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

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. The issue of interest for this Construction Newsletter is the way the Court defined "completion" of the work.

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 more than 90 days prior to giving its written notice, the subcontractor had submitted two notarized pay applications asserting the work was 100% complete 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:

First, if in doubt as to when the work is "complete," file the necessary notice at the earliest time. Second, 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." Third, 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. Fourth, 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

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 any 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

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,

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

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

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.

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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 **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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Sabra M. Barnett	Donna M. Crowe (d.c.)	Jonathan B. Head	Luke Martin	J. David Pugh
David H. Bashford (c)	Rob Dodson (j)	David R. Hume, Jr.	Michael D. McKibben	Katherine L. Ruff (d.c.)
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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

Inside:

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 or in equity 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

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

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

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,

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.

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.

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 ROSE & WHITE LLP **Third 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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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

Inside:

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

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

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.

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

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

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.

Inside:

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.

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.

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.

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

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.

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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