Project Owners Must Accept Risk That Comes With Control in Design-Build Model

The term design-build is well known, given its widespread use over the past 25-plus years. Simply put, it is a process in which an entity (i.e., the design-builder) contracts to develop a design that meets its client's stated needs, creates design documents based on that design, and constructs the project in accordance with those design documents. In contrast to design-build is design-bid-build. In this case, an owner separately hires a designer to complete design services and then uses that design to hire a different entity to perform construction.

One of the reasons a project owner uses design-build is to mitigate (and possibly eliminate) the risk that it will be responsible to the construction contractor for design defects, which is a direct result of the design-builder agreeing to design and construct the project. However, an owner using design-build generally has less control over the design process than under design-bid-build.

Every now and then an owner will try to have it both ways by using a creative contracting approach to design-build. A good example of this is a recent Connecticut case, *Centerplan Construction Co. LLC v. City of Hartford*, in which the primary question was who, among the owner, developer, and design-builder, "controlled" the architect and was therefore responsible for the architect's mistakes.

Just because something is called "design-build" does not mean it is.

The Case

In August 2014, the city of Hartford entered into a contract with an architect for the design of the Dunkin' Donuts Park, which would become the home of the city's minor league baseball team. The architect began designing the stadium under this contract. In February 2015, the city contracted with DoNo Hartford LLC to serve as the project developer, who agreed to administer and complete the architect's in-progress plans. DoNo also entered into a contract in February 2015 with Centerplan Construction Co. LLC. Centerplan was to serve as the project's design-builder and assume responsibility for administering and completing the architect's in-progress plans.

The development and design-build contracts stated that the city would be assigning the architect contract to DoNo. By the time the city made the assignment in May 2015, the design had been completed, and the only unperformed services left under the architect's agreement were for construction administration.

As the project proceeded, Centerplan and DoNo claimed that they were never given control over the architect or its design of the stadium and that the scope of the project had increased because of changes the city and baseball team made to the design. To resolve these issues, the city and DoNo executed a term sheet in January 2016, which, among other things, increased the contract price by $7.5 million and extended the substantial completion deadline to May 17, 2016.

Unfortunately, substantial completion did not occur on May 17, and a few weeks later the city terminated its agreement with DoNo and Centerplan's design-build agreement. This prompted DoNo and Centerplan to file a lawsuit against the city.

While there were a variety of issues considered by the trial court, the most significant was the question of what, if any, responsibility DoNo and Centerplan had for the architect's alleged errors. The trial court judge looked at all the agreements and concluded that the city had absolved itself from such liability and gave the following instructions to the jury:

> The parties also agreed that Centerplan and DoNo would be responsible for the architects and any mistakes they may have made; so, if the architects did something wrong, you have to start with the assumption that Centerplan and DoNo are to blame for it.

Consequently, the only issue left for the jury to decide was who was at fault for the stadium not being finished by its deadline. The jury found for the city, rejected the claims of Centerplan and DoNo, and awarded the city liquidated damages for late completion. Centerplan and DoNo appealed to the Supreme Court of Connecticut.

The Appeal

The Supreme Court considered a range of issues associated with the termination. However, the focus of its lengthy decision was devoted to determining who among the three parties had control of the architect and responsibility for the architect's design defects. Its analysis evaluated

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three time periods, and it ultimately reversed the trial court's decision and sent the case back for a new trial.

The first period was from February 2015 to May 2015, prior to the assignment (architect contract) having been put into effect. The city argued that the parties' agreements allocated to DoNo and Centerplan responsibility for and control of the architect and the stadium's design and that there was nothing in the agreements that conditioned this on the formal assignment of the architect's contract. As a result, the city contended that DoNo and Centerplan bore legal responsibility for the architect's acts and omissions.

The Supreme Court disagreed. It found that the plain language of the agreements manifested an intent that Centerplan and DoNo would control the architect and the stadium's design. However, the agreements were silent on whether this was to occur automatically or after the parties entered into the assignment.

The court concluded that the "later assignment of the architect agreement would have been superfluous if Centerplan and DoNo already had legal control of the architect from the outset," and it "would therefore be incongruous to read the parties' earlier contracts as automatically granting Centerplan and DoNo legal rights over the architect and design."

As a result, the court found that until the assignment was in place, the city maintained legal control of and responsibility for the architect, including any errors or omissions that occurred before the date of the assignment.

The next period was May 2015 to January 2016 — the period between the assignment and the term sheet. Centerplan and DoNo argued that the assignment was only a partial assignment, as the design was complete and only construction administration services were left for Centerplan and DoNo to direct. The city argued it was a full assignment and that the city's only obligation was to pay the architect for services already rendered. This did not include responsibility for any preexisting architect or design errors.

The court rejected both parties' positions. It found the city retained all obligations regarding the architect arising out of the architect's services before the assignment, including responsibility for any of the architect's errors and omissions. It also found that Centerplan and DoNo assumed legal control of the architect and the stadium's design upon assignment of the agreement.

