C. Circuit Court

On December 14, 2011, the United States Court of Appeals for the District of Columbia (D.C. Circuit) affirmed an OSHA citation issued against a general contractor under OSHA's multi-employer liability policy, joining several other federal appellate courts

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that have recently given the controversial policy their stamp of approval. This multi-employer liability policy provides that a general contractor may be cited by OSHA for a worksite safety hazard that the general contractor either created or had control over, even though none of the general contractor's own employees were exposed to the hazard. Pursuant to the policy, a general contractor may be held liable, as a "controlling" employer, for a safety hazard to which only the employees of one of its subcontractors were exposed, if the general contractor could reasonably have been expected to prevent, or to detect and abate, the unsafe hazard.

The D.C. Circuit's decision, in *Summit Contractors, Inc. v. Secretary of Labor and Occupational Safety and Health Review Commission*, ("*Summit Contractors*"), arose out of a citation that OSHA had issued to Summit Contractors, Inc. ("Summit"), the general contractor on an apartment complex project in Pennsylvania. Summit had only two employees at the project site. Those employees were responsible for the overall supervision and coordination of the project work. Summit sub-contracted the framing work on the project to another contractor which, in turn, subcontracted that work to another company, Mendoza Framing. Summit's direct subcontractor had only one employee on the project, a superintendant, but Mendoza Framing had several employees at the worksite.

OSHA conducted an inspection of the worksite and cited Summit for failing to ensure that the employees of Mendoza Framing were protected from a safety hazard resulting from two faulty pieces of equipment that Summit had rented to supply temporary electrical power to the project. OSHA issued the citation against Summit under its multi-employer liability policy. There was no evidence that either of Summit's own employees (or anyone other than Mendoza's employees) were exposed to the hazard.

Summit contested the citation, challenging the validity of the multi-employer liability policy. After an Administration Law Judge affirmed the citation, Summit sought review from the Occupational Health and Safety Review Commission ("OSHRC"). The OSHRC rejected Summit's challenge and issued a decision finding that Summit could be held liable either as a "creating" employer because it had ordered and not properly inspected the faulty equipment or as a "controlling" employer because it had maintained significant control over the worksite generally and the hazardous equipment in particular. In holding that Summit was a "controlling" employer, the OSHRC found it significant that Summit's superintendent routinely walked the jobsite and observed the project work and, at Summit's direction, pointed out safety hazards to its subcontractors.

Summit appealed to the D.C. Circuit, making three specific challenges to the OSHRC's decision. First, Summit argued that the imposition of liability on Summit under the multi-employer liability policy was improper because that policy had never been subjected to proper notice and comment rule-making under the procedures of the Administrative Procedures Act (APA), thereby rendering the policy invalid. The D.C. Circuit rejected this argument for two reasons. One, it held that the multi-employer liability policy was exempt from the APA's procedures because the policy was merely a general statement of OSHA's enforcement policy. And two, it found that the OSHRC's imposition of liability on Summit was not predicated *per se* on the multi-employer liability policy, but rather on OSHRC precedent holding general contractors liable in similar circumstances.

Second, Summit argued that the multi-employer liability policy violated a provision of the OSH Act stating that the Act shall not be "construed to . . . affect . . . the common law . . . duties, or liabilities of employers." Summit argued that OSHA's policy gave rise to a new duty of care by a general contractor to its subcontractor's employees, a duty that would increase the general contractor's liability. The D.C. Circuit noted simply that the argument provided no defense to the citation because "such liability would arise only from a court's (hypothetical) later action under state law – not for the OSH Act itself, which is all that [the OSH Act provision cited by Summit] addresses."

Third, Summit challenged the OSHRC's decision on the ground that OSHA had not proved that Summit had knowledge of the offending hazard and that,

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without such proof, Summit could not be held liable for a subcontractor's employees' exposure to the hazard. The D.C. Circuit also rejected this argument, holding that there was substantial evidence to support the OSHRC's finding that "Summit could have known of the violative condition with the exercise of reasonable diligence" and that such "constructive" knowledge was sufficient for purposes of the OSH Act." On this issue, the Court pointed to the subcontract between Summit and its subcontractor, which contemplated Summit's provision of temporary electrical services to the project site and the use of those services by others.

Summit Contractors confirms that OSHA may use the multi-employer liability policy as a safety enforcement tool against general contractors and others who oversee construction jobs. More and more frequently, general contractors are cited for safety hazards simply because they have general supervisory capacity and control over the worksite. *Summit Contractors* and other recent cases suggest that general contractors cannot insulate themselves from liability simply by attempting to contract away, to their subcontractors, the responsibility for employee safety. Under these cases, general contractors and others who manage construction jobs face an increased risk of liability if they do not proactively take measures to prevent, detect, and abate jobsite safety hazards.

By Keith Covington

Contractors Must Recognize Risks from the Implied Duty to Complete Construction in a Workmanlike Manner

A recent Tennessee Supreme Court case is a reminder that a contractor's legal responsibility does not end when it subcontracts work. Specifically, it reminds us that a contractor has an implied duty to complete any work it agrees to perform in a good and workmanlike manner, even if it subcontracts the work and even it the subcontract includes provisions purporting to shift all the risk to the subcontractor.

In *Federal Insurance Company v. Winters Roofing Company*, the contractor (Winters Roofing) agreed to install a new roof for a homeowner. The contractor had a subcontractor complete the roofing work. When the homeowners contacted the contractor about problems with the roof installation, the contractor subcontracted with Bruce Jacobs to perform remediation work. The subcontract with Bruce Jacobs included a provision stating: "[a]ny and all work will be the responsibility of Bruce Jacobs" and" [a]ny and all leaks/damages caused by the work performed . . . will be [Bruce Jacob's] responsibility."

The remediation work performed by Bruce Jacobs ultimately caused a fire and almost $900,000 in damages to the home. Neither the contractor nor Bruce Jacobs were insured at the time of the remediation work and resulting fire. The homeowners (via their insurers) demanded that the contractor pay for the damages. The contractor refused, arguing that it was not responsible because it did not perform any of the work and because Bruce Jacobs had contractually assumed all responsibility for the remediation work that caused the fire.

The Tennessee Supreme Court disagreed. The Court held that 1) "the general contract placed upon the [contractor] the implied duty to skillfully, carefully, and diligently install and repair the [homeowner's] roof in a workmanlike manner" and 2) "because the delegation of the responsibility to perform the services did not operate to release the contractor from liability [to the homeowners], the contractor, based on his contract with the [homeowners], may be held liable for the damages caused by the acts of [Bruce] Jacobs, the subcontractor."

Contractors must remember that they are obligated to perform all work in a workmanlike manner regardless of whether they actually perform the work or what a subcontract may state. Contractors can manage this risk by including risk shifting provisions in its subcontracts similar to those in the subcontract between Winters Roofing and Bruce Jacobs and other indemnification provisions. However, managing risks through subcontract provisions is only useful if the subcontractor has the ability to pay. Contractors can monitor a subcontractor's ability to pay in a number of ways including reports on a subcontractor's financial status and checking the status of a subcontractor's insurance (such insurance would generally include coverage for resulting damages, not

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the costs to repair the subcontractor's work itself). Contractors can also manage the risk associated with their subcontractor's work by keeping a current insurance policy covering the risks associated with subcontractor's work, being named as an additional insured on a builder's risk policy, or simply pricing the risk and including it in the price of the work.

By Bryan Thomas

General Contractor's Failure to Comply With Payment and Performance Bond Terms and Conditions Relieves Surety's Obligation to Perform

A recent federal district court decision in Michigan reminds us of the importance of understanding and adhering to the terms and conditions of a payment or performance bond. In *LaSalle Group, Inc. v. JST Properties, L.L.C.*, the contractor's failure to do so relieved the surety of its obligations under the performance bond and provided it with a meritorious defense of overpayment to the contractor's claims.

LaSalle Group, Inc. ("LaSalle") served as general contractor for the construction of a school in Gulfport, Mississippi. LaSalle subcontracted a portion of the concrete work on the project to Gulf Coast Construction, L.L.C. ("Gulf Coast"). LaSalle required that Gulf Coast provide a payment and performance bond for the full subcontract price. Gulf Coast obtained such bonds from American Contractors Indemnity Company ("ACIC").

During construction, LaSalle became aware that Gulf Coast was not paying its vendors and subcontractors. LaSalle sent a notice of default in accordance with the subcontract, requiring payment of all outstanding invoices within seventy-two hours. When this requirement was not met, LaSalle sent a letter terminating Gulf Coast's subcontract. Upon terminating Gulf Coast, LaSalle submitted to ACIC a formal claim against the subcontractor's payment and performance bonds.

ACIC denied LaSalle's claim on the performance bond for failure to comply with several conditions precedent. The bond clearly provided that, in order for the surety's obligation to arise, LaSalle had to (1) notify ACIC and Gulf Coast that it was considering declaring a default; (2) wait twenty days after such notice before declaring a default; and (3) pay ACIC any remaining contract balance as of the time of default. ACIC's denial of this claim prompted LaSalle to file suit alleging the surety's failure to perform under either bond.

The district court agreed with ACIC that LaSalle had not complied with the conditions requiring notice of impending default or the twenty-day waiting period. It found that LaSalle had not contacted ACIC at all regarding this issue until the point at which it informed the surety of Gulf Coast's termination and its claims on the bonds. The court did note, however, that while LaSalle clearly did not comply with these conditions, Michigan law states that failure to give notice as required in a bond will not in and of itself release the surety.

ACIC further claimed its obligations in the performance bond had not arisen because LaSalle had not paid over to it the remaining balance on Gulf Coast's subcontract. LaSalle contested by arguing that no balance remained on the subcontract because it had paid the balance to replacement contractors to complete or repair Gulf Coast's work. The court sided with the surety, finding that LaSalle had deprived ACIC of the opportunity to exercise its rights, which included contractor selection. The court concluded that none of the three conditions of the performance bond had been met and therefore ACIC's obligation to perform never arose.

The court also addressed ACIC's affirmative defense of overpayment against LaSalle's claims and its counterclaim for damages caused by such overpayment. The surety argued that LaSalle had overpaid Gulf Coast, resulting in a reduction of the contract balance which served as ACIC's collateral with respect to its indemnity and subrogation rights. LaSalle sought dismissal of these claims, but the court disagreed. It found that a contractor's overpayment can serve to discharge the surety's obligations where it results in "some injury, loss or prejudice" to the surety. Therefore, both the defense and counterclaim survived summary judgment.

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LaSalle provides several important lessons for contractors working with subcontractors covered by a payment or performance bond. First, it is essential that the contractor know and understand all provisions within the bonds. Second, the contractor must maintain communications with the surety regarding the subcontractor's performance, especially if it starts to decline. Finally, the contractor must take special care to ensure payments made to the subcontractor accurately reflect the amount of work performed to that point. As seen from this case, the failure to do so may release the surety from its obligations to perform.

By Charlie Baxley

Golfers Beware: The IBC May Not Apply to the Features on Golf Courses

With the approach of spring and the Masters, one's head naturally turns to striking that little white ball with a variety of well-designed sticks. A recent case from the federal trial court for the Eastern District of New York involves a hazard that was neither a trap nor a waterway. James, the plaintiff in the case, having downed 3-4 beers, decided to continue play at the 14th hole, though it had begun to rain steadily. As he approached the 15th green, he walked down a set of railroad tie and brick steps (pictured in the written decision), head down, talking, putter in hand. He slipped on the steps and broke his ankle.

James' expert opined that the root cause of the injury was the failure of the resort to follow the International Building Code by installing non-slip surfaces on the stairs. The judge made short shrift of the construction argument: "There is no indication that the IBC was intended to be applied to outdoor golf courses." Instead, just as James assumed the risk of extra strokes due to misplaced shots into sand traps, the rough, and the water hazards, he assumed the risk of the obvious and necessary dangers inherent in golf, particularly when playing in the rain.

The lesson for all golfers: mud, slippery grass, errant golf shots that become head shots, and playing and walking surfaces are open and obvious dangers in the sport of golf. Be warned. Be careful. One day you'll get that par. Hopefully, you won't break your leg doing it.

By Mabry Rogers

Two Key States, California And Texas, Enact Sweeping Construction Law Changes

Is it a revolutionary change in construction, prompted by conservative legislative wins in much of the U.S. in 2011? Even a leading construction and procurement practice group like BABC's does not have that good a political commentator! Regardless of its source, California and Texas have recently enacted significant changes in construction law in the two states.

In June, 2011, Texas Governor Rick Perry signed legislation which prohibits indemnity and insurance provisions in construction contracts which have the effect of indemnifying a party for its own negligence. The law prevents waiver of its protections. The bill is effective as to construction contracts or CIP programs established on or after January 1, 2012.

Texas also enacted in 2011 (also effective January 1, 2012) changes to its lien laws, including adoption of statutory forms for partial and final lien waivers. The law provides for statutory forms for waiver and release of mechanic's liens and payment bond claims, both conditional (upon receipt of payment) and unconditional (full and final). In order for a waiver and release to be effective, the form of lien waiver and release must be in substantial compliance with the statutory forms.

Four statutory forms have been created: (a) Conditional Waiver and Release on Progress Payment; (b) Unconditional Waiver and Release on Progress Payment; (c) Conditional Waiver and Release on Final Payment; and (d) Unconditional Waiver and Release on Final Payment. The difference between "conditional" and "unconditional" is that a "conditional" waiver and release may be given prior to actual receipt of payment (i.e., it is conditioned upon a payment to be made). When using a "conditional" waiver and release, the form must specifically reference the specific payment to be made. It cannot be used to require a claimant to

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provide a blanket waiver of its lien rights prior to a specific, promised payment. The statute expressly prohibits contractual waivers of lien rights except for contracts for labor or for labor and materials (but not materials-only contracts) for construction or "land development" of residential (single-family, townhouse or duplex) projects.

Questions remain about the use of the statutory forms in terms of the effectiveness of adding to them, such as true "bills paid" language and other issues associated with payment, such as a reaffirmation of warranties or representations about known claims. It is unclear whether those provisions can be combined into a single form or whether the separate statutorily prescribed waivers/releases have to be furnished.

California adopted legislation in 2011 that caps retainage on public projects (5% as of January 1, 2012) and shortens the time (from 10 days to 7) for a contractor to pay a downstream sub after receiving payment. The legislature also consolidated the lien and stop notice provisions, changing the statutory lien release forms (conditional and unconditional). The general contractor must now provide a preliminary work notice to lenders (which the owner must identify). "Completion" no longer includes "acceptance by an owner," which may affect the time for filing a lien or a stop notice.

The goal of both legislatures was to simplify the maze of construction law in each state, but the effect will likely be some confusion in the short run until contractors, owners, and subcontractors learn to change their forms to follow the new requirements. We suggest you contact your lawyer (or one of the lawyers below) to obtain a review of your practices, contracts, and forms in each state.

By Mabry Rogers

Bradley Arant Lawyer Activities:

Arlan Lewis was a featured panelist at the "Bonding & Insurance Workshop" for construction industry participants and government contractors on January 17th sponsored by the University of Alabama at Birmingham and the Alabama Department of Transportation.

Mabry Rogers, along with an outside business school professor, presented a client seminar for two days on fundamentals of negotiations, and will repeat the seminar in March, 2012.

David Taylor moderated and spoke on January 27th at a Tennessee Bar Association seminar in Nashville on "Remedies in Construction Law."

Wally Sears and **Mabry Rogers** attended the ACCL annual meeting in Laguna Beach, CA, from February 23rd thru 26th.

David Pugh attended ABC's BizCon Business Development Conference in Phoenix February 21st thru 22nd.

David Taylor spoke at a Construction Specification Institute national "webinar" on February 2 on "Using ADR to Resolve Construction Disputes."

David Bashford and **Mabry Rogers** will present client risk management seminars in California, Nevada, and Arizona in February, March, and April.

Eric Frechtel, **Steven Pozefsky** and **Aron Beezley** will be co-authoring for a federal construction publication a semi-monthly column on legal issues affecting small, disadvantaged and veteran-owned businesses.

David Taylor will be speaking at International Council of Shopping Centers Conference in Philadelphia on March 6 on "Using

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Mediation/Arbitration to Resolve Real Estate Disputes."

David Bashford was recently honored by *Super Lawyers* as a Rising Star in North Carolina for 2012 and recognized as a "Top Young Attorney in North Carolina."

David Taylor will be speaking at ABA ADR Section Annual Meeting in Washington, D.C. on April 20th on "Marketing an ADR Practice."

Doug Patin, **Bill Purdy**, and **Mabry Rogers** were honored in the "International Who's Who of Construction Lawyers 2011."

David Bashford presented client risk management seminars in California and in Australia in January and February.

Eric Frechtel attended The Moles Award Dinner in New York City on January 25th. The Moles is a prestigious group of leaders in the heavy construction industry, including tunnel, subway, sewer, and marine.

Ralph Germany was named a *Mid-South Super Lawyer* in the area of Construction Litigation for 2011.

David Pugh was recently named as a member of the Board of Directors for Design-Build Institute of America's South Central Region.

Frederic Smith recently authored an article in *Construction Executive* magazine's "Executive Insights" section.

Jim Archibald, Axel Bolvig, Ralph Germany, Frederick Humbracht, Doug Patin, David Pugh, Bill Purdy, Mabry Rogers, Wally Sears, and **David Taylor** were recognized in *The Best Lawyers in America* for 2012.

Jim Archibald, Axel Bolvig, Mabry Rogers, and **Wally Sears** were named Alabama Super Lawyers for 2011 in the area of Construction Litigation.

Mabry Rogers and **Bill Purdy** were recognized in *Chambers 2011* edition in the area of Construction Litigation while **Doug Patin** and **Bob Symon** were recognized in the area of Construction.

Charlie Baxley recently assumed the duties of Assistant to the Editor-in-Chief of the BABC CPG's newsletter, taking the helm from **Bryan Thomas**.

Chambers 2011 recognized Bradley Arant Boult Cummings' **District of Columbia Construction Practice Group** as a Leading Firm (Band One).

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

NOTE: YOU CAN FIND THIS NEWSLETTER AND PAST NEWSLETTERS ON OUR WEBSITE. IF YOU ACCESS THIS NEWSLETTER ON OUR WEBSITE, CASE-LINKS WILL BE AVAILABLE UNTIL THE NEXT NEWSLETTER IS PUBLISHED. WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY GO TO WWW.BABC.COM/PG_CONSTRUCT.CFM OR CONTACT ANY ATTORNEY LISTED ON PAGE 10 OF THIS NEWSLETTER.

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NOTES

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The lawyers at Bradley Arant Boult Cummings LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

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READER RESPONSES

If you have any comments or suggestions, please complete the appropriate part of this section of the *Construction & Procurement Law News* and return it to us by folding and stapling this page which is preaddressed.

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We are in the process of developing new seminar topics and would like to get input from you. What seminar topics would you be interested in?

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If the seminars were available on-line, would you be interested in participating? ☐ Yes ☐ No

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BRADLEY ARANT BOULT CUMMINGS LLP **Second Quarter 2012**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Proceed! Or You Lose

Many construction contracts include clauses imposing a duty to proceed under protest. These clauses are found at every level – prime contracts, subcontracts, purchase orders, etc. There are solid reasons behind imposing that duty. Having a duty to proceed can keep a dispute over a change order involving one part of the work from shutting down the entire job.

In *Dave's Excavating, Inc. v. City of New Castle*, the Indiana Court of Appeals held that the prime contractor had defaulted by failing to proceed under protest. In that lawsuit the prime contractor discovered what it contended was a differing site condition. The prime contract stated that upon discovery of such a condition the prime contractor was to stop work, notify the owner and the engineer, and do no more work in that area until the prime contractor received a written order to resume work in that area. The prime contract also contained the following additional language imposing a duty to proceed:

> CONTRACTOR shall carry on the Work and adhere to the progress schedule during all disputes or disagreements with OWNER. No Work shall be delayed or postponed pending resolution of any disputes or disagreements. . . .

Upon discovery of what it contended was a differing site condition, the prime contractor stopped work, notified the owner and engineer, and did no more work in the area. After a couple of weeks the engineer responded in writing that the differing site condition claim was being reviewed. In that same letter the engineer directed the prime contractor to proceed with the work in that area, and cited the duty-to-proceed language set out above. The engineer's letter expressly stated it was being issued per the directive of the owner.

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Despite the engineer's letter the prime contractor never restarted work in the area of the disputed differing site condition. The prime contractor contended that it did not have to restart work because it was entitled to a change order. The prime contractor completed all of its other work. Eventually the owner terminated the contractor's right to proceed under the prime contract on the basis of default and re-let the job for completion. Then the owner sued the prime contractor and its bonding company for the excess completion costs from the re-letting.

As part of their defense of the lawsuit the prime contractor and its bonding company argued that the prime contractor had no duty to proceed because the owner and engineer had breached their obligations to properly investigate and respond to the differing site condition claim. The prime contractor and its bonding company argued that those breaches by the owner and engineer excused the prime contractor from having an obligation to proceed under protest.

The Court rejected those arguments. The Court ruled that the prime contractor's refusal to proceed under protest had been the first breach, and that this first breach would have excused the owner and engineer from responsibility for any deficiencies with their investigation and response to the claim if there had been any such deficiencies. The Court went on to find that the owner and the engineer had in any event complied with their investigation and response obligations. The prime contractor and its bonding company were held liable for the excess completion costs.

The lesson here is clear: One acts at his peril when he fails to proceed under protest after receiving a proper directive to proceed.

By Ralph Germany

Agencies Beware: Flawed Environmental Analysis Stalls Highway Development

In an opinion that may impact major construction projects throughout the Southeast, on May 3, 2012 the Fourth Circuit Court of Appeals blocked plans for an $800 million highway bypass project in metropolitan Charlotte, ruling that the government failed to accurately disclose the environmental impact of the bypass as required by federal law.

In fall 2010, the Federal Highway Administration and the North Carolina Department of Transportation announced plans to build a highway bypass project connecting Union and Mecklenburg Counties in North Carolina. The project, known as the Monroe Connector, would relieve an overcrowded highway and shorten commutes between the two counties. Environmental groups challenged the plans, claiming that the FHA and NCDOT failed to abide by the requirements of the National Environmental Policy Act (NEPA). After a federal district court granted judgment in the government's favor, the environmental groups appealed. The Fourth Circuit agreed with the environmental groups and overturned the district court's judgment.

NEPA requires federal agencies to prepare environmental assessments and environmental impact statements evaluating the effects of their proposed actions. In this case, the FHA and NCDOT seemed to follow proper procedure: they issued a draft environmental impact statement analyzing a variety of alternative proposals, received and responded to public commentary, and eventually issued a final environmental impact statement for the winning proposal (the Monroe Connector).

During the period for public comment, however, the agencies and their consultant misrepresented the composition of data used to compare alternative proposals. The United States Fish and Wildlife Service, along with other environmental groups, questioned the agencies' assessment of the minimal environmental impact of the Monroe Connector when compared with their "no-build" alternative projection (the baseline comparison of no action against which all proposed actions were evaluated). In response, the agencies defended their calculations and incorrectly stated that the no-build alternative did not incorporate "build" assumptions. In fact, as the agencies admitted in litigation, the no-build alternative assumed construction of the Monroe Connector, skewing the comparisons to demonstrate less environmental impact.

The Fourth Circuit unanimously ruled that the agencies' inaccurate analysis violated NEPA by fail-

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ing to meet the procedural requirements of clarity and transparency of process. The agencies argued that their thorough analysis of the environmental impacts and procedure of accepting public commentary met NEPA standards. The court, although noting that NEPA does not require any particular outcome, disagreed. It held that the agencies' "mischaracterization related to a critical aspect of the NEPA process" and frustrated the purpose of the law by failing to accurately analyze the environmental impact of proposed action. The court noted that allowing agencies to admit their mischaracterization in litigation but continue with the proposed action would improperly allow them to contravene the NEPA process.

