THE LATEST INDUSTRY INSIGHTS FROM OUR CONSTRUCTION ATTORNEYS MARCH 2009

CONSTRUCTION CASE ALERTS

March 10, 2009: The Utah Supreme Court required a general contractor to pay a subcontractor in excess of $1 million in termination for convenience damages under the terms of the subcontract. Even though the subcontract incorporated the terms of the prime contract, which had priority in the event of a conflict, the court determined that the prime contract only applied to a termination of the contractor by the UDCOT. The case serves as a warning to contractors that broad incorporation by reference provisions with order of precedence clauses do not avoid the need for thoughtful subcontract drafting.

Encon Utah, LLC v. Fluor Amec Kremer, LLC (Utah Jan. 27, 2009).

Arizona: Supreme Court Upholds Limitation of Liability Clause

The Arizona Supreme Court upheld a limitation of liability clause in a design contract because it found that the clause had been bargained for and did not violate the anti-indemnity statute. The Arizona court expressly declined to follow the reasoning of other state courts which have invalidated limitation of liability clauses on the grounds that they violate the state’s anti-indemnity clause. The decision indicates that limitation of liability clauses are likely to survive judicial scrutiny in many jurisdictions and any analysis is likely to involve the terms of the anti-indemnity statute.


Utah: ADR Provision not a Condition Precedent to Right to Litigate

The Court determined that a mandatory mediation provision was merely a promissory provision and not a condition precedent to a party’s ability to litigate a dispute. The decision indicates that a party to a contract with a mediation provision can likely proceed directly to litigation without waiving its right.


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Keeping Your Green Project Out of the Red

By: David W. Zimmerman

With the buzz of “going green” as the latest trend, public and private owners alike are seeking environmentally-friendly construction projects. The trend comes with an increased risk of liability for designers and contractors on green projects. The leading edge of insurance claims against designers, contractors, and now lawsuits arising from Green building results, are starting to create waves in the industry.

The rise of claims is a warning that designers and contractors need to adjust their practices to keep their green projects from dragging their bottom line into the red. Best practices include:

1) Adjust expectations by engaging in clear project-level communication;
2) Understand the products to be used on the project; and
3) Avoid conduct that warrants or guarantees a final result.

Adjusting Expectations

Clear communication and contract language can ensure that all parties understand the risks of a green project and which party bears the risks. The following are actual claims that demonstrate problems which arose from misjudged expectations:

• An owner of a facility to be used for sensitive government contract work sued the designer because extensive daylight systems created security risks.
• An owner repeatedly altered its sustainability objectives on a project and then disputed the designer’s significantly increased BIM costs as arising from the designer’s inexperience with sustainable building.
• When owner requested aesthetic changes during construction reduced the project’s LEED rating, the owner claimed that the architect should have allowed for adjustments when calculating target LEED points.

It is important for an owner to understand that LEED certification is determined by a third-party organization (the USGBC). Therefore, LEED certification targets on projects need to be treated as target goals, not performance specifications or performance guarantees.

Each party should request clear contract language to limit its responsibility to its own respective LEED credits.

LEED 2009 Takes Effect in March 2009

Mandatory Ethics Reporting Rule for Government Contractors

Pay-if-Paid Clauses: Still Alive in Nevada

E-VERIFY: Federal Rule Suspended until at least May 21, 2009

Keeping Your Green

Project Out of the Red

Understanding Green Systems and Materials

- Eco-friendly materials that have leaked, molded, or simply not performed adequately create risk on green projects. Further, some green techniques have not been tested for unexpected consequences. For example, a university sued the designer of a fresh air system in a library after pigeons used the solar shading as shelter and introduced diseases into the air.

- LEED-friendly materials may be in short supply and not readily available for all construction projects. Reported claims have centered around the availability of specified green materials that caused project delays. When sufficient time is not available to research an innovative material or system design, the contractor and designer should be cognizant of the resulting risks. Where possible, the contracts should be modified to account for such risks.

- Avoid Guarantees or Warranties

- Designers and contractors can unwittingly expose themselves to claims by guaranteeing the project would achieve a certain level of certification, efficiency, or tax credits. Aggressive marketing materials or representations about a party’s experience with the LEED certification process or on LEED projects can give the owner basis to assert a claim for breach of guarantee, misrepresentation, fraud, or violation of consumer protection laws if the desired result is not achieved.