The last period was January 2016 to June 2016 — the period between the term sheet and termination. The court found that the term sheet was subject to different interpretations as to which party had legal responsibility for the architect and design. There was language that supported the view that Centerplan and DoNo had control of and responsibility for the design, as this was one of the main issues in contention that gave rise to the parties negotiating the term sheet.

The court found nothing in the term sheet that indicated these parties directly ceded control back to the city. However, the court also noted that the term sheet stated the city must consent to any design changes, which was broader than in the original contracts. The court believed it was reasonable to conclude that after the term sheet came into existence, the city gained additional control over the architect and design. Because the court found both parties' interpretations to be reasonable, the issue of architect control after the term sheet was ambiguous and needed to be determined by the trier of fact.

The Analysis

It is good to remember that with control comes responsibility. Under a normal design-build project, the design-builder's construction and design teams work together to meet the owner's needs, and the design-builder has control over the design process. This also means that if there are design mistakes, the design-builder has the consequent responsibility.

This decision is an example of how confusing things can become when an owner structures a design-build process to game the system. By all accounts, neither DoNo nor Centerplan had anything to do with the stadium's design for the six-month period prior to February 2016. This period was critical to project success, as the design was well into development and likely having construction documentation produced.

The city took away the ability to have the developer and design-builder administer (i.e., control) that process. There was also evidence presented that even when DoNo and Centerplan were under contract, the city and the baseball team secretly met with the architect and ordered changes to the design.

What happened here is a lesson for everyone. Just because something is called "design-build" does not mean it is. If an owner wants to control the design, fine. But the owner must also remember that it will also likely be responsible for any design problems, regardless of what a contract might say. **CE**

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The Challenges of Proving a Labor Inefficiency Claim

When projects are delayed or disrupted, it is quite common for contractors to submit claims for loss of labor productivity. These claims are based on the contractor incurring more labor hours than anticipated and believing that someone should pay for the attendant costs. To recover, contractors have to prove that their labor productivity was negatively impacted and that they should receive some financial recovery. Where they typically struggle is in proving what that recovery should be.

There is an abundance of literature that explains how to prove a loss of productivity claim. The most effective way is using what is commonly called a measured mile approach, which compares productivity on work that was not disrupted by problems with work that was disrupted. Industry research studies, such as those published by the Mechanical Contractors Association of America, approximate productivity expected from certain events — like the prolonged effect of overtime or working in congested areas.

A third approach is commonly called the total cost approach. With this method the contractor claims the difference between its actual and bid labor costs and argues that its counterparty caused the problems that created the overrun.

While each approach to proving loss of productivity costs is susceptible to challenge, the total cost approach creates the hardest path to successful recovery. This was shown in a recent case in Missouri, *Rand Construction Co. v. Caravan Ingredients Inc.,* in which the contractor, despite being disrupted, received nothing.

The Case

Rand entered into a contract with the owner of a food product manufacturing facility to provide mechanical construction services. The parties had worked together previously, and Rand was selected after the owner conducted a competitive selection process. Bid at $2.9 million, the contract stipulated an anticipated 15-person crew that would work 40 hours per week through the project's completion, set for February 2016. The contract was for a fixed price, but it included a time and materials provision that called for scope changes to be based on billing rates included in the contract.

Rand began work on the project in July 2015. During the course of the project, Rand received 187 change orders that disrupted its workflow; 136 of these orders came in the last three months of the project. Rand finished the project in mid-May 2016 and filed a mechanic's lien claim in September 2016 for $875,000 in unpaid labor, equipment, services, and materials.

> **Proving damages is something that needs to be accomplished before the trier of fact – be it an arbitrator, trial judge, or jury.**

Rand eventually filed a lawsuit to enforce the mechanic's lien in state court.

Rand claimed that "it was not paid pursuant to the 'time and materials' clause of the contract for its 'actual time and materials' costs incurred due to the project's change orders," according to the court documents. Its claim was predominantly based on loss of labor productivity. Rand argued that it exceeded its bid amount of labor hours by 7,566 and was owed an additional $716,000 in labor. The trial court disagreed, finding, among other things, that Rand failed to prove it was entitled to any damages for additional labor hours because it used a total cost approach to its recovery.

The Appeal

The Missouri Court of Appeals agreed with the trial court that Rand was not entitled to loss of labor productivity damages. The appellate court first cited the legal standard for determining damages in Kansas, which was the governing law for the dispute. Looking at prior case law, the appellate court stated, "'The basic principle of contract damages is to make a party whole by putting it in as good a position as the party would have been had the contract been performed.'"

Parties are not entitled to damages that are "'not the proximate result of the breach of contract and those which are remote, contingent, and speculative in character.'" Moreover, the claiming party must "'… show with *reasonable certainty* the amount of damage suffered as a result of the injury or breach.'"

Rand first argued that it was not using a total cost approach but was basing its claim for additional labor on the time and materials

clause of the contract, which had a billing rate of $94.69 per hour to be used for changes. The appellate court rejected this argument, as the number of hours used for this calculation (7,566 hours) was based on the difference between Rand's originally estimated hours and actual hours. This was the same calculation one would do for a total cost approach.