In so ruling, the Fourth Circuit set a strong precedent for judicial review of major construction projects within its jurisdiction, which includes Maryland, Virginia, West Virginia, North Carolina, and South Carolina. The decision may affect environmental challenges to major construction projects around the nation as lower courts follow the Fourth Circuit's interpretation of NEPA. Construction on the Monroe Connector, which was planned to begin in early fall, is at best significantly delayed until the agencies undertake a new, and accurate, environmental analysis of their proposed actions.

By Monica Wilson

Pay Close Attention to the Differences Between Statutes of Repose and Statutes of Limitation — Courts Do

Colorado has enacted a construction defect reform statute that requires certain procedural steps to make a defect claim, including time limitations (in the form of statutes of limitation and repose) within which to make those claims. A simplified distinction between statutes of limitation and statutes of repose is that statutes of limitation may be extended for various reasons (fraud, incapacity, statutory exception) while statutes of repose generally represent a drop-dead date for claims that can only very rarely be extended. In a recent case, the Colorado Court of Appeals rejected a claim as untimely that fell into an admittedly ambiguous portion of the statute. The issue involved whether the statute's tolling provision, which essentially calls 'time out' on the statute of *limitation* during claim review, also tolls the statute of *repose*. In this case, it did not.

The job in issue was a condominium complex built in multiple phases. Importantly for the outcome of this case, the local building authority issued certificates of occupancy at different times (during 2003 and up to January 2004) for the various phases. In 2007, the homeowners' association (HOA) made a claim for defects that remained under review for roughly a year and a half. Because the HOA did not originally sue the general contractor, the general contractor did not sue its subcontractors until March 2010, sixty days after being added to the lawsuit in January 2010. Unfortunately, the statute of repose for each phase ran six years from the dates of substantial completion and these dates, argued the subs, ran during the sixty-day intervening period.

The court had to decide two issues to rule on the case. First, it had to determine whether any unusual meaning should be given to the phrase "substantial completion," which wasn't defined in the statute. The general contractor argued that it should mean the substantial completion of the *entire improvement*, as certified by the architect. The court rejected the argument, opting instead for a more practical (and industry standard) view of substantial completion that was based on the actual habitability of the units, as attested by the local building official. The second issue was whether the statute of repose for the indemnity claims against subcontractors could be tolled by the defect statute's provision reading, "if a notice of claim [is filed timely], then the statute of limitations or repose is tolled until sixty days after the completion of the notice of claim process…."

The problem for the general contractor was that the subcontractors didn't receive a notice of claim from the HOA, though the court openly acknowledged that the statute "could reasonably be interpreted to mean" that such claims were also tolled. Cast into such doubt, the court looked at the policies of the defect statute — providing a cap on 'long-tail' liability, preventing "shotgun" subcontractor litigation by suing everyone potentially liable, and bringing

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parties with potential liability into the pre-suit screening process — and determined that disallowing the 'late' claim would best serve those purposes. The court also decided that an amendment to the law expressly deferring the statute of *limitation* for contractors 90 days to bring claims against subcontractors, but not mentioning the statute of *repose*, meant that the legislature did not mean to toll the statute of repose.

One can't help but have sympathy for the general contractor here. It followed all of the rules under the statute, presumably in reliance on the tolling language and belief that the "notice of claim" included those portions of the claim that really lay against subcontractors. It filed suit within sixty days after receiving the owner's claims. Ironically, the court's ruling here makes it much more likely, and prudent, that general contractors will fire off a shotgun complaint against all potentially liable subcontractors the day after they receive an HOA lawsuit. This is particularly likely to be the case if there is any doubt about when the statute of repose runs.

Our suggestion in similar situations is for the general contractor to engage the owner entity ahead of time to determine its intentions, and to consider otherwise unusual procedural maneuvers like filing a declaratory judgment action against the owner and subs, or having the owner (in cases where suit is inevitable) sue sooner rather than later. One might also attempt to negotiate a covenant not to assert the statute of repose with certain subcontractors who are likely 'targets' of the HOA or Owner (if such a covenant will be recognized by the courts as actually tolling the repose statute).

By Jonathan Head

Default Termination Improper where Government caused Performance Delays

The U.S. Court of Federal Claims recently held in the case of *Martin Construction, Inc. v. United States*, that the U.S. Army Corps of Engineers' ("USACE") termination of a contractor's contract was improper because the performance delays at issue were caused by the USACE's defective design specifications. As a result, the termination for default was converted to a termination for convenience. Martin Construction (the "Contractor") entered into a contract with the USACE in 2007 to construct a marina in North Dakota. After more than thirteen months of attempted performance, the USACE terminated the Contractor's contract for default on January 13, 2009. The contractor then brought an action in the Court of Federal Claims seeking to convert the default termination into a termination for the Government's convenience, thereby entitling the contractor to reimbursement of the costs incurred in performing the project, plus reasonable profit and overhead. The Contractor claimed that the USACE's default termination was improper for two main reasons: (1) the USACE's defective cofferdam design and subsequent modifications caused most of the delays, making it impossible to finish the project by the October 2011 contract completion date; and (2) the USACE waived the contract completion date.

Following trial, the Court found that the USACE's decision to terminate the contractor for default on January 13, 2009 was improper. According to the Court, the "overwhelming" evidence at trial established that the USACE's cofferdam design "suffered from a critical defect, which significantly impeded the construction of the project." In short, the Court found that the USACE "mistakenly specified a porous gravel material for the first zone of the cofferdam, making it practically impossible to dewater the marina area." The contractor's inability to dewater created successive construction failures and safety concerns that prevented timely performance.

In its decision, the Court opined that:

> The most troubling aspect of this case is the [USACE's] adamant refusal to accept any responsibility for its defective design, even while [the contractor] made every effort to comply with it. This relatively routine construction project did not need to end in contentious litigation. Competent procurement officials would have acknowledged the agency's obvious design mistake, made the necessary corrections, and afforded the contractor the additional time and money to complete performance.

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The Court's ruling in this case is significant because it sends a strong message to Government procurement officials that procuring agencies must take responsibility for their defective design specifications which result in project delays. In the event such defects occur, the Court has shown that it will not tolerate the Government's attempts to blame contractors for the Government's own delays.

By Aron C. Beezley

First Known Court Challenge to VA Denial of Service-Disabled Veteran-Owned Small Business Status

Recently, in what apparently is the first known court challenge of a U.S. Department of Veterans Affairs ("VA") denial of an application for inclusion in the VA's VetBiz Vendor Information Pages ("VIP") Verification Program, the U.S. District Court for the District of Columbia granted plaintiff CS-360, LLC's ("CS-360") Motion for Summary Judgment by remanding the denial back to the VA based on the VA's failure to provide a satisfactory contemporaneous explanation for its decision to deny CS-360's application. Being approved by the VA and included in the VIP database would have made CS-360 eligible to compete for VA service-disabled veteran-owned small business ("SDVOSB") set-aside contracts. Among other things, CS-360 had requested that the Court find that the VA's denial of CS-360's application was "arbitrary and capricious" under the Administrative Procedures Act.

After considering CS-360's claims, Judge Kollar-Kotelly ruled that, "in this case, the defects in the VA's written decisions are so many and so significant that they affect the whole, and preclude the Court from effectively exercising its review function." The Court went on to state:

> Given the ambiguous relationship between the Initial Determination and Final Decision, the vague and generalized explanations provided by the CVE [Center for Veterans Enterprise] on the administrative level, and the new explanations proffered by the VA before this Court, the Court cannot say with any level of confidence that it knows the precise grounds for the VA's decision to deny CS360's application for inclusion in the VetBiz VIP database and whether those grounds would hold up under review. Simply put, on this sparse and disjointed record, the Court cannot find that the VA has "provided a 'rational connection between the facts found and the choice made.'"

Meanwhile, the Court dismissed CS-360's claims that the VA acted beyond its statutory authority in establishing its regulatory process for verification and that the VA's decision was without due process.

This case is significant not only because it appears to be the first of its kind, but because the Court's ruling sends a strong message to the VA that its denials of such applications must be adequately supported by the record. We will continue to monitor this noteworthy case.

By Eric A. Frechtel, Steven A. Pozefsky and Aron C. Beezley

Bradley Arant Lawyer Activities:

David Taylor spoke at the International Council of Shopping Centers "College" in Philadelphia on March 2nd on the topic of "Managing Construction Disputes".

Eric Frechtel, **Steven Pozefsky** and **Aron Beezley** co-authored an article on the Small Business Contracting Fraud Prevention Act of 2011 which was published in the February/March 2012 issue of *Federal Construction Magazine*.

Ralph Germany was named a *Mid-South Super Lawyer* in the area of Construction Litigation for 2011.

David Taylor spoke at the American Bar Association's ADR National Meeting in Washington, DC on April 19th on the topic of "Selecting Neutrals".

Mabry Rogers, along with an outside business school professor, presented a client seminar for two days on fundamentals of negotiations in March 2012.

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David Bashford was recently honored by *Super Lawyers* as a Rising Star in North Carolina for 2012 and recognized as a "Top Young Attorney in North Carolina."

Doug Patin, **Bill Purdy** and **Mabry Rogers** were included in the "International Who's Who of Construction Lawyers 2011."

David Pugh was recently named as a member of the Board of Directors for Design-Build Institute of America's South Central Region.

David Taylor spoke on May 4th at the Tennessee Chapter of American Society of Professional Engineers in Nashville on "Contract Clauses that Can Bite Back"

Ryan Beaver, **Ralph Germany**, **Michael Knapp**, **David Pugh**, **David Taylor** and **Bryan Thomas** will be speaking at the Bradley Arant Boult Cummings LLP 2012 Construction Contract Claims Legal 101 seminars in Birmingham on May 11th, Nashville on May 18th, Charlotte on June 15th and Jackson on June 22nd. Please see the enclosed invitation for more information.

Keith Covington spoke recently on the latest developments at the National Labor Relations Board and the Department of Labor at two recent membership meetings sponsored by the Associated Builders and Contractors. Keith's presentation included discussion of the new NLRB posting rule, the NLRB's new rules on union election procedures, and the proposed changes to the DOL's labor persuader reporting rules.

Arlan Lewis was a featured panelist at the "Bonding & Insurance Workshop" for construction industry participants and government contractors on January 17th sponsored by the University of Alabama at Birmingham and the Alabama Department of Transportation.

David Taylor moderated and spoke on January 27th at a Tennessee Bar Association seminar in Nashville on "Remedies in Construction Law."

Bill Purdy, **Wally Sears** and **Mabry Rogers** attended the ACCL annual meeting in Laguna Beach, CA, from February 23rd thru 26th.

David Pugh attended ABC's BizCon Business Development Conference in Phoenix February 21st thru 22nd.

David Bashford and **Mabry Rogers** recently presented client risk management seminars in California, Nevada, and Arizona in February, March, and April.

Jim Archibald, Axel Bolvig, Ralph Germany, Frederick Humbracht, Doug Patin, David Pugh, Bill Purdy, Mabry Rogers, Wally Sears and **David Taylor** were recognized in *The Best Lawyers in America* for 2012.

Jim Archibald, Axel Bolvig, Mabry Rogers and **Wally Sears** were named Alabama Super Lawyers for 2011 in the area of Construction Litigation.

Brian Rowlson recently joined BABC's Construction Practice Group in the Charlotte office. Brian received his J.D. from Stetson University, M.B.A. from the University of South Florida, and his B.S. from Florida State.

Mabry Rogers and **Bill Purdy** were recognized in *Chambers 2011* edition in the area of Construction Litigation while **Doug Patin** and **Bob Symon** were recognized in the area of Construction.

Chambers 2011 recognized BABC's **District of Columbia Construction Practice Group** and **Birmingham, AL General Litigation Group** as Leading Firm (Band One) practice groups.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

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2012 CONSTRUCTION CONTRACT CLAIMS

LEGAL 101

Please choose a location and date most convenient to you:

May 11th
Birmingham, AL
One Federal Place
1819 Fifth Ave. North
Birmingham, AL 35203

May 18th
Nashville, TN
1600 Division St.
Suite 700
Nashville, TN 37203

June 15th
Charlotte, NC
Charlotte City Club
121 West Trade St.
Charlotte, NC 28202

June 22nd
Jackson, MS
188 East Capitol St.
Suite 400
Jackson, MS 39201

Summary

A complimentary seminar hosted by the Construction Lawyers of Bradley Arant Boult Cummings LLP on critical information everyone in the construction industry needs to know about construction contract claims:

- What Are the Typical Construction Contract Claims
- How to Recognize the Potential Claim
- How to Preserve, Develop, and Price Construction Contract Claims
- How to Evaluate Construction Contract Claims

Schedule

7:30 a.m. to 8:00 a.m.	Registration & Continental Breakfast
8:00 a.m. to 9:45 a.m.	Program: Part I
9:45 a.m. to 10:00 a.m.	Break
10:00 a.m. to 11:45 a.m.	Program: Part II

Who Should Attend?

- Project Managers
- Project Engineers
- Superintendents
- Contract Administrators
- Owners
- Architects
- Engineers
- Subcontractors
- Suppliers

RSVP

Seating is limited. Please RSVP no later than one week prior to the event by registering at the following link:

http://registration.babc.com/ccclegal101

If you have any questions, please contact Sarah Heaton at sheaton@babc.com *or* 205.521.8563

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The lawyers at Bradley Arant Boult Cummings LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

This newsletter is a periodic publication of Bradley Arant Boult Cummings LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact your lawyer or any of the lawyers in our group whose names, telephone numbers and E-mail addresses are listed below; or visit our web site at www.babc.com.

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BRADLEY ARANT BOULT CUMMINGS LLP Third Quarter 2012

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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CBCA Imposes Damages for Prime Contractor's Failure to Self-Perform at Least 50% of Contract Work

Recently, in what apparently is a case of first impression, the U.S. Civilian Board of Contract Appeals (the Board) in *Singleton Enterprises v. Department of Transportation* awarded contract damages to the Federal Highway Administration (the Government) for a prime contractor's failure to self-perform at least 50% of the contract work. While this decision does not have precedential effect (which means it is not binding on the Board in subsequent cases), it is nonetheless noteworthy because this case likely will be looked to for guidance in future cases involving the imposition of damages for breach of self-performance requirements. These requirements are common in Federal procurements, and the agencies administering Federal contracts are increasingly insistent on enforcement of the requirement. The stated rationale is to assure the general contractor's "adequate interest and supervision of the work."

The contract, which was a firm fixed price contract awarded to the prime contractor for a base price of $634,241.40, contained a provision requiring the prime contractor to self-perform work equivalent to at least 50% of the project work. The Board concluded that the prime contractor breached the contract by failing to meet this self-performance requirement and then turned its attention to the Government's proposed calculation of damages, which the Government calculated to be $22,538.17. The Government essentially calculated its damages by removing from the prime contract amount the premium (*i.e.*, the difference between the total price of the subcontractor's work and the total contract price) that the Government was paying to have the prime contractor perform the subject work.

At the outset of its examination of the Government's proposed damages calculation, the Board stated:

> The imposition of damages for failure to meet the 50% threshold is a matter of first impression for this Board. No cases that have been brought to our attention are directly on point, either as to the propriety of assessing damages for this particular breach or how to calculate

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> those damages. That said, after consideration, we find that the Government, as any contracting party, has a right to the benefit of its bargain and, thus, the right to recover damages due to a breach. There is no provision in this contract which prohibits the Government from seeking damages for the breach in issue or which provides a specific remedy for this type of breach.

The Board found that under these circumstances an assessment of damages was warranted and that the method of calculation used by the Government was reasonable and appropriate.

In this particular case, the damages were relatively inconsequential given the size of the contract. However, the damages calculation for breach of the self-performance requirement could be quite substantial, depending on the size of the contract, the nature of the dispute, and the actual percentage of work completed by the contractor. For example, the VA clause on this issue imposes a penalty of 15% on the amount of the work which was not properly self-performed. Where the self-performance shortfall is, say, $40,000,000 (as it may be on a large hospital job), the penalty is obviously substantial.

It should also be noted that failure to satisfy self-performance requirements can potentially open a contractor up to liability under the False Claims Act if the contractor falsely certifies the percentage of work that it is self-performing. Keep in mind that each and every time a contractor submits a payment application to the Federal Government directly, it is certifying compliance with the terms and conditions of the contract. Moreover, it is likely that the Government will latch on to the Board's decision in investigating whether self-performance requirements have been met and then use breaches of self-performance provisions as an offset against legitimate claims by contractors.

By Robert J. Symon and Aron C. Beezley

Construction Defect Complaint Alleging Negligent Misrepresentation May Trigger Insurance Coverage

Insurance companies routinely – and incorrectly in many states – deny coverage for construction defects cases by arguing that construction defect claims do not allege covered occurrences and, even if they do, various exclusions eliminate coverage. Before engaging in extended disputes over these coverage denials, business insureds should carefully scrutinize the complaint for alternative grounds for coverage. A recent insurance coverage case arising out of a lawsuit between a residential buyer and seller, *USAA Casualty Insurance Co. v. McInerney*, demonstrates the favorable impact of an alternative claim on coverage. The court in *McInerney* required the insurance company to defend a home seller from the home buyer's lawsuit because the complaint alleged negligent misrepresentation, even though the complaint also alleged admittedly non-covered claims.

This case arose out of problems with a leaking basement in Illinois. The sellers' home disclosure informed the buyer of flooding or reoccurring leakage problems in the basement that had been corrected by new drains and landscaping. The sellers also disclosed that "[o]n rare occasions, we have experienced slight seepage." Less than a year after the sale closed, the basement sustained water infiltration, flooding, and mold growth that rendered the basement uninhabitable and allegedly constituted far more than "slight seepage." The buyers sued the sellers, claiming that the sellers negligently misrepresented the potential for basement flooding. The buyers also alleged breach of contract, violation of the Residential Real Property Disclosure Act, and fraudulent misrepresentation. The buyers claimed that the flooding damaged their house and personal belongings, and also caused mold-related illnesses.

The sellers submitted the buyers' lawsuit to their liability insurer, but the insurer denied coverage and instead sued the sellers to obtain a ruling on coverage. The insurer argued that the complaint did not allege an occurrence, and, even if it did allege an occurrence, the occurrence was excluded from coverage because it resulted from intentional acts or arose from the sales contract. The sellers did not dispute the insurer's intentional acts and contract exclusion defenses, but argued that the buyers' claim for negligent misrepresentation was a covered occurrence not excluded under the policy.

The Illinois appellate court held that a negligent misrepresentation claim is not excluded from coverage as long as the insured did not expect or intend the injury. The court held that the complaint alleged an occurrence by alleging negligent misrepresentation and that the relevant exclusions did not eliminate that coverage. The complaint alleged an occurrence because the damage arguably was not expected or intended. The contract

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exclusion did not bar coverage because the disclosure report was not a contract and the buyers' lawsuit sought compensatory damages rather than contract-based relief.

Thus, the court seized on a single count – negligent misrepresentation – as the grounds for requiring the insurer to defend the entire case against the home seller. As the court explained, "if the underlying complaint against the insured contains several theories of recovery and only one of the theories is potentially covered, the insurer must still defend the insured [and] may become obligated to defend against causes of action and theories of recovery that the policy does not actually cover."

Construction defect complaints allege many alternative theories of recovery and one of those may be an "occurrence" (although many insurers may contest the point). Although insureds and insurers typically battle over exclusions to coverage, such as the "your work" and "faulty workmanship," exclusions, alternative bases for coverage may be available that avoid these disputes. Business insureds facing construction defect claims should search for alternative bases for coverage in complaints asserted against them. A single allegation, such as one for negligent misrepresentation, can be sufficient to trigger coverage for a claim that, from the insurer's perspective, is otherwise uninsured.

By Katherine Henry

Know Your State Law to Better Assess Risk

The recent Illinois case *1324 W. Pratt Condominium Association v. Platt Construction Group, Inc.* reminds contractors to be mindful of state policy considerations which may affect their risk assessments when constructing condominiums or high profile projects.

The case involved the construction and sale of an eight unit residential building in Chicago, Illinois. The project developer contracted with a general contractor for construction of the building, who then hired a number of trade subcontractors to perform the majority of the work.

After completion of the building in March 2005, the developer sold the eight units in the building as condominium units, entering into real estate contracts with each of the individual condominium unit owners. The general contractor and trade subcontractors had no direct contracts with the individual unit owners and were not involved in the sale of the units.

After sale of the condominium units, the developer became insolvent and entered bankruptcy. Shortly thereafter, leaks developed in the condominium building. The condominium association alleged that these leaks caused structural damages to the building and also caused mold to grow throughout the building with resultant medical problems for some of the owners. Because the developer had gone out of business, the condo association notified the general contractor of the leaks and requested that it repair the problems. The general contractor ignored these requests; so, the condo association sued the general contractor and some of its subcontractors asserting various causes of action, including breach of the implied warranty of habitability.

The general contractor first asked the Illinois trial court to dismiss the case because it had no contract with the unit owners or the condo association. While the trial court accepted this argument, on appeal the Illinois appeals court held that the implied warranty of habitability is meant to protect homeowners from improper construction and therefore, the implied warranty applied against the general contractor even when there was no contract between the general contractor and the unit owner.

On its second visit to the trial court, the general contractor attempted to rely on a provision in the real estate sales contract between the developer and the individual unit owners whereby the unit owners "disclaimed" the implied warranty of habitability. Again, the lower court accepted the general contractor's argument and ruled in favor of the general contractor. The unit owners again appealed.

Upon review, the appellate court noted that the real estate purchase contracts were between the individual unit owners and the developer; the general contractor was not a party to the contract. The court then noted that disclaimers of the implied warranty of habitability are strictly construed under Illinois law, as a matter of public policy. Here, the disclaimer of the implied warranty of habitability was only between the "Purchaser" and the "Seller" – between the unit owners and the developer. The court held that by its plain terms, this disclaimer could not apply to the general contractor. Therefore, the general contractor could still be held liable for breach of the implied warranty of habitability.

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This case reminds contractors to be careful when constructing multi-unit residential buildings and other properties that may be subject to important "policy considerations" under a given state's law. To remain profitable, it is important that contractors put in place effective contractual mechanisms for assigning and disclaiming risks that will be effective under the applicable law. To do so, contractors must have a solid understanding of the legal structures under which they operate. While there is no "sure" answer here, the contractor might have been successful in having its contractual partner agree to place a disclaimer favorable to the contractor and its subcontractors in the condominium sales contracts.

By Luke Martin

If Your Warranty Fails, Will You Be Liable For Consequential Losses?

Two important elements of any commercial contract are the warranty and the exclusion of consequential losses. In the context of the sale of goods, warranty provisions will typically cover defective products and the seller's liability will be limited to the replacement or repair of the goods and may not cover so-called "consequential" damages. However, when a warranty fails of its essential purpose, contractual limitations on recovery of consequential losses can be compromised.

"Failure of essential purpose" of a warranty is a legal term that describes the situation where a warranty provides insufficient remedies to a purchaser. In a construction setting, the most typical example of this is the purchase of a piece of commercial equipment that is in some way defective. When the defect is discovered, the purchaser contacts the seller and requests that the seller fulfill its warranty obligations by fixing the equipment. Courts have held that a "limited repair or replace" warranty fails of its essential purpose when the seller is not able to fix the equipment in a reasonable amount of time, even if numerous attempts at repair are undertaken.

A warranty can also fail of its essential purpose when a volume purchaser discovers a "serial defect"- *i.e.*, a defect present within a large number of similar units. Even if the seller replaces the products under warranty, the warranty may still fail of its essential purpose if the purchaser is required to absorb the cost of uninstalling the products and shipping them back to the seller (as well as absorbing the resulting loss in production or cooling or other output). The theory behind this doctrine is that mere replacement of the defective products does not sufficiently compensate the purchaser – in legalese, the purchaser is deprived of the "benefit of the bargain."

When a warranty has failed of its essential purpose, the purchaser may be allowed to recover consequential losses despite a contractual exclusion of the same. The Uniform Commercial Code ("UCC"), which governs the sale of goods and is adopted in some form by every state, specifically addresses failure of a warranty and consequential losses. Section 719 of the UCC expresses the following rules: first, if a warranty fails of its essential purpose, all "normal" remedies (including recovery of consequential losses) become available to the purchaser; second, if a consequential loss exclusion is unconscionable, it is not valid. The interplay between these provisions begs the question: if a warranty fails of its essential purpose, thereby allowing the purchaser the full range of remedies available for breach of contract, does a consequential loss exclusion remain valid if it is not unconscionable? In other words, is a contractual consequential loss exclusion automatically extinguished when a warranty fails of its purpose?

