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THE KEYS TO SUCCESSFUL CLAIMS MANAGEMENT: EARLY IDENTIFICATION AND TIMELY NOTICE

Introduction

There are two main reasons why construction subcontractors fail to obtain compensation for valid claims: the failure of project managers to recognize potential claim situations as they develop, and the failure to give proper notice of the existence of claims. These are both management problems, which can be solved by education concerning claims identification, and the establishment of company policies with respect to giving timely notices.

The Contractual Basis for Claims

It is a fundamental principle of construction law that an unforeseen loss or unforeseen delays resulting from difficulties in performing a contractor's work do not in and of themselves entitle the contractor to extra money or a time extension. Merely proving that you incurred a loss on a job does not entitle you to file a claim. There are three alternative bases for a claim:

* Claims can be based on entitlement-granting contract clauses. Where a clause in the Contract Documents provides that in the event a specific event occurs, then a claim can be based on such a clause.

* Claims can be based on breaches by your contracting party of express contractual obligations.

* Claims can be based on breaches of duties implied in a contract by operation of law.

The first step in successful claims management is a full and complete understanding of these three alternative bases for claims, and the recognition of claims based on each of the three categories.

Claims Based on Entitlement Clauses

Entitlement clauses providing a basis for claims are often not found in a subcontract agreement itself, but rather are often incorporated by reference from the Owner-General Contractor contract. This is particularly so on federal and state contracts, where the rights to obtain equitable adjustments to the contract price are spelled out in great detail.

The theory underlying the concept of "equitable adjustment" to a contract is that by assuring contractors they will be compensated if unexpected events occur, they will not find it necessary to include "contingency" money in their bids.

Remedy-granting clauses are much more common in government procurement than in private contracting. Examples of clauses in federal procurement which authorize both payment of additional money and the granting of time extensions include the Changes clause, the Differing Site Conditions clause, the Suspension of Work clause, and the Owner-Furnished Property clause.

Other clauses, including those related to unusually severe weather and unforeseeable events, authorize time extensions but no increase in contract price.

Claims Based on Breach of Express Contract Clauses

General contractors customarily use pre-printed subcontract forms which contain clauses which are carefully drafted to protect them from loss, and which rarely provide for specific remedies for the subcontactors.

Usually the only claims which arise in construction projects based on express contractual remedies are payment disputes. Even those are often met with defenses based on contractual clauses which give your customer the right to hold your money or delay paying you until various events have occurred.

Claims Based on Breaches of Implied Duties

While most time-related downstream claims are based on alleged breaches of contract -- for example, failure to meet contractual completion dates or contractual delivery dates, upstream claims tend to be based on breaches of duties implied by law rather than breaches of express contractual promises.

Thus it is important when considering whether to file a claim in a particular situation to keep the following point in mind:

> **The fact that your contract does not specifically state that your customer is liable to you for hindering or interfering with your performance should not discourage you from filing a claim under the appropriate circumstances. Most subcontractor claims are based on breach of implied duties, not breach of express contractual provisions.**

In construction law, claims on the basis of implied duties tend to be raised in the context of the failure of owners or upper-tier contractors to provide adequate working conditions for the parties with whom they are in contract. Such claims are generally framed in two categories: breach of the duty to cooperate, and breach of the duty not to hinder or interfere with performance. In the context of the general contractor-subcontractor (or construction manager-trade contractor) relationship, the courts recognize implied duties on the part of the upper-tier contractor, including:

* The duty to schedule and coordinate the sequence of the work of the subcontractors in a reasonable manner.

* The duty not to disrupt, hinder, delay or interfere with the performance of its subcontractors.

* The implied warranty of the adequacy of the plans and specifications.

The courts recognize that the ability of each subcontractor to perform its work is closely interrelated to the progress of the work of the other trades, and that only the general contractor or construction manager has the power to direct performance in a harmonious manner. This is not to say, however, that the general contractor provides a guarantee that each trade will be able to be completely free from interference from any other trade. A reasonable amount of give and take is normal. The fundamental question when disputes arise is at what point does interference become unreasonable? As one perceptive judge put it:

> It is well established that there are certain implicit duties between contracting parties, particularly the duty not to prevent performance by the other party. ... In the case of construction contracts, courts have construed those mutual duties in light of the prevailing practices of the trade and out of deference to the inherent uncertainties of the timing and conditions of the actual performance. However, there is a point at which a contracting party exceeds the necessary latitude of discretionary action, even in construction contracts.

A wide variety of claims have been successfully made on the basis of breach of implied duties, including:

Breach of Duty to Provide Site Access. Particularly where a trade contractor is obligated to conduct its work in a manner so as to ensure completion before a specific time, there is an implied duty on the part of its upstream contractor to do everything reasonably necessary in order for it to be able to perform within such time. This duty includes providing both *timely* and *adequate* site access. Failure to have the site ready for the contractor's work in time to complete the work on schedule without excess costs, failure to provide an adequate access road for a contractor's equipment, and failure to provide a lay-down area for assembly of materials have all been found to constitute a breach of that duty.

Breach of Duty to Schedule and Coordinate. Claims frequently arise based on breach of the implied duty to schedule and coordinate the work where the general contractor permits work of one trade to be performed out of sequence, thereby providing physical obstructions to another contractor's work. Similar successful cases have been based on the failure of general contractors to assure that work which is required to be in place before a follow-on contractor can commence its operation is completed on a timely basis. Other successful claims framed in terms of breach of implied duties have involved evidence of the incompetence of a general contractor's job superintendent combined with frequent changes of supervisory personnel leading to delays in job progress; insufficient supervisory personnel; unreasonable mingling and stacking of trades in a confined area; failure to engage in adequate advance planning; the failure to promptly rectify errors and omissions in drawings; and the failure to monitor the timely preparation, review and approval of shop drawings.

Breach of Duty Not to Hinder or Interfere. Where it is necessary for a contractor to approve the use of proposed materials, or to approve the method or manner of a subcontractor's performance, unreasonable delay in granting such approval can provide a basis for a claim against the general contractor for breach of the implied duty not to hinder or interfere with the subcontractor's performance. The withholding of relevant information; the failure to make progress payments on the timely basis; and the failure to provide materials required by a subcontractor in order to perform have been found to be within the scope of the implied duty not to interfere or hinder.

Implied Warranty of Plans and Specifications. It is a well-established principle of construction law that when the owner (through the architect) provides the plans and specifications to the general contractor, there is an implied warranty that if they are followed, satisfactory performance will result. This same doctrine applies where a general contractor provides plans and specifications to a subcontractor. There is an exception to this doctrine where the superior party contracts for a particular result, by way of "performance" specifications, which describe the result to be achieved rather than the details of the work.

It is always preferable for a subcontractor or supplier to spell out *in the contract* its expectations of its contracting party. For example, the duty to schedule, the duty of coordination, and the duty not to interfere can all be included in the contract as mutual duties of the parties. Care must also be taken in contract negotiation not to lose the benefit of these implied duties by agreeing to contract terms that place duties normally resting on upstream contractors on oneself.

The Importance of Timely Notice of Claims

The first step in successful claims administration is the timely recognition of a claim, and the filing of a timely notice of claim. Most construction contracts require that as a precondition to filing of a claim, a prompt notice of the basis of the claim must be filed.

The notice requirement nearly always applies to claims for changes and extras, and frequently applies as well to claims for delay, interference and disruption.

