



National Cooperative Highway Research Program
Selected Studies in Transportation Law

Volume 1

Construction Contract Law

TRANSPORTATION RESEARCH BOARD
OF THE NATIONAL ACADEMIES

Introduction

Cover, Title Page, and Project Committee Information

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**Selected Studies
in
Transportation Law**

Volume 1

CONSTRUCTION CONTRACT LAW

Transportation Research Board

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CONSTRUCTION CONTRACT LAW

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PREFACE

This volume revises Selected Studies in “Highway Construction Contracting,” Volume 3, *Selected Studies in Highway Law* (SSHL). That volume consisted of 12 legal research reports. Four articles incorporated into this volume were published subsequent to the last revision of SSHL in 1991.

The SSHL Volume dealing with construction contracting was unique in that some of the topics were first published in the initial SSHL Volume (1978) and not issued as Legal Research Digests. Some were subsequently supplemented by Research Results Digests. See the organization and relevant digests below:

- Licensing and Qualification of Bidders
 - Supplement to *Licensing and Qualifications of Bidders* in *Selected Studies in Highway Law*, NCHRP Research Results Digest No. 157, by Ross D. Netherton (1986).
 - Suspension, Debarment and Disqualifications of Highway Construction Contractors*, NCHRP Legal Research Digest No. 12, by Darrell Harp (1990).
- Competitive Bidding and Award of Highway Construction Contracts
 - Supplement to *Competitive Bidding and Award of Construction Contract in SSHL*, NCHRP Research Results Digest No. 163, by Ross D. Netherton (1987).
- Indemnification and Suretyship
 - Indemnification and Insurance Requirements for Design Consultants and Contractors on Highway Projects*, NCHRP Legal Research Digest No. 37, by Darrell W. Harp (1996).
- Labor Standards in Federal-Aid Highway Construction Contract
 - Supplement to *Labor Standards in Federal-Aid Highway Construction Contracts*, NCHRP Legal Research Digest No. 5, by Ross D. Netherton (1989).
- Control of Conflicts of Interest in Highway Construction Contract Administration
 - Control of Conflicts of Interest in Highway Construction Contract Administration*, NCHRP Research Results Digest No. 109, by Ross Netherton (1979).
- Legal Problems Arising from Changes, Changed Conditions, and Disputes Clauses in Highway Construction Contracts.
- Legal Effect of Representation as to Subsurface Conditions
 - Legal Effects as to Representation of Subsurface Condition*, NCHRP Research Results Digest No. 39, by John C. Vance and A. Alling Jones (1972).
- Liability for Delay in Completion of Highway Construction Contract.
- *Enforceability of the Requirement of Notice in Highway Construction Contracts*
 - NCHRP Research Results Digest No. 152, by John Vance (1986).
- Trial Strategy and Techniques in Highway Contract Litigation
 - Trial Strategies and Techniques in Highway Contract Litigation*, NCHRP Research Results Digest No. 108, by Orrin F. Finch and Kingsley T. Hoegstedt (1979).
- Minority and Disadvantage Business Enterprise Requirements in Public Contracting
 - Minority and Disadvantage Business Enterprise Requirements in Public Contracting*, NCHRP Research Results Digest No. 146, by Orrin F. Finch (1985).

—*Supplement to Minority and Disadvantaged Business Enterprise Requirements in Public Contracting*, NCHRP Legal Research Digest No. 25, by Orrin Finch (1992).

- Legal Implications in the Use of Penalty and Bonus Provisions in Highway Construction Contracts: The Use of Incentive and Disincentive Clauses as Liquidation Damages for Quality Control and for Early Completion.
- *Preventing and Defending Against Highway Construction Contract Claims: The Use of Change or Differing Site Condition Clauses and New York State's Use of Exculpatory Contract Provisions and No Claims Clause*, by Darrel Harp (1993).
- *Liability of Contractors to State Transportation Departments for Latent Defects in Construction After Project Acceptance*, NCHRP Legal Research Digest No. 39, by Darrell W. Harp (1997).

The overall focus of this revised Volume is to follow the Construction Contracting process from start to finish, from contract planning to conclusion of the claims processes. Many of the older articles present considerable historical information as well as extensive tables setting forth state by state statutory citations. We have removed a significant portion of the historical information, updated the statutory citations, and sought to focus this volume much more towards assisting the practicing attorney.

SECTION 1

**THE TRANSPORTATION CONSTRUCTION
CONTRACT**

A. METHODS OF CONTRACTING FOR TRANSPORTATION CONSTRUCTION

1. Competitive Bidding—The Design-Bid-Build Method

State and federal law nearly always requires that public works projects be procured through a competitive selection process.¹ Most transportation construction projects have traditionally used the “design-bid-build” method, or competitive sealed bidding. Using this method, the transportation agency designs the project, either with its own staff or through a consultant, and prepares the project plans and specifications. The agency then advertises the project for bids, and selects the lowest responsible bidder to build the project. Recently, some state transportation agencies have obtained legislative authority to use other methods such as design-build and public-private partnerships; however, most agencies still use the design-bid-build method for most projects.

The 2000 Model Procurement Code for State and Local Governments includes processes for competitive sealed bidding as well as competitive sealed proposals, which is used for design-build and other alternative contracting methods.² The Model Code no longer states a statutory preference for competitive sealed bidding, although it is still the default source selection method.³

Procedures for selection of contractors to construct, maintain, improve, and repair public highways are based on state statutes and administrative rules.⁴

¹ Portions of this section are derived from *Competitive Bidding and Award of Highway Construction Contracts* by Dr. Ross D. Netherton, published by the Transportation Research Board in 1976 and included in the first edition of *SELECTED STUDIES IN HIGHWAY LAW*, vol. 3., p. 1175 or supplemented *id.* at pp. 1214–51 (1988).

² AMERICAN BAR ASSOCIATION, MODEL PROCUREMENT CODE FOR STATE AND LOCAL GOVERNMENTS (hereinafter “Model Code”) § 3-202 (2000). A number of states have enacted some variation of the Model Code as their state procurement code. In those states, the commentary contained in each section of the Model Code may be useful as legislative history. In addition, the ABA regularly publishes compilations of cases decided under state law in states that have enacted the Model Code. For further discussion of the development of the 1979 Model Code, see C. Cushman, *The ABA Model Procurement Code: Implementation, Evolution, and Crisis of Survival*, 25 PUB. CONT. L.J. 173–98 (1996); and F.T. vom Baur, *A Personal History of the Model Procurement Code*, 25 PUB. CONT. L.J. 149–72 (1996) (written by chairman of ABA committee that drafted 1979 Model Code).

³ Model Code, *supra* note 2, at xiii.

⁴ *Aschen-Gardner, Inc. v. Superior Court In and For County of Maricopa*, 173 Ariz. 48, 839 P.2d 1093, 1095–96 (1992) (competitive bidding for public works projects is required only when mandated by statute); see also *Smith v. In-*

These rules have no common law antecedents, and thus they constitute a set of positive policies and requirements that distinguish the conduct of public officials from the practices of those in private business. Two objectives underlie the development of most of today’s laws and regulations requiring competitive bidding—the prevention of favoritism in spending public funds, and the stimulation of competition in the construction industry.⁵

The importance of complying with statutory bidding procedures is illustrated in cases in which governments have attempted to use the public contracting process to help achieve policy and program goals, especially in connection with social and economic issues and public safety. When an agency modifies its competitive bidding procedures to accommodate extraneous public interests, disappointed bidders may challenge the award as violating bidding requirements.⁶ This occurred when a transportation authority awarded a contract to paint subway stations to a nonprofit corporation engaged in rehabilitating the work habits of persons with poor employment records resulting from alcoholism, drug addiction, imprisonment, or “social disability.” The organization’s clients came from governmental and quasi-public sources, and its program implemented the state’s social services laws. The painter’s union successfully challenged the transportation authority’s award. The court held that neither the good intentions of the contracting agency nor the laudable work of the contractor could overcome the statutory requirement for competitive bidding.

The intent of the bidding statute is to prevent favoritism, improvidence, extravagance, fraud and corruption and to promote economy in public administration and honesty, fidelity and good morality in administrative officers. This policy is so strong that a violation of [it]...renders a public works contract void.

Thus, the questions become whether...the [transportation authority] has the right to make an exception for contracts, that clearly contemplate public works, when the contractor is an organization that is itself performing a valuable service in the public interest....

tergovernmental Solid Waste Disposal Ass’n, 178 Ill. Dec. 860, 605 N.E.2d 654, 664, 239 Ill. App. 3d 123 (1992) (in absence of statute requiring it, competitive bidding is not necessary for public agency to enter into valid contract); *but see City of Philadelphia v. Commonwealth of Pa. Dep’t of Env’tl. Resources*, 133 Pa. Commw. 565 577 A.2d 225, 228 (1990).

⁵ *Computer Shoppe v. State*, 780 S.W.2d 729, 737 (Tenn. App. 1989) (public bidding statutes are intended to promote public interest by aiding government in procuring best work or materials for lowest practical price, providing bidders with fair forum for competing for government contracts, and protecting public from its officials’ self-dealing, extravagance, and favoritism).

⁶ *District Council No. 9, Int’l Bhd. of Painters & Allied Trades v. Metropolitan Transp. Auth.*, 115 Misc. 2d 810, 454 N.Y.S.2d 663, 667 (1982).