The appellate court found that Rand had not provided any case law demonstrating that Kansas law recognized the use of the total cost approach in pricing claims. Regardless, the court concluded that it did not matter what Rand called it, as "Rand's calculations suffer from the same defect courts note about the total cost method, and …are too speculative to meet the reasonable certainty requirement."

The court said Rand presented no evidence to demonstrate that its bid was reasonable or that the owner was the sole reason for the labor overrun. But according to court documents, "these two presumptions are the very factors that courts have pointed out make the total cost method problematic as a measurement of damages."

The appellate court found other flaws in Rand's calculations. For example, Rand failed to provide evidence that clearly separated hours spent on base contract work from those spent on change order work. It also failed to submit evidence reflecting when its base contract work stopped and when additional change order work started.

Rand's claim also requested compensation for rejected change order work, but Rand did not prove that such change orders were properly the responsibility of the owner.

Finally, the appellate court noted that Rand's lost productivity expert was found by the trial court "'to be lacking, without substance, of no assistance to the court, and void.'"

The appellate court did not question the trial court's witness credibility determinations.

Aside from its labor productivity claim, Rand also argued at trial that it "suffered 'cost impacts due to schedule (delays),' which included additional supervisor hours, overtime, site safety representatives, site overhead, and rental equipment costs."

There are times when projects are so disrupted that the only real way to price loss of labor productivity is with a total cost approach.

The trial court found these damages as also being too speculative to meet Kansas' reasonable certainty standard. The appellate court agreed, stating that these claims lacked documentation "linking these additional costs to any change orders."

The Analysis

There is one final quote from the decision that is critical for readers to remember:

> Ultimately, whether Rand had presented sufficient credible evidence to prove damages attributable to its performance of approved change order work presents a factual question for the fact-finder to decide. … We will generally not second guess a fact-finder's rejection of evidence offered by the party with the burden of proof.

What does this mean in practical terms? Proving damages is something that needs to be accomplished before the trier of fact — be it an arbitrator, trial judge, or jury. If one does not succeed with the trier of fact, there is little hope of having an appellate court overturn that opinion. Stating it differently, if Rand had convinced the trial judge of its position, there is a reasonable chance the appellate court would have upheld that decision.

There are many other parts of this case that we could have discussed but for space limitations did not. This includes the issue of whether Rand properly gave notice of its loss of productivity claim. While it was not the reason Rand lost, both courts noted that Rand knew early in the project that it was experiencing loss of productivity, but it did not give notice until late in the project.

This is another reminder for our readers: Make sure you follow those contractual processes, as they can create a major roadblock to recovery for changes.

We have one final thought: There are times when projects are so disrupted that the only real way to price loss of labor productivity is with a total cost approach. Do not assume that this will be a losing argument.

It is true that total cost claims are disfavored and viewed with suspicion, for all the reasons cited by the appellate court. But they can be successful if the trier of fact finds that the contractor's bid and actual costs are reasonable and that the contractor has accounted for any of its own problems. **CE**

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When Payment Protections Fall by the Wayside, Subcontractors Bear the Brunt

There are myriad ways in which public and private owners seek to ensure that subcontractors and suppliers get paid for their work. Every state has some type of mechanic's lien statute that, in general, enables an entity providing improvements to a property to place a lien on that property if it is not paid. Many states also have construction trust fund and/or prompt payment statutes.

However, perhaps the most common form of payment protection is through a payment bond, whereby a surety will financially guarantee the general contractor's payment obligations to subcontractors and suppliers. This is especially important on public projects for which government land cannot be liened.

The obligation for general contractors to post payment bonds on federal projects is codified in the Miller Act, and most states have so-called Little Miller Acts that serve the same function. What happens, however, when the government does not enforce the requirement for a bond and subcontractors go unpaid? This issue's case, *Constructora Guzman S.A. v. the United States*, addresses this situation on a federal project in which the subcontractor sued the government, arguing that its actions in waiving the bond requirement created a legal obligation for the government to pay the unpaid subcontractors.

The Case

The disputes arose from an embassy renovation project in Guyana. In September 2013, the U.S. Department of State awarded a firm-fixed price contract to Enviro-Management & Research Inc. for the renovation. The total adjusted contract value was approximately $17 million. EMR engaged Guzman to perform construction-related services for $8.3 million. Guzman completed its work, but EMR failed to pay Guzman approximately $1.5 million. Under the State Department and EMR prime contract, the Miller Act bonding requirement was incorporated:

> The Contractor shall furnish (1) performance and payment bonds ... in the amount of 100% of the contract price for the performance bond and 100% of the contract price for the payment bond, or (2) comparable alternate security approved by the Government as authorized and in accordance with Federal Acquisition Regulation (FAR) Section/Part *690 28.204, Alternatives in Lieu of Corporate or Individual Sureties.

The Miller Act, however, also allows for waiver of the bonding requirement in foreign countries if the contracting officer "finds that it is impracticable for the contractor to furnish the bonds."

In October 2013, EMR sent a letter to the government's contracting officer stating that it was unable to obtain the required Miller Act bonds. EMR proposed an alternative arrangement in which the government would retain additional moneys from each invoice until certain completion milestones were met, at which point the retainage would be released to EMR. The contracting officer agreed and issued a contract modification waiving the bonding requirement.