The notice requirement is fully justified where the source of the problem is the owner or a party upstream from your contracting party, since your contracting party's ability to pass a claim upstream depends on its receiving prompt notice of the situation. The notice requirement is justified as well with respect to alleged breaches of contract by your immediate contracting party, since by giving prompt notice the other party is given the opportunity to avoid causing further damages. Further, it frequently occurs that the ultimate source of a problem on a job is not readily apparent.

There are several theories available to get around notice requirements where you inadvertently fail to submit notice of a claim on a timely basis, but the fact that these may be available should not be relied upon. There is no substitute for simply giving notice as required, and litigation of the validity of a notice requirement is a waste of time and money.

On-site personnel should be trained to recognize claims, and given the authority, when any impact on performance occurs, to immediately go to a telephone and send a mailgram to your contracting party, with a message that goes "This is to provide you with formal notice that our company was impacted in its performance today as the result of _____."[1]

1 A mailgram may be sent by calling 1-800-325-6000 and dictating your message to the operator. The message will then be delivered the next day by mail, with a copy of the mailgram sent to your office.

Summary of Chapter

The keys to successful claims management are early identification of claims, and timely notice to your contracting party.

While some claims -- particularly those in the public sector -- are based on remedy granting clauses, most claims are based on breaches of the implied duties to cooperate with and not to interfere with one's contracting party. Claims based on such implied duties can be destroyed by contract clauses which give the right to your contracting party to interfere with and hinder your efficient performance.

Many valid claims are lost due to the simple fact that the project manager failed to send out a one page letter to the general contractor, stating that his company had a claim for extra compensation.

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OBTAINING FAIR COMPENSATION FOR EXTRAS AND CHANGES

Introduction

Unlike the previous topics, which have concentrated primarily on how construction contractors can obtain advantageous contract terms in order to enhance their negotiating leverage, the battle for full and fair compensation for extras and changes is fought not at the contract negotiating table, but rather in the field. This is not to say that there are not important contract terms to consider. There are, and those will be adequately addressed. The major point to be made in this chapter, however, is that the key to success with respect to the inevitable extra work requests and change orders is the training and management of alert first line supervisors, backed up by diligent and aggressive project managers.

The most frequently made construction claims are for changes and extras, and are normally based on the changes clauses and clauses dealing with procedures for obtaining payment and time extensions for extra work. In virtually all projects there is a necessity for changes, some of which involve extra work. It is customary in the industry for the changes clause to require changes and extras to be performed on an expedited basis, with the questions of time extensions and often payment to be worked out later.

The Nature of "Changes" and "Extras"

A "change" is normally defined as any modification of the work required to be done by the contract documents. A change may involve simply an alteration in contract work with no change in time or money. It may also involve an elimination of work, in which it is commonly referred to as a deductive change; or may add work, in which case it is referred to as an "extra."

The degree to which compensation may be readily available for extras depends somewhat on the source of the claim. Where an owner decides to make a change, and issues a formal change order as desired, there is rarely an issue about either time or money. Extra work based on claims that do not arise out of written change orders can, however, be difficult to collect on. These types of claims can arise in a variety of circumstances.

Elements of Proof for Extras

While different courts have spelled out different requirements for the proof required to obtain compensation for extra work, the generally recognized requirements are:

* First and most importantly, that the work in question be outside of the scope of work of the contract;

* Secondly, that the extra items were ordered by your customer;

* Third, that your customer acknowledged or agreed, either by his words or conduct, to pay for the work as an extra;

* Fourth, that the claimant did not perform the work as a volunteer;

* Fifth, that the need for the extra work was not caused by the fault of the claimant; and

* Sixth, the amount claimed must be fair and reasonable.

Extras Resulting from Scope of Work Issues

One of the most difficult areas of dispute over extras involves claims for work for which there is a dispute over whether the work was included in the scope of the base contract. Where such situations arise, it is necessary to immediately provide notice of the situation to one's upstream party. The sooner such scope of work issues are addressed the more likely it is that compensation or time extensions will be available. Conversely, simply proceeding along with the idea that a claim can be made later is one sure way to lose your rights to any relief.

Extras Resulting from Oral Directives

One of the most common areas of dispute between general contractors and subcontractors over extras involves the situation where work not within the scope of your contract is ordered by the project superintendent. Where the job superintendent orally orders your forces to perform work that is not within your scope, how should that be handled? The solution to that problem is to have on hand a pre-printed extra work form that consists of two parts:

* The first part of the recommended form has a place where a description of the work ordered to be performed is described, followed by a statement that the work in question is acknowledged to be an extra, and a place for the person ordering the work to sign and date it.

* The second part has a place where names of the individuals performing the work are identified, with their pay category (journeyman or apprentice), and the number of hours worked. This is then followed by a second signature block, for an acknowledgment that the work was in fact performed.

These forms should be preprinted with multiple copies. Once the second part is signed, one copy should be given to your contracting party, one should be placed in your job file, and one sent immediately to your accounting department for the preparation of an invoice. The reason for putting the pay category of each worker on the form is to assist your accounting department in identifying the correct hourly rate (whether foreman, journeyman, apprentice, etc.)

A serious question arises where extra work is ordered orally, but your contracting party's representative refuses to sign your extra work form. If you coerce your contracting party into signing an extra work acknowledgment form by otherwise refusing to perform work required (in order to keep project progress moving), your extra work order can later be disavowed on the basis that there was no valid consideration for the signature -- coerced compliance not being valid. You also do not want to be charged with delaying the project by a refusal to perform work as directed. On the other hand, I have seen time and time again situations where subcontractors have attempted to be "nice guys" and go along with orally directed extra work requests, and later not get paid for the work.

It is a thin and difficult line to walk, but from a legal point of view it is always best to insist on your rights to a written order before starting work on an extra. Further, if a delay arises as a result of a dispute over your demand for a written extra work order which impacts your ability to proceed efficiently with your contract work, this may give rise to a disruption or interference claim, for which you should give immediate written notice.

Another issue which sometimes comes up is whether the person signing your extra work form actually has the authority to sign such forms. It has been my experience that this is usually not much of a problem, since the law recognizes "apparent" authority, regardless of the person's actual authority. It's much better to get the signature of anyone working for your customer, and to argue about authority later.

The Pricing of Changes and Extras

The pricing of changes that involve extra work is best done, where possible, on a time and materials basis, with your standard markup for overhead and profit. Where disputes arise over pricing, most construction contracts, of course, contain an obligation to proceed with the work and resolve the pricing later.

Where an equitable adjustment to a public works contract is involved, an equitable adjustment is properly calculated on a basis that makes the contractor whole. For changes resulting in extra work, this is normally the reasonable value of the work performed. There are, of course, both objective and subjective elements to what is "reasonable." Absent exceptional circumstances, pricing of change orders should be on the basis of actual direct costs plus normal markups.

Deductive change orders can be more difficult to price, particularly where the work involves heavy up-front mobilization costs. Deductions should be pro-rata for costs of the work itself only. If you pro-rate your mobilization costs, you end up with a loss where there is a large deductive change order.

On unit price contracts, you may want to consider including a provision in your subcontract for adjusting the unit price in the event of a significant change in quantity. There is authority for the argument that a major adjustment in quantity comes within the changes clause, and can be the basis for an equitable adjustment in unit prices as well.

Limits on Right to Make Changes

One last question comes up with respect to changes, and that is, is there a limit to an owner's or upstream contractor's right to make changes? The answer is, yes there is, but the discretion to make changes under the changes clause is very wide, and it is only in the most severe or unusual situations in which this discretion will be hampered.

There are two overlapping legal theories that place limits on the degree to which changes can be made to a contractor's work under the changes clause. These two theories are known as abandonment and cardinal change.