As well motivated as this sentiment may be, the statute does not support [the authority's action].⁷

Even though avoidance of favoritism and fraud is important, it is not the most important purpose of public bidding rules. The primary objective has always been to obtain a full and fair return for an expenditure of public funds.⁸ This may be accomplished by extending invitations for public contract work on an open and equal basis to all persons who are able and willing to perform the work. Through effectively supervised competition among the parties, the public is assured that there will be a real and honest cost basis for the work desired.⁹

Therefore, competitive bidding requirements serve multiple purposes, and statements of these purposes by the courts have varied in emphasis. An illustrative list of the major objectives of competitive bidding is found in *Wester v. Belote*:

[T]o protect the public against collusive contracts; to secure fair competition upon equal terms to all bidders; to remove, not only collusion, but temptation for collusion and opportunity for gain at public expense; to close all avenues to favoritism and fraud in its various forms; to secure the best values [for the public] at the lowest possible expense; and to afford an equal advantage to all desiring to do business with the public authorities, by affording an opportunity for an exact comparison of bids.¹⁰

a. The Essential Principles of Competitive Bidding

i. *The Form of Competitive Bidding Rules.*—An agency satisfies the objectives of competitive bidding when it follows uniform procedures relating to: (1) public advertisement to bidders inviting the submission of proposals; (2) preparation of plans, specifications, and related information about the work and the location where those materials may be obtained by prospective bidders; (3) formal submission of proposals to the contracting agency, together with the deposit of financial security guaranteeing that the bidder will accept the award of a contract if it is the lowest responsible bidder; (4) consideration of proposals under uniform criteria, and (5) award of contracts to lowest responsible bidders.

Any effort to fully describe the law relating to competitive bidding and award of contracts must take into account statutes, administrative regulations, and the informally followed practices of the contracting agency. Patterns regarding the mix of statutory and administrative elements in the law vary from state to state. Connecticut's statute illustrates an unusually broad

delegation of procedural rule making authority to administrative officials:

The commissioner may, at any time, call for bids to construct, alter, reconstruct, improve, relocate, widen or change the grade of sections of state highways or bridges.

All bids shall be submitted on forms provided by the commissioner and shall comply with the rules and regulations provided in the specifications....¹¹

In contrast, other states leave certain aspects of bidding to administrative judgment, and specify other aspects in statutes. Such variations in the form of competitive bidding laws reflect the tension between allowing flexibility and curbing the agency discretion that pervades public contract law. The Model Code sets out very general requirements, with more detailed requirements left to agency regulations.¹²

ii. *Single or Separate Contracts.*—Public works agencies customarily have wide discretion as to when to subdivide a project and award separate contracts for each segment or component of the work. Because this decision determines the monetary size of the contract, the agency's decision in this matter may directly affect the number and type of available bidders. However, compelling economic, engineering, and financial reasons may influence an agency's decisions regarding the dividing of contracts. As long as these considerations are reasonable, courts have tended to uphold the contracting agency's actions in determining the size and scope of the contract.

However, if the specifications issued by the contracting agency result in limiting the bidding or otherwise impairing free competition in the selection of public contractors, the award may be enjoined or nullified, or the agency may be required to reject all bids and re-advertise on more appropriate terms. For example, an agency was not allowed to arbitrarily divide a project for installation of traffic signals into separate contracts for procurement of materials, equipment, and labor where these items were parts of an integrated project. The apparent purpose of the separation was to keep each contract under the statutory minimum price for requiring competitive bidding.¹³

On the other hand, where these items are not necessarily integrated in the type of construction work called for, they may be provided under separate contracts. Specialty work frequently is sufficiently different from basic construction tasks to warrant separation of contracts.¹⁴ Separate contracts have also been upheld for

⁷ *Id.* at 667–68 (citations omitted).

⁸ See, e.g., *City of Atlanta v. J.A. Jones Constr. Co.*, 260 Ga. 658, 398 S.E.2d 369, 370, *on remand*, 198 Ga. App. 345, 402 S.E.2d 554, *cert. denied*, 111 S. Ct. 2042 (1990).

⁹ *Carbro Constr. Co. v. Middlesex County Util. Auth.*, 233 N.J. Super. 116, 558 A.2d 54, 58 (1989) (curtailing local discretion and requiring strict compliance with bidding requirements protects public against favoritism, extravagance, and corruption).

¹⁰ 103 Fla. 976, 723–24, 138 So. 721, 722 (1931).

¹¹ CONN. GEN. STAT. ANN. § 13a-95 (1999).

¹² Model Code, *supra* note 2.

¹³ *National Elec. Contractors Ass'n, Puget Sound Chapter v. City of Bellevue*, 1 Wash. App. 81, 459 P.2d 420, 421 (1969) (where bidding statute was written in conjunctive, "improvement, including materials, supplies, and equipment," a project could not be broken out into separate contracts for materials and installation).

¹⁴ See, e.g., notes 16 through 19 *infra*.

construction of two similar facilities where the projects were to be paid for from separate funding sources.¹⁵

Although state laws mandating separate bidding for different construction trades are not normally applicable to transportation construction contracts, the Ohio Supreme Court addressed the question of whether a state separation statute applied to a contract for the construction of roadside rest areas. A local mechanical contractors association sought to enjoin the advertisement, claiming that the state bidding law required separate contracts for each mechanical trade involved in the project.¹⁶ In this case, each rest area involved construction of public facilities and storage buildings with janitors' and storage rooms, and installation of a complete wastewater treatment system. Examining the Ohio Department of Transportation's statutory authority to enter into contracts, the court concluded that although the legislature had not authorized construction of roadside rest areas in specific terms, ample authority could be inferred from other legislation making the agency responsible for highway and roadside conditions.¹⁷ The more difficult question was whether the Department of Transportation was subject to a statutory requirement that state contracts involving plumbing, gas fitting, steam heat and power, and electrical equipment must be awarded in separate contracts for each mechanical trade involved.¹⁸ Construing the applicable statutes, the court held that they required the Department to advertise and award separate contracts for each mechanical trade involved in the desired work.¹⁹

Because transportation construction programs generally use standard specifications and procedural manuals, the room for discretionary combining or splitting of projects for bidding is reduced.²⁰ Competitive bidding practices have been standardized along lines that courts, agencies, and contractors agree are reasonable and feasible and that do not weaken the process of pro-

curement by competition. This standardization has also contributed to stabilizing this aspect of bid preparation.

iii. Lump Sum Versus Unit Price Bids.—Another aspect of bidding that is normally left to the discretion of the contracting agency is whether bids must be submitted in the form of a lump sum for the entire project or in a series of prices for units of work or materials. Lump sum bids are favored where construction jobs involve a variety of operations and it is impractical to break down the work into a few basic units of materials and labor. Ultimately, the success of this method requires complete and accurate specifications, detailed work plans, and accurate quantities of labor and materials. Failure to provide full guidance on these technical matters increases the risk of excessively high bids as bidders attempt to price risks that they cannot reasonably evaluate.

Unit price bidding is favored where a project requires large quantities of relatively few standardized materials and construction operations, or where the exact quantities of materials and labor are not known in advance. A proposal form is furnished to bidders, containing the agency's estimate of the quantities to be used in the project. In submitting its bid, the contractor inserts the unit price as requested, and extends the unit prices by the agency's estimated quantities.²¹

When a contract is bid on a unit price basis, reasonable variations may be made in the work without the necessity of formal change orders. However, this flexibility applies only to items originally covered in the contract. If material discrepancies occur between the estimated and actual quantities required for the work, the agency may reconsider the original contract.

In a bid based on unit prices, discrepancies may occur between the total unit price shown in the bid and the same price as calculated by multiplying the unit price by the number of units to be furnished. If bidding instructions anticipate such situations and specify which figure will be accepted, the parties to the contract are held to resolving discrepancies by that means. Whether the bid must be rejected will depend on how much discretion an agency's statute allows in resolving bidder mistakes.²² One court has held that the contracting agency could not reject the bid as being ambiguous when this error occurred.²³ Another has held that the agency had the right to reject a bid in spite of an "errors in bid" formula contained in the bid advertisement, where accepting the bid would have allowed the bidder to choose between two differing price totals.²⁴ Where the

¹⁵ *Daves v. Village of Madelia*, 205 Minn. 526, 287 N.W. 1, 123 A.L.R. 569 (1939).

¹⁶ *Mechanical Contractors Ass'n of Cincinnati v. State*, 64 Ohio St. 2d 192, 414 N.E.2d 418 (1980) (rest areas were considered part of the highway, thus the Department of Transportation was authorized to contract for their construction and improvement).

¹⁷ *Id.* at 420–21.

¹⁸ OHIO REV. CODE ANN. §§ 153.02, 153.03 (1985 Supp.), repealed 1996.

¹⁹ A dissent argued, however, that the Director of Transportation could act under special highway enabling legislation and award contracts for highway and bridge work in any manner deemed advantageous to the public. 414 N.E.2d at 421–22 (citing OHIO REV. CODE § 5529.05).

²⁰ See UTAH CODE § 72-6-102 (agency required to adopt standard plans and specifications for construction and maintenance of state highways).

²¹ *State Highway Admin. v. David A. Bramble, Inc.*, 351 Md. 226, 717 A.2d 943, 944 (1998).

²² See Model Code, *supra* note 2, at § 3-202(6) and commentary.

²³ *Pozar v. Department of Transp.*, 145 Cal. App. 3d 269, 193 Cal. Rptr. 202 (1983).

²⁴ *Colonnelli Bros. v. Ridgefield Park*, 665 A.2d 1136, 1139 (N.J. Super. A.D. 1995).

specifications clearly require that both unit prices and total prices for each bid item be included, a bid may be found nonresponsive for failure to include both.²⁵ A Louisiana court addressed this issue:

Even though DOTD's rigid specifications as to the bid form may have seemingly harsh results, any interpretation but the most literal would contravene the *stricti juris* nature of the public contract laws. As our brethren on the Fourth circuit have noted:

"[B]idding in accordance with the advertisement is essential to satisfy the purposes for which the public bid laws were enacted. If public bidding is an honest attempt at getting the best value for tax moneys, then every bidder must be held bound by the terms of the advertising. To allow anything less than a bid conforming on its face to the advertised specifications would constitute an open invitation to the kind of impropriety and abuse the public bid laws were designed to prevent."²⁶

One cause of confusion may be a contracting agency's reservation of the right to award contracts on only a part of the total work described in the bid advertisement. In *Devir v. Hastings*, a municipal agency requested bids for resurfacing four streets, but reserved the right to award contracts for less than all four.²⁷ The bid advertisement specified that bids must be submitted on a per yard basis. The challenger argued that the agency's reservation deprived bidders of a common basis for such a unit price bid. The court held, however, that prospective bidders could determine both the minimum and maximum amounts of material needed and so could compete on an equal footing.

b. Advertisement for Bids

i. *General Requirements for Advertisement.*—For competition to be fostered in public bidding, (1) everyone qualified and desiring to bid on the project must be adequately informed of it, and (2) all bidders must be given equal opportunity to bid and have their bids considered on the same terms. Requirements for public advertisement of projects and invitations to bid are implemented through a publication of a formal call for proposals or invitation for bids. This must contain the essential information about how bids should be submitted, and must inform bidders of all the essential features of the project.²⁸ For example, Louisiana's public procurement statute, which is based on the Model Code, requires that the invitation for bids contain all contractual terms and conditions applicable to the procurement, as

well as the evaluation criteria to be used.²⁹ Requirements of state laws regarding advertisement for bids on highway construction are found in Appendix A.