The majority of states hold that the two UCC provisions are dependent – that a consequential loss limitation is automatically extinguished when a warranty fails of its purpose and the purchaser is allowed to recover consequential losses despite the contrary limitation in the parties' contract. The logic of this position is that the balance of risk inherent in a contract between two parties is materially altered when a warranty fails to serve its purpose. The majority states include Alabama, Delaware, Idaho, Illinois, Massachusetts, Michigan, Ohio, South Dakota, and Wisconsin. The minority of states hold that the two UCC provisions are independent – that a contractual limitation on recovery of consequential losses remains valid even when a warranty fails of its purpose. The logic of this position is that the balance of risks was negotiated between the parties and it should not be disturbed. Minority states include some behemoths in commercial contracting: California, New Jersey, New York, North Carolina and Tennessee. Some states, such as Mississippi, have not explicitly addressed this issue.

In order to better protect against liability for consequential losses, manufacturers and sellers of equipment and materials should consider including a contractual provision explicitly stating that the consequential loss

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exclusion functions independently from the terms of the limited warranty. The provisions should state that the parties agree the consequential loss exclusion will remain in place even if the warranty fails of its essential purpose. Even in the majority rule states, this type of contractual clause has a good chance of holding up in a court of law because the UCC can be modified or overwritten by a contractual agreement. The following are two sample clauses, which can be added to consequential loss exclusions:

"This disclaimer and exclusion shall apply even if the express warranty set forth above fails of its essential purpose."

"Customer acknowledges and agrees that Seller has set its prices and entered into the Agreement in reliance upon the disclaimers of warranty and the limitations of liability set forth herein, that the same reflect an allocation of risk between the parties (including the risk that a contract remedy may fail of its essential purpose and cause consequential loss), and that the same form an essential basis of the bargain between the parties."

Of course, the purchaser, whether contractor or owner, faced with this effort by the equipment supplier, should be diligent in attempting to negotiate more favorable terms.

By Vesco Petrov

Owner's Approval of Means and Methods may not Relieve Contractor of Liability

When faced with a risky means and methods issue—excavating near an existing structure, for example—contractors frequently seek or otherwise receive input (whether they want it or not) from the owner or its on-site representative. In other cases, the contractor may simply take comfort in the fact that the owner is observing the means and methods in progress and is not objecting to them. In either case, the contractor may assume that so long as the owner somehow "buys in" to the contractor's plan and the contractor properly executes it, the owner will bear some or all of the risk if something goes wrong. This is not a sure assumption.

Generally, a contractor is solely responsible to implement the owner's design concept through means and methods of its choosing, so long as the owner or owner's designer does not dictate in the design that the contractor employ specific means and methods. Moreover, inspection provided by or for the owner generally does not guarantee the contractor's performance or relieve its obligation to perform work in accordance with the drawings and specifications. It is common for contracts to spell out these principles. The AIA A201 (2007), for example, provides that the "Contractor shall be solely responsible for, and have control over, construction means, methods, techniques, sequences and procedures and for coordinating all portions of the Work under the Contract, unless the Contract Documents give other specific instructions concerning these matters."

While these are generally well understood principles, the analysis is less obvious when the owner has somehow indicated its approval of the means and methods. An older but frequently cited case out of Iowa, *Shepherd Components, Inc. v. Brice Petrides-Donohue & Associates, Inc.*, illustrates why a contractor should not assume that it is off the hook in these cases. *Shepherd* involved sewer system improvements that required excavation near an existing structure. Although the contracts for the project clearly assigned sole liability for means and methods to the contractor, the owner's engineer, upon request for consultation from the contractor, provided its approval of the contractor's proposed method for protecting the adjacent property during excavation. The contractor installed sheet piling designed to retain the soil supporting the existing structure but—thinking it would solve a separate vibrations problem—deviated from the plan by excavating some material from the existing structure-side of the sheet piling. Signs of a potential failure quickly appeared. The contractor consulted the engineer and proposed a new plan to him. Although the engineer apparently did not formally approve this second plan, he was intimately aware of the plan and discussed it with the contractor in several meetings. The contractor followed the new plan without objection from the engineer. Nevertheless, a significant failure occurred and the owner of the existing structure sued the contractor and engineer.

Despite these "bad facts" for the engineer, which made it appear that he at least tacitly approved the plan, the court focused primarily on the terms of the contracts at issue and the customary lines of responsibility discussed above. Under its contract with the owner, the contractor had sole authority over means and methods. In contrast, while the engineer's contract with the owner

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contained a duty to inspect the construction site, he had no authority to control means and methods. At trial, the property owner and contractor argued that the engineer should be primarily liable for the failure based on his negligence in failing to object to the plan or propose a plan of his own, especially given his involvement in the situation. Nevertheless, the court found that the engineer's on-site involvement did "not change the fact that [he] had no legal duty to interfere with [the contractor's] judgment on which construction procedures to utilize." In the end, the contractor was left holding the bag.

Understandably, contractors may view the owner's engineer as a good source of input, and there is nothing inherently wrong with seeking such input. However, the lesson of *Shepherd* is that contractors should not assume that the owner or owner's engineer has taken responsibility for a means and methods issue just because the engineer has observed, participated in, or even approved the method.

By James Warmoth

Magic Words Make For Bad Law

Homebuilders in Ohio, and those litigants who might be influenced by the Supreme Court of Ohio, should take note of the recent decision in *Jones v. Centex Homes* that the duty to build in a workmanlike manner is non-waivable as a matter of law. This decision flies in the face of the industry practice of disclaiming common law implied warranties and substituting limited express warranties in their place. The court achieved this result by claiming that building in a workmanlike manner was a "duty" rather than an "implied warranty." It appears that this has been in the law in Ohio for close to thirty years, yet the Ohio Legislature hasn't acted to fix this problem.

One of the first things lawyers learn is that the civil law draws its duties largely from contract and tort. While most people in our industry are quite familiar with contracts, many have heard of torts but aren't quite sure what the term means. Tort duties are duties that do not arise under contract, but arise because of the nature of society. They are those that a "reasonable person" would undertake in exercise of ordinary care to those around her. In the non-construction context, this means driving one's car at a reasonable rate of speed to protect other drivers or not driving while intoxicated. For our industry, it might mean not building weak scaffolds near public walking areas or leaving open excavations where the public would be likely to walk into them. Generally, it has not meant taking on duties to specific homeowners with whom the builder has a contract because the contract is the best way for those two parties, dealing at arm's length, to define their responsibilities to one another. If a homeowner wants a warranty, he or she can ask for one in the contract. For this reason, the law recognizes that promises regarding the quality of construction and directed at the homeowner, *i.e.*, warranties, spring from the contractual relationship and would not exist without it. Several states recognize that a party who promises to do something in a contract also has a duty to do that act reasonably — that is, contract duties can give rise to tort duties. Other states reject this view and adopt the economic loss rule, holding that purely economic damages arising from a contract may not also have a remedy in tort.

Why on earth should one care about this discourse on contracts vs. torts? In the Ohio case, the court focused on the builder's characterization of the duty to build in a workmanlike manner as an "implied warranty," in keeping with the general rules of the construction industry. Indeed, the court appears to have no problem with the notion that implied warranties can be waived and replaced by contract, but it claimed "that issue is not squarely before us." In Ohio, the obligation of a builder to provide a habitable home is a duty that arises from the contract, but is not an "implied warranty." Therefore, the duty cannot be waived in the way a warranty can. One supposes that a mere deviation from plans and specifications might not support this tort duty if the deviation were not "unreasonable" or was not alleged to make the home uninhabitable.

However, in practice, this is a harmful rule for construction businesses. First, by placing the duty in tort (specifically, negligence), the court takes away builders' ability to avoid a lengthy trial, as almost every negligence suit inherently turns on jury-decided questions. Second, the Ohio court changes the legal risks by not allowing parties, contracting at arms' length, to alter this particular tort duty in their contracts. Our advice to those building homes or condominiums in Ohio is to review your risk allocation clause, attempt to insure this particular risk, and, where possible, place strict notice limitations on a homeowner asserting a habitability claim. Finally, talk to your lawyer about other potential ways to limit this risk.

By Jonathan Head

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Bradley Arant Lawyer Activities:

David Taylor spoke at the International Council of Shopping Centers "College" in Philadelphia on March 2nd on the topic of "Managing Construction Disputes."

Eric Frechtel, **Steven Pozefsky** and **Aron Beezley** co-authored an article on the first known court challenge of a U.S. Department of Veterans Affairs ("VA") denial of an application for inclusion in the VA's VetBiz Vendor Information Pages Verification program which was published in the April/May 2012 issue of *Federal Construction Magazine*.

Michael Knapp, **Ryan Beaver**, **Brian Rowlson**, **James Warmoth** and **Monica Wilson** recently attended the ABC Carolinas Construction Conference in Wilmington, NC, where the Charlotte office was recognized as the ABC Carolinas Associate Member of the Year for 2012.

Ralph Germany was named a *Mid-South Super Lawyer* in the area of Construction Litigation for 2011. **Alex Purvis** was also named a "Rising Star" in the area of Insurance Coverage.

Brian Rowlson recently authored an article that was selected for publication in the Florida Bar Journal and will also be published in the next Division 7 newsletter for the ABA Forum on the Construction Industry.

Arlan Lewis spoke at the ABA Forum on the Construction Industry's 2012 Annual Meeting in Las Vegas, NV in April on "Federal Contracting for Small, Minority and Women-Owned Businesses."

David Taylor spoke at the American Bar Association's ADR National Meeting in Washington, DC on April 19th on the topic of "Selecting Neutrals."

Doug Patin, **Bill Purdy** and **Mabry Rogers** were honored in the "International Who's Who of Construction Lawyers 2011."

David Pugh was recently named as a member of the Board of Directors for Design-Build Institute of America's South Central Region.

David Taylor spoke on May 4th at the Tennessee Chapter of American Society of Professional Engineers in Nashville on "Contract Clauses that Can Bite Back."

Ryan Beaver, **Ralph Germany**, **Michael Knapp**, **David Pugh**, **David Taylor** and **Bryan Thomas** recently spoke at the Bradley Arant Boult Cummings LLP 2012 Construction Contract Claims Legal 101 seminars in Birmingham on May 11th, Nashville on May 18th, Charlotte on June 15th and Jackson on June 22nd.

Stanley Bynum attended the ABA Section of International Law's Spring Meeting from April 17th to 24th in New York City.

Keith Covington spoke on the latest developments at the National Labor Relations Board and the Department of Labor at two recent membership meetings sponsored by the Associated Builders and Contractors. Keith's presentation included discussion of the new NLRB posting rule, the NLRB's new rules on union election procedures, and the proposed changes to the DOL's labor persuader reporting rules.

Jim Archibald, **Axel Bolvig**, **Ralph Germany**, **John Hargrove**, **Rick Humbracht**, **Russ Morgan**, **David Owen**, **Doug Patin**, **David Pugh**, **Bill Purdy**, **Mabry Rogers**, **Wally Sears**, **Frederic Smith**, **Harold Stephens** and **David Taylor** were recognized in *The Best Lawyers in America* for 2013.

Jim Archibald, **Axel Bolvig**, **John Hargrove**, **Doug Patin**, **Mabry Rogers**, **Harold Stephens, Wally Sears** and **Robert Symon** were recognized as Super Lawyers for 2012. **David Bashford** and **John Mark Goodman** were recognized as Rising Stars.

Mabry Rogers and **Bill Purdy** were recognized in *Chambers 2012* edition in the area of Construction Litigation. **Doug Patin** and **Bob Symon** were recognized in the area of Construction. **John Hargrove** was recognized in the area of Labor & Employment.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

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BRADLEY ARANT BOULT CUMMINGS LLP Fourth Quarter 2012

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Ninth Circuit: Underbids Can Constitute False Claims

Recently, in the case of *Nyle J. Hooper v. Lockheed Martin Corp.*, the U.S. Court of Appeals for the Ninth Circuit ruled for the first time that underbidding or making false estimates in bids or proposals submitted in response to federal government solicitations may constitute violations of the False Claims Act. The agencies administering Federal contracts are increasingly insistent on enforcement of the requirement. The stated rationale is to assure the general contractor's "adequate interest and supervision of the work."

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In the *Hooper* case – a *qui tam* action filed by a former Lockheed Martin senior project engineer – Lockheed Martin allegedly defrauded the U.S. Air Force by intentionally underbidding on a cost reimbursement plus award fee contract that required it to install hardware and software to support space launch operations at Cape Kennedy in Florida and Vandenberg Air Force Base in California. Specifically, Hooper claimed that Lockheed Martin instructed its employees to lower Lockheed Martin's bids by almost half to improve its chances of winning the contract. Lockheed Martin was awarded the contract based on a bid of $432.7 million. By the time the court case was instituted, it had requested and been reimbursed over $900 million for its work on the contract, according to the Ninth Circuit's opinion.

Lockheed Martin argued that "[e]stimates of what costs might be in the future are based on inherently judgmental information, and a piece of purely judgmental information is not actionable as a false statement." The Ninth Circuit disagreed, stating that "[a]s a matter of first impression, we conclude that false

estimates, defined to include fraudulent underbidding in which the bid is not what the defendant actually intends to charge, can be a source of liability under the [False Claims Act], assuming that the other elements of a [False Claims Act] claim are met."

Having determined that False Claims Act liability may be premised on false estimates, the Ninth Circuit held that "there is a genuine issue of material fact whether Lockheed acted either knowingly, in deliberate ignorance of the truth or in reckless disregard of the truth when it submitted its bid." The Ninth Circuit's holding was based on testimony of Lockheed Martin employees who said that they were instructed to lower their estimate of costs, without regard to actual estimated costs, and that Lockheed Martin was "dishonest" in the productivity rates used to estimate costs for the contract. In addition, the Ninth Circuit cited the Air Force's own analysis of Lockheed Martin's bid which stated that the bid was "optimistic about some of its inputs . . . , resulting in an overstated potential for cost savings."

Contractors should heed the warning of the *Hooper* case: false statements and representations made in connection with bids or proposals may – in the right circumstances, such as the extreme allegations by the Hooper *qui tam* plaintiff – form the basis for liability under the False Claims Act, despite the lack of a formal contract with the governmental entity at the time such statements or representations are made.

By Aron C. Beezley

State Courts Limit CGL Coverage for Property Damage Arising From Defective Construction

Courts have generally recognized that property damage arising from faulty or defective work performed on a construction project constitutes an "occurrence" under commercial general liability (CGL) policies. In turn, contractors have frequently relied on these policies to provide insurance coverage for property damage claims arising from negligent work performed by their subcontractors. However, recent court decisions in a number of states have eroded the definition of an "occurrence," limited coverage under CGL policies, and altered the construction industry's widespread reliance on these policies as a risk-management mechanism.

The South Carolina Supreme Court issued one of the most publicized opinions on this issue in *Crossman Communities of North Carolina, Inc. v. Harleysville Mutual Insurance Company* ("*Crossman I*"). In *Crossman I*, a developer was sued by several homeowners in a condominium development located in South Carolina for defective construction. Specifically, the exterior components of the projects were negligently constructed, leading to water intrusion issues and subsequent damage to non-defective components of the projects. The developer settled with the homeowners and later sought coverage under its CGL policies for the damages incurred. The trial court found that the homeowners' property damage claims were an "occurrence" covered by the CGL policies. On appeal, the South Carolina Supreme Court overruled prior state precedent on the issue, and held that the water damage was a direct result of the faulty construction and therefore could not have been an unintended consequence of the negligent work. Coverage under the CGL policy was denied. The January 7, 2011 opinion received immediate and widespread criticism from the construction industry.

The South Carolina legislature quickly enacted Senate Bill 431 in the spring of 2011 in an attempt to counter the *Crossman I* decision. The new law provides that South Carolina CGL policies "shall contain or be deemed to contain a definition of 'occurrence' that includes: (1) an accident, including continuous or repeated exposure to substantially the same general harmful conditions; and (2) property damage or bodily injury resulting from faulty workmanship, exclusive of the faulty workmanship." Section 3 of § 38-61-70 also states that the Act applies to "any pending or future dispute" as to "commercial general liability policies issued in the past, currently in existence, or issued in the future." The statute's aim was apparently to remove all CGL policies from the grasp of the *Crossman I* decision.

On May 23, 2011, the South Carolina Supreme Court reheard the arguments from *Crossman I*, reversed course on its prior decision, and issued a new opinion in August 2011 ("*Crossman II*") finding coverage under the CGL policies. Without making reference to the new law, but essentially restating the statutory language, the *Crossman II* court stated its intent to clarify that negligent construction resulting in damage to non-defective components "may" constitute property damage subject to coverage as an occurrence under the policy. As provided by the newly-enacted statute, damage arising from the faulty workmanship itself would not be covered by the policy.

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Legislatures in states such as Colorado, Hawaii, and Arkansas have passed similar legislation in response to court decisions limiting CGL coverage for property damage arising from defective construction. However, despite the apparent widespread opposition to these limitations on CGL policies, some state courts continue to rule in favor of limiting coverage. Recently the Supreme Court of Ohio in *Westfield Insurance Company v. Custom Agri Sys., Inc.* ruled that claims for defective construction did not constitute "property damage" caused by an "occurrence" under a CGL policy. While it remains to be seen whether the Ohio legislature will step in and counter the *Westfield* decision, the ruling is a reminder that construction industry participants must remain cognizant of the governing law on this issue in their respective jurisdictions. The failure to do so may be costly to contractors, who may be liable for property damage claims that have been covered by CGL policies in many states.

By Brian M. Rowlson

Construction Contractor Prevails in Court of Federal Claims Bid Protest Action

Recently, the U.S. Court of Federal Claims held in favor of a construction contractor in a bid protest action that was brought against the U.S. Postal Service ("USPS") in connection with the award of a firm, fixed-price contract for replacement of the heating, ventilation, and air conditioning system in the principal post office in Portland, Maine. The Court's decision in *J.C.N. Construction, Inc. v. United States* reaffirms that the Court has jurisdiction over claims for breach of the government's implied duty to fairly and honestly consider offerors' proposals and highlights little-known risks that exist when contracting with the USPS.

In *J.C.N. Construction, Inc.*, the contractor argued that the USPS improperly evaluated offerors' proposals and acted arbitrarily and capriciously throughout the procurement. Specifically, after the contractor had successfully protested under the USPS's bid protest process, the contractor contended that the USPS treated it unfairly by allowing the awardee to have inside information about the true scope of work and relaxed scheduling requirements. Indeed, when the awardee's prior contract was not terminated for convenience after the contractor's initial success at the agency-level protest, the awardee was able to significantly reduce its price under the revised solicitation because its bid and insurance costs had already been purchased under the original contract award and because the public statement of work overstated the work, as the awardee knew privately. In short, the USPS's mishandling of the procurement provided an improper advantage to the awardee and constituted a breach of the government's implied duty to consider proposals fairly and honestly in the earlier solicitation for the same work.

In response to these claims, the USPS argued that the contractor waived its claim associated with inaccuracies in the second solicitation issued by the USPS by failing to raise these inaccuracies with the USPS before the close of bidding. In addition, the USPS argued that the Court did not have jurisdiction over the contractor's claim that the government breached its implied duty to fairly and honestly consider the contractor's proposal. The Court rejected these arguments, finding that the inaccuracies in the second solicitation were latent and, as a result, the contractor was not required to raise this issue before the close of bidding under the second solicitation. In addition, the Court held that it had jurisdiction over the contractor's claims for breach of the implied covenant of fair and honest consideration.

Despite the Court's finding in favor of the contractor on the merits of its claims, the Court declined to grant the contractor's request that the Court terminate performance of the awarded contract because the majority of the work required by the contract had already been performed by the time the Court issued its decision. The reason that the contract had neared completion was because the contractor was required by regulation to exhaust the USPS's unique protest process before filing suit in the U.S. Court of Federal Claims and the USPS's protest process, unlike some other US agencies, does not provide for an automatic stay of contract performance. However, the Court did order the USPS to pay the contractor's bid preparation and proposal costs, and there is still the possibility that the contractor will recover a portion of its attorneys' fees under the Equal Access to Justice Act.

This case is significant because it reaffirms that the U.S. Court of Federal Claims has jurisdiction over contractors' claims for breach of the implied duty to fairly and honestly consider offerors' proposals and highlights little known risks of contracting with the USPS.

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[The editors note that this article's authors, Mr. Symon and Mr. Beezley, served as bid protestor's counsel in this successful bid protest.]

By Robert J. Symon and Aron C. Beezley

Save Your Own Bacon: Verify Davis-Bacon Act Certifications or False Claims Liability Could Follow

The Sixth Circuit Court of Appeals in *U.S. ex. rel. Wall v. Circle C Construction, L.L.C.*, recently found a general contractor liable under the False Claims Act ("FCA") for submitting certified payrolls which falsely declared that a subcontractor had paid its employees the wage rate required by the Davis-Bacon Act. The court imposed liability on Circle C Construction, L.L.C., the general contractor, even though Circle C had no first-hand knowledge regarding whether its subcontractor actually paid the required Davis-Bacon wages. This case makes clear that a contractor can be held liable under the False Claims Act if it wrongly certifies that a lower-tier contractor paid required Davis-Bacon Act wages when the subcontractor failed to do so, especially where the contractor takes *no action* to verify the accuracy of the certification.

The Circle C case involved a construction contract with the Army to perform work at Fort Campbell. As required by federal regulations, the contract required Circle C to submit complete and accurate certified payroll and to ensure that subcontractors paid employees according to the Davis-Bacon wage determinations in the contract. Although Phase Tech was Circle C's electrical subcontractor on the project, it performed this work without executing a subcontract. Circle C provided Phase Tech with the wage determination excerpts from its prime contract, but did not (1) discuss the Davis-Bacon requirements with Phase Tech; (2) provide a blank certified payroll form to Phase Tech; or (3) verify whether Phase Tech submitted certified payroll during project performance. According to the court, Circle C "lacked a protocol or procedure to monitor Phase Tech's employees' work on the Fort Campbell project and did not take measures to ensure payment of proper wages under the Davis-Bacon Act."

During the project (from 2004 to 2005), Circle C submitted certified payroll for every subcontractor except Phase Tech. In 2008, after the False Claims Act case was commenced, Circle C asked Phase Tech to submit new certified payrolls for 2004 and 2005. Circle C ultimately submitted the certified payrolls to the government without verifying the accuracy of the documents.

Each of the certified payrolls contained a certification that the court decided was false under the FCA. Based on this certification by Circle C, the government identified 62 false payroll certifications among the certified payrolls submitted by Circle C. The government alleged the certified payroll was false in two respects: (1) the payroll was not "complete" as certified because Circle C failed to submit payroll for Phase Tech employees; and (2) the 2008 payroll wrongly represented that Phase Tech employees were paid the required Davis-Bacon wage rate.

The Sixth Circuit agreed with the government that these payroll certifications constituted false certifications under the FCA and that Circle C was liable for damages. In making its ruling, the Sixth Circuit recognized an important legal distinction regarding contractor liability for false Davis-Bacon Act certifications; namely, the court held that a contractor can only be held liable under the FCA based on false Davis-Bacon certifications when the allegedly false statement is made about the *amount* of wages paid. Cases cannot be brought under the FCA where the false statement concerns the *classification* of employees under the Davis-Bacon Act, a determination that requires analysis of complicated federal regulations regarding how certain laborers are classified for the purpose of determining the applicable wage rate. This particular legal ruling is consistent with prior court cases on that issue.