During the project, the government began receiving complaints that EMR was not fulfilling its payment obligations. The government enclosed a list of subcontractors from which it had received complaints and ordered EMR to demonstrate that they had been paid or resolved. The government also expressed concerns about the truthfulness of EMR's partial releases and certifications submitted in connection with monthly payment requisitions.

Just as the project neared completion, the government made an inquiry to an EMR subcontractor (unnamed in the decision) regarding payment. Specifically, the contracting officer stated: "Before the (government) pays out the remaining contract amount, please confirm your company has received final payment by contractor EMR." The subcontractor responded with its unpaid invoices and stated it had not yet received payment.

The government responded by assigning negative ratings to EMR in its contractor performance assessment report. In disputing this negative rating, EMR responded that there were several reasons that some subcontractors had not been paid, including but not limited to: "invoices not received, invoices that are inaccurate, incorrect banking information on invoices, invoices that do not belong to EMR, and accounts that need to be reconciled for final payments."

EMR submitted a final payment application for $982,134, which was the amount that had been withheld by the government pursuant to the modified retainage agreement and for potential liquidated damages and overtime. The payment application certified that "all payments due to subcontractors and suppliers" were paid. The government paid EMR, but Guzman did not receive payment of the approximately $1.5 million that it alleged it was due.

Guzman ultimately filed suit against the U.S. in the Court of Federal Claims, even though it had no privity of contract with the government. Guzman did so by asserting that either it was a third-party beneficiary of the prime

contract with EMR *or* that it had an implied-in-fact contract with the government. Under both theories, Guzman alleged that the government failed to withhold funds to pay it for its work on the project.

The government moved to dismiss the complaint, arguing that Guzman's claim for breach of an implied-in-fact contract was not viable. The court quickly agreed that Guzman did not allege facts sufficient to establish the existence of an implied contract with the government. However, the court allowed Guzman's third-party beneficiary claim to proceed. After the parties exchanged discovery, the government moved for summary judgment, asking the court to dispose of the third-party beneficiary claim again.

The Ruling

The court began its analysis by noting the general principle that the government only "consents" to be sued by those with whom it has direct privity of contract. However, there are exceptions to that general rule. One such exception exists when the suit brought against the government is by an "intended third-party beneficiary" to a government contract. "In order to prove third-party beneficiary status, a party must demonstrate two things: (1) that the contract not only reflects the express or implied intention to benefit the party but (2) that it reflects an intention to benefit the party directly" — in this case, Guzman, according to court documents.

Guzman argued that it was a third-party beneficiary to the prime contract with EMR because by retaining money from each payment to EMR in lieu of the bonding requirement, the government clearly stated its intention to guarantee payment to EMR's subcontractors. The court found, however, that although Guzman met the first prong (the contract reflected an intention to benefit the subcontractors), Guzman was not able to meet the second. Guzman could not demonstrate that the government intended to confer a *direct* benefit to it. As such, the court disposed of Guzman's claim summarily.

With respect to the second prong, the court stated that to determine whether a subcontractor is a direct beneficiary to a contract, the critical distinction is based on whether a payment is made directly to the third party. For example, no joint payment clause was present in this contract.

Additionally, the court looked to the government's actions during the project upon learning of the nonpayment to subcontractors. In that regard, upon learning of EMR's payment issues, the government sent a letter to EMR requesting that it provide a project accounting. The court found that the government placed the burden on EMR to resolve its own debts.

Ultimately, the court found that the contract modification did not establish a mechanism for the government to pay EMR's subcontractors directly, nor did it change the express terms of the contract that made EMR solely liable for paying its subcontractors.

The Analysis

Subcontractors will certainly find this ruling unjust, as they are the parties least able to control what payment protections exist in the prime contract. Here, the government knew of nonpayment to subcontractors. And while it specifically established a mechanism to protect against that nonpayment, it nevertheless released all the money to EMR without demanding proof that subcontractors did not have unpaid invoices.

The legal result is not surprising. Stated simply: It is very difficult to sue the federal government under a third-party beneficiary theory. However, the facts here make the ruling especially harsh. The court found that the government's oversight of EMR's payments to its subcontractors conveyed "nothing more than its interest, present in all government projects, in ensuring timely and compliant completion of the project." That finding seems to be at odds with the contract modification that required an extra 10% retainage held every month in lieu of the payment bond requirement.

From our view, the government had more than a passing interest in timely completion. It even went so far as to state in writing to one subcontractor that it would not be paying out the final contract amount without assurances that subcontractors had been paid to date. However, for reasons that are unexplained, the government paid out moneys anyway.

What is the takeaway? At the highest level, contractors need to know that working on federal government contracts is fraught with risk. There are compliance issues, reporting requirements, false claims exposure, and layers of agency-specific regulations to consider. However, this case highlights that one of the protections that subcontractors/suppliers believe they have under the Miller Act might be taken away by a government waiver.