Abandonment. Under the first theory, by doing such things as failing to follow the plans and specifications and by failing to follow procedures required by the contract with respect to changes and extras, in extreme cases courts have found that the contract had been abandoned. Abandonment results where the parties act in a manner which is inconsistent with a contract. Abandonment can occur by words or can be inferred by conduct. There are some California cases that held that abandonment of a contract can occur where there is an unreasonable number of changes made. These cases, however, have not been followed in other jurisdictions.

Where abandonment of a contract occurs, the contractor's compensation is no longer limited by the contract price, and may obtain recovery under what is known as *quantum meruit,* meaning the fair value of the work performed -- whether more or less than provided in the contract.

The Cardinal Change. The cardinal change doctrine was developed in federal procurement disputes, but has also been recognized in private construction disputes. Under that doctrine, a change or group of changes can be so drastic, and cause the job to be so different than originally contemplated, that the changes constitute a breach of the existing contract. The standard in determining whether a cardinal change has occurred is whether the modified job is essentially the same work the parties bargained for when the contract was awarded. A cardinal change exists where the change or changes fundamentally alter the contractual undertaking, and where the nature of the changes was not comprehended by the changes clause.

Cardinal changes have been found, for example, where as a result of defective specifications an airline hanger had to be completely rebuilt and where a change in footings changed the entire magnitude of a contract. Substantial deductions from the scope of contracts -- in one case the elimination of one entire building -- have also been found to constitute cardinal changes.

Claims based on an alleged abandonment of a contract or a cardinal change to a contract are rarely successful, and should only be attempted where the impact on your operations is truly drastic. It's something you should at least know about, but not something that can be relied upon in the ordinary course of your business.

Change Order "Impact" Claims

"Impact" claims arise when multiple change orders impact the ability of a contractor to perform its base contract work efficiently. Changes can, under certain circumstances, have cost and time ramifications far beyond any costs related to the change itself. In order to be able to make claims for such matters, you have to be very careful not to give up your claim in the process of closing out the change order itself.

Change Order Impact Claims are often lost due to waivers of claims contained in change orders. What frequently happens is that the upstream party's change order form contains a clause which states that acceptance of the change order is in full satisfaction of all claims for money or time impacts resulting from the change. The signing of such a form involves a settlement, or what is known in the law as an accord and satisfaction, of all claims related to the change in question -- including potential change impact claims.

There are two things that you can do to get around this. The first is to include a provision in your bid terms that states that any agreement on the price of a change order does not constitute an accord and satisfaction of any claims for impact of such changes. That may or may not work, however, since the change order itself may say differently. The other thing that you can do -- is to amend each change order by adding a provision which states:

> This change covers only the direct costs incurred by the contractor in performing the work which is the subject of this change order.

An alternative approach is to include as part of a change proposal the following:

> This proposal is based solely on direct cost elements, such as labor, material, and normal markups, and does not include any amount for changes in sequence of work, delays, disruptions, rescheduling, extended overhead, acceleration, wage and material escalations, or other impact costs, and the right is expressly reserved, and notice of potential claim hereby made, for any and all of these and related items of cost prior to any final payment under this contract.

Summary of Chapter

In order to qualify as a valid extra work claim, the work in question must be outside of your scope of work, ordered to be performed by your contracting party with knowledge that you expected to be paid for extra work, that the need for the extra work was not your fault, and that the amount requested is fair and reasonable.

Despite the fact that most subcontracts require extra work orders to be in writing, there are a number of exceptions to that rule.

The right to make changes is very broad, but not totally unlimited. Under certain very unusual circumstances, drastic changes may result in a finding by a court or arbitrator that the general contractor has abandoned the job, or has made such drastic changes as to constitute a "cardinal" change, which is a form of breach of contract.

Sometimes the cumulative effect of change orders on the ability of a contractor to perform its work provides the basis for a change order "impact" claim. In order to preserve change order impact claims, it may be necessary to add additional language to routine lien waivers which preserves existing or future claims.

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PROVING DELAY AND DISRUPTION CLAIMS

Introduction

Pure "delay" claims -- that is, claims based on changes in scheduling which shift either entire projects or the performance of specific activities of a project into a different time period -- are usually governed (and most often, defeated) by specific contract provisions which govern compensation in the event of delay. While delays which occur in inflationary times can impact a contractor's costs -- from materials escalation or wage increases -- there is usually limited impact from pure delay. While it is common in the construction industry to make reference to "delay" claims, in fact, most cost impacts for which compensation is awarded are due not to delay but rather disruption, -- events which impact both a contractor's efficiency and the duration of its performance, rather than the particular time period the work is performed.

Identification of Disruption Claims

There are a number of different ways in which subcontractor operations can be impacted which are caused by disruption and interference by their upstream contractors or by the owner. The following reviews some of the major sources of disruption and interference claims.

Defective Specifications

The first type of claim in this category is one for increased costs caused by defective plans or specifications. When an owner provides a contractor with specifications, the law imposes an implied warranty of their suitability and accuracy.

Put another way, where design specifications are provided to a contractor, the owner is deemed under the law to have warranted that if those specifications are followed, that the desired result will be accomplished.

The warranty which the law deems provided by an owner to a subcontractor is also applied in the context of the general contractor/subcontractor relationship. A subcontractor's claim for defective specifications is against its contracting party, which can in turn pass it on to the owner.

The basis for the warranty I have been discussing is a federal procurement case called Spearin v. United States, and hence the existence of such warranty is often referred to as the Spearin doctrine.

The Spearin case involved the construction of a dry dock at the Brooklyn Navy Yard. Part of the work involved relocating a section of a storm sewer, which was accomplished without difficulty.

About a year later, when the work on other parts of the job were in progress, as a result of a combination of heavy rains and a high tide, the sewer in question broke apart, flooding the dry dock site. The contractor claimed that the design of the sewer system was defective, and refused to continue work until the government made changes to it. The government annulled the contract and the contractor sued for damages. The United States Court of Claims ruled in favor of the contractor, and the Supreme Court affirmed, holding that in providing the specifications, the government warranted that if they were complied with the sewer would be adequate.

There have been hundreds of both cases involving both state government and private contracts that have adopted this principle, and it is now established in all jurisdictions that where design specifications are provided to a contractor its duty is simply to follow the specifications, without liability if the result is different from that desired by the owner. For example, in a Missouri case involving a contract with a municipal school district where the roof leaked, the owner was required to prove that the contractor deviated from the plans or specifications or constructed the roof in an unworkmanlike manner. A North Carolina case stated the rule in a similar fashion. If the contractor follows the plans and specifications, it is not liable for any consequences of defects in the work caused by inadequacies in those plans or specs. However, a contractor makes deviations from the specifications at its peril, and if it does not follow them, it guarantees the suitability of the work, notwithstanding any defects in the plans or specs.

The first requirement for proof of a claim based on defective specifications is that the specifications provided be what are known as "design" specifications. Design specs provides detailed instructions to the contractor as to what to provide, including such characteristics as nature of materials, height, width, weight, tolerances, durability, inspection requirements, etc. The contractor is required to follow the specs as one would follow a road map. The contractor is given little or no discretion as to what to provide.

In contrast, where a "performance" specification is provided, the information given to the contractor is results oriented, and the contractor is given the discretion to provide whatever is necessary to achieve the results described.

Where design specifications are provided, they do not need to be perfect, but they must be adequate to the task, or reasonably accurate.