The facts of the Circle C case show that Circle C could have avoided FCA liability by taking two precautions with respect to submitting certified payrolls to the government. First, the 2008 certified payroll submitted by Circle C clearly showed that the wages being paid by Phase Tech were below the amount required by the Davis-Bacon Act. A quick comparison of Phase Tech's payroll with the wage requirements of the statute would have made this fact apparent. Second, Circle C was held liable for falsely certifying that the certified payroll it submitted was "complete." Circle C could have avoided liability by ensuring that complete certified payrolls were submitted for all subcontractors.

BABC's lawyers are aware that the U.S. government is focusing on Davis-Bacon compliance throughout the

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country. While the general contractor is not required to audit each weekly payroll by each subcontractor, it is prudent to adopt a protocol for checking for missing certifications, for spot-checking certifications for obvious errors (classifications of mechanics as laborers, for example), and, where a problem appears, arranging for interviews of randomly selected employees of one or more subcontractors. Subcontractors must also ensure compliance. While the general contractor may face generally only financial penalties, the subcontractor will often face the death-knell of debarment.

By Thomas Lynch

Is a Developer's Arbitration Clause Effective Against a Third Party Owners' Association?

The construction of large condominium and multi-home development projects presents a number of challenges for courts in interpreting the applicability of the various necessary agreements, declarations, restrictions, etc. among the competing interests on a project. In *Pinnacle Museum Tower Assoc. v. Pinnacle Market Development (US), LLC,* the California Supreme Court addressed just such a situation when a condominium developer sought to enforce an arbitration clause contained in its recorded declaration against the third party owners' association for the condominium.

In that case, the developer constructed a mixed-use residential and commercial common interest community in San Diego, California. Pursuant to the requirements of California law, the developer drafted and recorded a "Declaration of Restrictions" to govern its use and operation of the project. The declaration contained a number of easements, restrictions, and covenants, and established an owners' association which was responsible for managing and maintaining the project property. The declaration also included an arbitration clause which provided that, by accepting a deed for any portion of the property, the owners' association and each condominium owner agreed to waive their right to a jury trial and instead agreed to have any construction dispute resolved exclusively through binding arbitration. Further, the individual owners entered into purchase agreements that were signed subject to the terms and conditions of the declaration.

Following completion of the development, the owners' association filed a construction defect suit against the developer. In response, the developer filed a motion to compel arbitration, citing the arbitration clause in the declaration. Finding against the developer, the lower appellate court held that the arbitration clause could not be binding against the owners' association. The court reasoned that the agreement to arbitrate did not provide the owners' association sufficient notice, time to consider the agreement, or an opportunity to consent, because the association was not a party to the declaration and did not even exist when the developer first filed the declaration.

The California Supreme Court overruled and held in favor of the developer on the motion to compel arbitration. The Court reasoned that the authority of the owners' association to consent to the arbitration agreement was effectively delegated to the individual owners of the condominiums. Via the terms of the purchase agreements, the owners and the developer had an expectation that the terms of the declaration would govern their interactions, and the owners' association, which represented the interests of the owners, could not frustrate those expectations by claiming an exemption from the provisions of the declaration as a non-party. The Court was further influenced by the judicial and legislative interests that favor arbitration as an efficient and cost-effective alternative means to resolve disputes.

The Court's application of the arbitration clause to the third party owners' association demonstrates the lengths to which courts will often go to funnel parties into the use of agreed alternative dispute resolution methods. Planned community developers and owners should pay particular attention to this decision as they draft future declarations and other development-related instruments, but owners and contractors in other complex projects should also take heed when drafting or entering into complex agreements with multiple parties.

By Aman Kahlon

Contractor Recovers Delay Costs Despite No-Damage-for-Delay Provision

Despite a no-damages-for-delay provision in the construction contract, a North Carolina appellate court decided in *Southern Seeding Service, Inc. v. W.C. English, Inc.*, to allow a contractor's delay claim for additional labor and material costs under the contract's equitable adjustment provision.

Southern Seeding Service, Inc., a subcontractor, provided grassing work on a transportation project in

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Greensboro, North Carolina, pursuant to a subcontract with W.C. English, Inc. The subcontract, which paid Southern Seeding a unit price for seeding and mulching services, contained two provisions relevant to payment for project delays: an equitable adjustment provision and a no-damages-for-delay provision.

The project was delayed 256 days beyond its originally scheduled completion date. Southern Seeding invoiced W.C. English for its additional unit costs for labor and materials arising from the delay. The trial court ruled Southern Seeding was barred by the no-damages-for-delay provision from any additional compensation due to the delay. Southern Seeding appealed.

The appellate court distinguished the no-damages-for-delay provision and the equitable adjustment provision, finding that each provision allocated distinct risks which should be treated separately. The no-damages-for-delay provision barred only damages resulting from delay to the extent such damages were not compensated to W.C. English by the project owner or another third party. The equitable adjustment provision, on the other hand, stated that the unit prices in Southern Seeding's subcontract were "based on the assumption that the contract will be completed within time as specified in the specifications at time of bidding. Should [Southern Seeding's] work be delayed beyond said time without fault on [Southern Seeding's] part, unit prices herein quoted shall be equitably adjusted to compensate" Southern Seeding for its increased cost.

The court ruled that the equitable adjustment provision allowed Southern Seeding to recover its "market driven cost increases associated with material and labor costs" incurred after the originally scheduled completion date. Such costs, it found, were the result of conditions which significantly differed from those indicated in the subcontract and contemplated by the parties, and as such, recovery of these costs was not prohibited by the no-damages-for-delay provision. The court also allowed Southern Seeding to seek recovery of such costs, to the extent not collected from W.C. English, under the payment bond for the project.

Contractors may note several important contracting pointers from the *Southern Seeding* opinion. First, a contractor should identify each contractual provision providing a basis for recovery in addition to the contract price. When a changed condition arises, or a project suffers delays, the contractor should ask whether the change implicates any entitlement provision to form the basis for recovery of its increased costs (noting that the condition may implicate more than one contractual provision). Second, as demonstrated by Southern Seeding's repeated letters to W.C. English in the above-described project, a contractor facing increased costs for a changed condition should follow all contractual notice requirements, citing every potential contractual basis for its claim (or, alternatively, citing no specific clause, but instead relying on "the contract and applicable law"), to prevent any allegation that the contractor waived its contractual right of recovery. Recovery seemingly barred under a no-damages-for-delay provision may in fact be permitted by an equitable adjustment clause or other similar provision in a construction contract.

Finally, for owners, contractors, and subcontractors, Southern Seeding "won" this argument when it successfully negotiated a contract adder that expressed the basic assumption for its unit prices. Absent that important provision to the changes clause, it is likely the general contractor would have prevailed, even if such a result might be deemed unfair.

By Monica L. Wilson

Are You Sure? Strict Construction of Conditions of the Performance Bond

A recent case from the Federal court that supervises the trial courts in New York, Connecticut, and Vermont, *Stonington Water Street Associates v. National Fire Insurance Company of Hartford*, is a caution to be mindful of the suretyship conditions contained in the AIA A-312 performance bond.

The case involved the construction of a $20 million condominium complex in Connecticut. Stonington, the owner, contracted with a local general contractor to build the complex. In return, the general contractor secured National Fire Insurance Company of Hartford to act as surety, and National Fire executed an AIA A-312 performance bond in favor of the general contractor. As is customary, the terms of the AIA A-312 performance bond provided that National Fire would assume the responsibilities of the general contractor for defective work and, if necessary, complete the project upon the occurrence of certain circumstances enumerated in the bond form.

The construction of the condominiums proved difficult. The project experienced three costly delays due

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to a fire, installation of defective materials, and a burst sprinkler hose. As a result, the financial condition of the general contractor deteriorated to the point that Stonington considered declaring the general contractor in default. Ultimately, the general contractor ceased working, and the owner hired replacement contractors to complete the project.

Two months after the general contractor stopped working, Stonington notified National Fire that it was terminating the general contractor and asserted that National Fire was responsible for fulfilling the contract's obligations. National Fire denied coverage on the grounds that Stonington had failed to strictly comply with the terms of the performance bond. Stonington then filed suit in federal court.

The trial court agreed with National Fire. Construing the terms of the construction contract and the performance bond together, the trial court reasoned that the owner had to fulfill several conditions necessary to invoke the surety's performance. First, under Section 3.2 of AIA A-312, the owner must declare a contractor default and formally terminate the general contractor, a process that requires written certification from the architect and seven days notice to the surety. Additionally, under Section 3.3 of AIA A-312, the owner must agree to pay the surety the balance of the contract price.

Stonington had not fulfilled either of these conditions, which prejudiced the ability of National Fire to protect its interests. Specifically, the unilateral hiring of replacement contractors deprived the surety of the opportunity to mitigate its damages. National Fire did not have the chance to participate in the selection of the replacement contractors, which may have been more expensive than the contractors National Fire would have selected. Moreover, because the owner had paid the replacement contractors the balance of the contract price, the surety had no further protection against the owner. In other words, because the owner depleted the contract balance, the surety was exposed in the event it had to complete construction. As a result, the trial court held that the terms of the performance bond were materially breached.

Upon review, the appeals court affirmed without requiring a showing of prejudice. The court agreed that the surety's interests were compromised because the owner did not properly abide by the terms of the performance bond. They concluded that the requirements to give notice and pay the contract balance to the surety were conditions precedent to the surety's performance. Without satisfying the conditions precedent, the surety's obligations did not come into existence. Additionally, they concluded that prejudice in fact was shown, even though that showing was not required.

While there is some split among courts applying the AIA form language, this decision, from an important commercial area of the country, stands for the proposition that an owner must be faithful in adhering to the exact terms of the performance bond if there is any likelihood that it will need to be invoked. Moreover, many courts hold the claimant to strict compliance with the notice requirements of the bond, whether or not the surety is prejudiced by the lack of compliance.

By J. Wilson Nash

Economic Development Group Joins Bradley Arant Boult Cummings

Well-known economic development attorney Alex B. Leath has joined the firm as a partner, and he brings with him three associates: David H. Cooper, Jr.; Charles B. "Trey" Hill III; and Matthew A. Hinshaw. Mr. Leath and his colleagues join the Economic Development and Incentives Group and State and Local Tax Practice Group. These additions continue Bradley Arant Boult Cummings' strong strategic growth over the past year, during which more than 60 attorneys have joined.

Mr. Leath has played a significant role in numerous economic development projects in 23 states over the last two decades. Recently, he advised Volkswagen Group of America on the site selection process for the company's U.S. manufacturing headquarters. Mr. Leath has a history of partnering with construction firms in all stages of the economic development process to assist them in understanding the opportunities available when large construction projects are initiated by owners/developers.

The addition of Mr. Leath's group helps expand the firm's footprint in the national and international markets enjoyed by the Construction and Procurement Practice Group.

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Bradley Arant Lawyer Activities:

U.S. News recently released its "Best Law Firms" rankings for 2013: **BABC's Construction Practice Group** is ranked as Tier One nationally. The Birmingham, Nashville, Jackson, and Washington, D.C. offices received similar recognition in the metropolitan rankings.

Jim Archibald, Aron Beezley, Rick Humbracht, Russ Morgan, David Pugh, and Mabry Rogers are recognized by *Best Lawyers in America* in the category of Litigation - Construction for 2013.

Aron Beezley, **Ralph Germany**, **David Owen**, **Doug Patin**, **David Pugh**, **Bill Purdy**, **Mabry Rogers, Wally Sears,** and **David Taylor** are recognized by *Best Lawyers in America* in the area of Construction Law for 2013.

Mabry Rogers and **David Taylor** are also recognized by *Best Lawyers* in the areas of Arbitration and Mediation for 2013.

David Owen is declared by *Best Lawyers in America* as the "Lawyer of the Year" in Birmingham in Construction Law for 2013.

Jim Archibald recently published an article in the August edition of *Construction Executive* entitled "Executive Insights: How Can Contractors Minimize the Potential for Disputes?"

David Taylor became the Chair of the Tennessee Association of Construction Counsel in December.

Eric Frechtel, **Steven Pozefsky** and **Aron Beezley** will publish an article for the upcoming edition of *Federal Construction Magazine* on the U.S. Small Business Administration's ("SBA") Office of Inspector General's recent report on the SBA's Mentor-Protégé Program.

Michael Knapp, **Ryan Beaver**, **Brian Rowlson**, **James Warmoth** and **Monica Wilson** recently attended the ABC Carolinas Construction Conference in Wilmington, NC, where BABC's Charlotte office was recognized as the ABC Carolinas Associate Member of the Year for 2012.

BABC's Nashville Office hosted the Pulte Summit for national homebuilder PulteGroup November 13th through 15th.

Brian Rowlson recently authored an article summarizing North Carolina's latest lien law revisions that was selected for publication in the Florida Bar Journal and will also be published in the Division 7 newsletter for the ABA Forum on the Construction Industry.

Russ Morgan attended the Associated General Contractors of America luncheon on November 6.

David Taylor recently spoke in Phoenix, Arizona to the National Meeting of the Construction Specifications Institute (CSI) on "Allowances and Owner Contingencies".

Jerry Regan, **Steve Pozefsky**, **Tom Lynch** and **Aron Beezley** conducted a seminar on October 24th on The Fundamentals of Joint Venturing in Construction for the Associated Builders and Contractors, Inc.'s Metro Washington Chapter.

David Taylor spoke to the construction/production team on October 23rd at the Hemlock Semiconductor plant in Clarksville, Tennessee on "Tennessee Lien and Licensing Laws"

David Pugh was recently named as a member of the Board of Directors for Design-Build Institute of America's South Central Region.

Jim Archibald, Axel Bolvig, Ralph Germany, **Doug Patin**, **Bill Purdy**, **Mabry Rogers**, **Wally Sears**, **Bob Symon** and **David Taylor** were named to *Super Lawyers* for 2013 in the area of Construction, Real Estate, and Environmental Law.

Chambers annually ranks lawyers in bands from 1-6, with 1 being best, in specific areas of law, based on in-depth client interviews. **Bill Purdy** and **Mabry Rogers** are in Band One in *Litigation: Construction*. **Doug Patin** was ranked in Band Two and **Bob Symon** in Band Three, both in the area of *Construction*.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

NOTE: YOU CAN FIND THIS NEWSLETTER AND PAST NEWSLETTERS ON OUR WEBSITE. IF YOU ACCESS THIS NEWSLETTER ON OUR WEBSITE, CASE-LINKS WILL BE AVAILABLE UNTIL THE NEXT NEWSLETTER IS PUBLISHED. WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY GO TO WWW.BABC.COM/PG_CONSTRUCT.CFM OR CONTACT ANY ATTORNEY LISTED ON PAGE 10 OF THIS NEWSLETTER.

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READER RESPONSES

If you have any comments or suggestions, please complete the appropriate part of this section of the *Construction & Procurement Law News* and return it to us by folding and stapling this page which is preaddressed.

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We are in the process of developing new seminar topics and would like to get input from you. What seminar topics would you be interested in?

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If the seminars were available on-line, would you be interested in participating? ☐ Yes ☐ No

If you did not participate on-line would you want to receive the seminar in another format? ☐ Video Tape ☐ CD ROM

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BRADLEY ARANT BOULT CUMMINGS LLP **First Quarter 2013**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

James F. Archibald, III	Joel Eckert (n)	Michael W. Knapp (c)	J. David Pugh	Frederic L. Smith, Jr.
David H. Bashford (c)	Eric A. Frechtel (d.c.)	Michael S. Koplan (d.c.)	Bill Purdy (j)	H. Harold Stephens (h)
Charlie Baxley	Ralph Germany (j)	Alex B. Leath	Alex Purvis (j)	Robert J. Symon (d.c.)
Ryan Beaver (c)	Daniel Golden (d.c.)	Arlan D. Lewis	Jerry Regan (d.c.)	Bethany A. Tarpley (j)
Aron Beezley (d.c.)	John Mark Goodman	Tom Lynch (d.c.)	Lewis Rhodes (d.c.)	David K. Taylor (n)
Axel Bolvig, III	John W. Hargrove	Luke D. Martin	E. Mabry Rogers	D. Bryan Thomas (n)
Stanley D. Bynum	Jonathan B. Head	J. Wilson Nash	Brian Rowlson (c)	C. Samuel Todd
Robert J. Campbell	Michael P. Huff (h)	David W. Owen	Walter J. Sears III	Darrell Clay Tucker, II
Jonathan Cobb	Rick Humbracht (n)	Douglas L. Patin (d.c.)	Chris Selman	Paul S. Ware
F. Keith Covington	Aman Kahlon (d.c.)	Vesco Petrov	Eric W. Smith (n)	James Warmoth (c)
		Steven A. Pozefsky (d.c.)		Monica Wilson (c)

Significant Commercial General Liability ("CGL") Insurance Changes on the Horizon

On April 1, 2013, the Insurance Services Office, Inc. ("ISO") will introduce some significant changes to standard Commercial General Liability ("CGL") forms and endorsements. This is particularly important to the construction industry where CGL coverage still remains a key component of risk management and transfer.

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First, many significant changes relate to Additional Insured ("AI") coverage. There are three changes to the standard AI endorsement that are particularly noteworthy: (1) ISO is adding language that should eliminate prior confusion over whether an AI must have privity of contract with the named insured in order to obtain coverage; (2) ISO is adding language related to the application of anti-indemnity statutes to insurance requirements in contracts, and it appears ISO is seeking to clarify that anti-indemnity statutes should not affect parties' ability to transfer risk through insurance; (3) ISO is adding language in an attempt to clarify that the insurance limits available to the AI should be tailored to the underlying contract requirements and not necessarily connected to the limits stated for the named insured in the policy declarations. These changes could have a major impact on the meaningful use of additional insured requirements in construction contracts.

Second, ISO is amending the "other insurance" clause, which typically pushes the primary risk for any loss to other available insurers. The new language should clarify that when a party is seeking coverage under its own policy as a named insured and under another's policy as an additional insured, the additional insured's coverage should have primary responsibility for providing a defense and indemnity for any claim.

This has always been the intent, but ambiguities in the "other insurance" language of some policy forms has led to ongoing debate on this point.

Third, ISO is revising the definition of "insured contract" in the policies to confirm that assumed tort liability must be caused in whole or in part by the named insured. This will be significant to parties that agree by contract to indemnify others without regard to ultimate responsibility. Historically, one route to coverage related to such indemnity agreements was through the "insured contract" exception to the "contractual liability" exclusion in the CGL policy. All parties now need to recognize that under this new language, this typical route to coverage may no longer be available if the named insured (the indemnifying party) is not even a partial cause of the damage.

The ultimate significance of these changes will not be known until parties and courts have had opportunity to apply and interpret them in response to real losses. For now, these changes further illustrate the need for all parties to carefully consider (including consultation with insurance brokers and agents) the actual terms of any insurance policies that may satisfy the insurance requirements in a construction contract. Once a coverage dispute develops, the language in the as-issued insurance policy will almost always control, regardless of any contrary intent or understanding by the party seeking coverage. The time for clarification is before the project begins, or at the time these changes are issued to your company as a renewal amendment of an existing policy, not after coverage is needed to respond to a lawsuit.

By Alex Purvis

New Tax Court Decision Highlights Need for Construction Contractors to Consider Expanded IRS Voluntary Worker Classification Settlement Program

For years, the question of whether construction workers should be treated as employees or independent contractors has been an important issue that many contractors have overlooked or chosen to ignore. However, a recent U.S. Tax Court decision highlights the need for construction contractors to focus on how they classify their workers for employment tax purposes.

The taxpayer in *Kurek v. Commissioner* was a sole proprietor who worked as the general contractor in renovating home interiors. During the tax year at issue, the taxpayer hired approximately 30 workers to assist him on various home renovation jobs. None of the workers worked full time for the taxpayer, and he paid them on a project-by-project basis. He paid each worker a weekly flat fee based on the percentage of work completed on a particular job. The workers set their own hours and work schedules. The taxpayer supervised the workers' progress on a project and was at the worksite once a day or once every other day. Although the taxpayer permitted the workers to work simultaneously on other projects with him or with other construction groups, he would replace workers if a deadline was approaching or if a worker was holding up a job.

The workers brought their own sets of small tools, worth around $1,000, to the worksites. The taxpayer did not reimburse the workers for those tools, but he did buy or rent all larger tools, which he left at the worksites. He also purchased materials needed for the projects, and the homeowners would reimburse him. Occasionally, workers purchased lightweight materials as needed during the project, and the taxpayer would reimburse them.

The taxpayer did not offer any employee benefits nor did the workers sign an independent contractor agreement. He did not carry unemployment insurance or workers' compensation insurance for the workers. Most importantly, the taxpayer did not issue Forms 1099-MISC or Forms W-2 to any of the workers for the tax year at issue. Following an employment tax audit, the IRS determined that the workers were the taxpayer's employees and that he should have paid Federal Insurance Contributions Act (FICA) and Federal Unemployment Tax Act (FUTA) taxes, as well as income tax withholdings on the workers' wages. The taxpayer appealed the IRS's determination to the U.S. Tax Court.

Whether a worker is an employee or an independent contractor is a factual question. In short, the right of the principal to exercise control over the agent, whether or not the principal in fact does so, is the "crucial test" for the existence of an employer-employee relationship. Under the common law, an employer-employee relationship exists when the principal has the right to control and direct the service provider regarding the result and how the result is to be accomplished. The

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principal need not actually direct or control the manner in which the services are performed; the principal need only have the right to do so.

Despite the presence of several factors in favor of independent contractor status, the Tax Court concluded that the workers should be classified as the taxpayer's employees because the taxpayer failed to prove that he did not have control over the workers. Although the workers set their own hours and provided their own small tools, the taxpayer set deadlines and monitored their work, visiting the worksite daily or every other day. The Tax Court found it important that the taxpayer: (1) had the ultimate authority in instructing the workers as to their job responsibilities, (2) had the right to approve the quality of their work, and (3) paid them weekly rather than at the end of the project. Moreover, only the taxpayer communicated with the homeowners, and he alone was responsible for the success or failure of the projects. The Court also held that the taxpayer did not qualify for alternate relief otherwise available under Section 530 because he did not file Forms 1099 for any of the workers, which is a critical element of that statutory safe harbor. This case highlights the importance of properly classifying workers and of completing the proper paperwork to satisfy tax code requirements.

The IRS recently announced that it has expanded its Voluntary Classification Settlement Program (VCSP) to allow more taxpayers to reclassify their workers as employees for future tax periods. The VCSP offers substantial relief from federal payroll taxes to eligible employers who have been treating their workers (or a class or group of workers) as independent contractors or otherwise as nonemployees and now wish to begin treating them as employees. A significant caveat about how one approaches the reclassification: as an exclusively federal tax program, VCSP can provide no shelter with regard to possible problems with various state and local authorities. Those authorities apply their own standards for determining employee status, which may differ substantially from federal tax standards. Thus, the VCSP does not affect state payroll tax, state unemployement insurance tax, or workers' compensation obligations.

Under the expanded VCSP program, employers under IRS audit (other than an employment tax audit) can still qualify for the VCSP. To be eligible to participate in the VCSP, an employer must currently be treating workers as nonemployees; consistently have treated the workers in the past as nonemployees, including having filed any required Forms 1099 (see below for a special limited-time exception to this requirement); and not be currently under audit on payroll tax issues by the IRS or on worker classification issues by the Department of Labor or a state agency.

Normally, employers are barred from the VCSP if they failed for the past three years to file required Forms 1099 for the workers they are seeking to reclassify. However, the IRS is waiving this eligibility requirement for taxpayers who come forward *before June 30, 2013*. Contractors not previously eligible for the VCSP due to their failure to file Forms 1099 should decide quickly whether to take advantage of this brief window of opportunity to clean up their worker classification practices before they find themselves in the same boat as the general contractor in *Kurek*.

Employers can apply for the program by filing Form 8952, Application for Voluntary Classification Settlement Program, at least 60 days before they want to begin treating the workers as employees. Employers accepted into the program will generally pay an amount effectively equaling just over one percent of the wages paid to the reclassified workers for the past year. No interest or penalties will be due, and the employers will not be audited on payroll taxes related to these workers for prior years.