The requirement for public advertisement, and the terms on which it must be provided, are based in statute.³⁰ Typically, statutes relating to advertisement of public works projects set forth the times, places, and forms of publication of the advertisement. Most statutes favor newspapers of general circulation in the county where the work is to be done as the principal means of advertisement.³¹

In addition, since contractors often do business in multi-state regions, they may be contacted more easily through industry trade journals than through local newspapers. Therefore, contracting officers in many states are either directed or authorized to publish notices of their projects and invitations to bid in these trade journals. Other devices for accomplishing this same purpose include publication in an "official newspaper" of the state, and listing in a departmental bulletin published by the state transportation agency.³² Some states also post information about projects and bid opening dates on their Internet web sites. Colorado allows Internet publication as follows: "The executive director of the department of transportation may invite bids using electronic on-line access, including the internet, for purposes of acquiring construction contracts for public projects on behalf of the department of transportation."³³

Agencies must strictly comply with the statutory time for publication of bid announcements. Where exact dates are not given, the rules must be construed so that the agency accomplishes the legislative purpose of adequate and reasonable notice. Confusion has occasionally arisen over the method of correctly calculating the period over which notices must appear. One typical style of drafting this provision states that the agency shall advertise "for two consecutive weeks" in designated newspapers. An Ohio court gave this interpreta-

²⁹ *Pacificorp Capital v. State, Through Div. of Admin., Office of State Purchasing*, 647 So. 2d 1122, 1124 (La. App. 1 Cir. 1994), *writ denied*, 646 So. 2d 387 (1994).

³⁰ In the absence of legislation, public advertisement for bids would be entirely discretionary with the contracting agency, and when utilized would follow procedures designated in the contracting agency's resolution authorizing the contract. Failure to comply with the requirements of such a resolution may defeat the validity of a contract just as surely as failure to comply with procedures specified by statutes or regulations. *Reiter v. Chapman*, 177 Wash. 392, 31 P.2d 1005, 1006-07, 92 A.L.R. 828 (1934).

³¹ See Appendix A.

³² See ALASKA STAT. § 36.30.130 (1998) (publication by the procurement office is required in Alaska in the online Public Notice System for 21 days prior to bid opening); MISS. CODE § 65-1-85 (requiring publication in newspaper of general circulation published in state capital, having general circulation throughout the state).

³³ COLO. REV. STAT. § 24-92-104.5 (1999); see also D.C. CODE § 2-303.03 (C-1) (2002).

²⁵ *V.C. Nora, Jr. Building & Remodeling v. State, Dep't of Transp. and Dev.*, 635 So. 2d 466, 472-73 (La. App. 3d Cir. 1994).

²⁶ *Id.* (quoting *Gibbs Constr. v. Board of Sup'rs of L.S.U.*, 447 So. 2d 90 (La. App. 4th Cir. 1984)).

²⁷ 277 Mass. 502, 178 N.E. 617 (1931).

²⁸ Model Code, *supra* note 2, at § 3-202(2), (3), and commentary.

tion: “In our opinion, the work ‘for’ [means that]...such advertisement is required ‘during the continuance of’ or ‘throughout’ the period of two weeks....[I]t follows that two full calendar weeks must elapse subsequent to the date of the first publication before the date fixed for receiving the bids.”³⁴

Some statutes address this potential statutory construction problem by specifically requiring publication “at least once per week” for 2 consecutive weeks.³⁵

Federal approval is required before any advertisement for bids or undertaking of bids in federally-funded projects. The Federal Highway Administration (FHWA) requires that a minimum of 3 weeks must be available to bidders before the opening of bids.³⁶ However, the FHWA Division Engineer is authorized to approve shorter periods in special cases.³⁷ Ultimately, the question of justification is likely to be a practical one. FHWA recognizes that advertising longer than 3 weeks is desirable for “large, complicated projects that will require considerable time for study and developing of cost data before realistic bids can be prepared.”³⁸ In contrast, small, simple problems of construction and maintenance can be prepared and submitted on short notice.

ii. Content of Bid Advertisements.—Bidding statutes have a variety of approaches to informing prospective bidders of the nature of the work required. The contracting agency’s announcement must be sufficient to indicate the character, quality, location, and timetable of a construction project, or the type, quantity, and delivery requirements for purchases of supplies and construction materials.³⁹ When a bidder claims that there is a patent ambiguity in bid documents, a court limits its inquiry to whether a reasonable person could find gross discrepancies, obvious errors in drafting, or a glaring gap.⁴⁰ Bid documents are subject to the same rules of interpretation as are contracts: the documents must be interpreted so as to give meaning to all parts and in a manner that does not create internal conflicts.⁴¹ An

agency’s exercise of discretion in adopting bid specifications is reviewed for arbitrary action.⁴²

Requirements relating to the content of bid advertisements often vary according to the transportation system involved. Within a state, there may be separate laws regarding state highways, county and municipal roads, turnpikes, and transit systems. Each may differ regarding the information that bid advertisements must contain. For example, Kansas’s law relating to contracts of the state highway commission and the county boards of commissioners illustrates these differences. Notice of state highway projects must “specify with reasonable minuteness the character of the improvement contemplated, the time and place at which the bids will be received, and invite sealed proposals for the same....”⁴³

For projects undertaken by county boards of commissioners, the public notice must

specify with reasonable minuteness the character of the improvement contemplated, where it is located, the kind of material to be used, the hour, date and place of letting of such contract, when the work is to be completed, and invite sealed proposals for the same. Such other notice may be given as the board may deem proper....⁴⁴

In addition to the character and location of the work, some states have added other items in which there is special interest. Examples include notice that prevailing wage rates must be paid to laborers on the job,⁴⁵ whether prequalification of subcontractors is required,⁴⁶ whether bids must lie on the entire project unless the contracting officer formally determines that a separation is necessary,⁴⁷ and that bid bonds will be required in specified amounts.⁴⁸ It is also common for statutes to require that bid invitations reserve to the contracting agency the right to reject all bids if it is deemed appropriate.⁴⁹ They may also require that the notice include information as to where the project plans, specifications, and other pertinent papers may be inspected.⁵⁰ Where bid specifications set out the factors on which bids may be evaluated, they are not necessarily re-

³⁴ State ex rel. Dacek v. Cleveland Trinidad Paving Co., 35 Ohio App. 118, 171 N.E. 837, 840–41 (1929).

³⁵ See, e.g., 29 DEL. CODE § 6962(b) (1998).

³⁶ 23 C.F.R. § 635.112(b) (1999).

³⁷ *Id.*

³⁸ FEDERAL-AID POLICY GUIDE, Oct. 9, 1996, Transmittal 16 (nonregulatory supplement to 23 C.F.R. § 635.112).

³⁹ See *Wilson Bennett, Inc. v. Greater Cleveland Regional Transit Auth.*, 67 Ohio App. 3d 812, 588 N.E.2d 920, 925, *jurisdictional motion allowed*, 53 Ohio St. 3d 717, 560 N.E.2d 778 (1990), *cause dismissed*, 57 Ohio St. 3d 721, 568 N.E.2d 1231 (1991) (invitation to bid and specifications present common basis for bidding).

⁴⁰ *Fry Communications v. United States*, 22 Cl. Ct. 497, 509 (1991).

⁴¹ *Vanguard Security v. United States*, 20 Cl. Ct. 90, 103 (1990).

⁴² *Glacier State District Services v. Wis. DOT*, 221 Wis. 2d 359, 585 N.W.2d 652, 656 (1998) (specifications reviewed to determine whether they were arbitrary or unreasonable).

⁴³ KAN. STAT. ANN. § 68-408 (1999).

⁴⁴ KAN. STAT. ANN. § 68-521(a)(1999); see also, e.g., S.D. Codified Laws § 5-18-3 (2001) (requirements for advertising of state highway projects) and § 31-12-14 (2001) (requirements for advertising county road projects).

⁴⁵ OR. REV. STAT. § 279.312(1)(a) (1999).

⁴⁶ 29 DEL. CODE ANN. § 6962(c) (1999).

⁴⁷ CAL. PUB. CONT. CODE § 10141 (1999).

⁴⁸ MONT. REV. STAT. § 18-2-302 (1999).

⁴⁹ See, e.g., 23 ME. REV. STAT. ANN. § 753 (2002).