Some of you may ask, "I don't work on international projects, so what difference does it make to me?" What happens if, for some reason, the government either: (a) waives a Miller Act requirement on a domestic project, such as a project that you think is a construction project but the government disagrees, or (b) by mistake, there is no Miller Act payment bond posted on a project.

The ruling of this case tells you that you are likely out of luck in chasing the federal government for relief. **CE**

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Contractor Faces Legal Hurdle When Proving Its Delay Claim

There are times when a contractor believes its right to a time extension is so obvious that it does not need to support its claim with a typical scheduling analysis. This can occur when the contractor thinks that the owner is on the same page as to why the project was delayed.

This month's case, *Appeal of Wright Brothers, The Building Company, Eagle LLC*, provides an interesting lesson about this topic, explaining how a contractor that was delayed on a project by more than three years thought it had an understanding with the federal government that it was entitled to a time extension and additional money, only to lose the case entirely.

The mere fact that an owner extends the contract completion date does not automatically mean the contractor also gets additional money.

The Case

The disputes arose on a $3.8 million construction project for the repair and renovation of a building at Minot Air Force Base in North Dakota. The project was to be completed in 365 days, but it ended up being 1,021 days late. The U.S. Air Force issued contract modifications for 986 days and had also paid Wright Brothers for some delay-related costs. However, because the project was completed late for reasons the Air Force attributed to Wright Brothers, the Air Force charged 35 days of liquidated damages. The Air Force also denied Wright Brothers' entitlement to approximately $450,000 in delay-related costs.

Wright Brothers filed a request for equitable adjustment that was denied in large part by the Air Force's contracting officer in its final decision. Wright Brothers appealed that final decision to the Armed Services Board of Contract Appeals. The parties agreed that the appeal would be heard based on the submissions of briefs and declarations from witnesses and without a hearing.

Wright Brothers' appeal was primarily related to the costs it had incurred because of the Air Force delay (due to the contract modifications). Wright Brothers submitted essentially the same claim submission it had provided to the Air Force over the course of the project, and it was largely based on the report of its claims expert. Wright Brothers argued that the "existence of delay to the overall Project and the Government's acceptance of the vast majority of the delay is not disputed."

Wright Brothers attributed government delays to the failure of the Air Force to: (a) allow it site access; (b) timely respond to requests for instruction and requests for information; and (c) approve contract submittals. Wright Brothers argued that "the Government accepted responsibility for 97% of the additional time the job required (which) is ample proof alone that (Wright Brothers) is not responsible for the increased costs associated with that delay," according to the appeal.

Additionally, Wright Brothers asserted that the Air Force "acknowledged and accepted" these delays as its responsibility when it issued contract modifications. The 97% figure was derived from 986 days of modifications versus the 1,021 days of delay, but other than that, Wright Brothers did not explain how the Air Force acknowledged and accepted responsibility for 97% of the delay. The expert for Wright Brothers did not perform a critical path method analysis, stating that it was not required because "in this case, the amount of excusable and/or compensable delay was determined through the Government granting time extensions due to its actions," according to the appeal.

The Air Force stated that it did not accept any responsibility for Wright Brothers' cost overruns and that the contract modifications only "identified government delays for no more than 246 days out of 1,021 days, which (was) less than a quarter of the total days of delay identified by" Wright Brothers. For these interruptions, the Air Force had already paid Wright Brothers. In terms of the changes that did not relate to the delays by the government, the Air Force stated that: "The mere grant of a contract extension does not establish that the government was responsible for the delay."

The Air Force also argued that Wright Brothers was obligated to demonstrate that any alleged claim for a compensable time extension had to be based on a showing that the Air Force was at fault and delayed the critical path. The Air Force cited prior case precedent to support this position; Wright Brothers did not provide a rebuttal.

The Ruling

The ASBCA started its assessment by looking at the applicable case law on delays claims. It cited longstanding precedent holding that a contractor seeking to prove the government's liability for a delay had to establish a "causal link between the government's wrongful acts and the delay in the contractor's performance, and the alleged harm to the contractor for the delay." The ruling in relation to precedent continues: "To establish that causal link, the contractor must show that the government's actions affected activities on the critical path of the contractor's performance of the contract."

Furthermore, the ASBCA stated that "broad generalities and inferences" that the government must have caused some delay and damage because the contract took longer to complete than anticipated were not sufficient.

In applying that precedent to this case, the ASBCA concluded that Wright Brothers had not met its burden of proof. Although Wright Brothers provided a litany of alleged delays and disruptions, its request for additional money was based on the combined effects of the numerous delays due to the Air Force's actions that changed the project from a one-year to a four-year project through no fault of Wright Brothers. In doing so, however, Wright Brothers "provided no context to support a finding that the alleged delays and disruption ran through the project's critical path, and, as such, (Wright Brothers) has failed to meet its burden of proof."

The ASBCA was influenced by the fact that Wright Brothers had already been paid for some delay damages. In the board's view, this was all the more reason Wright Brothers was required to "establish an impact to the project's critical path," as it had to demonstrate that it had not already been paid for costs it was claiming. "As an adjudicative body, it simply is not our role to piece together a contractor's allegations of delay and disruption to determine their impact upon the contractor's performance."