Employers accepted into the program no longer will be subject to a special six-year statute of limitations on such reclassifications; instead, they will come under the three-year statute that usually applies to payroll taxes. Employers that failed to file Forms 1099 may also apply for the temporary relief program, but they likely will pay a slightly higher amount (including some penalties) and will need to file any unfiled Forms 1099 for the workers they are seeking to reclassify as employees.

If you have any questions regarding worker classification issues, or if you are interested in participating in the IRS VCSP, feel free to contact your lawyer or lawyers in our BABC Tax Practice Group.

By Jim Archibald, Bruce P. Ely,
Stuart J. Frentz, and William T. Thistle, II

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Contractors Whose Bids are Improperly Rejected as Nonresponsive on Federal Contracts are Not without Recourse

The U.S. Government Accountability Office ("GAO") recently sustained a construction contractor's bid protest after it determined that the procuring agency's rejection of the contractor's bid as non-responsive was unreasonable. This case, *W.B. Construction and Sons, Inc*., is noteworthy because it illustrates that contractors whose bids are improperly rejected by procuring agencies are not without recourse.

In *W.B. Construction,* the procuring agency rejected the contractor's bid submitted in response to the invitation for bids ("IFB") because the contractor failed to provide the price for one of many line items included in the bid schedule and because, in the agency's view, the bid was "materially unbalanced." The contractor argued that its omission of the price for the line item was immaterial and should be waived as a "minor informality" under GAO case law. In addition, the protester argued that, even if its proposed prices were "materially unbalanced," this should not render its bid nonresponsive because the agency did not determine that this lack of balance in the contractor's pricing posed an "unacceptable risk" in accordance with Federal Acquisition Regulation ("FAR") 15.404-1(g).

The GAO concluded that the agency's rejection of the contractor's bid as nonresponsive was unreasonable. Specifically, GAO concluded that rejection of the bid for failing to provide the price for one of many line items in the bid schedule was improper because the item for which the price was omitted was divisible from the IFB's overall requirements, was *de minimis* as to total cost, and would not affect the competitive standing of the other bidders. In other words, the omission should have been waived as a minor informality. In addition, the GAO concluded that rejection of the bid as "materially unbalanced" was improper because the agency failed to conduct a risk analysis to determine whether the contractor's unbalanced bid posed an unacceptable risk to the government, as required by FAR 15.404-1(g).

Given its conclusions, the GAO recommended that the agency re-evaluate the contractor's bid to determine if the lack of balance in its bid posed an unacceptable risk to the government. If the agency determined that the lack of balance did not pose an unacceptable risk, the GAO instructed the agency to waive the omission of the one line item price as a "minor informality," and to award the contract to the contractor. This noteworthy result illustrates that the bid protest process remains available to contractors whose bids are improperly rejected by procuring agencies. If you believe that your bid has been improperly rejected, be sure to contact your lawyer immediately, because the bid protest process contains short deadlines which can trap the unwary bidder.

By Aron C. Beezley

The Eroding Protection of the Limited Liability Company in South Carolina

South Carolina limited liability contractors should take heed of a recent decision by the Supreme Court of South Carolina in *16 Jade Street, LLC v. R. Design Construction Co., LLC,* in which the Court allowed an individual member of a limited liability company to be held personally liable for negligent construction performed by the LLC under his direct supervision.

This case involved the construction of a condominium project located in Beaufort, South Carolina. The general contractor for the project was R. Design Construction Co., LLC (the "General Contractor"), a limited liability company with only two members, Carl Aten, Jr. and his wife. Mr. Aten was also the license holder and qualifier for the General Contractor.

The General Contractor commenced work on the project under the direct on-site supervision of Mr. Aten, but quickly was confronted with alleged construction defects. Despite consultations with the engineer and assurances to the owner, the General Contractor did not correct the alleged defects identified by the engineer. Eventually, the General Contractor abandoned the project. The owner hired a replacement general contractor to complete the project. Upon beginning work, the replacement contractor and engineer identified over 60 individual defects in the work performed by the General Contractor.

As a result of the defective construction on the project, the owner sued the General Contractor for breach of contract and Mr. Aten, individually, for negligence. The claim against Mr. Aten centered on the fact that he was the individual responsible for on-site

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supervision of the work performed by the General Contractor and its subcontractors. Despite statutory language that appears to shield individual members of an LLC from personal liability for work performed on behalf of the LLC, the trial court found that Mr. Aten was individually liable for the defective construction performed by the limited liability company under his supervision. The Supreme Court of South Carolina confirmed the decision to hold Mr. Aten individually liable because he personally supervised the construction, and did so in a negligent manner. The Supreme Court's rationale was further highlighted by its explicit finding that Mr. Aten's wife, the other member of the LLC, was not individually liable for the defective work since she did not have any personal involvement in the supervision of the construction.

In reaching its decision, the Supreme Court of South Carolina relied heavily on similar decisions regarding individual liability from a multitude of other jurisdictions across the nation, suggesting that the danger of personal liability for negligent supervision of construction exists outside South Carolina.

Individuals that personally supervise the work of their limited liability company should take note of this decision, regardless of the jurisdiction in which the LLC is formed or works. The general protections against individual liability previously provided by the structure of an LLC may not protect individual members of an LLC if the individuals are personally involved in the performance and supervision of the work.

By Ryan Beaver

Don't Poke the Bear—A Reminder Regarding Environmental Regulations

Many articles in this newsletter and in recent construction industry publications have noted an increase in federal and state stormwater pollution enforcement actions. Non-point source pollution is a contractor's single most prevalent, though not necessarily the most severe, environmental risk. The Environmental Protection Agency ("EPA") has made violations of the stormwater regulations an enforcement priority. Simply put, if you haven't learned the rules in this area, learn them now. Violation of these rules can result in significant penalties, including jail time for aggravated misconduct.

A recent case from the Western District of Washington reminds owners and contractors of the need to heed applicable environmental regulations. The case is exceptional for the contractor's blatant disregard of applicable regulations, but it is a healthy reminder to all contractors to obey environmental regulations.

In *United States v. Stowe,* a contractor and its president pled guilty to knowing and intentional stormwater violations. The contractor's actions led to a six-month jail sentence (with an additional one-year supervised release) and a $300,000 fine for the president (the corporation was assessed a separate $350,000 fine). Violations included:

1. Exceeding a clearing permit's area limits by 300%;
2. Vastly exceeding the amount of discharge (more than 200% of the standard) allowed;
3. Failing to respond or offer remediation for violations found in seven different inspections;
4. Avoiding a detention pond by piping stormwater directly into a creek;
5. Precipitating three landslides closing two highways (one of the two closures lasted a week); and
6. Joining in or ordering falsification of reports to the government.

While any one of these actions could lead to trouble, the combination of these violations unsurprisingly brought about swift response from the EPA. The severity of these violations reminds me of the old maxim – "Don't poke the bear" – meaning that you shouldn't give someone in authority even more interest in you by acting like a jerk. The same principle applies to everyday operations that carry potential criminal sanctions, such as stormwater violations.

Contractors often, many times with good reason, complain about federal overreach in regulations. However, the contractor here asked for trouble, and it got it. What is the lesson to a responsible business, which would certainly never allow violations of this severity? One mistake leads to another. Good companies can slip into serious violations by allowing, and then covering up, rule-breaking. Consult your lawyer, or one of us listed on the back cover, if you have a question

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about environmental regulations and compliance at the national, state, or local level.

By Jonathan Head

Third-party Liability of Design Professionals in California Residential Construction

The potential for third party tort liability remains an ongoing concern for design professionals, a concern that was driven home in the recent California case, *Beacon Residential Community Association v. Skidmore, Owings and Merrill LLP*. In that case, a California Court of Appeal held that design professionals could be sued by a third party homeowners association ("HOA") for negligent design defects.

The HOA alleged multiple defects in the project caused by negligent architectural and engineering design. The design professionals sought dismissal of these claims, arguing that they owed no duty of care to the third party HOA. The design professionals claimed that the owner of the development had exercised control over the design specifications. The trial court agreed, and the HOA appealed.

On appeal, the California Court of Appeal reversed the trial court's decision and reinstated the HOA's claims. The Court concluded that the foreseeability of harm to the HOA and other policy considerations created a third party duty of care. Specifically, the Court balanced and analyzed the following six factors to determine that a duty of care existed:

(1) The extent to which the transaction was intended to affect the plaintiff;
(2) The foreseeability of harm to him or her;
(3) The degree of certainty that the plaintiff suffered injury;
(4) The closeness of the connection between the defendant's conduct and the injury suffered;
(5) The moral blame attached to the defendant's conduct; and
(6) The policy of preventing future harm.

Addressing these factors, the Court found that (1) the design professionals were aware of the impact defective designs would have on third party home purchasers, (2) the licensing requirements of the design industry signal the critical nature of design in the construction of projects such that the impacts of defective design on third parties should have been foreseeable, (3) if true, the alleged design defects were certain to lead to damage to the HOA, (4) the construction defects alleged were clearly linked to defective design regardless of other contributing factors, (5) substantial moral blame could be attributed to the design defects insofar as they resulted in the alleged defects which resulted in "life safety hazards," and (6) public policy concerns favored protection of unsophisticated homebuyers with a limited ability to discern potential defects at the point of purchase over knowledgeable design professionals with a greater ability to effectively distribute loss. Given that each of the six prongs of the analysis supported the imposition of liability, the Court concluded that the design firms owed a duty of care to the third party HOA.

The Court also relied on the recent passage of California Senate Bill No. 800 to buffer its determination that the design firms could be liable to a third party. This bill provides standards for residential housing construction, defining what constitutes a defect in construction. The text of the bill includes design professionals as parties that may be held liable for the negligent violation of the applicable construction standards described. Further, the Court gleaned from the bill's legislative history that the Legislature intended to assign liability to negligent design professionals for defects which resulted in damages to third parties. The court concluded that, even if its policy analysis of the six factors discussed above had not been conclusive, the plain language and legislative history of the bill confirmed that design professionals can owe a duty of care to third party purchasers in residential construction.

This case demonstrates that design professionals may owe a duty of care to third party purchasers for defects in the design. The case provides a potential avenue for third parties to recover damages for design defects, and reiterates the need for design professionals to maintain adequate insurance coverage over their design.

By Aman Kahlon

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Economic Loss Rule Bars Condominium Homeowners Association's Claim for Negligence against Contractor

In *Long Trail House Condominium Association v. Engelberth Construction, Inc.*, the Vermont Supreme Court held that the economic loss rule barred a condominium owners association's claim of negligence against a contractor despite a lack of privity of contract between the two parties.

This case involved the allegedly deficient construction of a condominium complex known as the Long Trail House Condominium project. Stratton Corporation (the "Owner") and Engelberth Construction (the "General Contractor") entered into a standard form agreement for construction of the condominiums. After the completion of the project, the Long Trail House Condominium Association ("Association") notified the Owner and General Contractor of defects at the condominiums. The Owner and the Association entered into a settlement agreement and release of claims, where the Owner paid the Association over $7 million for the design and construction defects. The Owner then filed suit against the General Contractor for these damages.

After its settlement with the Owner, the Association hired a repair contractor to repair the defects. This repair cost approximately $1.5 million more than the Association received in the settlement from the Owner. The Association sued the General Contractor on a negligence theory for the repair costs. The General Contractor moved for summary judgment based on the economic loss rule, which limits the damages contractual parties can recover to those arising out of the contract (as opposed to arising out of tort). The trial court granted its motion, despite the lack of contractual privity between the Association and the General Contractor. The Association appealed. The Vermont Supreme Court agreed with the trial court, upholding dismissal of the Association's claim.

The Court found that despite the lack of a direct contractual relationship with the General Contractor, the Association's damages were contractual in nature. In the Court's view, reductions in value or costs of repairs from construction defects are contractual in nature. The Court further highlighted the fact that the Association had already recovered over $7 million from the Owner for these defects based on a breach of contract action, and noted that the Owner had an ongoing action against the General Contractor for these same damages. The Court therefore dismissed the Association's negligence claim.

The Court rejected the Association's argument that contractual privity was required before the economic loss rule could be applied. While the Court acknowledged that recovery for purely economic loss due to construction defects was possible in tort cases, it noted that a special relationship was required between the parties to create a cognizable duty between them. The Court found no such duty existed between the General Contractor and the Association which would entitle the Association to purely economic damages.

The Court's ruling in this case may have been influenced by the fact that both the Owner and Association were suing the General Contractor for similar damages. However, it is a good reminder that most construction disputes are contract disputes, and will be governed by the terms of the contract between the parties. The economic loss rule is a method courts in some jurisdictions use to ensure that parties' disputes are decided pursuant to contractual agreements.

By Bethany Tarpley

Bradley Arant Lawyer Activities:

U.S. News recently released its "Best Law Firms" rankings for 2013. **BABC's Construction Practice Group** received a Tier One National ranking, the highest awarded, in both Construction Law and Construction Litigation. The Birmingham, Nashville, Jackson, and Washington, D.C. offices received similar recognition in the metropolitan rankings.

Jim Archibald, Axel Bolvig, Rick Humbracht, Russ Morgan, David Pugh, and **Mabry Rogers** were recognized by *Best Lawyers in America* in the category of Litigation - Construction for 2013.

Axel Bolvig, **Ralph Germany**, **David Owen**, **Doug Patin**, **David Pugh**, **Bill Purdy**, **Mabry Rogers, Wally Sears,** and **David Taylor** were recognized by *Best Lawyers in America* in the area of Construction Law for 2013.

Mabry Rogers and **David Taylor** were also recognized by *Best Lawyers in America* in the areas of Arbitration and Mediation for 2013.

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David Owen was recognized by *Best Lawyers in America* as the "Lawyer of the Year" for Construction Law in Birmingham for 2013.

Jonathan Head recently attended LegalTech New York, the largest national trade show for lawyers doing electronic discovery, and the service and product suppliers that support them.

David Taylor recently became the Chair of the Tennessee Association of Construction Counsel for 2013.

Russ Morgan was recently featured in the "Q&A Keys to successful crisis communications" in the NashvilleBizBlog. Russ was interviewed after a recent seminar entitled "Crisis Communications In a Word of Instant Media."

Aron Beezley authored an article in January 2013 for the Bloomberg BNA Federal Contracts Report entitled "Recent Court of Federal Clams Bid Protest Decision Highlights Little-Known Issues That Exist When Contracting With The U.S. Postal Service".

Ryan Beaver and **Monica Wilson** co-authored an article for Construction Executive magazine entitled "Contractual Modifications for a Changing Marketplace".

Eric Frechtel, **Steven Pozefsky** and **Aron Beezley** published an article in *Federal Construction Magazine* on the U.S. Small Business Administration's ("SBA") Office of Inspector General's recent report on the SBA's Mentor-Protégé Program.

Michael Knapp, **Ryan Beaver**, **Brian Rowlson**, **James Warmoth** and **Monica Wilson** recently attended the Associated Builders and Contractors (ABC) Carolinas Construction Conference in Wilmington, NC. BABC's Charlotte office was recognized as the ABC Carolinas "Associate Member of the Year" for 2012.

BABC's Nashville Office hosted the Pulte Summit for national homebuilder PulteGroup on November 13-15.

Eric Frechtel recently taught a seminar at the Mechanical Contractors Association of America's Advanced Institute for Project Management in Austin, Texas.

David Pugh moderated a panel of speakers on the topic of Trends in Major Land Development at the ABC BizCon Business Development Conference in Ft. Lauderdale on February 19-20. David was also recently appointed to serve a two year term on the ABC's National Board of Directors.

David Taylor recently spoke in Phoenix, Arizona to the National Meeting of the Construction Specifications Institute (CSI) on "Allowances and Owner Contingencies".

Eric Frechtel, **Steve Pozefsky**, and **Aron Beezley** authored an article entitled "The Gutting of The Veterans First Contracting Program?" for the January/February 2013 edition of Federal Construction Magazine.

David Taylor spoke to the construction/production team at the Hemlock Semiconductor plant in Clarksville, Tennessee on "Tennessee Lien and Licensing Laws" on October 23.

Jim Archibald, Axel Bolvig, Ralph Germany, **Doug Patin**, **Bill Purdy**, **Mabry Rogers**, **Wally Sears**, **Bob Symon** and **David Taylor** were named *Super Lawyers* for 2013 in the area of Construction, Real Estate, and Environmental Law.

Eric Frechtel, **Steven Pozefsky**, and **Aron Beezley** have written for the February/March 2013 issue of *Federal Construction Magazine* an article on key small business provisions of the National Defense Authorization Act of 2013.

Chambers annually ranks lawyers in bands from 1-6, with 1 being best, in specific areas of law, based on in-depth client interviews. **Bill Purdy** and **Mabry Rogers** are in Band One in *Litigation: Construction*. **Doug Patin** was ranked in Band Two and **Bob Symon** in Band Three, both in the area of *Construction*.

It is with mixed emotions that we report that Joel Brown has decided to accept a very exciting new position working in-house with one of our long-time construction clients. We wish Joel the best, and are delighted to continue to work with him in his new endeavor.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

NOTE: YOU CAN FIND THIS NEWSLETTER AND PAST NEWSLETTERS ON OUR WEBSITE. IF YOU ACCESS THIS NEWSLETTER ON OUR WEBSITE, CASE-LINKS WILL BE AVAILABLE UNTIL THE NEXT NEWSLETTER IS PUBLISHED. WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY GO TO WWW.BABC.COM/PG_CONSTRUCT.CFM OR CONTACT ANY ATTORNEY LISTED ON PAGE 9 OF THIS NEWSLETTER.

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The lawyers at Bradley Arant Boult Cummings LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

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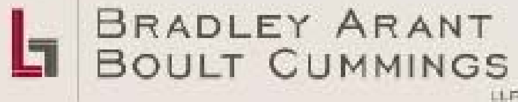

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2013 Construction Seminar: Getting Paid on a Construction Project

Please choose a location and date most convenient to you:

May 3	May 17	May 24	May 31
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Summary

A complimentary seminar hosted by the Construction Lawyers of Bradley Arant Boult Cummings LLP on critical information everyone in the construction industry needs to know:

- Key Payment Contract Clauses
- Insurance and P&P Bond Claims
- Mechanics Lien Claims
- Top 10 Payment Mistakes Made

Schedule

7:30 a.m. to 8:00 a.m.	Registration & Breakfast
8:00 a.m. to 10:30 a.m.	Program: Part 1
10:30 a.m. to 10:45 a.m.	Break
10:45 a.m. to 11:45 a.m.	Program: Part 2
11:45 a.m. to 12:00 p.m.	Question & Answer

Who Should Attend?

- Project Managers
- Project Engineers
- Superintendents
- Contract Administrators
- Owners
- Architects
- Engineers
- Subcontractors
- Suppliers

To confirm your attendance please e-mail rsvp@babc.com no later than one week prior to the event.

Seating is limited.

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READER RESPONSES

If you have any comments or suggestions, please complete the appropriate part of this section of the *Construction & Procurement Law News* and return it to us by folding and stapling this page which is preaddressed.

Your Name:

☐ I would like to see articles on the following topics covered in future issues of the BABC *Construction & Procurement Law News*:

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We are in the process of developing new seminar topics and would like to get input from you. What seminar topics would you be interested in?

____

If the seminars were available on-line, would you be interested in participating? ☐ Yes ☐ No

If you did not participate on-line would you want to receive the seminar in another format? ☐ Video Tape ☐ CD ROM

Comments:

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Bradley Arant Boult Cummings LLP **Second Quarter 2013**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Tom Lynch (d.c.)
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J. David Pugh
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Robert J. Symon (d.c.)
Bethany A. Tarpley (j)
David K. Taylor (n)
D. Bryan Thomas (n)
C. Samuel Todd
Darrell Clay Tucker, II
Paul S. Ware
James Warmoth (c)
Monica Wilson (c)

Proving a Type I Differing Site Conditions Claim

Many construction contracts contain differing site conditions clauses that grant the contractor the right to seek additional time and compensation if it encounters unexpected conditions that make the work more difficult. These clauses usually recognize two types of differing site conditions: a Type I condition, where the site conditions differ from the conditions described in the contract documents, and a Type II condition, where the site conditions differ from the conditions that the contractor would ordinarily expect to find in the area.

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The Armed Services Board of Contract Appeals (ASBCA) discussed the requirements for asserting a Type I differing site conditions claim in its recent decision *Appeal of NDG Constructors*. The ASBCA denied the contractor's Type I claim because, even though the site conditions were wet and difficult, the contractor could not show that the actual conditions differed materially from any specific representation about the site conditions in the contract documents. The ASBCA's decision underscores the danger of making assumptions about site conditions based on optimistic interpretations or extrapolations from the data in pre-contract geotechnical reports.

To establish a Type I differing site conditions claim a contractor must prove that (1) the conditions indicated in the contract differ materially from those actually encountered during performance; (2) the conditions actually encountered were not reasonably foreseeable based on the information available to the contractor at the time of bidding; (3) the contractor reasonably relied upon its interpretation of the contract and contract-related documents; and (4) the contractor was damaged as a result of the material difference between expected and encountered conditions.

In *Appeal of NDG Constructors*, the contractor entered into a fixed price contract with the Corps of Engineers to construct a 16 inch waterline under I-90 to bring water into Ellsworth Air Force Base in Idaho. The contract documents contained two soils reports, showing seven borings performed in the area around the proposed waterline. During construction, the contractor claimed that it encountered shale deposits in the wrong location as well as unexpectedly prevalent "fat" clay soils and wet conditions that delayed its

work and increased its costs. According to the contractor, the shale location, "fat" clay, and wet conditions each differed materially from what the two soils reports described, and it submitted a Type I differing site conditions claim for additional time and money. The contracting officer denied the claim, and the contractor appealed.

In a lengthy opinion, the ASBCA thoroughly dissected the contents of the two soils reports and carefully compared the reports to the conditions encountered in the field. The ASBCA stringently applied the rule that a Type I claim requires proof that actual conditions differ from something actually stated in the contract documents. In each of its three claims, the contractor predicated its position on either an outright assumption or an optimistic interpretation of mixed data contained in the two soils reports.

First, the contractor claimed that it encountered "Carlile Shale" material in a different location than expected, based on the contract documents. The contractor had assumed the location of Carlile shale by drawing a straight line connecting the point at two borings where "Carlile Shale" was indicated. The ASBCA recognized that the soils report did not precisely state where "Carlile Shale" would be located. Yet, the ASBCA refused to grant the contractor relief for incorrectly assuming that the soil would transition from clay fill material to "Carlile Shale" along a straight line because the contract documents did not promise a straight line transition.

Next, the contractor argued that it encountered unexpectedly large amounts of "fat" clay soil, when the soils report indicated a mixture of "fat" and "lean" clay. "Fat" clay has higher moisture content than "lean" clay. The ASBCA scrutinized the soils reports and boring logs and found, once again, that the actual conditions were not inconsistent with any specific representation made in the contract documents. The soils reports stated that soil conditions could vary all the way from "fat clay" to "lean clay," and the boring logs did not say "mostly lean clay" or preclude "mostly fat clay." The contractor assumed that it would encounter approximately equal amounts of "fat" and "lean" clay, but the soils report did not offer any conclusions about what the ratio might be. Indeed, the soils reports alerted the contractor that subsurface conditions could differ at different times and locations. The ASBCA concluded that actual conditions were within the range of what was promised. The contractor's optimistic interpretation of the borings - that it would encounter roughly equal amounts of "fat" clay and "lean" clay - was found lacking because the soils reports did not specifically say that equal amounts would be encountered.

Finally, the contractor claimed that site conditions were wetter than anticipated. Once again, the ASBCA found that the soils report notified the contractor that wet conditions could be present on the site. The contractor attempted to show that it encountered excessive moisture beyond what the soils reports indicated through testing and sampling, but the ASBCA found that the contractor relied on an "unconventional" sampling technique applied to samples that were likely contaminated by the contractor's own work efforts. Thus, the contractor's excessive moisture proof was rejected. If the contractor had compiled better evidence showing higher percentages of moisture than the percentages indicated in the contract documents, this claim might have succeeded.