⁵⁰ *Id.*; see also *Ragland v. Commonwealth*, 172 Va. 186, 200 S.E. 601, 602–03 (1939) (plans and specifications placed on file for public inspection or as a reference to bidders become the only authentic and binding specifications).

quired to include the relative weight that will be given to those factors.⁵¹

Contracts in which federal-aid funds are used must comply with certain requirements of federal law or regulations, which must be mentioned in the project advertisement. Federal-aid regulations call for specific assurance that state procedures afford all qualified bidders a nondiscriminatory basis for submitting proposals and having their proposals considered.⁵² If there are any features of state law that may operate in a manner to prohibit submission of a bid, or prevent consideration of a bid made by a qualified contractor, the project advertisement must state that those features are not applicable to the advertised contract.⁵³ In addition, all advertisements must advise prospective bidders that, as a condition precedent to federal approval of the contract, the successful contractor must execute and file with the state transportation agency a sworn statement that it has not been a party to any collusion or restraint of free competitive bidding in connection with the project.⁵⁴

Finally, federal-aid regulations specifically state that bid advertisements shall not be issued until the provisions of regulations and directives covering administration of the Uniform Relocation Assistance Act have been met and that all needed right-of-way has been acquired.⁵⁵ In the event the requirement that all right-of-way be available is not met before advertisement, the advertisement must include appropriate notice identifying all locations where right of possession and use has not been obtained.⁵⁶

iii. Change of Specifications Following Advertisement.—The project announcement and bidders' proposals are considered to be only invitations and offers, either of which may be changed or withdrawn without penalty prior to the opening of bids and contract award. However, limits are placed on an agency's reserved right to make changes by addendum during the bidding process. Properly issued and provided to all prospective bidders, the addendum becomes part of the invitation for bids.⁵⁷ A change announced unilaterally by the contracting agency after advertisement of a project must not give any bidder or group of bidders an unfair advantage, nor may the contracting agency include in the contract any provision benefiting the successful bidder that was not within the terms or specifications that were the basis for the bidding.⁵⁸ Extensions of time for performance

and agreement to accept substitute materials or modified designs are common types of changes that test the application of this rule. Where the change made in the originally announced terms or specifications is substantial, the validity of the competitive award can be preserved best by re-advertising the project for bids, giving consideration to the changed terms.

If a contracting agency decides to make additions or modifications in the specifications or bidding instructions after they have been advertised but before the bids are opened, it must make those changes in a manner that assures that all bidders receive notice of them.⁵⁹ If statutory procedure is silent on the notification method, the contracting agency's own bidding instructions may provide the necessary guidance. In the absence of any such guidance, the agency still is responsible for notifying all prospective bidders in a manner that ensures the integrity of the bidding process. Accordingly, where an addendum page was disseminated by simply inserting it into the packets of bidding documents remaining to be picked up by prospective bidders, it was held that the agency had not fulfilled its duty of notification.

But where as here, an alternative procedure for giving notice of an addendum to the plans and specifications is utilized after the statutory notice has been published...the alternative procedure so utilized, as a matter of law, must, as a minimum, establish *actual knowledge* on the part of the prospective bidder of the fact of the addendum. Thus, as a matter of law, where a challenge to that alternative procedure is promptly entered by an actual bidder who presents a *prima facie* case that he was unaware of the addendum to his prejudice, the bidding procedure employed...fails and the trial court is required to order the board to reject all bids....⁶⁰

In issuing an addendum, the agency must be careful that the addendum provides all of the information that it expects bidders to abide by, and that it states very clearly what is being amended in the original invitation for bids. For example, in *Air Support Services International, Inc. v. Metropolitan Dade County*, the court held that the agency could not impose the time limit for submission of bids that was included in the invitation for bids where none was given in the addendum that extended the time for submission.⁶¹ The court found that the addendum implied that bids would be due by the close of business on the date indicated, rather than at the earlier time of day stated in the original invitation for bids.

⁵¹ *Dunnuck v. State*, 644 N.E.2d 1275, 1279 (Ind. App. 1 Dist. 1994).

⁵² 23 C.F.R. § 635.110 (1999).

⁵³ 23 C.F.R. § 635.112(d) (1999).

⁵⁴ 23 C.F.R. § 635.112(f) (1999).

⁵⁵ 23 C.F.R. § 635.309(c) (1999).

⁵⁶ 23 C.F.R. § 635.309(c)(3) (1999).

⁵⁷ *Leaseway Distribution Centers v. Department of Admin. Servs.*, 49 Ohio App. 3d 99, 550 N.E.2d 955, 960 (1988).

⁵⁸ *Lake Constr. & Dev. Corp. v. City of New York*, 221 A.D. 2d 514, 621 N.Y.S.2d 337, 338 (1995).

⁵⁹ See *Air Support Services Internal v. Metropolitan Dade County*, 614 So. 2d 583, 584 (Fla. App. 3 Dist. 1993) (public bid requirements may not be materially altered after submission of bids); *Glynn County v. Teal*, 256 Ga. 174, 345 S.E.2d 347 (1986) (agency cannot make material changes in plans and specifications without notice to prospective bidders); 29 Del. Code § 6923 (g) (2001).

⁶⁰ *Boger Contracting Corp. v. Bd. of Comm'rs.*, 60 Ohio App. 2d 195, 396 N.E.2d 1059, 1064 (1978) (emphasis in original).

⁶¹ 614 So. 2d 583, 584 (Fla. App. 3 Dist. 1993).

Most agencies' procedures limit the time that an addendum may be issued, and may prohibit the issuance of an addendum within a certain short period of time before bid opening. This time limitation acknowledges that late-issued addenda may not reach all bidders prior to bid opening, and also recognizes that bidders may need time to adapt their bids to the new specifications. Thus a Louisiana court found that an addendum issued within 72 hours of bid opening was issued improperly.⁶² Not all bidders had been informed of the change, resulting in bidders submitting bids on different specifications. The court enjoined the Parish from awarding the contract, thus requiring the agency to reject all bids.⁶³

c. Bid Security Deposits

The purpose of the statutory requirement for a bid security deposit is to assure that the bidder is acting in good faith, and that if its bid is successful it will enter into the contract and furnish the necessary bonds for performance of the work and for payment for labor and materials.⁶⁴ Maine's statute is an example:

Each bidder must accompany his bid with a deposit of a good and sufficient bid bond in favor of the State for the benefit of the department, executed by a corporate surety authorized to do business in the State, or certain securities, as defined in Title 14, section 871, subsection 3, payable to the Treasurer of State, for an amount which the department considers sufficient to guarantee that if the work is awarded to him, he will contract with the department for its due execution....⁶⁵

Statutes or regulations typically specify the amount of the deposit, either as a percentage of the total amount of the bid, or a fixed dollar amount determined by the contracting agency, and the acceptable method or methods of providing the security. A comparative summary of state statutes and regulations relating to bid security deposits is given in Appendix B. In most instances, the statutes and regulations also specify how security deposits will be released or returned to unsuccessful bidders.⁶⁶ For example, Alabama's statute provides that all bid bonds except those of the three lowest bidders will be returned immediately after determination of the low bidder, with others returned after the contract is executed.⁶⁷ Requirements for bid bonds may

also be detailed in standard specifications, consistent with the agency's statutory authority.⁶⁸

State statutes may also specify the form of the bid bond. Where a statute required the bonds for public works projects to be written by a surety that was currently on the United States Treasury Department Financial Management Service list of approved bonding companies, bid bonds were held to be covered by that requirement.⁶⁹ More typically, statutes require that the bond be issued by a surety authorized to do business in the state.⁷⁰

When bidders may satisfy security requirements by furnishing a surety bond, the surety's obligation typically covers the difference between the amount of the bid and the amount the contracting agency must pay to another contractor to perform the work covered by the bid.⁷¹ When bidders may meet security requirements by depositing a check or bank draft, they must post a specific dollar sum, which is then subject to forfeiture if the bidder fails to execute the contract.

Whether bid security deposits are penalties or liquidated damages has frequently been questioned. One court has considered the forfeiture of the bid bond to be liquidated damages, intended to compensate the agency for its costs in awarding to the next low bidder or re-advertising.⁷² Another has interpreted the bid bond as a penalty, noting that the bid bond document describes the amount of the bond as a "penal sum."⁷³ The language of these forms has not, however, been considered conclusive proof of their intention or effect. When questions of enforcement have arisen, courts have allowed the circumstances to govern each case, and forfeiture of security deposits may be avoided where unusual hardship or inequity would result.

Much of the reported litigation over interpretation of bid security requirements arises from circumstances where bidders want relief from bid mistakes.⁷⁴ However, one case involved the bidder's deliberate refusal to execute the contract because of alleged failure of the

⁶⁸ See WASH. REV. STAT. § 47.28.090 and WASHINGTON STATE DEPARTMENT OF TRANSPORTATION, *Standard Specifications for Road, Bridge and Municipal Construction*, § 1-02.7 (2002).

⁶⁹ *Gibson Roofers v. Terrebonne Parish Consol. Gov't*, 577 So. 2d 362, writ denied, 580 So. 2d 672 (La. App. 1 Cir. 1991).

⁷⁰ See KAN. STAT. ANN. § 68-410 (2000).

⁷¹ *City of Cheyenne v. Reiman Corp.*, 869 P.2d 125, 127 (Wyo. 1994) (forfeiture of bid bond is liquidated damages for low bidders' failure to execute contract or proceed with construction); WYO. STAT. § 15-1-113 (2002); see also Nebraska Standard Specifications § 103.05 (forfeiture of bid security for failure to execute contract is not penalty but rather in liquidation of damages sustained).

⁷² See *Reiman Corp.*, supra note 71.

⁷³ *Powder Horn Constructors v. City of Florence*, 754 P.2d 356, 366-68 (Colo. 1988).

⁷⁴ See § 3.

⁶² *Grace Constr. Co. v. St. Charles Parish*, 467 So. 2d 1371, 1374 (La. App. 1985).

⁶³ *Id.*

⁶⁴ Model Code, supra note 2, at § 5-301.

⁶⁵ 23 ME. REV. STAT. ANN. § 753 (2002).

⁶⁶ See *Environmental Safety and Control Corp v. Auburn Enlarged City Sch. Dist.*, 167 A.D. 2d 876, 561 N.Y.S.2d 972 (1990).

⁶⁷ See ALA. CODE § 39-2-5 (2001 supp.).

contracting agency to perform. A successful bidder believed that the contracting agency would not be able to furnish the needed right-of-way by the time of execution, and delayed executing the contract.⁷⁵ Ultimately, the contractor had to forfeit its deposit when the court held that the contracting agency had adequate legal authority to obtain the right-of-way through condemnation, and was under no obligation to acquire the land in advance of the contract execution. Unless conditional terms are set out and accepted in the bid, the bidder is not relieved of its contractual duty under the bid merely because it believes that the contracting agency will not be able to perform its part of the contract.