The ASBCA rejected the opinion by Wright Brothers' expert that a CPM analysis was not required because the Air Force had granted time extensions due to its actions. The ASBCA concluded that Wright Brothers not only had to establish that the Air Force's actions affected activities on the critical path but also that "delays of the parties were not otherwise concurrent or intertwined."

Wright Brothers also raised other theories in support of its position, including that the conversion of the project from one year to four was a cardinal change. While the ASBCA recognized that this theory could be used, it stated that this required a "fact-intensive inquiry into the events that led to the excess work and their effect on the parties."

Wright Brothers did not accomplish this and only provided generalities about the project growing in duration. "Again, it is not the responsibility of the Board to provide, in the first instance, (Wright Brothers') factual and legal analysis. … 'We won't do (Wright Brothers') work for it.'"

The Analysis

It is easy to feel sorry for Wright Brothers. There was extraordinary growth in contract duration and there was little, if anything, in the appeal that pointed the finger at Wright Brothers for having contributed to the delays. However, given the substantial precedent in federal contracting that a CPM analysis is needed to prove a delay claim, Wright Brothers certainly took a calculated risk that it could win an ASBCA appeal without having that analysis. Stated differently, it might have seemed logical for Wright Brothers to rely upon the fact that the Air Force had provided time extensions. But it did not appear that Wright Brothers provided any legal precedent that these time extensions were a way to avoid the requirement for a CPM analysis.

The decision gave a clue as to why a CPM analysis is needed. The ASBCA noted that Wright Brothers failed to explain whether there were any concurrent delays. The reason this is important is because if there is a concurrent delay, the contractor is entitled to a time extension but not to any delay damages. Consequently, the mere fact that an owner extends the contract completion date does not automatically mean the contractor also gets additional money. Because this appeal was essentially all about Wright Brothers wanting additional money for the delays, it had to do more than just prove there was a time extension.

Finally, we provided a few quotes where the ASBCA admonished Wright Brothers for not doing its job in supporting its claim. The "we aren't going to do your job for you" statement is an important takeaway from this case. It is not unusual for contractors to provide scant details about change orders during contract performance and later in adversary proceedings. Those who are evaluating these change orders may have the patience to sort out the details, while others may simply conclude that the contractor did not do its job and reject the claim.

If you take a shortcut with your evidence, be prepared for the consequences. **CE**

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Subcontractor Found Liable for Owner's Lost Profits

By Michael C. Loulakis and Lauren P. McLaughlin

One of the biggest risks contracting parties face on private sector construction projects is an owner's claim that it is entitled to recovery of lost profits as the result of project delays. Contractors often manage this risk by insisting that owners agree to clauses that waive lost profits and other consequential damages. Another way to manage this risk is through liquidated damages, which define the contractor's liability for delay and enable the contractor to understand its financial plight if the project is delayed.

But what happens when the prime contract does not limit the contractor's liability for lost profit? As demonstrated in this issue's case, *Redstone International Inc. v. J.F. Allen Co.*, the results can be devastating.

THE CASE

The disputes in this case arose from a West Virginia gas processing facility owned by MarkWest Liberty Midstream & Resources. MarkWest had a "take-or-pay" contract with EQT Corp., whereby MarkWest processed natural gas for EQT. Under the contract, EQT had the option to direct MarkWest to expand its facility to process additional gas. In spring 2014, EQT directed MarkWest to add an additional processing plant, which was required to be complete in 24 months.

The project included the design and construction of a 100 ft high by 1,250 ft wide retaining wall to contain soil excavated in connection with the new processing plant and to level the site to make room for future buildings. MarkWest awarded a design-build contract for the wall to J.F. Allen Co. Allen subcontracted the design of the wall to AMEC Foster Wheeler Environment & Infrastructure and the construction of the wall to Redstone International Inc. AMEC's design called for Redstone to sequentially drill, install, and grout soldier piles and rock anchors (horizontally) into a mountainside and then "install precast concrete lagging panels and walers between the vertical soldier piles up to the elevation of the horizontal rock anchors," according to the opinion.

The wall construction was delayed and impacted by a number of problems. For example, in some locations, when Redstone tested the rock anchors, the vertical soldier piles shifted and the concrete lagging panels installed between the soldier piles cracked. Some of the rock anchors began to shear off the wall's face, while others failed. Relations among the parties soured, and Allen ultimately terminated Redstone for cause after Redstone had completed about 95% of its scope of work. For a variety of reasons, including the wall construction, plant operations started one year behind schedule.

MarkWest ultimately sued Allen, AMEC, and Redstone in a West Virginia state court. MarkWest's lawsuit asserted a number of claims, including a delay claim against Allen for MarkWest's lost profits under its take-or-pay contract with EQT. Allen, AMEC, and Redstone also asserted a variety of claims against each other and MarkWest. The case was transferred to West Virginia's Business Court Division, and, after a 17-day trial, the business court issued a 153-page decision sorting out all the claims, including MarkWest's claim for lost profits.