Damages for defective specifications can involve virtually all types of construction damages, depending on the impact of such defects. They can include:

* Extra work to overcome the impact of the defects

* Efficiency impacts of performing the base contract work

* Delay damages, from extending the duration of performance

Failure to Disclose Information

Similar to the duty to provide adequate plans and specifications is the duty of one's contracting party to disclose material information that would have a bearing on costs of performing work on a project. There are numerous federal, state and private cases which have upheld claims based on the failure of one party to divulge to the other important information bearing on its costs of performance.

For example, even in the absence of a differing site conditions clause, there would be liability for extra costs arising out of a concealed condition that the upstream party had actual knowledge of, but failed to disclose to its contracting party.

Impact of Changes

Another frequent source of claims is the impact of changes on the base contract work. Changes can impact a contractor in a variety of ways, many of which involve additional time and extra costs of performing base contract work. Where such instances occur, the contractor should be able to obtain its impact costs in addition to the costs of the changes themselves.

Where an item of additional work is added to a contract, recovery of overhead for such changes is generally limited to a percentage markup. There are circumstances, however, where the performance duration of base contract work is extended as the result of impacts of changes. In such cases, additional overhead covering the period of extended duration should also be permitted to be recovered.

Failure to Coordinate the Trades

One of the duties of general contractors and construction managers which is implied by law is the duty to coordinate the work of the trades. Many loss of efficiency claims arise on the basis of the failure of GCs and CMs in carrying out that duty. One of the main functions of general contractors or construction managers is the planning of work so that the various trades do not interfere with each other.

Damages from failure to coordinate also include virtually all of the types of construction damages, including loss of efficient production and extended duration.

Disruptions and Interferences, Generally

There are a variety of additional ways in which a contractor's operations can be disrupted and interfered with, some of which are closely interrelated to types of claims already discussed.

For example, trade activity commencement delay or delay in completion of predecessor activities are often accompanied by an attempt to make up for such delay, by crowding and stacking of trades, and by acceleration.

Elements of Proof

Once you have identified a claim event and formed an idea as to the types of damages you have suffered as the result of that event, the next step is to establish a causal link between the acts which provide the basis for a claim and your damages.

There can be multiple causes of disruption and delay on a construction project. On problem jobs it frequently occurs that you can suffer losses partly due to your own fault; partly due to events which are beyond the control of all parties and for which entitlement is limited to time extensions only; and partly due to events for which you are entitled to both time extensions and additional compensation. There are numerous court decisions which have held that the failure to segregate out the impacts of claim events from other events can cause an otherwise potentially valid claim to fail.

If you were going to lose money on a job anyway, you cannot expect to be made whole as the result of a claim event. Claims are designed to pay only for delay or disruption events for which you are either entitled to time extensions or additional money under the contract or under the applicable law -- not to compensate you for losses you would have suffered even if the claim event had not occurred.

Claims for money are based on proof of costs. The degree to which you can put together a claim depends largely on the availability of cost information. This in turn comes back to the degree to which you kept accurate information during the course of the project.

The fact that at the time information is being recorded there is no obvious use for it is by no means a basis for not recording it. A lot of times you simply can't tell what you will need in order to support a claim until after the job has been completed.

What I like to see when I am working on a claim is first and foremost, a detailed daily job log, which states:

* Who was on the job, for how long.

  -- You need to know whether the workers were foremen, journeymen, apprentices, etc., without having to sift through time cards.

  -- You also need their names for ready reference as potential witnesses or sources of information.

* In as exact terms as possible, what each crew did each day.

  -- I realize that this is asking a lot from supervisors who are not used to keeping such records, but having this information can make or break your claims.

  -- It's not enough to describe the work in general phrases. You need to identify where on the job the work is being done, and the amount of productivity of each crew.

* Details about the weather.

* Records of any unusual events, particularly moves out of sequence, changes, change requests, requests for information, inspections, etc.

Another thing that is helpful is a detailed daily diary kept by the senior supervisor on the job.

There is a tendency in the industry for claimants to simply turn over all records on a project after it is completed to a claims consultant, who attempts to reconstruct the job on the basis of the written record. The consultant can then appear in court or in an arbitration proceeding and express his or her opinion as to entitlement and the amount of a claim. The problem with that approach is that the other side inevitably hires its own claims consultant who, on the basis of the same record, but with emphasis on different documents, somehow comes up with a radically different conclusion. In most cases a much more believable story can be told by a project supervisor who was actually on the job, who has kept good records of what happened and what the problems cost. Even though many claims consultants are practiced in the art of presenting court or arbitration testimony and make excellent witnesses, most judges and juries give more credence to the testimony of someone who was actually present on the job, and who kept simultaneous records of what was going on.

Another good reason for subcontractors to keep detailed records is that general contractors and construction managers know that when they keep records of the events on a job, it is not helpful to their careers to document problems that are the fault of their own company. When all the information which is recorded on a job has been kept by the GC or CM, it is nearly certain that there will be minimal documentation unfavorable to themselves. Thus, as I have seen time and time again, the claims consultants hired by GCs or CMs review the documents of their clients and come to a conclusion based on that information that all delays and disruptions were the fault of someone else.

It is also important to claims on "problem" jobs for you to keep detailed production records on favorable jobs, so you have proof of what your "normal" production is. There is what is known in the law of damages as the "yardstick" approach to proof, which involves comparison of costs on an impacted and unimpacted basis. What you can do is to establish impact on productivity by comparing production on a job in dispute with productivity on other, un-impacted jobs. If you can establish productivity norms, backed up by accurate records, your ability to establish loss-of-efficiency-type impact is greatly enhanced.

One of the new trends in claims is proof of impact on learning curve. This involves keeping records of productivity on, say a daily or weekly basis, and comparing productivity early on with that later on in your jobs. Proof of a normal learning curve can be a further basis for proof of impact on jobs where learning curve is interfered with by delays or disruptions.

The Importance of Understanding and Using CPMs

Another useful tool in claims preparation is CPM analysis. I assume that most of you have a working knowledge of CPM scheduling techniques, but I will at least mention the basic concepts for review purposes. The Critical Path Method of project scheduling involves lining up each individual activity which must be performed on a job in a logical sequence, so that work which must be in place before other work can be done is scheduled first. These are known in CPM lingo as "predecessor" and "successor" activities. The identification of each activity that must be performed on a project and the interrelationships among activities is a useful exercise, regardless of the degree to which the CPM is used during the project as a management tool.

The accuracy of a CPM depends, of course, on the accuracy of the planned subcontractor durations. There is commercially available software which is compatible with software used by GCs and CMs to schedule entire jobs, which subcontractors can use to input schedules of their own activities. The subs can put their own planned schedules on a disk, which can then be incorporated into the overall schedule. At the other end of the extreme are schedules prepared with minimal subcontractor input, which are all but useless.

What you end up with is a long list of activities with planned work durations. Through use of computer programs, four key dates are established for each activity.

The degree to which the courts will rely on CPM analysis depends on a number of factors. At one extreme, if a CPM is based on active subcontractor input, is actually used in the management of a project, and if the CPM is continuously updated as events on the project occur, it will be given great weight. At the other extreme, where there was no CPM even prepared for use in project management, but an after-the-fact CPM prepared solely for use as support for a claim, it will be given minimal weight. At the very minimum, to be given any weight an after-the-fact CPM must be based on accurate project records.

Use of Demonstrative Evidence

Claim preparation offers numerous opportunities for creativity. Particularly with the ready availability today of computer software that can easily turn tabulations of data into charts and graphs, virtually all claims can be supported by graphical depictions of the key events on a project.