This case offers important guidance for estimators and for claimants. At the estimating stage, contractors should be careful about making assumptions that are not supported by the contract documents. Overly optimistic projections or extrapolations about overall site conditions based on limited, qualified data may result in an estimate that is too low to cover the actual cost of overcoming the site conditions, with an insufficient basis for making a viable claim. If a claim arises, the contractor must review the contract documents carefully, and make every effort to tie its differing site conditions arguments to specific representations from the contract documents.

By James Archibald

Hasta La Vista, Baby: Threatening To Stop Work Can Provide Valid Basis for Terminating Contract

A federal court recently ruled in *Mometal Structures, Inc. v. T.A. Ahern Contractors Corp*. that a general contractor was justified in terminating a subcontractor for default because the subcontractor threatened to stop work unless the general contractor agreed to perform certain actions that were not required under the parties' contract. The Court ruled that the general contractor was justified in terminating the subcontractor even though: (1) the subcontractor continued working on the project until the date of termination; (2) the general contractor had no reason to terminate the subcontractor, other than the subcontractor's threat to stop work; and (3) the general contractor was delaying and increasing the cost of subcontractor work by failing to timely respond to subcontractor RFIs and other design submittals. The *Mometal* case is an important reminder regarding the legal concept of "anticipatory breach," which generally holds that a party breaches a contract when he "declares his intention not to fulfill a contractual duty."

The *Mometal* case arose out of a three-phase construction project for the New York City School Construction Authority ("Owner"). T.A. Ahern, the general contractor on the project, hired Mometal to fabricate and erect structural steel. Mometal's work included preparing erection and fabrication drawings in accordance with design drawings provided by the Owner. Mometal was scheduled to begin its on-site work in October 2007. Due to project delays caused by design and architectural issues, the site was *still* not available for

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structural steel erection in August of 2008, when Mometal was terminated.

During this period of delay, the general contractor failed to provide information that Mometal required in order to begin steel fabrication including approval of outstanding drawings, responses to outstanding RFIs, and approval of Mometal's crane logistics plan. At the time of termination, these issues were still preventing Mometal from timely completing its work. In August of 2008, Mometal wrote a letter to Ahern stating it would only start erecting structural steel in September 2008 (the date requested by Ahern) if Ahern met seven conditions: (1) the site be fully available; (2) all shop drawings be approved and returned; (3) the parties agree on a change order covering Mometal's delay and extra work claims; (4) agreement to payment by joint check; (5) voiding of the contractual liquidated damages provision; (6) holding Mometal free of responsibility for acceleration costs; and (7) agreement to pay for the storage of fabricated material.

Ahern refused to meet Mometal's demands and instead terminated Mometal for default. Mometal then sued Ahern for breach of contract. Ahern asserted a counterclaim for its costs to complete Mometal's work. The Court concluded that Mometal breached the contract, even though Mometal's work was not faulty and it did not stop work prior to its termination, because its threat to stop work constituted an anticipatory breach. The court relied on two key facts in reaching this conclusion: (1) the contract contained a standard AIA "disputed work" provision requiring Mometal to continue work despite the existence of contractual disputes; and (2) Mometal had no contractual right to insist that Ahern comply with its seven demands.

The Mometal case illustrates the defining characteristic of an anticipatory breach that contractors should be careful to avoid. Merely communicating to your contracting partner that you intend to not perform your contractual duties, or threatening to not perform unless the contracting partner performs actions not required under the contract, can constitute a breach of contract. As this case shows, the threat to stop work can have serious consequences and contractors should consult legal counsel before issuing any letter threatening to stop work.

By Thomas Lynch

Failure To Comply With FAR And DFARS Clauses Could Leave Government Contractors Working For Free

A recent case from the U.S. Armed Services Board of Contract Appeals ("ASBCA"), *Dynamics Research Corp*., serves as an important reminder to government contractors to carefully comply with the requirements of the Defense Federal Acquisition Regulation Supplement ("DFARS") clause 252.232-7007 (Limitation of Government's Obligation), commonly referred to as the "LOGO" clause, and similar Federal Acquisition Regulation ("FAR") clauses.

The contract in *Dynamics Research Corp*. incorporated the DFARS LOGO clause. The DFARS LOGO clause, which is similar to the FAR Limitation of Costs clause (FAR 52.232-20), requires the contractor to "notify the [Contracting Officer] in writing at least 90 days prior to the date when, in the Contractor's best judgment, the work will reach the point at which the total amount payable by the Government … will approximate 85 percent of the total amount then allotted to the contract[.]" The clause also provides that the contractor is not authorized to continue work once the total work performed approximates the amount allocated to the contract.

Nevertheless, the contractor in *Dynamics Research Corp*. performed work in excess of the funded amount and subsequently filed a claim demanding payment of more than $280,000 for "unfunded work" that it performed. The Contracting Officer denied the contractor's claim because, among other things, the contractor failed to comply with the LOGO clause requirements. The contractor then filed an appeal with the ASBCA.

Ultimately, the ASBCA denied the contractor's appeal, finding that the contractor failed to notify the Contracting Officer when it reached 85% of the funded amount and that the contractor failed to stop work when it reached the funded amount. In denying the contractor's appeal, the ASBCA remarked: "A contractor cannot create an obligation on the part of the Government to reimburse it for a cost overrun by voluntarily continuing performance and incurring costs after the cost limit has been reached."

Limitation of funding type clauses are difficult to manage, but difficulty is not an excuse for mismanagement. One must forecase not simply when the "incurred" costs are at 85%, but, if one has claims for changes, delays, or the like, those costs too must be assessed in determining when to give the 85% notice. On a project that is not a federal project, but is a project funded solely by bonds issued by a single purpose entity, a similar issue arises about continuing to work when the costs forecast to complete (including changes and amounts owed by the owner to other entities like the designer) exceed the bond amount, one must start managing the financial end. The ASBCA's decision in *Dynamics Research Corp*. serves as an important reminder to scrupulously comply with funding limits, either expressly stated, as in a LOGO clause, or as implied by a funding limit under state or local law. As the contractor in *Dynamics Research Corp*. learned the hard way, failure to manage these financial funding realities could result in a situation where the contractor is essentially performing work for free.

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By Aron C. Beezley

Florida Supreme Court Limits the Economic Loss Doctrine

Florida is one of several states in which the courts have held that parties in contractual privity – that is, parties with contracts between them governing their relationship – cannot recover damages based on non-contractual theories of recovery for economic losses arising from performance of a contract. This is known as the economic loss doctrine. The Florida Supreme Court, however, recently placed a substantial limitation on the economic loss doctrine in *Tiara Condominium Association, Inc., v. Marsh & McClennan Companies, Inc.*, limiting the ban on recovering economic losses in such instances to products liability cases.

The Court in *Tiara Condominium* held that a condominium association may bring an action for negligence and breach of fiduciary duty against its insurance broker, despite contractual privity between the parties and the absence of property damage or personal injury. In other words, the losses alleged were purely economic. The matter resulted from a dispute between a condominium association and its surety broker over the broker's representations regarding the scope of the condominium association's insurance coverage. After two hurricanes damaged the condominium, the association relied on the broker's assurances of coverage in selecting remediation options for repair of the building. When the association sought payment from the insurer, the insurer insisted its loss limit was measured in the aggregate (rather than per occurrence, as the broker had stated), eventually leading the association and the insurer to settle for an amount less than the association's cost of remediation.

The Florida Supreme Court reviewed the history of the economic loss rule, noting that it was "developed to protect manufacturers from liability for economic damages caused by a defective product beyond those damages provided by warranty law," but that it had over time been extended to apply to all actions involving parties in contractual privity. The Court then declared that any expansion of the doctrine beyond the products liability context was "unwise and unworkable in practice." It ultimately held that "the economic loss rule applies only in the products liability context," overturning all prior holdings in Florida extending the rule beyond the products liability context.

The Court thus held that the association's claims in negligence and breach of fiduciary duty against the broker – claims based on non-contract theories of recovery, despite the existence of a contract between the parties – could proceed.

The *Tiara Condominium* opinion expands the sources from which an aggrieved contractor or subcontractor or owner may seek relief, because the doctrine had been used to exclude claims by a contractor against a designer for delays or impacts arising from poor design.Contractors, owners, and design professionals should be aware of this change in the law in Florida and should adjust risk assessments for projects in Florida accordingly.

By: Monica L. Wilson

The "Fear of Failure" May Constitute Property Damage Under a Commercial General Liability Policy

Traditionally, courts have held that "fear of failure" caused by faulty or defective workmanship is not sufficient to constitute "property damage" under a standard form commercial general liability ("CGL") policy. *Forrest Construction, Inc. v. The Cincinnati Ins. Co.*, a recent decision by the United States Court of Appeals for the Sixth Circuit (a federal supervisory court over trial courts in Kentucky, Michigan, Ohio, and Tennessee), applying Tennessee law, may provide insureds the opportunity to assert that such "fear of failure" claims are sufficient to trigger an insurer's duty to defend.

Forrest Construction, Inc. was hired to construct a home. A dispute arose between Forrest and the homeowners regarding the amount owed to Forrest, and Forrest filed suit. The homeowners filed a counterclaim for alleged defective workmanship. The allegations of defective workmanship were limited to the following:

- "Among other items, the [homeowners] discovered significant cracking in the foundation at the right rear corner of the dwelling, creating an unsafe and potentially life-threatening condition."
- "Forrest recklessly performed, or caused to be performed, work of such poor workmanship that it created an unsafe condition, causing a potentially deadly collapse of the residence."
- "Forrest recklessly constructed the foundation or recklessly caused to be constructed the foundation of the [homeowners'] residence."

Forrest asked its CGL to provide a defense. The insurer refused to defend Forrest and denied the claim based on the "your work" exclusion in the CGL policy. (CGL policies typically exclude coverage for claims arising from defective work performed by the insured). In its denial letter, the Insurer noted that the policy contained an exception to the "your work" exclusion for work that is performed by a subcontractor. However, the insurer stated that Forrest was not protected by this subcontractor exception because the counterclaim did not assert that any faulty work was performed by a subcontractor.

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After the insurer issued its denial, Forrest filed suit in federal court asserting that the insurer breached the insurance contract by failing to defend and indemnify, and the trial court found that the insurer breached its obligations under the policy when it failed to defend Forrest. The insurer appealed to the intermediate appellate court.

The appellate court noted that under Tennessee law, "an insurer's duty to defend the insured is triggered when the underlying complaint alleges damages that are within the risk covered by the insurance contract and for which there is a *potential* basis for recovery." The appellate court held that the allegations in the homeowners' counterclaim against Forrest were sufficient to trigger the insurer's duty to defend. Specifically, the court held the allegations in the underlying complaint that "Forrest recklessly performed, or caused to be performed" were sufficient to trigger the subcontractor exception to the "your work" exclusion because the "the usual way a contractor would 'cause' work to be performed is by hiring a subcontractor."

In addition, the appellate court rejected the insurer's argument that "property damage" occurs under a CGL only where there is damage to something other than the structure the contractor was hired to build. Instead, the appellate court held that "'property damage' occurs when one component (here, the faulty foundation) of a finished product (the house) damages another component." The court noted that the complaint alleged that the faulty workmanship "created an unsafe condition, causing a potentially deadly collapse of the residence." While the appellate court noted that the allegations were ambiguous as to the nature of the damages flowing from the faulty foundation, the allegations that the house was "unsafe to even enter" were sufficient to put the insurer "on notice that more than the foundation itself was affected by the faulty workmanship and that the [homeowners] were alleging loss of use of their property."

Forrest Construction may allow policyholders to assert that allegations of "an unsafe condition" or "fear of failure" of one part (or all) of a structure arising from another allegedly defective part are sufficient to satisfy the "property damage" requirement of a CGL policy, at least for purposes of determining whether an insurer has a duty to defend. It is important to note that in the insurance context, careful pleading regarding alleged faulty workmanship is often essential to triggering an insurer's duty to defend. It is critical that you involve your lawyer early in the process when you believe you may have a potential insurance claim under a CGL or similar policy.

By Heather Howell Wright

Follow Fundamentals Or Work Without Pay

We periodically choose to highlight a case in this newsletter that illustrates the fundamental concept that every state requires a company to register to do business in the state, and nearly every state requires a contractor, subcontractor, or designer to be licensed even to bid a project in that state or jurisdiction. California is one of those states, and an intermediate appellate court ruled recently in *Twenty-Nine Palms Enterprises Corporation v. Bardos* that the contractor for work on tribal land had to disgorge (that is, pay back) $751,995 for work it did on tribal land. Why? The contractor was not licensed when it performed the work on the casino at issue.

The case illustrates two arguments that companies sometimes make to try to get around licensing requirements, both of which generally fail. First, the contractor argued that the work was on tribal land for a tribal entity and therefore the state license requirement did not apply. The court ruled it mattered not where the work was done: no license, no pay. Second, the contractor was a sole proprietor, who owned another contractor, which was licensed, and he tried to "borrow" that license as a defense; the court disallowed borrowing the license and held that if the entity performing the work is not licensed, it cannot be paid, nor retain payments previously made under an illegal contract.

When one considers that the contractor had paid subcontractors for their work, it is easy to imagine the cost of this failure to observe the licensing statute as well over $1,000,000.

This case takes us back to the basics: check the licensing laws in a given jurisdiction; comply with them for the entity proposing the work (this can be tricky sometimes for joint ventures); be sure you renew the license timely. In many states, the penalty for working as an unlicensed entity is disgorgement of all payments under the contract and a possible misdemeanor charge from state officials. Many states do not allow a 'cure' of the failure to obtain a license or of working under an expired license, so timely renewals are as important as obtaining the original license.

By E. Mabry Rogers

Tennessee Court Rules that Liquidated Damages is an Owner "Claim" and Subject to the Strict AIA Imposed Time Limitations

Many times lawyers lecture their construction clients about the importance of meeting procedural deadlines for claims for both money and time: "Get It Right, Get It Written." Sometimes these arguments are discarded by judges or arbitrators on the basis of fairness, or the legal concepts of waiver are used to get around strict deadlines. Nonetheless, a

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decision by the Tennessee Court of Appeals in *RCR Building Corp v Pinnacle Hospitality Partners* shows that these claim deadlines have teeth and may be costly if ignored.

The project involved a hotel built under a modified AIA contract. The parties agreed on a liquidated damages clause of $1,500 per day. The project was not substantially completed until 158 days after the scheduled deadline, and while not stated in the opinion, the contractor agreed that some of the delays were his fault. However, the owner continued to make progress payments without deducting any amounts for LDs, and after the completion of the project, during negotiations, the owner admitted that he owed the contractor over $600,000. However, nine months after the project's substantial completion the owner demanded that $237,000 in liquidated damages be deducted from the $600,000 due the contractor. The contractor refused to accept this deduction, and filed suit for the entire contract balance.

The trial court agreed with the owner's position, ruling that while the owner contributed to some of the delays, under the contract, the deduction of LDs was automatic, and the contractor itself waived its rights by failing to seek an extension of time using the claims procedure in the contract. The contractor appealed the decision, and the appellate court reversed the ruling.

The owner presented several arguments, all of which failed. First, the owner argued that it was entitled to LDs as a "matter of law" because the contractor failed to request an extension of time. The owner next argued that its claim for LDs was not a "Claim" and therefore not subject to Article 4.3 of the AIA A201 General Conditions ("claims by either party must be initiated within 21 days after occurrence of the event giving rise to such claim") and Article 4.3.11 (strict compliance with Article 4.3 shall be a "condition precedent to the commencement of a dispute resolution proceeding concerning any claim"). Finally, the owner argued that going through the formal process of a "Claim" would have been fruitless because it was a "simple case of math."

The court rejected all of the owner's arguments and ruled that any claim for LDs, even if otherwise substantially valid, was not proper because the owner delayed making a claim under the contract. The court noted: "we cannot excuse the owner from compliance with the claims procedure simply because it now contends that it would have been a waste of time."

The individuals in charge of a project, whether for the owner, contractor or subcontractor, must be informed – over and over again – about any deadlines for notice under the terms of the contract. These days a simple email or letter may suffice. The failure to provide notice gives an easy excuse not to grant the relief requested, and as shown in the case above, that failure may be costly.

By David K. Taylor

Bradley Arant Lawyer Activities:

U.S. News recently released its "Best Law Firms" rankings for 2013. **BABC's Construction Practice Group** received a Tier One National ranking, the highest awarded, in both Construction Law and Construction Litigation. The Birmingham, Nashville, Jackson, and Washington, D.C. offices received similar recognition in the metropolitan rankings.

Jim Archibald, Axel Bolvig, Rick Humbracht, Russ Morgan, David Pugh, and **Mabry Rogers** were recognized by *Best Lawyers in America* in the category of Litigation - Construction for 2013.

Axel Bolvig, **Ralph Germany**, **David Owen**, **Doug Patin**, **David Pugh**, **Bill Purdy**, **Mabry Rogers, Wally Sears,** and **David Taylor** were *recognized* by *Best Lawyers in America* in the area of Construction Law for 2013.

Mabry Rogers and **David Taylor** were also recognized by *Best Lawyers in America* in the areas of Arbitration and Mediation for 2013.

David Owen was recognized by *Best Lawyers in America* as the "Lawyer of the Year" for Construction Law in Birmingham for 2013.

Brian Rowlson served as panelist on the ABC Carolinas lien law seminar on February 28, 2013, explaining recent changes to North Carolina's mechanics' lien law statutes effective April 1, 2013.

Jonathan Head recently attended LegalTech New York, the largest national trade show for lawyers doing electronic discovery, and the service and product suppliers that support them.

Lewis Rhodes recently spoke at the ABC Carolinas Charlotte luncheon about current issues and trends in the federal government contracting market.

David Taylor, as current President of the Tennessee Association of Construction Counsel, chaired the group's spring meeting in Memphis on May 10 and also spoke on "Ethical Issues facing Construction Lawyers."

Russ Morgan was recently featured in the "Q&A Keys to successful crisis communications" in the NashvilleBizBlog. Russ was interviewed after a recent seminar entitled "Crisis Communications in a World of Instant Media."

Aron Beezley authored an article in January 2013 for the Bloomberg BNA Federal Contracts Report entitled "Recent Court of Federal Clams Bid Protest Decision Highlights

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Little-Known Issues That Exist When Contracting With The U.S. Postal Service".

Ryan Beaver and **Monica Wilson** co-authored an article for Construction Executive magazine entitled "Contractual Modifications for a Changing Marketplace".

Eric Frechtel, **Steven Pozefsky** and **Aron Beezley** published an article in *Federal Construction Magazine* on the U.S. Small Business Administration's ("SBA") Office of Inspector General's recent report on the SBA's Mentor-Protégé Program.

Eric Frechtel recently taught a seminar at the Mechanical Contractors Association of America's Advanced Institute for Project Management in Austin, Texas.

David Taylor and **Bryan Thomas** gave a presentation to the Middle Tennessee Chapter of ABC on April 9 entitled "Tennessee Law Update and Retainage".

Eric Rechtel, Steve Pozefsky, and **Aron Beezley** wrote an article for the June/July 2013 issue of *Federal Construction Magazine* on the U.S. Court of Federal Claims' recent decision in *Miles Construction LLC v. United States.*

David Pugh moderated a panel of speakers on the topic of Trends in Major Land Development at the ABC BizCon Business Development Conference in Ft. Lauderdale on February 19-20. David was also recently appointed to serve a two year term on the ABC's National Board of Directors.

Axel Bolvig, **Stanley Bynum**, **Keith Covington**, and **Arlan Lewis** were recently recognized by *Birmingham's Legal Leaders* as "Top Rated Lawyers." This list, a partnership between Martindale-Hubbell® and ALM, recognizes attorneys based on their AV-Preeminent® Ratings.

David Taylor recently spoke in Phoenix, Arizona to the National Meeting of the Construction Specifications Institute (CSI) on "Allowances and Owner Contingencies".

Eric Frechtel, **Steve Pozefsky**, and **Aron Beezley** authored an article entitled "The Gutting of The Veterans First Contracting Program?" for the January/February 2013 edition of Federal Construction Magazine.

David Taylor and **Bryan Thomas** recently gave a presentation at the 12th Annual Tennessee Commercial Real Estate Seminar on May 1 on default termination entitled "Terminating your Contractor: the Nuclear Option".

Ryan Beaver and **Monica Wilson** recently co-authored an article in the Charlotte Business Journal entitled "Meeting Our Road Needs," addressing the challenges and opportunities for the construction industry to meet North Carolina's growing infrastructure needs.

David Taylor will be speaking to the Tennessee Municipal Lawyer's Association in Memphis on June 24 on "Avoiding Construction Disputes".

Eric Frechtel, **Steven Pozefsky**, and **Aron Beezley** published for the February/March 2013 issue of *Federal Construction Magazine* an article on key small business provisions of the National Defense Authorization Act of 2013.

Jim Archibald and **Luke Martin** will speak at a construction seminar on July 18 in Birmingham on "Understanding Bonding and Insurance Issues in Construction."

Chambers annually ranks lawyers in bands from 1-6, with 1 being best, in specific areas of law, based on in-depth client interviews. **Bill Purdy** and **Mabry Rogers** are in Band One in *Litigation: Construction*. **Doug Patin** was ranked in Band Two and **Bob Symon** in Band Three, both in the area of *Construction*.

The Construction Practice Group recently hosted the 2013 Construction Seminar entitled *Getting Paid on a Construction Project*. The seminars, held on May 3 in Birmingham, May 17 in Nashville, May 24 in Jackson, and May 31 in Charlotte, were taught by attorneys in the practice group. Thanks to all those who attended. We hope that it provided you with valuable tools to assist you on current and future projects.

An electronic copy of this newsletter, as well as prior editions, can be found on the BABC website at www.babc.com/construction_and_procurement.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

NOTE: YOU CAN FIND THIS NEWSLETTER AND PAST NEWSLETTERS ON OUR WEBSITE. IF YOU ACCESS THIS NEWSLETTER ON OUR WEBSITE, CASE-LINKS WILL BE AVAILABLE UNTIL THE NEXT NEWSLETTER IS PUBLISHED. WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY GO TO WWW.BABC.COM/PG_CONSTRUCT.CFM OR CONTACT ANY ATTORNEY LISTED ON PAGE 9 OF THIS NEWSLETTER.

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The lawyers at Bradley Arant Boult Cummings LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

This newsletter is a periodic publication of Bradley Arant Boult Cummings LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact your lawyer or any of the lawyers in our group whose names, telephone numbers and E-mail addresses are listed below; or visit our web site at www.babc.com.

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BRADLEY ARANT BOULT CUMMINGS LLP **Third Quarter 2013**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Ryan Beaver (c)
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Construction Defects: Navigating the Tense and Precarious Situation

A recent case out of Texas reminds contractors, designers, sureties, and owners alike of two fundamental principles intertwined with any construction defect: 1) a contractor's right to receive notice and to have an opportunity to cure a defect and 2) the responsibility of the owner to preserve evidence. Failure to comply with these principles can be very costly. In this Texas case, the failure to comply cost an owner almost two million dollars.

In *Miner Dederick Construction v. Gulf Chemical and Metallurgical Corp.,* the owner of a processing facility, Gulf Chemical, discovered a leak in an expansion joint that was constructed by Miner Dederick, its contractor. Gulf Chemical invited Miner Dederick to inspect the leak and asked that Miner Dederick make the repairs required by Gulf Chemical's architect. Miner Dederick visited the site to inspect the leak, but refused to make the repairs because it claimed that the leak was the result of a defective design, not defective construction. Gulf Chemical retained another contractor to make the repairs, hired a consulting firm to investigate the cause of the leak, and informed Miner Dederick that it would seek damages. Miner Dederick requested that it be allowed on-site during the repairs so that it could investigate the construction of the expansion joint that was not visible to it in its prior visits. Gulf Chemical refused, believing it had already provided Miner Dederick notice and an opportunity to investigate and cure its defective work. The trial court agreed with Gulf Chemical's approach and issued a judgment against Miner Dederick for the damages associated with the defective construction of the expansion joint.