Compliance with bidding procedure is an administrative function, and courts do not substitute their judgment for that of the contracting agency in the absence of fraud. So where an agency rejected a bid because the bidder's security deposit check was not properly certified, the court upheld the agency's action over arguments that the defective certification complied with the intent of the law.⁷⁶ Depending on statutory requirements, the requirement of a bid bond may be considered permissive and subject to waiver by the agency.⁷⁷ Also, where the contractor's signature on the bond is not necessary for enforcement of the bond, the requirement of that signature may be waived.⁷⁸ However, a bid could properly be rejected because of the surety's failure to use the bid bond form required by the agency, where the failure resulted in required information being omitted.⁷⁹ This was found to be an error of substance and not merely of form, because required information was not provided to the agency.

d. Other Bidder Requirements

Some agencies may require attendance at the pre-bid conference as a condition for having the contractor's bid considered. Where the invitation for bids expressly stated that a bidder's attendance at the pre-bid meeting was mandatory in order for its bid to be considered, the agency did not violate competitive bidding requirements when it rejected the low bidder who had not attended the pre-bid meeting.⁸⁰ Because of concern about

particular site conditions, the agency had determined that prospective bidders must visit the site before bidding, and had written the specifications to require attendance at a pre-bid meeting held at the site. The court did not rule as to whether the agency had authority to waive the attendance requirement, but found that it was not arbitrary to refuse to do so.⁸¹

e. Submission of Bids and Award of Contract

i. *Authority of Contracting Agencies.*—Procedures for submission of bids and award of contracts for public works projects are based on statutory provisions. The validity of an award depends on strict compliance with these statutes.⁸² In some instances, statutes describe in detail the steps that bidders and agencies must take in moving from bid filing to contract award. However, these procedural requirements may also be promulgated as rules. Where administrative rules are within the agency's statutory authority and are consistent with the implicit requirement that they be designed to strengthen free and open competition among qualified bidders, they have withstood challenge as unconstitutional delegations of rule making authority.

ii. *Submission, Opening, and Acceptance of Bids.*—Requirements designating the time and place for filing bids, and the form of the bid, may be set out in the contracting agency's regulations, in its standard specifications, and in the instructions issued with the proposal form.⁸³ Strict compliance with these requirements is essential. Contracting agencies, either by statute or administrative rules, generally reserve the right to reject any bid that fails to adhere to these requirements.⁸⁴ Courts have upheld these technical requirements as mandatory for both bidders and contracting agencies and have taken the position that these requirements may not be waived.⁸⁵ It is customary for state transportation agencies to require that proposals be submitted on official bid forms that include specific instructions as to the time and place for submission of bids, and that warn that proposals received after the time and date designated will be returned to the bidder unopened.⁸⁶

⁷⁵ *Coonan v. City of Cape Girardeau*, 149 Mo. App. 609, 129 S.W. 745 (1910).

⁷⁶ *Menke v. Bd. of Educ., Indep. School Dist. of West Burlington*, 211 N.W.2d 601 (Iowa 1973) (bank used rubber stamp to certify check instead of officer's handwritten signature).

⁷⁷ *F.H. Myers Constr. Corp. v. City of New Orleans*, 570 So. 2d 84, 85 (La. App. 4 Cir. 1990); *Thigpen Constr. Co. v. Parish of Jefferson*, 560 So. 2d 947, 953 (La. App. 5 Cir. 1990); LSA-R.S. 38:2218(A).

⁷⁸ *State v. Integon Indem. Corp.*, 105 N.M. 611, 735 P.2d 528, 530 (1987).

⁷⁹ *M & L Industries v. Terrobonne Parish Consol. Gov't*, 602 So. 2d 321, 322 (La. App. 1 Cir. 1992) *writ denied*, 604 So. 2d 1010.

⁸⁰ *Scharff Bros. Contractors v. Jefferson Parish School Bd*, 641 So. 2d 642 (La. App. 5 Cir. 1994), *writ denied*, 644 So. 2d 399, *reconsideration denied*, 648 So. 2d 384 (1994).

⁸¹ *Id.*, 641 So. 2d at 644.

⁸² *Percy J. Matherne Contractor v. Grinnell Fire Protection Systems Co.*, 915 F. Supp. 818 (M.D. La. 1995), *aff'd*, 102 F.3d 550 (5th Cir. 1995) (public bid law is mandatory, and any contravention of its provisions renders the contract null and void).

⁸³ *See, e.g., Hawaii Corp. v. Kim*, 53 Haw. 659, 500 P.2d 1165, 1169 (1972) (contracting officer could set out bidding procedure in absence of a specific statute doing so).

⁸⁴ MONT. REV. STAT. § 18-2-303(3) (1999) (agency may not accept bid that does not comply with statutory requirements).

⁸⁵ *Hawaii Corp. v. Kim*, 53 Haw. 659, 500 P.2d 1165, 1169 (1972).

⁸⁶ *But see Gostovich v. City of West Richland*, 75 Wash. 2d 583, 452 P.2d 737 (1969) (holding that where a bid was mailed more than 24 hours before the time for bid opening, and there was no suggestion of fraud or undue competitive advantage, the bid could be accepted despite its late arrival).

Bidding statutes and rules normally specify that bids will be opened in a public session, which all bidders may attend.⁸⁷ Courts have reached varying results on the issue of whether the time for submission of bids must be strictly complied with. The Washington Supreme Court has held that the timeliness requirement could be held to have been complied with when the bidder mailed its bid in enough time to reach the agency prior to bid opening, even though it did not arrive on time.⁸⁸ However, most courts have taken a much stricter approach. For example, the Georgia Court of Appeals held that the agency's award to an untimely bidder was improper, and upheld an award of bid preparation costs.⁸⁹ The court discussed at some length the importance of adhering to a strict rule of timely submission, noting how bidders often adjust their prices up to the last minute before bids are due.⁹⁰ Thus, even an additional few minutes could be a material advantage that the untimely bidder would have over the other bidders. The Virginia court also held that the statement in the invitation for bids fixing the time for submission of bids is a material and formal requirement that must be strictly complied with, and that cannot be waived.⁹¹ An Ohio appellate court held that while there is a presumption that the clocks in the agency's building are correct, it is a rebuttable presumption and the rejected bidder may be allowed to show that its bid was submitted in a timely fashion.⁹²

The rule on opening of bids in accordance with the terms set forth in the advertisement of the project and bidding instructions, together with a corollary requirement that the award will be announced at that time or within a specified or a reasonable time thereafter, are mandatory duties that contracting agencies owe to bidders. Thus, where an agency issued the original invitation for bids specifying that bids must be submitted on the due date by 1:00 p.m., then issued an addendum extending the date without setting a time, it was to presume that bids were due to be submitted by the close of business that day and not at 1:00 p.m.⁹³

⁸⁷ See Model Code, *supra* note 2, at § 3-202(4).

⁸⁸ Gostovich, 452 P.2d at 740. Query whether this would still apply when more reliable and commonly used methods of delivery, such as overnight mail, are now available to contractors.

⁸⁹ *City of Atlanta v. J.A. Jones Constr. Co.*, 195 Ga. App 72, 392 S.E.2d 564, 569 (Ga. 1990), *rev'd on other grounds*. 260 Ga. 658, 398 S.E.2d 369, 370 (1990). The Supreme Court upheld an award of bid preparation costs, but reversed awards of lost profits and damages for violations of due process.

⁹⁰ *Id.*, 392 S.E.2d at 566.

⁹¹ *Holly's, Inc. v. County of Greenville*, 250 Va. 12, 458 S.E.2d 454, 457 (1995).

⁹² *PHC, Inc. v. Village of Kelleys Island*, 71 Ohio App. 3d 277, 593 N.E.2d 386, 387 (1991).

⁹³ *Air Support Services Int'l, Inc. v. Metropolitan Dade County*, 614 So. 2d 583, 584 (Fla. App. 3 Dist. 1993).

Postponement of scheduled bid openings and contract award without strong justification may be challenged as abuse of discretion. Generally, the need to introduce changes in project specifications, or to enable bidders to evaluate and reflect such changes in their bids, has been the most readily accepted justification for postponement.⁹⁴

There is no contract until the bid is accepted and a contract is awarded by the agency. The agency's acceptance of the low bid may be conditional.⁹⁵ In *Dick Fischer Development No. 2, Inc. v. Department of Administration*, an agency acknowledged the submission of the low bid with a notice that indicated that the contract would be awarded provided that no bid protests were filed within 5 days.⁹⁶ The notice provided that if a protest was filed, the award would be held in abeyance until the protests were resolved. The project was then canceled before the protests were resolved. The court held that there was no breach of contract, because no contract had been formed due to the failure of a condition precedent, which was the resolution of bid protests.

The rules are positive and explicit regarding acceptance of bids that do not fully and precisely meet all formal requirements set forth in regulations and instructions. Bids that are technically defective or deficient must be considered "irregular" or "informal," and may be rejected. The rules calling for rejection of irregular bids are generally stated in permissive terms. As a result, the possibility of waiver of technical defects is always present.⁹⁷ However, the courts recognize a distinction between nonmandatory bidding requirements that can be waived and mandatory requirements that cannot be waived without impairing the essential competitive nature of the contract award.⁹⁸

f. Bidder Preferences and DBE Requirements

One or both of these items may be required as an element of bid responsiveness. Both are addressed in detail in Section 4.

g. Determination of Lowest Responsible Bidder

i. Time for Award and Execution.—Some states' statutes provide for a time period in which the agency must award the contract, and a subsequent time period in

⁹⁴ *Yonkers Contracting Co. v. Tallamy*, 283 A.D. 749, 127 N.Y.S.2d 646 (1954).

⁹⁵ *Dick Fischer Dev. No. 2, Inc. v. Department of Admin., State of Alaska*, 778 P.2d 1153 (Alaska 1989).

⁹⁶ *Id.*

⁹⁷ *Wilson Bennett, Inc. v. Greater Cleveland Regional Transit Auth.*, 67 Ohio App. 3d 812, 588 N.E.2d 920, 925 (1990), *cause dismissed* on joint applications to dismiss, 568 N.E.2d 1231, 57 Ohio St. 3d 721 (1991).