Charts and graphs are a very important way to present evidence in dispute resolution proceedings. For example, depictions of as-planned and as-built labor hours expended on a job on a weekly basis can very clearly demonstrate the impact of an event of delay or disruption. Similar charts can be prepared to show material deliveries, production per week, overtime hours incurred, and so on. These types of charts are particularly helpful when they can be used to compare impacted and non-impacted periods.

Summary of Chapter

Claims that result in disruption of your activities include defective specifications, failure to disclose information, the impact of multiple changes, a failure to coordinate the trades, and disruption and interference generally.

If you were partly at fault in disrupting your own efficiency, you must be able to clearly separate out your contribution to your damages, which, of course, cannot be recovered.

In order to recover damages based on a discrepancy between your estimate and your actual costs, you need to keep detailed, accurate records which establish that your estimates are unusually reliable. Absent such proof, an award of damages cannot be made based on a comparison of actual and estimated costs.

12

DEFENDING DELAY CLAIMS

Introduction

From a conceptual point of view, a delay claim brought by a general contractor against a subcontractor is a wholly different type of claim from a disruption claim brought by a sub against a GC. Usually the GC's case is founded on a failure to meet a contractual completion date, that is, the subcontractor used more work days than allowed by the schedule. Although it is not unusual for lower-tier parties to contest the validity of the scheduled completion date -- particularly where there have been schedule amendments -- most "downstream" delay claims are based simply on a failure to complete work on time. Successful defense to such claims depends on an analysis of the entire project, to allocate responsibility for all project delays where they properly belong.

The First Line of Defense -- No Project Delay

When a delay claim is brought by a general contractor or construction manager against a lower-tier project participant, it is not usually enough for the claimant to prove that there was a delay in completion of that party's *activity.* Rather, in order to recover damages, the claimant must establish that the activity delay in question negatively affected the *project* completion date.

In mounting a defense to a delay claim, the first point of attack is on the validity of the project schedule. Some questions to ask include:

* Was the schedule based on accurate input from the various trades?

* Were all activities included in the schedule?

* Was the schedule continuously updated throughout the job?

* Was the schedule revised to make allowances for changes?

* Was the schedule revised to account for delays by others?

* As the result of other delays, were other activities shifted to the critical path?

The second avenue of potential defense with respect to proof of project delay involves an attack on the claimant's factual proof of causation. The first step in this process is to gather all available evidence of other delays on the project, from whatever source. Such evidence is usually found in correspondence between the claimant and other trades, monthly progress reports, daily reports, correspondence with the owner, and internal memoranda.

The next step is to analyze the project to determine which of those delays had an ultimate impact on project completion, and to subtract such delays from the defendant's alleged delays.

The Second Line of Defense -- Proof of Concurrent Delay by Others

A subcontractor's second major line of defense to a delay claim is to demonstrate that, notwithstanding that the sub took longer than scheduled to perform its work, that either the general contractor, or another party for whom the general contractor was contractually responsible, contributed to that same delay. The existence of "concurrent" delay by some other party provides a defense to a delay claim.

The defense of current delay is based on the general legal principle that a claimant is not entitled to obtain recovery against another party for damages which he himself contributed to. The doctrine of concurrent delay is similar to the concept of contributory negligence, that is, a person who is partly at fault in causing his damages is not permitted to recover for those damages. The rule is well-established that where the owner or general contractor contributed to a delay, the GC cannot obtain damages from a sub. The question is a bit more complicated where there are two subs at fault. To successfully establish the concurrent delay defense, the defending sub must tie the other sub's delays back to some responsibility of the general contractor, such as failure to coordinate the work, failure to assure that predecessor work was in place on a timely basis, etc.

In the early development of the law, if the claimant caused any delay at all, under the "concurrent delay" doctrine the claimant was deemed ineligible, as a matter of law, from recovering delay damages against another project participant. With the advent of modern computerized scheduling techniques, this doctrine has been softened and modified. Now most states only apply the doctrine of concurrent delay where the claimant has contributed to a delay which overlaps in time with the defendant's alleged delay, or which has a concurrent impact with the defendant's alleged delay.

An alternative defense may be raised if it can be shown that some other party's performance was the "substantial cause" of a delay, and that the defendant's contribution to that delay was only a secondary cause.

Summary of Chapter

In defending a delay claim, the first line of defense is to attack proof of the causal link between any delay in your project activity and delay to the entire project. This can include an attack on the validity of the schedule. The second line of defense is to establish delays on the part of others. This can be done either by showing fault leading to delay on the part of the general contractor, or proof that delays by others was the primary cause of the general contractor's damages, and that your delays were only a secondary cause of such damages.

13

PRICING OF CLAIMS AND CALCULATION OF DAMAGES

The Legal and Contractual Standards for the Pricing of Claims

The approach to pricing a claim depends on the nature of the claim, more specifically, whether the claim is one for "damages" based on a theory of breach of contract, or is one for an "equitable adjustment" to the contract price, based on a remedy granting clause in the contract.

The Breach of Contract Standard

The legal standard for the measure of damages for breach of contract is the difference between the value of the promised performance and the actual cost of performance, and includes both losses suffered and gains prevented by the other party's breach. Breach of contract damages properly include lost profits which were prevented by the breach.

The Equitable Adjustment Standard

The legal standard for an equitable adjustment (which can either raise or lower the contract price, depending on the matter in question) is the difference between the reasonable cost of performance without the change, deletion or other event, and the reasonable cost of performance resulting from that change, deletion or event. An equitable adjustment allows only profits on work actually performed.

Where recovery is not available for either breach of contract or an equitable adjustment to the contract, there is a third theory that may be available, known as "quantum meruit." Recovery may be had in quantum meruit where one party provides goods and services to another, with the expectation of payment. Absent the existence of an express contract with respect to the transaction, the courts permit recovery of the fair value of the goods or services provided.

Damages for Faulty Performance

When any construction contractor is charged with not completing its work or with performing defective work, there are two alternative standards for damages, depending on the facts. These standards are known as the "cost" rule and the "value" rule.

If it is possible to complete the work or make corrections so that the work will conform to the contractual requirements without incurring unreasonable economic waste, then the standard for damages is the reasonable cost of performing such work. If, on the other hand, completion of the work or performing corrective work would involve unreasonable economic waste, then the damages are properly calculated on the basis of the value of the work contracted for if it had been done properly, and the value of the work as built.

The Relaxed Burden of Proof for Quantum

Once a claimant establishes that the other party has legal liability on a claim, the amount of the claimant's damages do not need to be established with exact and mathematical certainty. There is a more relaxed standard for proof of quantum once the existence of liability has been established.

All that is necessary for proof of the quantum of damages is a reasonable approximation of the losses suffered as the result of the event upon which liability is based.

Alternative Methods of Pricing Claims

By far the preferred method of pricing construction claims is to place a number on each specific event or alleged breach contained in the claim. In the situation where some of the claims are upheld and some denied, an award can be made without the difficult task of sorting out the damages which were requested on the unsuccessful claims.

Where a single, ballpark number is presented in a claim and there is no way for the judge, jury or arbitrator to separate out the unsuccessful portions of the claim, the entire claim must be rejected.

The standard practice where damages are based on project records is to present damage calculations through an expert witness, who applies his or her judgment to the matter.

Calculation damages based on a comparison of actual costs with projected costs are referred to as the "total cost" theory. Use of a pure total cost approach has been discredited and rejected by numerous courts, and should not be used. A modified total cost approach, however, has on occasion been successful, where the claimant establishes an evidentiary basis for a finding that the estimate is accurate, realistic and reasonable.