At trial, MarkWest contended that Allen was responsible for 8.8 months of delays to the project and that this resulted in lost profits of nearly $6.7 million because MarkWest could not deliver gas to EQT. Allen argued that MarkWest concurrently delayed the project. Allen also argued that its team caused a delay of 5.82 months and not 8.8. Of the 5.82 months, Allen argued it was "responsible for one month, Redstone for 3.2 months, and AMEC for 1.6 months," per the opinion. The business court agreed with Allen's calculations and ultimately found that Allen owed MarkWest approximately $2.65 million in delay damages for lost profits, with Redstone being responsible to indemnify Allen for about $1.5 million of that amount. Redstone appealed a number of issues to the West Virginia Supreme Court of Appeals, including the lost profit award against it.

THE RULING

In considering Redstone's arguments, the appeals court stated that it could not reverse the business court's account of the evidence if the evidence "is plausible in light of the record viewed in its entirety ... even though convinced that had we been sitting as the trier of fact, we would have weighed the evidence differently," per the opinion. With this background, the appeals court evaluated each of the errors alleged by Redstone and found against Redstone on each one.

Redstone first argued that it was not foreseeable that any delays in completion of the wall would cause MarkWest to lose profits because Allen's design-build contract was separate from the contracts to construct the processing plant. The appeals court rejected this argument, finding that the business court heard evidence demonstrating that Redstone was aware that MarkWest's wall construction was needed to permit the expansion of its gas processing plant at the project site.

Redstone next argued that MarkWest's delay damages claims were based on unreliable testimony by MarkWest's expert. Redstone claimed that the expert "ignored the impact of delays" by parties other than Redstone and that even MarkWest's actions significantly delayed completion of the project, according to the opinion. This, too, was rejected by the appeals court, which generally found that the business court had considered each of these points.

Redstone's final argument was based on its belief that the business court erroneously interpreted the subcontract to require Redstone to indemnify Allen. Redstone argued that Allen was barred from recovering from Redstone because of the following subcontract provision: "Redstone will not be liable for any additional costs, penalties, or back charges *due to* liquidated, actual, or consequential damages."

In response, Allen argued that the quoted language "does not relieve liability for consequential damages but only as to costs, penalties, or back charges due to such damages." Allen also cited the Damages for Subcontractor Delay provision of the subcontract, which stated, in part, that Allen "may suffer financial loss if the Work is not completed within the times specified. ... (Redstone) shall pay to (Allen) its actual damages, including those damages paid to (MarkWest) or others by (Allen) attributable to (Redstone's) failure to timely perform."

The appeals court agreed with Allen. It found that the language cited by Redstone did not broadly waive consequential damages. Moreover, the language of the Damages for Subcontractor Delay clause addressed directly the case at hand, as Allen was ordered to pay $2.65 million to MarkWest, which was an "actual damage," some of which was "attributable" to Redstone's failure to timely perform the construction. The business court found that Redstone's untimely performance resulted in $1.5 million of the $2.65 million judgment entered against Allen in favor of MarkWest.

THE ANALYSIS

Redstone had a nearly $6.6 million subcontract and was found liable for nearly a quarter of that subcontract value based on lost profits to the project owner. By the evidence presented, the court found that Redstone's deficient performance caused three months of project delay.

The Damages for Subcontractor Delay clause is not an unusual clause, and by its plain reading it exposed Redstone to the results of this litigation. Perhaps Redstone thought that the clause addressing "liquidated, actual, or consequential damages" would protect it. In this case it did not, and both the business and appeals courts' decisions are logical when one looks at this clause. The clause does not read like a typical waiver of consequential damages clause and in combination with the Damages for Subcontractor Delay clause, supports the courts' decisions.

A couple other takeaways from this case are noteworthy. It is not unusual to have experts disagree on excusable delay, concurrent delay, and allocation of delay among parties. This is a reminder that parties need to have experts who take credible positions and do not simply espouse extreme positions to maximize the positions of their clients. While we do not know for certain what happened before the business court, it appears that it significantly discounted (and maybe even fully disregarded) MarkWest's expert's opinion.

A related point to remember is the view taken by some that it is too difficult for an entity to prove lost profits, so that is not really a practical risk that should be considered. While it may be hard to prove these damages, it is not impossible, as evidenced by this case. In fact, there are many other reported decisions in which lost profits for delay have been awarded.

It is far better for parties to agree in advance on the loss associated with a delay and quantify that in a liquidated damage formula. This not only substantially eliminates the challenge of proving delay damages, but it enables the contracting parties to understand their exposures. **CE**

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To Recover Liquidated Damages, Make Sure You Do the Basics

By Michael C. Loulakis and Lauren P. McLaughlin

While most readers are likely familiar with the concept of liquidated damages, here's a quick refresher: LDs are a remedy established in a contract to address what happens if something goes wrong. In construction contracts, LDs are most closely associated with late completion of projects, where the LD amounts are expressed in terms of a dollar value per day of delay. An example is a clause that requires the contractor to pay the owner $1,500 per day for each day the contractor is late in achieving substantial completion.