⁹⁸ This is discussed more fully in § 2 *infra*.

which the contractor must execute the contract.⁹⁹ An Ohio court has held that the statutory time period for award and execution, which was 60 days, could be extended by mutual agreement of the parties, which could be implied from the parties' conduct.¹⁰⁰ The court further noted that the only entities that may invoke the 60-day limit are the parties, either of whom may withdraw its consent to further extensions of time.¹⁰¹

The Model Code allows the award to be made electronically. The award is required to be made in writing, and the Model Code defines "written or in writing" to include electronic means.¹⁰² Once an award of a contract has been made, it may not be withdrawn by the agency.¹⁰³

ii. Selection of Lowest Responsible Bidder.—State statutes generally require that public works contracts shall be awarded to the "lowest responsible bidder."¹⁰⁴ A comparison of State statutes regarding award of contracts is found in Appendix C.

One court has noted that even in the absence of a statutory requirement to do so, public policy requires the award of contracts to the lowest responsible bidder where the agency has chosen to solicit bids.¹⁰⁵ This term is often used without any language reserving the contracting agency's ability to consider any factors other than price. However, some statutes allow additional criteria for selection of successful bidders, such as Illinois' statute, which is based on the Model Code:

Bids shall be evaluated based on the requirements set forth in the invitation for bids, which may include criteria to determine acceptability such as inspection, testing, quality, workmanship, delivery, and suitability for a particular purpose. Those criteria that will affect the bid price and be considered in evaluation for award, such as discounts, transportation costs, and total or life cycle costs, shall be objectively measurable. The invitation for bids shall set forth the evaluation criteria to be used.¹⁰⁶

⁹⁹ See WASH. REV. CODE § 47.28.100 (contractor must execute within 21 days after award).

¹⁰⁰ *Prime Contractors v. Girard*, 655 N.E.2d 411, 101 Ohio App. 3d 249 (Ohio App. 11th Dist. 1995).

¹⁰¹ *Id.*, 655 N.E.2d at 416.

¹⁰² Model Code, *supra* note 2, at §§ 3-202(7), 1-301(26).

¹⁰³ *Fumo v. Redevelopment Auth. of Philadelphia*, 541 A.2d 817, 820, 115 Pa. Commw. 542; *appeal granted*, *Greek Orthodox Cathedral of St. George v. Fumo*, 557 A.2d 727, 521 Pa. 625; *appeal dismissed*, 568 A.2d 947, 524 Pa. 32; *reargument denied*, 580 A.2d 294, 525 Pa. 292 (1990).

¹⁰⁴ See, e.g., *Pataula Electric Membership Corp. v. Whitworth*, 951 F.2d 1238, 1241 (11th Cir. 1992), *reh'g denied*, *Georgia Power Co. v. Pataula Elec. Membership Corp.*, 506 U.S. 907, *appeal after remand*, *Flint Elec. Membership Corp. v. Whitworth*, 68 F.3d 1309, *opinion modified*, 77 F.3d 1321 (11th Cir. 1996) (Georgia law requires award to lowest responsible bidder).

¹⁰⁵ *City of Philadelphia v. Commonwealth Dep't of Envtl. Resources*, 577 A.2d 225, 228, 133 Pa. Commw. 565 (1990).

¹⁰⁶ 30 ILL. COMP. STAT. 500/20-10(e) (1999); Model Code, *supra* note 2, at § 3-202(5).

In a variation on determining the lowest responsible bidder, statutes may allow the agency to consider factors such as the time that the bidder proposes to take to complete the project in addition to the contract price. Arizona recently enacted a statute allowing "A + B" bidding, in which the agency may select the low bidder based on a combination of (A) the contract price, plus (B) the calendar days needed to complete the project.¹⁰⁷ In order to assign value to the calendar days, the agency determines the cost to the traveling public of using roads that are under construction.¹⁰⁸

Court decisions also provide a working definition of "lowest responsible bidder" that fits the pattern formed by most statutes and reflects the interests of the public and the capabilities of contract administration techniques. These decisions address both the elements of "bidder responsibility" and "bid responsiveness." Generally, a bid will be considered "responsive" if it promises to do what the bid specifications demand, and a bidder is considered "responsible" if it can perform the contract as it has promised.¹⁰⁹

Bidder responsibility thus includes a wide range of factors in addition to the capacity to supply labor and materials, and may involve business morality or trustworthiness.¹¹⁰ It may also include the bidder's previous performance on similar contracts.¹¹¹ However, the obligation to award to the lowest responsible bidder does not allow the agency to choose the "most responsible;" once a bidder is qualified as responsible, the agency may not compare relative degrees of responsibility.¹¹²

Most of the factors bearing on a contractor's ability to perform satisfactorily generally are discovered in the processes of licensing and prequalification.¹¹³ Thus, most instances in which a contracting agency rejects the lowest-priced bid in favor of a higher-priced offer occur because the rejected bid fails to meet some tech-

¹⁰⁷ ARIZ. REV. STAT. § 28-6923(I).

¹⁰⁸ See Arizona DOT's Web site for information about A+B Bidding at <http://www.dot.state.az.us/roads/constgrp/A+BGuide.pdf>.

¹⁰⁹ *Taylor Bus Service v. San Diego Bd. of Educ.*, 195 Cal. 3d 1331, 1341-42, 241 Cal. Rptr. 379 (1987); see also *Irwin R. Evens & Son, Inc. v. Board of Indianapolis Airport Auth.*, 584 N.E.2d 576, 585 (Ind. App. 4 Dist. 1992) (bid is responsive if it conforms in all material respects to the agency's bid specifications).

¹¹⁰ *Boydston v. Napa Sanitation Dist.*, 222 Cal. 3d 1362, 1369, 272 Cal. Rptr. 458, *reh'g denied*, 273 Cal. Rptr. 331, 222 Cal. 3d 1362 (1990); *Trap Rock Indus. v. Kohl*, 59 N.J. 471, 284 A.2d 161 (1971).

¹¹¹ *Nevada State Purchasing Div. v. George's Equipment Co.*, 105 Nev. 798, 783 P.2d 949, 954 (1989); *Hanson v. Mosser*, 247 Ore. 1, 427 P.2d 97, 101 (1967).

¹¹² *Boydston v. Napa Sanitation Dist.*, 462, 222 Cal. 3d 1362, 1369, 272 Cal. Rptr. 458 (1990) (citing *City of Inglewood-Los Angeles County Civic Center Auth. v. Superior Court*, 7 Cal. 3d 861, 103 Cal. Rptr. 689, 500 P.2d 601 (1972)); see also *Bowen Eng'g Corp. v. W.P.M., Inc.*, 557 N.E.2d 1358 (Ind. App. 2 Dist. 1990).

¹¹³ See Section 2 *infra*.

nical specifications of the project. Responsiveness to the advertised specifications is an essential element of the competitive bidding process. The contracting agency's duty to assure compliance with this requirement may be enforced either by a bidder who is passed over or by a taxpayer who has standing to challenge the agency's action. An unsuccessful bidder may be able to challenge the legality of the contracting agency's action by way of injunctive or declaratory relief or by mandamus.¹¹⁴ Some courts have held that in the absence of a statute, an unsuccessful bidder does not have standing to challenge an award unless it is also a taxpayer.¹¹⁵ In an Ohio case, the fact that the challenger paid gasoline taxes was insufficient to establish standing as a taxpayer, even though the project was funded with federal gas tax dollars.¹¹⁶ The use of a "special fund" required a showing that the plaintiff had a special interest in the use of that fund, that its own property rights were in jeopardy, and that it would sustain damages different from those sustained by the public generally.¹¹⁷

However, some statutes specifically allow unsuccessful bidders to challenge contract awards, even if they are not also taxpayers.¹¹⁸ A bidder on a federal contract has been found to have standing under the federal Administrative Procedure Act to challenge the award of a federal contract.¹¹⁹

iii. Rejection of All Bids.—A contracting agency may reject all bids received for a particular project and re-advertise the contract. Although it is arguable that this authority is implicit in the agency's general power to select the lowest responsible bidder, the authority of state transportation agencies to reject all bids is generally set forth in statute.¹²⁰ Therefore, actions challenging the use of this authority tend to look for violations of agency procedures or actions that exceed the scope of the contracting officer's lawful discretion. An agency's decision to reject all bids is subject to judicial review

under a variety of standards. However, in most jurisdictions, the decision will be sustained unless it was arbitrary or otherwise unlawful.¹²¹

In some cases it has been held that public authorities claiming the right to reject all bids must show that they had a rational basis for doing so.¹²² Others have required that there be a finding of just cause or best interest of the state.¹²³ Louisiana's statute was amended to include a requirement that the agency have just cause for rejecting all bids.¹²⁴ In overturning a lower appellate court, the Louisiana Supreme Court held that this amendment indicated the Legislature's intent to change the awarding agency's previous broad discretion in rejecting all bids.¹²⁵ Some states' statutes require that the agency set out in writing its reasons for rejecting all bids.¹²⁶ Where there is such a requirement and it is fulfilled, no further demonstration of facts supporting rejection of all bids is necessary.¹²⁷

If bids are to be rejected, fairness requires that determination and notification be prompt, but no standard for measurement of promptness fits all cases. Where there is a statute requiring the agency to award the contract within a certain period of time, it may be implied that if the agency is going to reject all bids, it should do so within that same time period.¹²⁸

Where rejected bidders are entitled to an administrative hearing, the hearing officer's inquiry is narrow and is limited to whether the purpose of competitive bidding has been subverted or whether the agency acted fraudulently, arbitrarily, or illegally.¹²⁹ However, one court has held that where all bids are rejected, as op-

¹¹⁴ *Conway Corp. v. Construction Eng'rs, Inc.*, 300 Ark. 225, 782 S.W.2d 36, 41, *cert. denied*, 494 U.S. 1080 (1989).