However, the appellate court saw the case differently, focusing instead on Gulf Chemical's failure to allow Miner Dederick to conduct a detailed inspection of the allegedly defective work as well as its duty reasonably to preserve the defective work. The appellate court considered the Owner's actions to constitute spoliation. Spoliation occurs when a) there is a duty to preserve evidence, b) the party with the obligation to preserve the evidence fails to do so, and c) the failure results in prejudice. The appellate court explained that a party has a duty to preserve relevant and material evidence when it knows or reasonably should know that a claim may be filed. Once the duty to preserve

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arises, reasonable care must be taken to preserve the evidence for inspection. If the court finds that reasonable care was not taken resulting in prejudice, it has the option of invoking any of several remedies, ranging from adverse jury instructions to barring claims.

The appellate court found that Gulf Chemical knew litigation was likely to occur with regard to the expansion joint. Before conducting the inspection and repairs, Gulf Chemical hired a consultant to determine the root cause of the leak and put Miner Dederick on notice of the defect. The appellate court concluded based on these facts that a duty had arisen requiring Gulf Chemical to exercise reasonable care to preserve evidence.

According to the appellate court, extraordinary measures to preserve the evidence were not necessary. However, Gulf Chemical's refusal to allow Miner Dederick to inspect the expansion joint during the repairs and before the inspection joint was covered in concrete was not reasonable, prejudiced Miner Dederick, and hindered its ability to present a defense. This, the court stated, constituted spoliation. The appellate court returned the matter to the trial court to determine the appropriate sanction.

The lesson from this case is to act with caution when dealing with construction defects. Given the circumstances, one must, where feasible, provide notice and an opportunity to cure the defect. While there are differences among applicable contracts and governing state laws as to what constitutes "notice' and "opportunity to cure," the principle remains constant. A party is entitled to reasonable notice and an opportunity to cure the defect. Contractors and subcontractors should insist on being given this opportunity and should document their requests. What constitutes "reasonable" will differ, depending on how urgent the problem is. Preservation will be measured, likewise, by the circumstances: is there a need to destroy the evidence in order to repair it? Must it be covered in order to repair it? Upon notice, has the contractor dragged its feet or made unreasonable inspection demands, increasing the owner's damages while awaiting repair? These factual indicators will influence what steps are "reasonable."

From an owner's or designer's perspective, if time permits, an owner should allow reasonable inspections requested by contractors, and should document all actions taken in this regard. Owners, designers, sureties, and contractors alike should always remember that notice and collaboration in the investigation may be beneficial, even if there is disagreement about financial responsibility. Moreover, it may be a breach of the contract not to provide notice, and it may be deemed "spoliation" that will bar otherwise collectible damages.

By Bryan Thomas

There's No Looking Back - Testing the Reasonableness of a Liquidated Damages Provision under Mississippi Law

Liquidated damages clauses are nothing new to construction contracts and play a major role in the day-to-day operations of the construction industry. The Mississippi Court of Appeals recently provided a refresher on the law surrounding liquidated damages provisions. In *Hovas Construction, Inc. v. Board of Trustees of Western Line Consolidated School District*, the Mississippi Court of Appeals enforced a liquidated damages provision because the court found the amount of damages prescribed by the contract to be "reasonable and proportionate to the overall costs of the project."

The Owner agreed to pay Hovas Construction, as general contractor, $450,000 for renovations and the construction of an addition to a high school in Mississippi. The contract contained a provision for liquidated damages at a specified rate of $500 for each day the project was delivered beyond the completion date. After beginning the job with little complication, Hovas was late in erecting the steel building addition because the manufacturer and supplier of the steel beams required additional time. In the end, Hovas achieved substantial completion 39 days late, resulting in $19,500 in liquidated damages, which the Owner withheld from Hovas. Hovas brought suit, asking the court to rule that the liquidated damages provision was unenforceable.

Hovas first argued that the contract's liquidated damages provision was not a reasonable estimate of the actual damages the school district would incur if the project was not delivered on time. Hovas contended that this provision was nothing more than a penalty.

In rejecting Hovas' arguments, the court reasoned that an agreement for liquidated damages will be upheld absent evidence showing that the amount of damages is "unjust or oppressive, or that the amount of damages is disproportionate to the damages that would result from the breach" of the agreement. The court reminded Hovas that oftentimes "parties agree to the payment of liquidated damages in circumstances where it is difficult to predict actual damages that may result from a breach." Relying on the parties' intent, their awareness of the contractual provision for liquidated damages, and the reasonableness

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of the amount of damages, the court concluded that Hovas' arguments were without merit.

Hovas next argued that the liquidated damages provision was not enforceable because the school district did not suffer actual damages due to the delay in completion. The court disagreed, responding that "the issue of actual damages does not have an impact on the amount of liquidated damages to which the [Owner] is entitled." The concurring opinion further explained that "Mississippi apparently utilizes a prospective or front-end approach that instead focuses on the reasonableness of a liquidated-damages clause as of the time the contract was executed—not in hindsight." Applying Mississippi's prospective approach, the court concluded that because the amount of damages was reasonable at the time the contract was executed, it was enforceable.

While liquidated damages provisions are commonplace in contracts today, this case serves as a reminder that the damages prescribed must be reasonable and may not equate to a penalty. In many states, such as Mississippi, reasonableness is determined at the time the contract is entered. However, in other states, reasonableness may be determined using a retrospective approach whereby the amount of liquidated damages required in the contract is compared to the amount of damages actually incurred. Regardless of the approach used, contracting parties should attempt to arrive at a reasonable estimate of expected damages at the time of contracting if they desire the liquidated damages provision to be enforceable. Because the Owner and its designer often calculate the liquidated damages, it is wise to preserve the evidence of how the damages were estimated in foresight, in the event a challenge is leveled that the LD's are unreasonable.

By Chris Selman

Clear Trend Finds Construction Defects Satisfy "Occurrence" and "Property Damage" Requirements of CGL Policy

The insurance coverage analysis under a commercial general liability ("CGL") insurance policy begins with the "insuring agreement." The standard CGL policy provides coverage for "those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage.'" The standard CGL policy further provides that the property damage must be caused by an "occurrence," which is, in turn, defined as "an accident." Many courts have held that a construction defect was not an "accident" and thus losses associated with such defects or faulty workmanship were not covered under a CGL policy. The recent trend, however, has been for many (but by no means all) courts to find that construction defects or faulty workmanship satisfy the "occurrence" and "property damage" requirements and that losses sustained as a result of such defects may be covered by a CGL policy.

Two additional states recently joined this nationwide trend of finding that claims of faulty workmanship can be covered under CGL policies. A West Virginia appellate court decided for the first time that construction defects may constitute an occurrence under a standard-form CGL policy. In addition, the Georgia Supreme Court, which had previously held that defective workmanship may constitute an occurrence, expanded CGL coverage by finding that an insured need not demonstrate damage to property or work of someone other than the insured in order the satisfy the "occurrence" requirement.

West Virginia

In *Cherrington v. Erie Insurance Prop. & Cas. Co.*, West Virginia joined the growing majority of states recognizing CGL coverage for defective workmanship. The state appellate court acknowledged in *Cherrington* that it was influenced by the trend of other states finding CGL coverage for defective workmanship and overruled several prior cases (decided between 1999 and 2005) that had reached the opposite conclusion.

Lisbeth Cherrington entered into a contract with The Pinnacle Group, Inc. ("Pinnacle"), for the construction of a home. Pinnacle had a CGL insurance policy issued by Erie Insurance Property and Casualty Company ("Erie"). After the home was completed, Cherrington alleged numerous defects, including an uneven concrete floor, water infiltration through the roof and chimney joint; a sagging support beam; and numerous cracks in the drywall throughout the house. Cherrington sued Pinnacle for negligent construction. Erie denied coverage to Pinnacle, and Pinnacle filed a third-party complaint seeking a declaration of coverage. The trial court ruled in favor of Erie, finding there was no "occurrence" or "accident" that had caused the damages.

On appeal, the appellate court reversed. After discussing the recent trend in "occurrence" decisions and the policy language defining "occurrence" as an "accident," the court found that Pinnacle did not

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intentionally construct a defective house: "Common sense dictates that had Pinnacle expected or foreseen the allegedly shoddy workmanship its subcontractors were destined to perform, Pinnacle would not have hired them in the first place. . . To find otherwise would suggest that Pinnacle deliberately sabotaged the very same construction project it worked so diligently to obtain at the risk of jeopardizing its professional name and business reputation in the process." As a result, Pinnacle's faulty workmanship, including the faulty workmanship of its subcontractors, was an "accident" and thus an "occurrence" under the CGL policy.

Georgia

In *Taylor Morrison Services, Inc. v. HDI-Gerling America Insurance Co.*, the Georgia Supreme Court answered two certified questions from the Eleventh Circuit regarding the interpretation of "occurrence" and "property damage" under a CGL policy under Georgia law: (1) whether Georgia law requires damage to property other than the insured's work for an "occurrence" to exist; and (2) if not, whether the "occurrence" requirement may be satisfied by claims for fraud or breach of warranty. The *Taylor Morrison* court held that defective construction can be an "occurrence," even without damage to property other than the work or property of the insured. The court also determined that while a fraud claim, with its intent element, likely would not constitute an "occurrence," a breach of warranty claim could be an "occurrence" sufficient to trigger coverage under a CGL.

Taylor Morrison, the insured, was a homebuilder that had been sued in a class action by more than 400 homeowners in California who alleged that the concrete foundations of their homes were improperly constructed. The class complaint alleged that the faulty foundations caused "tangible physical damage" to the homes, including "water intrusion, cracks in the floors and driveways, and warped and buckling flooring." HDI-Gerling America Insurance Company initially defended Taylor Morrison in the underlying construction defect action, subject to a reservation of rights.

HDI-Gerling then filed suit in federal trial court based in Georgia seeking a declaration that Taylor Morrison had no coverage under the policy. Even though the underlying construction defect lawsuit was pending in California, Georgia law applied to the interpretation of the policy because the policy at issue had been delivered to Taylor Morrison in Georgia. The trial court agreed with HDI-Gerling, ruling that there was no "occurrence" because the only property damage alleged was damage to the insured's work – the homes constructed by Taylor Morrison. On appeal, the federal appellate court sent the questions to the Georgia Supreme Court.

In addressing whether the insured's own defective construction can be an "occurrence," the Georgia Supreme Court noted that the insurance contract defined "occurrence" as an "accident." In a previous case, the court had held that faulty workmanship can constitute an "occurrence." In this previous case, however, the allegedly faulty workmanship had caused damage to "other property" – property other than the property of the insured.

In *Taylor Morrison,* there was no alleged damage to "other property." Rather, the damaged property was the work of the insured. The court considered the definition and usage of the term "accident" and found "the word is not used usually and commonly to convey information about the nature or extent of injuries worked by such a happening, much less the identity of the person whose interests are injured." Applying this analysis, the court found that the "occurrence" requirement of the CGL "does not require damage to the property or work of someone other than the insured."

As to the second certified question, regarding whether fraud or breach of warranty can constitute an occurrence, the court again focused its analysis on interpretation of the word "accident." Because the elements of fraud require an intentional act, the court found that "[i]t is difficult for us to conceive of a circumstance in which a claim of fraud might properly be premised upon 'bodily injury' or 'property damage' that was caused by an 'accident.'" As to a claim for breach of warranty, however, the court noted that while the making of a warranty is an intentional act, the breach of warranty may be committed negligently. The Georgia Supreme Court concluded that faulty workmanship may constitute such a breach of warranty, and therefore could be an accident or "occurrence."

Insureds should take note of the increasing trend of courts across the country that are finding that construction defects may be covered under a CGL policy. In the *Cherrington* and *Taylor Morrison* cases, both courts acknowledged that a proper CGL coverage

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analysis requires a step by step approach: First, the insured must identify property damage caused by an occurrence. Second, the insurance company must establish the applicability of any exclusions that apply. If you are confronted with a construction defect claim, consider alerting your insurance carrier(s) (for all potentially applicable time periods) as an early risk-management approach. If you investigate on your own, without notifying your carrier, you may be accused (by the carrier) of having violated various provisions of your policy.

By Heather H. Wright

New SBA Small Business Subcontracting Rule goes into Effect on August 15, 2013

The U.S. Small Business Administration ("SBA") recently issued a long-awaited final rule in 78 Fed. Reg. 42391 amending its regulations to implement certain provisions of the Small Business Jobs Act of 2010. The new regulations, which formally went into effect on August 15, 2013, will likely impact both large and small federal government contractors during both the proposal preparation and contract performance phases of the procurement process.

The final rule, which applies to all "covered contracts" (i.e., contracts for which small business subcontracting plans are required), requires prime contractors performing covered contracts, among other things, to "notify the contracting officer in writing whenever the prime contractor does not utilize a small business subcontractor used in preparing its bid or proposal during contract performance." The phrase "used in preparing the bid or proposal" is defined in the final rule to include the following situations:

(i) The offeror references the small business concern as a subcontractor in the bid or proposal or associated small business subcontracting plan;

(ii) The offeror has a subcontract or agreement in principle to subcontract with the small business concern to perform a portion of the specific contract; or

(iii) The small business concern drafted any portion of the bid or proposal or the offeror used the small business concern's pricing or cost information or technical expertise in preparing the bid or proposal, where there is written evidence (including email) of an intent or understanding that the small business concern will be awarded a subcontract for the related work if the offeror is awarded the contract.

The final rule also requires prime contractors to notify the contracting officer, in writing, if they "pay[] a reduced price to a small business subcontractor for goods and services provided for the contract or the payment to a small business subcontractor is more than 90 days past due under the terms of the subcontract[.]" The final rule states that "'[r]educed price' means a price that is less than the price agreed upon in a written, binding contractual document." The final rule further provides that prime contractors "shall include" in their written notifications to the contracting officer "the reason for the reduction in payment to or failure to pay a small business Subcontractor[.]"

Moreover, the rule clarifies that, as part of the overall performance evaluation of the prime contractor, the contracting officer is responsible for evaluating the prime contractor's compliance with its small business subcontracting plans. Among other things, the final rule makes clear that the contracting officer's review must include an evaluation of the prime contractor's written explanation for (i) failing to utilize during contract performance small business subcontractors that were used in preparing the prime contractor's proposal, and/or (ii) any reduced or untimely payments to small business subcontractors. The rule states that, if the contracting officer finds that the prime contractor "has a history of unjustified untimely or reduced payments to subcontractors," the contracting officer must "record[] the identity of the prime contractor in the Federal Awardee Performance and Integrity Information System (FAPIIS), or any successor database."

While several commentators have expressed uncertainty about how the rule will work in practice, it is clear that the SBA is serious about attempting to reform the way that certain prime contractors deal with small business subcontractors in both the proposal preparation process and during contract performance. As such, both large and small business contractors should familiarize themselves with these new regulatory provisions. If you have any questions about specific issues, contact one of the members of the CPPG or your lawyer.

By Aron C. Beezley

Florida Court Finds That Replacement Cost Insurance Coverage Includes Overhead and Profit of General Contractor

Insureds are often uncertain as to what costs are covered under their policies when a covered loss occurs. Florida's highest court recently considered, in *Trinidad v. Fla. Peninsula Ins. Co.*, whether replacement cost insurance coverage includes a general contractor's

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overhead and profit. The *Trinidad* court found these costs to be within the scope of a replacement cost policy where the insured is reasonably likely to need a general contractor for the repairs.

The home of Amado Trinidad ("Trinidad") was damaged by fire in 2008. Shortly thereafter he filed a claim with his homeowner's insurance company, Florida Peninsula Insurance Company ("Florida Peninsula"), though Trinidad had elected not to repair the home. Florida Peninsula admitted coverage and made a payment on a claim for the cost of the repairs. However, Florida Peninsula withheld from its payment an amount for a general contractor's overhead and profit. Florida Peninsula believed that, based on the language of the policy and relevant statutes, it was not liable for these amounts unless and until Trinidad made the repairs. Rejecting this viewpoint, Trinidad subsequently brought suit against Florida Peninsula for breach of its insurance policy. The matter reached the Florida Supreme Court.

The court noted that replacement cost insurance "is measured by what it would cost to replace the damaged structure on the same premises" and that it is "designed to cover the difference between what property is actually worth and what it would cost to rebuild or repair that property." The court defined overhead as "fixed costs to run the contractor's business, such as salaries, rent, utilities, and licenses" and profit as "the amount the contractor expects to earn for his services." Having defined the relevant terms, the Trinidad court's focus turned to a prior Florida appellate court opinion that had addressed a similar issue.

In that case, the court was asked to determine whether overhead and profit were included within the scope of an actual cash value policy. That court did not distinguish between overhead and profit and other costs of the repair, such as material and labor, reasonably incurred by the insured. The court in that case concluded that overhead and profit are included in the scope of an actual cash value policy "where the insured is reasonably likely to need a general contractor for repairs."

The *Trinidad* court found the earlier case instructive because of the relationship between replacement cost and actual cash value. Actual cash value is generally defined as "replacement costs minus normal depreciation." Therefore, replacement cost policies provide greater coverage because depreciation is not excluded from replacement cost coverage. Because that case had previously found the narrower actual cash value policies to include overhead and profit, the *Trinidad* court reasoned that replacement cost policies should also include such costs.

The limiting language used by the earlier decision, adopted in *Trinidad*, is important to note. A general contractor's overhead and profit are proper replacement costs only in those circumstances in which the repairs are reasonably likely to require the services of a general contractor. If only the services of an individual trade contractor, such as an electrician or plumber, are required, then only the overhead and profit of that contractor would be proper.

The *Trinidad* opinion serves as a useful guidepost for insureds that experience a covered loss under a replacement cost policy to determine what repair costs are properly payable.

By Charlie G. Baxley

Bradley Arant Lawyer Activities:

U.S. News recently released its "Best Law Firms" rankings for 2013. **BABC's Construction and Procurement Practice Group** received a Tier One National ranking, the highest awarded, in both Construction Law and Construction Litigation. The Birmingham, Nashville, Jackson, and Washington, D.C. offices received similar recognition in the metropolitan rankings.

Jim Archibald, Axel Bolvig, Rick Humbracht, Russ Morgan, David Pugh, and **Mabry Rogers** were recognized by *Best Lawyers in America* in the category of Litigation - Construction for 2013.

Axel Bolvig, **Ralph Germany**, **David Owen**, **Doug Patin**, **David Pugh**, **Bill Purdy**, **Mabry Rogers, Wally Sears,** and **David Taylor** were *recognized* by *Best Lawyers in America* in the area of Construction Law for 2013.

Mabry Rogers and **David Taylor** were also recognized by *Best Lawyers in America* in the areas of Arbitration and Mediation for 2013.

David Owen was recognized by *Best Lawyers in America* as the "Lawyer of the Year" for Construction Law in Birmingham for 2013.

David Taylor, as current President of the Tennessee Association of Construction Counsel, chaired the group's spring meeting in Memphis on May 10 and also spoke on "Ethical Issues facing Construction Lawyers."

An article authored by **Eric Frechtel**, **Steven Pozefsky**, and **Aron Beezley** on the importance of complying with 8(a) subcontracting limitations will be published in the August/September 2013 issue of *Federal Construction Magazine*.

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David Bashford and **Monica Wilson** co-authored an article in the upcoming edition of Solar Business Focus entitled "Site Conditions on a Solar Project: Contractual Risk and Project Enforcement."

Eric Frechtel recently taught a seminar at the Mechanical Contractors Association of America's Advanced Institute for Project Management in Austin, Texas.

David Taylor and **Bryan Thomas** gave a presentation to the Middle Tennessee Chapter of ABC on April 9 entitled "Tennessee Law Update and Retainage".

Eric Frechtel, Steve Pozefsky, and **Aron Beezley** wrote an article for the June/July 2013 issue of *Federal Construction Magazine* on the U.S. Court of Federal Claims' recent decision in *Miles Construction LLC v. United States.*

Ryan Beaver and **Monica Wilson** attended the ABC of the Carolinas Summer Conference in August, where BABC was a sponsor as a member of ABC Carolinas' Platinum Executive Club.

Axel Bolvig, **Stanley Bynum**, **Keith Covington**, and **Arlan Lewis** were recently recognized by *Birmingham's Legal Leaders* as "Top Rated Lawyers." This list, a partnership between Martindale-Hubbell® and ALM, recognizes attorneys based on their AV-Preeminent® Ratings.

David Taylor recently spoke in Phoenix, Arizona to the National Meeting of the Construction Specifications Institute (CSI) on "Allowances and Owner Contingencies".

Eric Frechtel, **Steve Pozefsky**, and **Aron Beezley** authored an article entitled "The Gutting of The Veterans First Contracting Program?" for the January/February 2013 edition of Federal Construction Magazine.

David Taylor and **Bryan Thomas** recently gave a presentation at the 12th Annual Tennessee Commercial Real Estate Seminar on May 1 on default termination entitled "Terminating your Contractor: the Nuclear Option".

Ryan Beaver and **Monica Wilson** recently co-authored an article in the Charlotte Business Journal entitled "Meeting Our Road Needs," addressing the challenges and opportunities for the construction industry to meet North Carolina's growing infrastructure needs.

David Taylor spoke to the Tennessee Municipal Lawyer's Association in Memphis on June 24 on "Avoiding Construction Disputes".

Luke Martin spoke at a construction seminar on July 18 in Birmingham on "Understanding Bonding and Insurance Issues in Construction."

Chambers annually ranks lawyers in bands from 1-6, with 1 being best, in specific areas of law, based on in-depth client interviews. **Bill Purdy** and **Mabry Rogers** are in Band One in *Litigation: Construction*. **Doug Patin** was ranked in Band Two and **Bob Symon** in Band Three, both in the area of *Construction*.

BABC's Construction and Procurement Practice Group recently hosted the 2013 Construction Seminar entitled *Getting Paid on a Construction Project*. The seminars, held on May 3 in Birmingham, May 17 in Nashville, May 24 in Jackson, and May 31 in Charlotte, were led by attorneys in the practice group. Thanks to all those who attended. We hope that it provided you with valuable tools to assist you on current and future projects. A related seminar is planned for Washington D.C. in November.

Carly Miller will join the Construction and Procurement Practice Group in early September and will be working in Birmingham, AL. Carly graduated in May from Tulane Law School. We look forward to having her join our practice group.

Lisa Markman recently joined the Construction and Procurement Practice Group and is working in our Washington, D.C office. Lisa graduated in May from Washington & Lee Law School. We look forward to having her join our practice group.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

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NOTES

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Note: The following language is required pursuant to Rule 7.2 Alabama Rules of Professional Conduct: *No representation is made that the quality of the legal services to be performed is greater than the quality of the legal services performed by other lawyers.*

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READER RESPONSES

If you have any comments or suggestions, please complete the appropriate part of this section of the *Construction & Procurement Law News* and return it to us by folding and stapling this page which is preaddressed.

Your Name:

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We are in the process of developing new seminar topics and would like to get input from you. What seminar topics would you be interested in?

If the seminars were available on-line, would you be interested in participating? ☐ Yes ☐ No

If you did not participate on-line would you want to receive the seminar in another format? ☐ Video Tape ☐ CD ROM

Comments:

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Bradley Arant Boult Cummings LLP **Fourth Quarter 2013**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

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Limitations of Liability: Are they Enforceable?

A limitation of liability clause limits the amount for which the party at fault may be liable to the other party. For instance, the AIA's limitation of liability states that:

> [t]he Owner agrees that to the fullest extent permitted by law, the Architect's total liability to the Owner shall not exceed the amount of the total lump sum fee due to negligence, errors, omissions, strict liability, breach of contract or breach of warranty.

In a recent case decided by the federal appeals court that supervises trial courts in Indiana, Illinois, and Wisconsin, the court examined and applied Indiana law to enforce the above limitation language, notwithstanding the architect's own negligence in the design of a hotel. The architect designed a Homewood Suites for the Owner (in Ft. Wayne, IN) which, upon completion and before occupancy, was condemned by local code officials. It was torn down, costing the Owner $4.2 M. The architect's contract, however, was for $70,000, and the court ruled that the limitation of liability limited the Owner's recovery to $70,000, even though the limitations clause did not specifically refer to the architect's own negligence.