For example, if on the basis of historical data it can be shown that a specified number of units of production can be anticipated during a specified period of time, this provides a basis for an assertion as to what the reasonable cost should have been for performing a stated volume of work. This is generally not enough, however. It is also necessary to present an analysis of the project which either rules out any other causes of lost productivity, or which accounts for any other reasons for loss of productivity and deducts from the damage calculation an amount allocable to such cause(s).

Under what has been called the "jury verdict" approach, the trier of fact is requested to review all relevant evidence and then make an educated assessment of what would be a reasonable amount of compensation. A jury verdict approach is sometimes used where successful challenges are made to the validity of a portion of the evidence supporting a claim, and the trier of fact wishes to make adjustments downward from the amounts sought, in light of the weaknesses in the claimants case.

Calculation of Delay Damages

The first step in pricing a claim for delay is to calculate the number of days of delay. This depends, of course, on the type of delay involved. For commencement delay, this would be the difference between the contemplated and actual start date. For suspension, damages start accruing until after an unreasonable period of delay.

Extended duration is much more difficult to determine, since it is necessary to make a judgment as to when substantial completion would have occurred, absent the events on which the claim is based. It is also necessary in determining the number of days of compensable extended duration to deduct from the claim non-compensable delays, or delays caused by a third party.

Once the number of days of delay has been determined, the next step is to calculate the per diem damages that were incurred. The amount of per diem damages also depends on the type of delay.

For delay in starting work, usually the only type of damage compensable is wage and material escalation, keyed to the date on which identifiable increases occurred.

For suspension and extended duration claims, damages are divided into two major categories -- field costs and home office costs. Field costs are usually fairly easy to determine. These costs include extended labor costs; extended supervision; and extended field costs, such as the office trailer, telephone, electricity, water, trash removal, office machinery, vehicles, insurance, per diem bond costs, etc. All of these costs should be determined on a per diem basis and added to come up with total per diem field costs.

Equipment rates can be determined either through depreciation schedules or through consultation with reference manuals (Contractors Equipment Ownership Expense Schedule, put out by the American General Contractors Association, the Associated Equipment Distributors Rental Rate Compilation, or the Rental Rates Blue Book for Construction Equipment. The standard rule is to apply a 50% reduction for idle equipment.

Calculation of Unabsorbed Home Office Overhead

The determination of proper compensation for unabsorbed home office overhead is a controversial issue over which there is little agreement in the construction industry. The theory which underlies the recovery for unabsorbed home office overhead is that a portion of the overall overhead of a company -- executive and support staff salaries, office rent, office equipment, telephone, insurance, etc. must be recovered from each job. If a project is not completed when anticipated, this will interfere with the ability of the company to take on other jobs, which would absorb additional portions of the company's overhead. Thus a loss results when the overhead -- basically a fixed cost -- is not covered.

The standard approach is derived from that used in federal government contract law, arising out of a 1960 Board of Contract Appeals case known as the Eichleay decision. The formula used in that matter has become known as the "Eichleay formula."

The Eichleay formula involves a three-step process:

-- **Step one** involves a determination of the amount of overhead that was allocated to the contract in dispute. This is done by taking the percentage which the contract price for that contract represents of the total company billings for the period of the contract, and multiplying that percentage times the total home office overhead for the contract period.

-- **Step two** involves a calculation of the actual daily overhead for the contract at issue. This is done by taking the allocable overhead, and dividing that by the number of days of actual performance of the contract, including all delays.

-- **Step three** involves multiplying the daily contract overhead by the number of days of compensable delay, to come up with a daily overhead rate. This rate is then multiplied by the number of unexcused days of delay, to come up with the amount of the home office overhead claim.

The use of the Eichleay formula is not appropriate in all situations. For example, where a delay occurs as a project is winding down -- and particularly where the general contractor is the claimant and most of the work performed by the GC with its own forces has long since been completed, the Eichleay formula can vastly overstate the actual home office overhead damages suffered by the claimant.

Calculation of Loss of Efficiency Claims

Damages for disruption of work are difficult to determine, since they involve what are basically judgment calls concerning the efficiency with which the claimant performed its work. Loss of efficiency claims are usually determined by judgments of expert claims consultants, with support from historical data on work performance. Where data concerning normal rates of production for the claimant do not exist, reference can be made to more generic studies.

One of the most popular studies used for reference purposes is a study on the impact on efficiency of long-term overtime work which was conducted by the Business Roundtable. That study showed, for example, that working seven ten-hour days four weeks in a row results in a drop in efficiency to 60%.

Determination of Interest and Attorneys' Fees

There are two separate items related to the time value of money in a construction claim. The first is the cost of money as an element of project expenses. This cost of money can be an element of damages. The second aspect is interest on the total damages, once they are determined. The second item is known as pre-judgment interest.

Recovery of pre-judgment interest is a matter of state law. The general rule is that such interest is recoverable for liquidated amounts -- for example, the contract balance due -- but is not available for general damage awards. The capital cost of money as a project expense can sometimes be recovered where pre-judgment interest would be rejected.

Under what is known as the American Rule, attorneys' fees are awardable for breach of contract only where the contract provides for such an award. Where the contract provides for an award of attorneys' fees, the calculation is normally based on the number of hours spent on successful issues in the case, multiplied by the generally recognized hourly rates for the type of work in question in the community where the case arose.

Summary of Chapter

There are two alternative standards for proof of damages: the breach of contract standard is the difference between the value of the promised performance and the actual cost of performance, including lost profits caused by the breach. The standard for an equitable adjustment to the contract under a "remedy-granting" clause is the difference between the reasonable cost of the work without the change and the cost of the work as changed.

Where a claim is brought against a contractor for faulty or incomplete performance, there are two alternative standards for damages, depending on the facts. If it is possible to complete the work or make corrections without unreasonable economic waste, then the standard is the cost of the corrections or additional work. If completion of the work or the performance of corrections would cause unreasonable economic waste, then the standard is the difference between the value of the work contracted for and the value of the work provided.

Once proof of liability on a claim is established, there is a relaxed standard of proof for the amount of damages.

"Total cost" calculations of damages -- where actual costs are compared to estimated costs -- are not generally accepted, absent persuasive proof of the validity of the estimate.

Delay damages are based on a determination of a per diem rate for extra costs, multiplied by the number of days of delay.

14

EFFECTIVE DISPUTE RESOLUTION

Introduction

Disputes during the course of construction projects are, unfortunately, part of the routine of doing business. Your approach to dispute resolution has a significant impact on the success of your operations. There is no single approach to dispute resolution that works every time. The key to success is to be flexible, and to adapt your response to the specific facts presented.

Pass-Through Claims as an Option to Litigation

The first step to take in potential claim situations is to identify, to the extent possible, the ultimate cause of your problems. If the source of a problem is a party upstream from your customer, consider joining with your customer in a pass-through claim, rather than filing a claim directly against your customer. A pass-through claim is one that is generated by a lower-tier party and passed up the chain of contracts. A typical example is a subcontractor claim being submitted to the Owner by the General Contractor. In many cases, cooperating with your customer in claiming against an upper-tier party offers more potential for success than litigation or arbitration with your customer.

Whenever you pursue a joint claim with your contracting party against a party further up the chain of contracts, you need to insist that any ultimate award or settlement specifically designate what is being paid for your portion of the joint claim, and you must take an active role in the prosecution of the claim. Do not give your contracting party the opportunity to bargain away your claim in exchange for dropping a claim against it, or to settle your claim for a small amount while getting a better deal on its own claim.

Procedure for Dealing With Disputes

Before staking out a position on a dispute, try to obtain as much information as possible about other interested parties' positions, so that you can evaluate the entire situation with some measure of detachment. If you believe that an independent party should be consulted -- such as the Owner's Representative -- do so early in the dispute, before the positions of the interested persons have become hardened.