- For example, an owner recently sued a contractor for in excess of $600,000 in lost tax credits after a project failed to achieve its LEED goal. An owner could make a strong argument that lost tax credits are direct damages arising from an alleged breach by a contractor.

- Parties should avoid language in contracts, proposals, and marketing materials that guarantees performance. Examples include statements that indicate the completed structure will be “30 percent more energy efficient than similar structures” or “increase employee productivity by 15 percent.” Contract documents should not incorporate proposals that represent a certain certification or efficiency level will be achieved.

- Waivers or caps on potential damages become important because an owner can seek to recover costs such as lost energy efficiency, diminution in rental value, or lost tax credits if the project fails to achieve a target goal.

- Parties need to carefully craft contract language to mitigate risks. Standard form contracts simply do not address risks unique to LEED, sustainable, and performance-based contracts.

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David Zimmerman has more than 20 years of experience in the area of construction law, and focuses on representing general contractors in delay, disruption, and impacts claims. Contact David at (801) 799-5848 or dzimmerman@hollandhart.com.

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Mandatory Ethics Reporting Rule Released

By: Charlie Lucy

On December 11, 2008, the FAR Council issued its long-awaited Final Rule aimed at curtailing contractor misconduct under federal procurement contracts. The Final Rule became effective on March 21, 2009. It is a significant development in connection with the performance of the contract, or a subcontract thereunder, that the contractor has an interest, bribe, or gratuity violations found in Title 18 of the United States Code, as well as violations of the False Claims Act. With the exception of small businesses or contracts for commercial items only, Section 52.203-13(b)(3) creates an affirmative duty for many contractors to disclose certain types of conduct to the Government. Minimum business conduct requirements that many Contractors have to maintain in connection with the business with the Federal Government are also provided.

The Final Rule sets out standards that are applicable primarily to contracts expected to exceed $5 million and take longer than 120 days to perform. However, it is crucial to recognize that it also creates a new ground for suspension or debarment of any contractor, regardless of:

- the expected cost or duration of the contract;
- the contractor is big or small;
- the contractor for commercial items; or
- the contract is to be performed overseas.

Any contractor may be suspended or debarred if that contractor’s principal, as broadly defined by the Rule, knowingly or negligently failed to timely disclose misconduct, or an equivalent failure to disclose significant overpayments on the contract or a violation of the contract.

1) Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code; or
2) The Civil False Claims Act (31 U.S.C. §§ 3729—3733). FAR § 52.204-6(a) and 52.204-7 (amended by Final Rule).

The Final Rule also sets out a number of requirements contained in a heavily revised version of FAR § 52.203-13(b)(2). Contractors and subcontractors must agree to:

The court refused to enforce the prospective lien waiver and noted that, as drafted, the “lien waiver provisions” are unenforceable. Although the court’s decision did not address the contractor’s E-Verify clause, it is also possible that the May 21 date may be extended.

What is E-VERIFY?

E-Verify is an electronic system that employers can use to verify the employment eligibility of current employees. The E-Verify system was created by a partnership between the Department of Homeland Security and the U.S. Citizenship and Immigration Services (USCIS) to verify the employment eligibility of current employees.

Under the E-Verify system, employers can obtain a free, electronic subscription that allows them to verify the employment eligibility of current employees. The subscription is available at www.e-verify.gov.

E-VERIFY: Federal Rule Suspended until at least May 21, 2009

By: John Scorsine

The U.S. Department of Justice (DOJ) issued a Federal Rule on April 17, 2009 that made E-Verify mandatory for all contractors. The rule was effective as of May 21, 2009, and was recently extended again to May 21, 2009. As a result of the DOJ’s agreement, contractors may require contractors to include the E-Verify clause. It is also possible that the May 21 date may be extended.

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PAY-IF-PAID CLAUSES: STILL ALIVE IN NEVADA

By: Greg S. Gilbert
Las Vegas Office

In a time of economic turmoil, the issue of which party bears the risk of owner insolvency or non-payment is a hot issue. In Nevada, pay-if-paid clauses: still alive in Nevada. Contractors can still pass this risk downstream. With an initial decision in June and a revised opinion in October, the Nevada Supreme Court indicated that pay-if-paid clauses are enforceable in Nevada in the Lehrer McGoey Bovis, Inc. v. Bullock Insulation, Inc. case. The court arose from a subcontractor’s claim for payment on the Vanedan project in Las Vegas. A subcontractor filed a lien claim and then sued to recover amounts owed. The owner and general contractor asserted that a prospective lien waiver and a pay-if-paid provision in the subcontract agreement barred the subcontractor’s claim.