¹¹⁵ *L & M Enterprises v. City of Golden*, 852 P.2d 1337, 1339 (Colo. App. 1993) (contractor not among class of persons protected by public bidding statute); *Michael Facchiano Contracting v. Pa. Turnpike Comm'n*, 153 Pa. Commw. 138, 621 A.2d 1058, 1059 (1993) (disappointed bidder must be a taxpayer to sue; has no property interest in contract and has suffered no injury entitling it to a remedy).

¹¹⁶ *Ohio Valley Mall Co. v. Wray*, 104 Ohio App. 3d 629, 662, N.E.2d 1108 (1995).

¹¹⁷ *Id.*, 662 N.E.2d at 1111.

¹¹⁸ *See, e.g.*, ALA. STAT. § 41-16-31.

¹¹⁹ *Clark Constr. Co. v. Pena*, 930 F. Supp. 1470, 1475 (M.D. Ala. 1996).

¹²⁰ Model Code, *supra* note 2, at § 3-301. In the absence of a legislative reservation of the right to reject all bids, courts have recognized that public authorities have this right implicit in their contracting authority. *See* Annotation, 31 A.L.R. 2d 469 (1953).

¹²¹ *William A. Gross Constr. Assoc., Inc. v. Gotbaum*, 150 Misc. 2d 478, 568 N.Y.S.2d 847, (1991).

¹²² *Computer Shoppe v. State*, 780 S.W.2d 729, 737 (Tenn. App. 1989).

¹²³ *See* WASH. REV. STAT. § 47.28.090.

¹²⁴ *New Orleans Rosenbush Claims Service v. City of New Orleans*, 653 So. 2d 538, 544 (La. 1995) (applying La. Stat. Ann. — R.S. 38:2214).

¹²⁵ *Starlight Homes, Inc. v. Jefferson Parish Council*, 632 So. 2d 3, 4 (La. 1994); *reconsideration denied*, 638 So. 2d 1079 (1994) (prior to amendment of statute, court held that rejection of all bids did not require a showing of just cause, as rejection of low bidder would require).

¹²⁶ *See, e.g.*, CAL. PUB. CONT. CODE § 10185; COLO. REV. STAT. § 24-92-105 (1998).

¹²⁷ *Vining Disposal Service v. Board of Selectmen of Westford*, 416 Mass. 35, 616 N.E.2d 1065, 1067 (1993).

¹²⁸ *New Orleans Rosenbush Claims Service v. City of New Orleans*, 653 So. 2d 538 (La. 1995) (at end of 30-day period for agency to award contract, mandamus will lie to compel award).

¹²⁹ *Fort Howard Co. v. Department of Management Services of State of Florida*, 624 So. 2d 783, 784 (Fla. App. 1 Dist. 1993).

posed to the low bidder being rejected individually, a rejected bidder is not entitled to a hearing.¹³⁰

A contracting agency may be denied the right to exercise its authority to reject all bids because of its own mistakes or procedural errors. Such questions have been raised when illegal bids were accepted,¹³¹ bids exceeded estimated costs or appropriated funds for the contract,¹³² errors were committed in official estimates,¹³³ and acceptance of a bid was withdrawn prior to notification of the bidder.¹³⁴ In *Clark Construction Company v. Pena*, Clark was the low bidder for a federally-funded contract being awarded by the Alabama Department of Transportation (ADOT).¹³⁵ FHWA refused to concur in the award to Clark due to the Department's omission of a traffic control note in the approved plans and specifications. The Department then rejected all bids and readvertised the project. Clark sued to enjoin the award after the second round of bidding. The federal court found that the omission of the traffic control note was immaterial to the integrity of the bidding process. The Department admitted that but for FHWA's lack of concurrence, it would have awarded the contract to Clark. The court held that both ADOT and FHWA had violated the Federal Highway Act, and permanently enjoined the award and ordered ADOT to accept Clark's original bid.¹³⁶ The court sought to avoid sending a message to future bidders that their chances of obtaining government contracts would be dependent on the agency's not making "careless mistakes of questionable importance," and also sought to prevent public officials from violating bid award requirements at will.¹³⁷

In another federal case involving the review of a rejection of all bids, the court held that clear and convincing evidence would be required in order to support reinstatement of the canceled solicitation, as reinstatement amounted to a form of injunctive relief.¹³⁸

An agency was found to have exceeded its power when it rejected all bids and intended to readvertise,

¹³⁰ *Gannett Outdoor Co. v. City of Atlantic City*, 249 N.J. Super. 217, 592 A.2d 276, 278 (1991).

¹³¹ *Hankins v. Police Jury*, 152 La. 1000, 95 So. 102 (La. 1922).

¹³² *Williams v. City of N.Y.*, 118 A.D. 756, 104 N.Y.S. 14 (1907), *aff'd* 192 N.Y. 541, 84 N.E. 1123 (1908); *Marshall Constr. Co. v. Bigelow*, 29 Haw. 641 (1927).

¹³³ *Charles L. Harney, Inc. v. Durkee*, 107 Cal. App. 2d 570, 237 P.2d 561 (1951).

¹³⁴ *Schull Constr. Co. v. Board of Regents of Educ.*, 79 S.D. 487, 113 N.W.2d 663, 3 A.L.R. 3d 857 (1962).

¹³⁵ 930 F. Supp. 1470 (M.D. Ala. 1996).

¹³⁶ *Id.* at 1492 ("the ADOT must resubmit Clark Construction's original bid and the FHWA must concur and/or approve said bid"). The court also noted that its holding vindicated ADOT's original position. *Id.* at n.19. *See also* 23 U.S.C. § 112(b)(1).

¹³⁷ *Id.* at 1491.

¹³⁸ *RADVA Corp. v. United States*, 17 Cl. Ct. 812, 818-19, *aff'd*, 914 F.2d 271 (1989).

hoping to get a bid for the same amount as a low bid that had been properly rejected as nonresponsive.¹³⁹

Also, a board that had authority to negotiate with the lowest bidder could not do so after notifying all other bidders that all bids were being rejected and that the project would be readvertised.¹⁴⁰ In another case, however, the court held that the expectation of attaining better bids for surplus property constituted a rational basis for rejecting all bids.¹⁴¹ Also, a New Jersey court found that a concern for obtaining lower bids was an adequate reason to reject all bids.¹⁴²

iv. Right of Low Bidder to Award of Contract.—Throughout the process of awarding contracts through competitive bidding, public contracting agencies must act in accordance with due process. Accordingly, rejection of the lowest bid received may be challenged as taking or injuring the bidder's right to the contract award.¹⁴³ Where it appears that a contractor has a legitimate property right or liberty interest that is entitled to protection, due process requires that the contracting agency grant a hearing in which the rejected bidder is told the reasons for the action and has an opportunity to answer and explain the agency's concerns.¹⁴⁴ Due process protections are required only where property rights or liberty interest are involved, however, and neither courts nor legislatures have been inclined to recognize that every unsuccessful bidder has lost the right to pursue a livelihood when it is not awarded a contract in a properly conducted competition.¹⁴⁵ On the other hand, an agency's actions or written materials may serve to create an entitlement to due process, where it has represented that contracts will always be awarded to the lowest responsible bidder.¹⁴⁶

¹³⁹ *Petricca Constr. Co. v. Com.*, 37 Mass App. Ct. 392, 640 N.E.2d 780, 782 (1994).

¹⁴⁰ *Building and Constr. Trades Council of Northern Nevada v. State ex rel. Public Works Bd.*, 108 Nev. 605 (1992), 836 P.2d 633, 636.

¹⁴¹ *Feldman v. Miller*, 151 A.D. 2d 755, 542 N.Y.S.2d 777 (1989).

¹⁴² *Marvec Constr. Corp. v. Township of Belleville*, 254 N.J. Super. 282, 603 A.2d 184, 187 (1992).

¹⁴³ *Compare LaCorte Elec. Constr. and Maintenance v. County of Rensselaer*, 152 Misc. 2d 70, 574 N.Y.S.2d 647, 649 (1991) (low bidder has liberty interest but not property interest in award of contract) *with* *Scott v. Buhl Joint School Dist.* No. 412, 123 Idaho 779, 852 P.2d 1376, 1384 (1993) (low bidder has property interest in contract award).

¹⁴⁴ *Id.*; *Triad Resources and Systems Holdings v. Parish of Lafourche*, 577 So. 2d 86, 89, *writ denied*, 578 So. 2d 914 (La. App. 1 Cir. 1990) (bidder whose bid is substantially unresponsive is not entitled to due process).

¹⁴⁵ *See Envirologix Corp. v. City of Waukesha*, 192 Wis. 2d 277, 531 N.W.2d 357, 364 (1995) (statutory bid requirements are intended to benefit public and low bidder has no fixed right to award of contract).

¹⁴⁶ *Pataula Elec. Membership Corp. v. Whitworth*, 951 F.2d 1238, 1242 (11th Cir. 1992) (Georgia law recognizes that the lowest responsible bidder may have a property interest in award of the contract, based on agency's "vendor manual" that

v. Rejection of Low Bidder.—The process of receiving, recording, and accepting bids; determining the lowest responsible bidder; and awarding a contract on the basis of that determination has been characterized as being judicial or quasi-judicial in nature, and not merely a ministerial function.¹⁴⁷ Accordingly, courts have been cautious about overruling contracting authorities in the exercise of discretion.¹⁴⁸ There is a presumption that the power and discretion of government officials in awarding bids has been properly exercised.¹⁴⁹ As a rule, agency decisions are not upset except where the challenger shows that fraud, deceit, or flagrant abuse of discretion has prejudiced the competitive bidding.¹⁵⁰ Within a wide range of lawful methods, administrative discretion is permitted to control selection of the lowest responsible bidder, just as it is accepted in determining the prequalification of bidders. As in the case of prequalification of bidders, courts reserve the right to intervene where it appears that abuse of discretion may threaten the policy of competitive award of public contracts.