The time to establish a good personal rapport with your contracting party and other project participants is well before a dispute arises. Everything you do on the job, in areas where there is no dispute, will affect the ultimate outcome of the matter in dispute.

Your first attempt at resolving a dispute should be at the management-to-management level, without involvement of lawyers and claims consultants. If a good faith effort to resolve matters through negotiation fails, then consider requesting the assistance of a mediator. If mediation is rejected, then move swiftly to up the ante, by filing a notice of intent to lien, a bond claim, a lawsuit or an arbitration demand -- whatever is appropriate to the situation -- and then immediately make another overture towards a negotiated resolution of the matter.

When it appears that a major dispute is brewing, there are certain things you can do to protect yourself:

* Engage a claims consultant to visit the project, and become familiar with the problems as they are happening. One of the main criticisms that claims consultants tend to get is that they never visited the project as it was being built. In order to save money, however, it is recommended that you do everything possible to reach a resolution before authorizing the claims consultant to proceed with his or her analysis of the project record. The time to line up this assistance, in case you will need it later, is during the course of the job.

* Document areas of job problems with photographs if appropriate. There are high-quality digital cameras on the market which are designed so that you can transfer the photos directly onto your computer, and print them out as part of a claims document.

* Answer each letter from your contracting party with a full response.

* Send a Western Union mailgram documenting your position. (1-800-325-6000)

* Have an attorney review your contract and advise you on the strength of your position before you enter into settlement negotiations.

* When and if litigation of arbitration seems necessary, don't bother with threats, just file it.

Just as is true in the early stages of dispute resolution, when formal dispute resolution procedures are commenced, be flexible and do only what is necessary and appropriate to the circumstances. Not all disputes require expensive discovery methods.

Mediation as an Alternative to Formal Dispute Resolution Proceedings

Mediation is an extension of direct negotiation, which is conducted with the assistance of a trained intermediary who is skilled in assisting parties in resolving their differences. Mediation differs from arbitration, in that the mediator has no authority to decide the dispute. The purpose of mediation is to assist the parties in reaching their own solution.

A typical mediation involves an initial meeting of both parties with the mediator, in which the parties jointly outline the nature of the dispute to the mediator. It is not unusual in this initial session for one or both of the parties to express their anger and frustration at the other party's position. A skilled mediator recognizes that expressions of anger at this initial meeting are merely part of the normal process. It is important when the parties vent their frustrations that the mediator remains neutral, calm and detached -- giving no expressions of agreement with or sympathy for either side. The objective of this session -- no matter how long it takes -- is to make sure that each party has the opportunity to fully state its case, and for the other party to acknowledge that although they may not agree with what is being said, that they have at least fully heard and understood the other's position. In order to make sure that each party has been fully heard, it is important at the end of this session for the mediator to clearly and calmly restate each party's position, and then to ask in turn whether the summary is accurate. By doing so, the mediator can assist each of the parties to get beyond their anger and frustration, and to start looking at the dispute objectively, as a problem that needs to be solved.

At the end of the initial session, after restating and summarizing each party's position, the mediator usually also attempts to obtain the mutual commitment of the parties to do their best to come to agreement, and to identify the potential impact on each of them if no agreement can be reached.

The next step in a mediation is for each of the parties to meet with the mediator in a private, confidential session, at which time they advise the mediator of any information about the dispute they do not want the other side to know. At this time each party usually informs the mediator what their bottom line position is -- although skilled mediators realize that during the negotiations to come that position may well change.

The procedure that follows depends on the nature of the case, but the normal practice is for the mediator to have the parties go to separate rooms, and then for the mediator to go back and forth between them, carrying offers and counteroffers, and urging compromise.

Where a deadlock occurs but both parties are intent on resolving the dispute, the parties will sometimes decide to appoint the mediator as a "final offer" arbitrator. Each party will then write down a final figure and hand it to the

mediator, who is then empowered by them to choose which of the two figures is the most fair. It is not unusual in such circumstances for both parties to submit almost identical numbers -- each realizing that if they don't submit a fair number the other side's number will be chosen.

There are many advantages of mediation, not the least of which is the low cost relative to litigation or arbitration. A successful mediation further leads to a healing of the relationship between the parties, enabling them to go on doing business with each other with no hard feelings.

Arbitration Versus Litigation

When a dispute becomes so entrenched that it cannot be resolved by the parties through negotiation or mediation, the dispute must be then submitted to a third party for decision -- either through litigation or arbitration. Litigation, of course, involves filing suit in court, with all the attendant expense of pre-trial discovery procedures. Arbitration involves a much more informal proceeding, where the case is presented, through witnesses and documents, to an arbitrator or panel of arbitrators.

There are no hard and fast rules for when arbitration is preferable to litigation. Generally speaking, when the project is located in a jurisdiction where the courts have crowded dockets and it takes considerable time to obtain a trial, arbitration is preferable due to the speed with which an arbitration can be conducted.

Arbitration also works much better than litigation where there are technical issues, where knowledge and training in construction matters is helpful to their resolution, since most judges are unfamiliar with practices in the industry. This is particularly true in scope of work disputes and extra work claims.

The main drawback to arbitration is the lack of formal pre-hearing discovery procedures. This drawback can be overcome by including in your arbitration clause an obligation to produce documents as required by the rules of the court in the jurisdiction in which the project is located (or the Federal Rules of Civil Procedure).

Arbitration using an arbitrator who is familiar with customs and usages in the building industry is clearly preferable to litigation, where complex issues involving the construction process are involved. Arbitration works very well when the parties are cooperative, and where the possibility exists that the parties may do business with each other again in the future. Where a party is blatantly uncooperative, disruptive, or hostile, arbitration can be a very difficult process.

Another major drawback to arbitration can arise where there are three or more parties who have an interest in a dispute, and where there is an arbitration clause in the contract between two of the interested parties, but no such clause on the other contract(s). This can lead to parallel proceedings and the possibility of inconsistent results.

Mere collection lawsuits, where the contract's formal dispute resolution procedures are invoked simply to obtain a judgment for monies due, are better suited for the courts, in jurisdictions where there is no major delay in getting to trial.

If one party to an arbitration agreement refuses to participate, you can file a petition with the local court to obtain an order requiring their participation. If one party to an arbitration agreement files suit in court, and the other party engages in meaningful participation in the court proceeding without objecting or moving to stay or dismiss the case pending completion of arbitration, that party waives its right to arbitrate the dispute.

If there is an arbitration clause in your contract and you are not assured of payment by your customer of an arbitration award if you win, you are advised to take whatever actions are necessary to protect the continued validity of whatever payment security may be available to you -- whether involving a mechanic's lien or payment bond. If in order to protect your payment security rights you need to file a lawsuit to enforce lien or bond rights, you can always seek to have the case stayed pending the outcome of the arbitration.

Where the parties are particularly interested in cooperating with each other in resolving their dispute, mediation offers a less contentious alternative to arbitration. Unlike arbitration, where the arbitrator is given the power to decide the dispute, in mediation the mediator has no power to issue or enforce a decision, Rather, the mediator works with the parties to help them reach their own agreement.

In situations where conducting a full-scale arbitration would involve more preparation and expense than the parties wish to engage in at the time, or where neither party is willing to place control of the result in the hands of another person, another alternative is to engage in a non-binding type of arbitration, in which summary evidence and argument is presented to a knowledgeable party for a proposed resolution. While neither party is bound by the result, if the arbitrator is well respected and his or her opinion is valued, that opinion may (and frequently in such situations does) result in a negotiated settlement.