The subcontract agreement incorporated a provision from the prime contract through which the subcontractor effectively contracted “not to suffer or permit any lien or other encumbrance to be filed” against the project. The subcontract agreement also contained a pay-if-paid clause where the subcontractor agreed that it had no right to payment against the general contractor unless the owner paid the general contractor for work performed by the subcontractor.

The court refused to enforce the prospective lien waiver and noted that, as drafted, the “lien waiver provision applies regardless of whether [subcontractor] received any payment,” and therefore waives the subcontractor’s lien claim against the owner and general contractor for work performed by the subcontractor for which the owner has not paid. The court deems pay-if-paid provisions to be enforceable only in limited circumstances and is subject to the restrictions laid out in NRS Chapter 185 P.3d 1055 (June 12, 2008). The greater issue is that the decision’s limiting language may confuse district courts about the enforceability of pay-if-paid provisions. This court reasoning can be applied to pay-if-paid clauses to avoid a challenge or determination that the clause violates the provisions of NRS 624. The court further determined that the enforceability of a lien waiver provision is a case-by-case determination and the court did not offer guidance as to what types of lien waiver provisions would be enforceable without full payment. The articulated public policy against prospective lien waivers, coupled with NRS 108.2453(1), suggests that without payment in full, mechanic’s lien rights cannot be waived.

What is E-VERIFY?

E-Verify is an electronic system that employers can use to verify employment eligibility of potential workers. The E-Verify system was created by a partnership between the Department of Homeland Security and the Social Security Administration (SSA). U.S. Citizenship and Immigration Services (USCIS) oversees the program.

E-Verify functions by allowing participating employers to electronically compare employee identification data and Social Security numbers against Form I-9 (the paper-based employee identification verification form) maintained by SSA and IRS (an online service). Contact Greg at (702) 669-4620 or gsgilbert@hollandhart.com.

E-VERIFY: Federal Rule Suspended until at least May 21, 2009

By: John Scorsine
Colorado Springs Office

The U.S. Department of Justice (DOJ) recently released a Notice of Proposed Rule Making (NPRM) which would require federal contractors to use the Employment Eligibility Verification (E-Verify) system to verify the immigration status of all new and existing employees. The suspension of the rule arises from a legal challenge by a number of industry groups and several employer associations. The Notice of Proposed Rule Making had been scheduled to go into effect January 15, 2009. The effective date has twice been delayed, most recently extended again to May 21, 2009.

As a result of the DOJ’s agreement, federal contracts awarded prior to May 21, 2009 will not require contractors to use the E-Verify clause. It is also possible that a second clause may be extended.

Mandatory Ethics Reporting Rule Released

By: Charlie Lucy
Los Angeles Office

On November 12, 2008, the FAR Council issued its long-awaited Final Rule aimed at curtailing con-tractual misconduct by federal government contractors. The Final Rule became effective on December 2, 2008. It is a project by Project "Close the Contractor Fraud Loophole" (Pub. L. 110-252, Title VI, Chapter 1) and adds multiple, significant agency requirements. The Rule includes the addition of regional credits; extra points within a project’s rating system with the rollout of LEED Version 3; and provisions in their contracts.

The U.S. Department of Justice (DOJ) Office of the Inspector General (OIG) has the authority to receive complaints from the public regarding possible violations of federal criminal law involving fraud, conflict of interest, bribery, or gratuities found in Title 18 of the United States Code, as well as violations of the False Claims Act. The Office of the Inspector General (OIG) has the authority to receive complaints from the public regarding possible violations of federal criminal law involving fraud, conflict of interest, bribery, or gratuities found in Title 18 of the United States Code, as well as violations of the False Claims Act.

With the exception of small businesses or contracts for commercial items only, Section 52.203-13(c) states that all covered contractors must have a written code of business ethics and conduct and a mechanism to disclose to the Government any known misconduct or non-compliance with the Federal procurement process. Among other things, the Final Rule requires the contractor to include the contractor’s new ground to have been scheduled to go into effect January 15, 2009. The effective date has been extended again to May 21, 2009.

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