LDs are not only used for delays but for other types of failures. On some large projects, contracts require the payment of LDs if contractors fail to keep their key personnel on the projects. On some industrial projects, LDs are used to compensate owners for shortfalls in performance guarantees, such as guaranteed electrical capacity for a power project. The bottom line is that if the parties want to establish in a contract an agreed-upon remedy for a potential problem, LDs are the way to do it.

However, even though the contract may establish LDs for a given issue, that does not mean a court will find the clause enforceable. There are some common rules associated with recovering LDs, and the party seeking to recover them has to prove entitlement. The case of *City of Brookhaven v. Multiplex LLC* provides an excellent reminder of these rules and what happens if they are not followed.

THE CASE

The city of Brookhaven, Georgia, contracted with Multiplex LLC for the construction of a new park. The contract had a delay clause that stated:

> (Multiplex) shall have 180 days from the notice to proceed to complete the project. Failure to complete the required construction as specified will result in the assessment of Liquidated Damages at the rate of $1,000.00 per calendar day.

The project fell behind schedule, and the city notified Multiplex it was in breach of the contract's timeline for completion. The city also warned Multiplex it would enforce the delay clause if the project was not completed on time.

After the project was substantially completed, the city filed suit against Multiplex in a Georgia state court, alleging that Multiplex delayed the project by 271 days and that the city was entitled to LDs in the amount of $271,000. Multiplex argued that the delay clause was unenforceable and filed a motion for summary judgment on the city's LD claim. The trial court agreed with Multiplex and granted the motion. The city appealed to the Court of Appeals of Georgia.

THE RULING

The appeals court cited Georgia law that states parties are free to agree in their contracts what the damages for a breach shall be, and "unless the agreement violates some principle of law, the parties are bound thereby." In assessing whether the LD clause violated some principle of law (i.e., was unenforceable), the court re-cited the three-factor test under Georgia law: (1) the injury must be difficult to estimate accurately, (2) the parties must intend to provide damages instead of a penalty, and (3) the amount must be a reasonable estimate of the probable loss.

The appeals court stated that Multiplex had the burden of proving that the LD clause was an unenforceable penalty. However, Multiplex could meet this burden by proving that any of the three factors was lacking. Multiplex did not contest the first factor, but it argued that the second and third factors had not been met. The appeals court agreed with Multiplex and found the LD clause was unenforceable.

As to the second factor, the appeals court examined the contract language to determine the intent of the parties regarding

> *... There should be something in the precontract record that explains how the LD dollar value and formula were developed and why they are reasonable.*

the purpose of the LD clause. The court observed that the clause lacked any language indicating that the $1,000 per day LD amount was not intended to be a penalty. While this in and of itself was not dispositive of the issue, the court stated that the absence of such language enabled it to consider evidence about the effect the provision was intended to have.

After examining the evidence, the court concluded that the LD clause was inserted into the contract for the purpose of deterring Multiplex from breaching the contract and was therefore a penalty. The key evidence was deposition testimony from the city's designated representative. The representative testified that timely construction of the new park was important because the existing park would have to be demolished before construction could start on a new elementary school, and residents in the area would have to go to other parks outside their neighborhood for recreation if the new park was still under construction. The representative agreed that the intent of the delay clause was to "disincentivize delays" because Multiplex was "going to have to pay $1,000 a day out of (its) net profits if (it did not) get the project done on time."

As to the third factor, the court found that the LD clause failed because there was no evidence that the $1,000 per day amount was a reasonable estimate of the probable loss resulting from a delay in the park's construction, according to the court summary. "(T)he touchstone question is whether the parties employed a reasonable method under the circumstances to arrive at a sum that reasonably approximates the probable loss."

The city offered no evidence it had made a reasonable pre-estimate of the probable loss prior to the execution of the Multiplex contract. Instead, it argued that the LD clause should be upheld because the LDs were less than 0.0004% of the $3 million project cost for each day of delay. The city also argued that LD clauses are "'very' common in its construction contracts and that the $1,000 per day number was not project specific, but was instead a 'standard' number."

Because there was no evidence the city had reasonably pre-estimated the $1,000 per day amount, the court found that the LD clause was unenforceable. In fact, the court cited the city's standard number argument as evidence the city had not pre-estimated the damages and that the $1,000 per day amount "plainly has no reasonable relation to any probable actual damage which may follow a delayed completion of the project."

THE ANALYSIS

There are several important takeaways from this case. At the outset, do not consider this to be a case unique to Georgia. Almost every state has legal precedent similar to the three-factor test expressed in the *Brookhaven* case. This means, among other things, that there should be something in the precontract record that explains how the LD dollar value and formula were developed and why they are reasonable. Our experience is that many owners do not go through this exercise and instead use standard figures like the city of Brookhaven did. Do so at your peril.

Another interesting takeaway was the question of the party's intent — i.e., was the clause truly a measure of damages, or was it there to motivate the contractor to finish on time? Many well-drafted LD clauses will expressly say that the LDs are not considered penalties. However, what happens if the court, arbitrator, or jury sees evidence that the clause was really intended as a "stick" to prod the contractor to finish on time? Query whether that clause will be considered a penalty, even though it says it is not. **CE**

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