Filing for and Conducting an Arbitration

An arbitration is commenced by sending a one-page form to the American Arbitration Association, with a copy of the contract which contains an arbitration agreement, and the fee. A copy of the form is set forth as Appendix 4, Notice of Demand for Arbitration.

There are three tracks of arbitration, as follows:

Fast Track is used for claims of less than $75,000. In most cases there is a single day of hearing, which is held within thirty days of appointment of an arbitrator, with a decision seven days later. The standard processing time is about 60 days. For cases less than $10,000 in dispute, cases are normally decided on documents only (with no hearing). Administrative fees run from $500 for up to $10,000 in dispute, and $750 for up to $75,000 in dispute.

Regular Track is used for cases from $75,000 to $1 million. The arbitrator has broad authority to control the discovery process and the hearing. Administrative fees run $1,250 to $6,000, plus a Case Service Fee and an hourly or daily arbitrator's fee. For larger cases, a three-arbitrator panel may be used, but is not required.

Complex Track is used for cases over $1 Million. Administrative fees start at $8,500, plus a Case Service Fee and daily rates for what is normally a three-arbitrator panel, with each arbitrator charging an hourly or daily fee.

In regular and complex cases, it is customary to hold a pre-hearing conference, to require a pre-hearing document exchange, and to require the submission of formal pre-hearing position papers. In lengthy hearings, hearing dates will often be spaced over a period of weeks, since the arbitrators have their own businesses to conduct and are most often not available for consecutive weeks.

An arbitration proceeding is conducted much like a trial. The main difference is that speeches and histrionics typical of court proceedings are not effective (or appropriate) in an arbitration setting. A low-key, factually-oriented approach with a minimum of argument and posturing is the customary approach.

All documents which may be used in an arbitration should be bound together in booklets, or placed in notebooks, with sequential numbering, so that they can simply be referred to by page number. The contract documents should be the first exhibit. Important segments or excerpts from documents should be highlighted for easy reference.

The formal rules of evidence do not apply in arbitration hearings, but the arbitrators will likely give reduced or little weight to the type of evidence, such as hearsay, which is not admissible in court.

Once the hearing is completed, the arbitrator has a stated period of time within which to issue a decision. Usually the decision is simply a one line statement, directing one party to pay the other party a specified sum of money, with no explanation for the basis of the decision.

Where an arbitration involves both a general contractor claim and one or more pass-through claims on behalf of subcontractors, it is common to request the arbitrator(s) to specify in the decision how much is awarded, if any, for the benefit of the subs. Similarly, where there is a portion of a claim or counterclaim which may be covered by insurance, it is customary to request the arbitrator(s) to specify in the decision how much of the award, if any, is attributable to that matter.

Post-Arbitration Proceedings in Court

Once an award is made by the arbitrator(s), the next step, if payment is not made voluntarily, is for the winning party to file a petition in court, under the Uniform Arbitration Act, in the state court in the jurisdiction in which the arbitration was conducted, for what is known as "confirmation" of the award. When a judge confirms an award, the order of confirmation becomes a court judgment, just as if the matter had been tried in that court.

Where parties from different states are involved, there may be Federal jurisdiction for confirmation of the award in Federal court, under the Federal Arbitration Act.

If the losing party wishes to challenge the award, it may file a petition to vacate the award. There are very limited grounds on which an arbitration award may be vacated. The court will not rehash the arguments or review the evidence, or try to second-guess the arbitrator(s). The only basis for vacating an award is a defect in the proceeding itself. For example, an award can be overturned upon proof that an arbitrator had a financial interest in the outcome of the case; an undisclosed relationship with one of the parties; was biased or prejudiced; refused to grant a reasonable request for postponement; refused to hear material and pertinent evidence; issued an award that was in manifest disregard of the law or which was grossly irrational; or which was obtained by fraud, corruption, or undue means; or if an arbitrator otherwise engaged in some form of material misconduct.

One common ploy by disgruntled losers is to claim that the decision was a result of fraud, and then for the loser to point to testimony that it asserts was false as the basis for such a finding. Part of the job of the arbitrator(s) is to make judgments about credibility, and the fact that the truth of particular testimony is challenged by the other side is no basis for a finding of fraud. The type of fraud that would provide a basis for the vacation of an award would be bribing an arbitrator, bribing a witness to give knowingly false testimony, the discovery that a party had introduced fake documents or phony invoices, etc. Offering testimony of a witness whose credibility is subject to question does not constitute fraud.

Contractual Referral of Disputes to a Third Party

It is not unusual in construction contracts to provide that certain types of disputes -- most frequently scope of work issues -- are to be referred to a specified third party -- usually the project architect -- for decision. Some such clauses make the decision in question final, appealable only on grounds of fraud or bad faith, while other such clauses permit the decision to be challenged by arbitration.

Where parties agree in advance to abide by a decision of a specified third party, such agreements are fully valid and enforceable. Many courts have placed limits on such decisions, permitting them to be challenged on the grounds that they are contrary to custom and usage in the trade, or are arbitrary and capricious.

Contract Termination

When, if Ever, Should You Walk Off a Job?

The circumstances under which a participant in a construction project can refuse to continue to perform -- essentially walk off the job -- without incurring major liabilities are very limited.

> **Even when a subcontractor or a supplier is not being paid, unless there is a provision in the contract which spells out its right to discontinue performance upon the failure of its contracting party to make timely payments, a refusal to perform is a very risky action to take.**

Walking off a job should never be done without consultation with your attorney and a full review of the risks involved.

In government contracts, and in most private contracts, a contractor must continue to perform despite the existence of disputes over change orders, etc. These duties frequently are passed down to subcontractors and suppliers through contractual flow-down clauses.

Even threatening a walk-off can be risky, since your threats might be seized upon by your contracting party as the basis for declaring an anticipatory breach, and firing you, with the intent of using a claim of damages to offset your own claim of damages. Use of a threatened walk-off as a negotiating ploy should be oral and couched in very vague terms, such as "I am giving consideration to...," etc.

The Risks Involved in a Termination for Default

Similarly, an upstream party takes a very substantial risk in the default termination of a lower-tier contractor. If it turns out that there was in fact no material default on the part of the terminated party -- or if any performance deficiency was tied to a pre-existing default on the part of the upstream party -- then the upstream party may end up paying substantial damages, including lost profits prevented by the termination.

Where your contracting party is terminated for default for reasons not related to your performance, immediate action is recommended to pursue any avenues of payment security. In such cases, the party making the default termination will normally offer to take over your contract so that continuity on the project will not be lost.

The AIA General Conditions contains a clause (Section 5.4.1) which permits the owner to take over the subcontracts where the general contractor is terminated for default. Where there is no such contractual provision, it is standard practice for the owner to engage in a novation with the subcontractor, in which all duties of the sub to the prime are transferred to either the owner or to a new general contractor.

Summary of Chapter

Occasional disputes are an unfortunate but inevitable part of doing business. Most disputes can be resolved quickly by negotiation. If direct negotiations fail, and the amount in dispute is significant, involving a skilled mediator can often lead to resolution of the matter.

In those rare cases where neither negotiation nor mediation can resolve a dispute, arbitration is usually favored, under the Construction Industry Rules of the American Arbitration Association. Arbitration works well when both parties are cooperative and interested in resolving the dispute in a manner which maintains their relationship.

Although contractors are frequently tempted to simply shut down operations and walk off a job, the circumstances under which that solution is appropriate are rare indeed. Never walk of a job without advice of counsel and a full understanding of the risks involved.