This result might not be applicable in every jurisdiction, but the drafting and negotiation point is clear: If one negotiates, or is confronted with, a limitation of liability clause, it may well be enforceable, even as to the party at fault. The parties should give careful consideration then to the amount of the limitation and whether it is adequate for the reasonably foreseeable damages that might arise from a party's breach or negligence, to the availability of insurance for the reasonably foreseeable events, and to the costs, to one party or the other, of increasing

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the risks of the contract by increasing (or decreasing) the damages that might be at issue.

By Mabry Rogers

Acceleration Costs for Failure Timely To Acknowledge Excusable Delay

Recently, the U.S. Civilian Board of Contract Appeals ("CBCA") in *Fluor Intercontinental, Inc., d/b/a J.A. Jones International v. Dep't of State* awarded a construction contractor damages for constructive acceleration costs incurred in connection with its performance of a U.S. Department of State ("DOS") contract for the construction of a new embassy in Haiti. This case highlights the importance of methodically maintaining project schedules and tracking and documenting all delays and costs, regardless of the contract type.

In 2005, the contractor and the DOS entered into a firm, fixed-price, design-build contract to construct a new embassy in Port-au-Prince, Haiti. The contract was to be substantially completed by July 3, 2007. Subsequently, the DOS extended the performance period, which resulted in a revised substantial completion date of January 29, 2008. Substantial completion ultimately occurred on March 31, 2008.

During the performance of the contract, the security situation in Haiti worsened. The contractor had anticipated certain security issues prior to entering into the contract and sought time extensions for excusable delays due to the unforeseen security issue.

After completing the project, the contractor filed suit in the CBCA, seeking damages for constructive acceleration, breach of the implied duty of good faith and fair dealing, and differing site conditions, among other things. The CBCA denied all of the contractor's claims, except the excusable delays claim. Excusable delays entitle a contractor to an extension of time but not compensation for the delay. The CBCA determined that the contractor was entitled to excusable delays totaling 111 days, but that the contractor already had been compensated for those days, given that the Contracting Officer previously granted the contractor 143 additional days. However, the CBCA found that the DOS's late recognition of excusable delays caused the contractor to accelerate performance. Ultimately, the CBCA found that 5% of the contractor's acceleration costs were linked to excusable delays and awarded minimal damages based on that calculation.

Although the contract at issue was a firm, fixed-price, design-build contract, the contractor was able to recover for constructive acceleration due to its methodical tracking of the schedule, excusable delays, and acceleration costs. This case thus underscores, for the contractor, the importance of closely tracking and documenting project schedules and all delays and costs, and, for the owner (or contractor faced with a subcontractor's request for time extensions), the importance of evaluating the request timely and measuring the delay "price" against an accelerating "price."

By Aron Beezley

Claim for Latent Defects Untimely, Even Though Discovered in Time under the State Statute of Limitations

An owner of a construction project has a limited amount of time to file a lawsuit for construction defects. The time limits for filing such actions can be established by law or by agreement. In a recent California appellate court case, *Brisbain Lodging, L.P. v. Webcor Builders, Inc.*, the owner of a hotel in California was precluded from pursuing its contractor for latent construction defects, because the owner did not timely file suit, even though it did not learn of the defects until after the statute of limitations had run. The court instead applied language from the parties' contract which rendered the owner's claims untimely.

All states have statutes of limitations that limit the time period for a claimant to assert construction defect claims. Depending on the state, the time limits typically range from two to 10 years from the date the claim arises. A general rule is that a claim arises when a wrongful act is done and damages arise.

A latent defect is a kind of defect where the potential claimant is not aware of its claim and thus fails to file suit within the statute of limitations. Most states have a "discovery rule" for latent defects.

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Discovery rule requirements may vary among states, but, in general, discovery rules delay the accrual of a cause of action for latent defects until the defect was discovered or could have been discovered through the exercise of reasonable diligence.

The owner in *Brisbain* discovered defective plumbing below its hotel approximately five years after substantial completion. The owner notified its contractor who notified the plumbing subcontractor. The subcontractor unsuccessfully attempted to repair the defective work. The Owner then discovered that ABS pipe was used instead of cast iron as was required by code. The owner brought suit against the contractor for the defects.

According to California's "discovery rule" the owner timely filed its suit; however, the court dismissed the lawsuit for violating the statute of limitations. The contract between the owner and contractor was a 1997 AIA form contract with A201 general conditions. The contract stated that all claims accrued upon "Substantial Completion" of the project. Using substantial completion as the accrual date for the latent defects, rather than discovery, the owner failed to file its suit within the statute of limitations. The court pointed out that other states had similarly enforced this same AIA A201 provision.

The *Bisbain Lodging* opinion is a valuable reminder that when negotiating contract provisions, one should be mindful of how provisions may limit remedies otherwise available under the law.

By David W. Owen

Failure to Strictly Comply with Notice Provisions May Bar Recovery

A recent federal decision applying Iowa law confirms that a party that relies on oral representations, rather than contractual terms, does so at its own peril. In the case of *In re Central States Mechanical*, the subcontractor (Central) agreed with the prime contractor (Agra) to provide approximately twenty five million dollars of piping work for two biofuel plant projects located in Iowa. The subcontracts between Central and Agra incorporated the terms of the prime contract between Agra and the plant owner, including the general conditions and notice provisions for extra work and time extensions. Central was contractually required to submit written requests and claims for extensions of time and additional work to Agra within time periods varying from three to twenty-one days. The contract also provided that all modifications to the contract must be in writing and that a change order must be issued before beginning additional work.

During the course of the projects, Agra's designer repeatedly failed to timely provide the necessary drawings. As a result, Central was significantly delayed and required to accelerate its work. Agra also failed to timely process submitted change order requests and urged Central to perform additional work even before a formal change order was approved. Central performed the work requested, incurring over $1.1 million dollars in costs for delays, scope of work changes, and acceleration. However, Central did not comply with the contractual notice requirements and waited nearly five months later to submit its requests for additional compensation for these claims.

Central suspended its work and walked off the site following Agra's refusal to pay in full Central's pay application. Agra terminated Central and hired a replacement contractor to complete the project. Central eventually filed bankruptcy. The bankruptcy court disallowed Central's $1.1 million impact damages claim against Agra. The court instead awarded Agra $3 million needed to complete the projects due to Central's improper suspension of its work. Despite finding evidence that Agra made oral representations that payment would be allowed prior to approval of a formal change order, the bankruptcy court ruled that the parties did not waive the formal notice requirements contained in the contracts.

On appeal, the Kansas federal trial court rejected Central's arguments that the failure to comply with the notice requirements was a 1) "technical breach," 2) unenforceable due to waiver, or 3) futile. To the contrary, the court found that the parties had clearly contemplated that potential delays may occur on the complicated, design-build projects, and that strict compliance with the notice procedure was necessary to ensure efficient completion of the job. The court

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recognized that written change orders may be waived in certain circumstances, but there was no definitive evidence that Agra had agreed to relax the contractual notice requirements. Even though Agra had made representations of payment during the parties' "frenzied efforts" to complete the project, these communications were insufficient to constitute an enforceable oral modification. Finally, Central's futility argument was rejected, because Agra had paid the majority of the change order requests that were timely submitted by Central. Accordingly, the trial court affirmed the bankruptcy court's ruling in favor of Agra.

Central States confirms that handshake agreements during the course of a project are not always reliable, and strict compliance with the contract is mandatory to ensure payment for work performed. Regardless of informal representations made on site, contractors, subcontractors, suppliers, and design professionals would be wise to heed the warnings articulated in *Central States* and submit their claims in writing within the timelines specified in the contract. Otherwise, these parties bear the risk of nonpayment for their hard-earned efforts.

By Brian Rowlson

U.S. Supreme Court Enforces Contractual Forum Selection Clauses

Forum selection clauses are often negotiated as part of construction contracts and allow parties to designate a specific forum for dispute resolution. Recently, the Supreme Court resolved a split among federal circuit courts and established clear guidelines on the enforceability of these clauses. At issue in the case, styled *Atlantic Marine Construction Co., Inc. v. United States District Court for the Western District of Texas*, was the procedure available to a defendant who seeks to enforce a forum-selection clause.

The case first came before the United States District Court for the Western District of Texas on claims of breach of contract, quasi contract and violations of Texas law pursuant to a subcontract for construction work done at Fort Hood, Texas. The subcontract included a forum selection clause designating courts in Virginia as the proper forum. The court first addressed whether the plaintiff, J-Crew Management, Inc. ("J-Crew") could avoid the forum selection clause by invoking a Texas statute which makes forum selection clauses in construction contracts voidable by the party obligated to perform the construction when that construction is performed within Texas and the forum selection clause designates the courts of another state as the appropriate venue for disputes. The court held the statute inapplicable by noting that Fort Hood is a federal enclave to which state law does not apply. This issue was not addressed by either the circuit court or the Supreme Court on appeal. Therefore, it is unclear what, if any, impact this result will have on state forum selection clauses like the clause in Texas which requires venue in Texas state court for construction projects performed in Texas. The trial court's finding that Fort Hood is a federal enclave was not examined by the appellate courts.

The issue which carried the case to the Supreme Court presented itself when the defendant, Atlantic Marine Construction Co. ("Atlantic") moved the court to dismiss the action on the basis of the forum-selection clause under a federal statute which obligates district courts to dismiss an action if it is brought in the wrong venue or, if in the interest of justice, the court may transfer the case to a district in which the case could have been brought. In the alternative, Atlantic requested the court transfer the suit to Virginia under a separate federal statute which permits a district court to transfer an action for the convenience of the parties or in the interest of justice to another district in which the case could have been brought, although venue is proper in the original court. The district court noted that if the forum-selection clause had designated a state-court forum, an arbitral forum, or a forum in a foreign country, the proper remedy would be dismissal, but because the forum selection clause designated a specific federal forum, it determined a transfer analysis was the proper approach. The court noted that federal law determines when venue is proper in a federal court, and because the Western District of Texas was a proper venue under federal law, the court would not dismiss on the basis of improper venue.

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The trial court next looked to whether transfer would be appropriate. The court placed the burden on the defendant, Atlantic (who had not chosen the forum initially, but had invoked the venue clause in the contract), to establish the propriety of transfer. The court determined that the private and public interests weighed in favor of retaining the case and declined to transfer the action to Virginia, notwithstanding the forum selection clause.

Atlantic appealed to the federal appeals court which supervises trial courts in Texas, which affirmed the district court decision. It stated that the result was logical because private parties should not have the power to transcend federal venue statutes that have been duly enacted by Congress and render venue improper in a district where it otherwise would be proper under congressional legislation. The Fifth Circuit also agreed with the district court's decision to place the burden on Atlantic to show the propriety of transfer.

The Supreme Court reversed the lower courts. According to the Supreme Court, the presence of a valid forum-selection clause changes the calculus for evaluating the proper venue in three ways. First, the plaintiff's choice of forum merits no weight (unlike the case where there is no forum selection clause), and the plaintiff bears the burden of establishing that transfer to the forum for which the parties bargained is unwarranted. Second, the district court should not consider the parties' private interests because, when parties agree to a forum-selection clause, they waive the right to challenge the preselected forum. Accordingly, private interest factors weigh entirely in favor of the preselected forum. Third, when a party bound by a forum-selection clause ignores its contractual obligation and files suit in a different forum, transfer of venue will not carry with it the original venue's choice-of-law rules—a factor that in some circumstances may affect public interest considerations. The Court remanded the case to the district court to see if any other public interest factors outweighed transfer.

Atlantic Marine establishes clear rules to enforce contractual forum-selection clauses. It ensures that parties who disregard venue selection clauses in the applicable contract will have a heavy burden to avoid the contractual venue (unless there are other considerations, such as a state law that invalidates such clauses, as is the case, for example, in Texas and Florida). Accordingly, the decision may reduce forum-selection related litigation and provide some security to parties who rely on these clauses to forecast possible litigation obligations.

By Lisa Markman

Mississippi's Stop-Notice Statute for Subcontractors Struck-down

Those performing work in Mississippi should keep an eye on continued developments regarding the validity of Mississippi's 'stop-notice' statute. A federal appellate court in *Noatex Corporation v. King Construction of Houston, LLC* recently struck down the statute as unconstitutional. The *Noatex* ruling means that subcontractors working on un-bonded private Mississippi construction projects have lost a powerful statutory remedy that allowed them effectively to suspend - for their own benefit - the prime contractor's payments from the owner. It is currently unknown whether the *Noatex* decision will be appealed to the U.S. Supreme Court.

Prior to the *Noatex* decision, Mississippi law allowed a subcontractor on un-bonded private Mississippi construction projects the right to issue a notice (commonly referred to as a "stop-notice") to the project owner of amounts claimed to be owed by the prime contractor and asserting the right to have this amount withheld from future payments to the prime contractor. Upon receipt of a stop-notice the owner was left at risk of double payment if the owner failed to withhold the claimed amount out of future payments to the prime contractor. In *Noatex*, the federal appeals court ruled that this statute was unconstitutional because it allowed the prime contractors' project earnings to be withheld without due process.

In *Noatex*, King Construction of Houston, LLC ("Subcontractor") agreed to perform work for Noatex Corporation ("Prime Contractor") on a project for Auto Parts Manufacturing Mississippi ("Owner"). A dispute arose between the Prime Contractor and

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Subcontractor. The Subcontractor issued a stop-notice to the Owner claiming to be owed $260,410.15. As a result, the Owner suspended all payments to the Prime Contractor. At the point when the Subcontractor issued the stop-notice to the Owner, no court ruling or arbitration award had established whether the Prime Contractor actually owed the amount the Subcontractor claimed it was owed.

In response to the stop-notice, the Prime Contractor filed suit against the Subcontractor claiming, among other things, that the Mississippi stop-notice statute was unconstitutional because it allowed subcontractors to seize prime contractors' project earnings without due process of law. Upon appeal, the appellate court agreed that the statute was unconstitutional. The court noted that the following facts were instrumental in its decision:

(i) The stop-notice statute did not require any hearing before the stop-notice was issued or went into effect;
(ii) the Subcontractor did not have to provide an affidavit supporting its entitlement to the amount claimed;
(iii) the statute did not require the Subcontractor to post a bond to stand as security; and
(iv) the statute did not require any showing of extraordinary circumstances that would justify the seizure.

The *Noatex* decision has drawn significant attention in the Mississippi construction community. Various industry groups are investigating what if anything will be done in terms of legislative action to address the court's ruling. In addition, it is unknown at this point whether the decision will be appealed to the U.S. Supreme Court. For now, please contact your present counsel or any of the construction lawyers in our Jackson, MS office if you are currently performing work under, or negotiating to perform work under, a contract for projects in Mississippi and have questions regarding this issue. Moreover, for work in other states that provide a "stop notice" remedy to subcontractors, this decision provides cause for examining the constitutionality of the particular state law provisions to determine whether a "due process" challenge may be appropriate for enforcement of that powerful tool.

By Ralph Germany

Construction Industry Employers and the Play-or-Pay Penalties under the Affordable Care Act

Beginning in 2015, "applicable large employers" will become subject to the "shared responsibility payments" (sometimes called "play-or-pay" penalties) under the Affordable Care Act ("ACA") as well as related mandatory reporting requirements. These employers may be subject to penalties if they do not offer the required minimum essential coverage or even if they offer such coverage but have employees who are certified as eligible for premium tax credits or cost-sharing reductions. However, employees are generally not eligible for the premium tax credits or cost-sharing reductions if the coverage meets the affordability and minimum value requirements under ACA.

Who is an Applicable Large Employer?

An "applicable large employer" is defined under ACA as one that employed an average of at least 50 full-time employees, including full-time equivalent employees, on business days during the preceding calendar year. Accordingly, the number of employees during 2014 will determine the status of an employer as an applicable large employer for purposes of the play-or-pay penalties in 2015.

A "full-time employee" under ACA is generally one who works at least 30 hours per week. "Full-time equivalent employees" are determined by taking the number of hours of paid service in a month and dividing by 120. To determine "applicable large employer" status for play-or-pay purposes in 2015, an employer should, for each month in 2014, calculate its number of full-time employees and full-time equivalent employees.

If the average monthly result is less than 50, the employer is not an applicable large employer for 2015. If the average monthly result is 50 or more, the employer will be subject to the play-or-pay penalties unless the seasonal worker exception applies.

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What is the Seasonal Worker Exception?

ACA contains an exception for employers with seasonal workers, which are common in the construction industry. Seasonal employees perform services on a seasonal basis where, ordinarily, the employment pertains to, or is of the kind exclusively performed at, certain seasons or periods of the year and which, from its nature, may not be continuous or carried on throughout the year. The seasonal employee exception provides that an employer will not be considered to employ more than 50 full-time employees if (1) the employer's workforce exceeds 50 full-time employees for 120 days or fewer during the calendar year, and (2) the employees in excess of 50 during such period were seasonal workers. If the seasonal employee exception does not apply, the employer will be an applicable large employer for 2015.

If you have questions about the new regulations, please contact any of the attorneys in the Construction or Employee Benefits & Executive Compensation groups at Bradley Arant Boult Cummings LLP.

By Marc Bussone

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Bradley Arant Lawyer Activities:

David Pugh Appointed to ABC National Board of Directors

David Pugh was recently appointed to serve on the National Board of Directors for the Associated Builders and Contractors ("ABC"). David has worked tirelessly for this organization since 2008, when he began as a Board member for the ABC Alabama Chapter.

Jay Reed, President of ABC Alabama, had this to say of David's role in ABC:

> *David's leadership role in our association has been a key part of our success. His background represents the real face of ABC and what we stand for. Both the contractor and the associate member share an equal voice. David's appointment to the Executive Committee is a testament to our representing the entire industry.*

Fellow board member, and outgoing Chairman for the Alabama chapter's board of directors Bruce Taylor, who serves as President of Marathon Electrical Contractors, Inc., was also very complimentary of David's hard work within ABC:

> *David's strong points have been extremely important to the Board of Directors over the past few years. His knowledge of our industry made him the perfect fit for our Executive Committee. He brings leadership, construction experience and contract law experience to the table. All of these traits have proven invaluable as we raise the association's political presence in Montgomery and DC.*

U.S. News recently released its "Best Law Firms" rankings for 2013. **BABC's Construction and Procurement Practice Group** received a Tier One National ranking, the highest awarded, in both Construction Law and Construction Litigation. The Birmingham, Nashville, Jackson, and Washington, D.C. offices received similar recognition in the metropolitan rankings.

Jim Archibald, Axel Bolvig, Rick Humbracht, Russ Morgan, David Pugh, and **Mabry Rogers** were recognized by *Best Lawyers in America* in the category of Litigation - Construction for 2013.

Axel Bolvig, **Ralph Germany**, **David Owen**, **Doug Patin**, **David Pugh**, **Bill Purdy**, **Mabry Rogers, Wally Sears,** and **David Taylor** were *recognized* by *Best Lawyers in America* in the area of Construction Law for 2013.

Mabry Rogers and **David Taylor** were recognized by *Best Lawyers in America* in the areas of Arbitration and Mediation for 2013. **Keith Covington** was also recognized in the area of Employment Law – Management.

David Owen was recognized by *Best Lawyers in America* as the "Lawyer of the Year" for Construction Law in Birmingham for 2013.

Bill Purdy and **David Taylor** were named *Mid-South Super Lawyers* for 2013 in the area of Construction Litigation. In addition, **Alex Purvis** was named a *Mid-South Rising Star* for 2013 in the area of Insurance Coverage.

Keith Covington taught a client seminar on December 3 on "Modern Communications: Perils and Pitfalls of Email Communications".

Jim Archibald and **Eric Frechtel** led a panel discussion at the Construction SuperConference in San Francisco entitled "The Government's Duty of Good Faith and Fair Dealing: The Bell Tolls for Thee?"

David Taylor, as current President of the Tennessee Association of Construction Counsel, chaired the group's spring meeting in Memphis on May 10 and also spoke on "Ethical Issues facing Construction Lawyers."

Ryan Beaver, **Brian Rowlson**, and **Monica Wilson** attended the ABC of the Carolinas Excellence in Construction Awards Banquet on November 21 in Charlotte. Monica presented awards at the ceremony as co-chair of the Excellence in Construction Committee.

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An article authored by **Eric Frechtel**, **Steven Pozefsky**, and **Aron Beezley** on the importance of complying with 8(a) subcontracting limitations was published in the August/September 2013 issue of *Federal Construction Magazine*.

David Bashford and **Monica Wilson** recently co-authored an article published in the December 2013 edition of Solar Business Focus entitled "Management of a Utility-Scale Solar Project: Contract by Communication."

Mabry Rogers, **Bill Purdy**, and **Doug Patin** were recently named to *The International Who's Who of Business Lawyers 2013*. The list identifies the top legal practitioners in the world in 32 areas of business and commercial law. All three were recognized in the area of Construction Law.

Monica Wilson attended the 2013 Energy Summit hosted by the Charlotte Chamber of Commerce, focusing on the roles that clean and safe energy, technology, and the government play in the future of the industry.

In July **Jim Archibald** was selected to serve as Vice President of the Alabama State Bar's Section on the Construction Industry.

David Taylor spoke in San Diego to the ICSC Legal Conference on "Using Arbitration in Commercial Real Estate disputes"

Ryan Beaver and **Monica Wilson** attended the ABC of the Carolinas Summer Conference in August, where BABC was a sponsor as a member of ABC Carolinas' Platinum Executive Club.

An article authored by **Eric Frechtel**, **Steven Pozefsky** and **Aron Beezley** on a proposed bill that would move the VA SDVOSB certification function to the Small Business Administration was published in the October/November 2013 issue of *Federal Construction Magazine*.

Axel Bolvig, **Stanley Bynum**, **Keith Covington**, and **Arlan Lewis** were recently recognized by *Birmingham's Legal Leaders* as "Top Rated Lawyers." This list, a partnership between Martindale-Hubbell® and ALM, recognizes attorneys based on their AV-Preeminent® Ratings.

David Taylor recently spoke in Phoenix, Arizona to the National Meeting of the Construction Specifications Institute (CSI) on "Allowances and Owner Contingencies".

Monica Wilson attended The Solar Power: "3-Day MBA" program hosted by Green Power Academy, focusing on key issues and trends affecting the solar business worldwide.

David Taylor and **Bryan Thomas** spoke at the National Meeting of the Construction Specification's Insitute held in Nashville on "The Nuclear Option: Terminating a Contractor for Cause".

Luke Martin spoke to construction project managers for a client's project management group on documentation on the construction project in December.

Ryan Beaver and **Monica Wilson** recently co-authored an article in the Charlotte Business Journal entitled "Meeting Our Road Needs," addressing the challenges and opportunities for the construction industry to meet North Carolina's growing infrastructure needs.

Charlie Baxley participated in the ABC of Alabama's 2013 Future Leaders in Construction class, a four day leadership training seminar attended by representatives of various construction industry companies.

David Taylor spoke to the Tennessee Municipal Lawyer's Association in Memphis on June 24 on "Avoiding Construction Disputes".

Luke Martin spoke at a construction seminar on July 18 in Birmingham on "Understanding Bonding and Insurance Issues in Construction."

Chambers annually ranks lawyers in bands from 1-6, with 1 being best, in specific areas of law, based on in-depth client interviews. **Bill Purdy** and **Mabry Rogers** are in Band One in *Litigation: Construction*. **Doug Patin** was ranked in Band Two and **Bob Symon** in Band Three, both in the area of *Construction*.

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Mabry Rogers, **Wally Sears**, **Bob Symon**, **Bryan Thomas**, and **Monica Wilson** taught the client seminar Contracts 401: Advanced Discussion of EPC Contracts in an Industrial, Power Plant, or Commercial Design and Construction Context on November 8 in Washington, D.C.

We would like to welcome two new associates to our practice group, **Carly Miller** and **Lisa Markman**. Carly, who graduated in May from Tulane Law School, is working in our Birmingham, AL office. Lisa, who graduated in May from Washington & Lee Law School, is working in our Washington, D.C. office. We are delighted to have both joining our practice group.

For more information on any of these activities or speaking engagements, please contact Terri Lawson at 205-521-8210.

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The lawyers at Bradley Arant Boult Cummings LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

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