Determination of the lowest responsible bidder is an "exercise of *bona fide* judgment, based upon facts tending reasonably to the support of such determination."¹⁵¹ However, contracting agencies may be challenged for arbitrary and capricious action where circumstances suggest that this may have been the case.¹⁵² The agency has an implied contractual duty to consider solicited bids in a fair and honest manner.¹⁵³ Thus, when the agency's decision to reject the low bid is challenged, the standard of review is whether the agency acted fraudulently, arbitrarily, illegally, or dishonestly.¹⁵⁴ The fact that the agency acts in error may not

stated that "contracts or open-market purchases will in all cases be awarded to the lowest responsible bidder." This was sufficient to create an entitlement.).

¹⁴⁷ Even when public bidding and contract award is carried out by a legislative body, the same standard applies; the legislative body is not afforded the same level of discretion that it is in legislative actions. *Pittman Constr. Co. v. Parish of East Baton Rouge*, 493 So. 2d 178, 181 (La. App. 1 Cir. 1986) *writ denied*, 493 So. 2d 1206.

¹⁴⁸ *Great Lakes Heating, Cooling, Refrigeration and Sheet Metal Corp. v. Troy School Dist.*, 197 Mich. App. 312, 494 N.W.2d 863 (1992).

¹⁴⁹ *Colonnelli Bros. v. Village of Ridgefield Park*, 284 N.J. Super. 538, 665 A.2d 1136 (1995).

¹⁵⁰ *Ghilotti Constr. Co. v. City of Richmond*, 45 Cal. 4th 897, 903, 53 Cal. Rptr. 2d 389, 392 (Cal. App. 996).

¹⁵¹ *Inge v. Bd. of Pub. Works*, 135 Ala. 187, 33 So. 678, 681 (1902).

¹⁵² *Catamount Constr., Inc. v. Town of Pepperell*, 7 Mass. App. 911, 388 N.E.2d 716 (1979).

¹⁵³ *Kila, Inc. v. State, Dep't of Admin.*, 876 P.2d 1102, 1105 (Alaska 1994).

¹⁵⁴ *Overstreet Paving Co. v. State, Dep't of Transp.*, 608 So. 2d 851, 852-53 (Fla. App. 2 Dist. 1992).

be sufficient to overturn its decision under this standard. In one case, the agency's own erroneous estimate was the basis for rejection of all bids, yet because there was no evidence of fraud or arbitrary action, the agency was not required to accept the low bid.¹⁵⁵

In one case, the award to the second lowest bidder was held to be arbitrary since the contracting agency acted contrary to the preponderance of the evidence in the bids, and appeared to be persuaded by the fact that the second lowest bidder had had similar contracts for the agency in the past.¹⁵⁶ In other instances, however, judicial review has upheld the contracting agency's action in rejecting low dollar bids for reasons bearing on the bidder's responsibility¹⁵⁷ and bid responsiveness.¹⁵⁸

¹⁵⁵ *Department of Transp. v. Groves-Watkins Constructors*, 530 So. 2d 912 (Fla. 1988).

¹⁵⁶ *Berryhill v. Dugan*, 89 Commw. 46, 491 A.2d 950, 952 (Pa. Commw. Ct. 1985).

¹⁵⁷ *Turnkey Constr. Corp. v. City of Peekskill*, 51 A.D. 2d 729, 379 N.Y.S.2d 133 (1976) (lack of experience in building construction, insufficient financial resources, and reason to believe that if awarded the contract bidder intended to assign it to another for performance); *L&H Sanitation v. Lake City Sanitation*, 585 F. Supp. 120 (E. D. Ark. 1984) (bidder only recently organized and not incorporated at time of bid, lacked any experience in proposed construction, submitted a contingent bid); *John Carlo, Inc. v. Corps of Engineers*, 539 F. Supp. 1075 (N. D. Tex. 1982) (lack of integrity of bidder's present officers and association with contractors having unsatisfactory records of integrity and performance); *Keyes Martin & Co. v. Director, Division of Purchase and Property*, 99 N.J. 244, 491 A.2d 1236 (1985) (recent publicity on possible conflict of interest deemed sufficient to conclude that award to lowest bidder would undermine public confidence); *Automatic Merchandising Corp. v. Nusbaum*, 60 Wis. 2d 362, 210 N.W.2d 745 (1973) (second lowest bidder offered greater amount of new equipment than lowest bidder); *Cave-of-the-Winds Scenic Tours, Inc. v. Niagara Frontier State Park and Recreation Comm'n*, 64 A.D. 2d 818, 407 N.Y.S.2d 301 (1978).

¹⁵⁸ *International Telecommunications Systems v. State*, 359 So. 2d 364 (Ala. 1978) (low bidder's samples failed tests for specifications); *E.M. Watkins & Co. v. Board of Regents*, 414 So. 2d 583 (Fla. App. 1982) (low bidder's material variance with bidding instructions determined to give it advantage over other bidders); *Conduit and Foundation Corp. v. City of Philadelphia*, 41 Pa. Commw. 641, 401 A.2d 376 (Pa. Commw. 1979) (low bidder's material variance with bidding instructions determined to adversely affect other bidders); *William v. Board of Supervisors, of Louisiana State Univ. Agric. and Mechanical College*, 388 So. 2d 438 (La. App., 1980) (irregular and incomplete bid); *Gibbs Constr. Co. v. Board of Supervisors of Louisiana State Univ.*, 447 So. 2d 90 (La. App. 1984) (attendance at pre-bid conference); *Monoco Oil Co. v. Collins*, 96 Misc. 2d 631, 409 N.Y.S.2d 498 (1978) (failure to describe pricing formula); *Land Constr. Co. v. Snohomish County*, 40 Wash. App. 480, 698 P.2d 1120 (1985) (failure to list certified women's business enterprise as a subcontractor in violation of bidding instructions); *Kuhn Constr. Co. v. State*, 366 A.2d 1209 (C. Cl., Del. Ch. 1976) (failure to list specialty subcontractors held to be material to statutory requirement for bidding, and omission cannot be waived without encouraging bid

The extent of a contracting agency's discretion in basing contract awards on factors other than dollar cost is limited by the terms of the advertised specifications and bidding instructions, and the agency may not utilize extraneous factors. The validity of a contract may be questioned if the bid documents are indefinite or misleading, and capable of being interpreted in different ways by different contractors. If an irregularity in the bid documents contributes to contractors submitting bids on different terms or with unequal information, the bidding process and any contract awarded will be considered invalid.¹⁵⁹ Where the specifications for a construction project did not give any date for completion of the desired work, or state that the length of construction time would be a determining factor in the award, it was held that that contracting agency acted arbitrarily in using that factor to reject the lowest bid in favor of a higher one that called for an earlier completion date.¹⁶⁰ In another case, it was held to be arbitrary for an agency to induce bidders to submit high quality offers, implying that selection would be made on the basis of best value, and then reject the highest quality offer on the basis of a relatively insignificant price difference.¹⁶¹

On the other hand, where matters are clearly stated in the specifications or bidding instructions as being necessary for the performance of the contract or pertinent to the selection of a contractor, courts generally uphold rejection.¹⁶² Bids must conform to the bid specifications in all material respects. However, not every deviation will cause an agency to find a bid to be found nonresponsive. The deviation must be substantial and must give the bidder an advantage over competitors.¹⁶³ Thus, when a bidder failed to include the time for project completion, supply pertinent data that affected budget considerations, and include an affirmative action plan, its bid was properly rejected as nonresponsive.¹⁶⁴ Errors such as lack of a corporate resolution or a

signature of an authorized individual authorized to bind the bidder to a contract will also be considered a substantial error that renders the bid nonresponsive.¹⁶⁵ Such an error could be used by a bidder to withdraw its bid after bid opening, giving it an unfair advantage over other bidders who could not do the same thing without forfeiting their bid bonds.¹⁶⁶ The bidder bears the risk that its bid might contain a nonwaivable error; the contracting agency is under no duty to examine bids for errors and inform bidders accordingly.¹⁶⁷

After bid opening, the agency may not allow bidders to correct substantive errors. Some states prohibit this by statute, as in Illinois: "After bid opening, no changes in bid prices or other provisions of bids prejudicial to the interest of the State or fair competition shall be permitted."¹⁶⁸

However, this does not mean that communication between agency personnel and bidders is not allowed after bid opening. The agency may have a duty to contact a bidder to confirm a bid if the agency suspects that there is a mistake.¹⁶⁹ In *Clark Construction Company v. Pena*, it was discovered after bid opening that ADOT had omitted a traffic control note from the plans and specifications.¹⁷⁰ ADOT contacted the bidder, who assured ADOT that the omission of the note would have no effect on its bid. FHWA then refused to concur in the award to Clark, contending among other things that the communication amounted to "reverse bid rigging" under an FHWA policy memorandum. The court held that FHWA's and ADOT's rejection of Clark as the low bidder was without a rational basis, and found that the communication was not an attempt by ADOT to gain a price reduction but rather was a means of evaluating the materiality of the omission.¹⁷¹

However, any attempt by the agency or the contractor to negotiate after the opening of bids is generally found to be improper, at least in the absence of a statute that permits negotiation with the low bidder.¹⁷² The contract

shopping); *LeCesse Bros. Contracting v. Town Board of Town of Williamson*, 62 A.D. 2d 28, 403 N.Y.S.2d 950 (1978) (failure to give names of manufacturers of equipment as required in bid instructions); *L. Pucillo & Sons, Inc. v. Mayor and Council of Borough of New Milford*, 73 N.J. 349, 375 A.2d 602 (1977) (failure to bid on 5-year contract option in addition to 1, 2, and 3-year options was not minor irregularity that could be waived, but rather was substantial departure from instructions).

¹⁵⁹ *Brewer Env'tl. Indus. v. A.A.T. Chemical*, 73 Haw. 344, 832 P.2d 276, 278 (1992).

¹⁶⁰ *Gerard Constr. Co. v. City of Manchester*, 120 N.H. 391, 415 A.2d 1137 (1980).

¹⁶¹ *Latecoere Int'l. v. U.S. Dep't of the Navy*, 19 F.3d 1342, 1360 (11th Cir. 1994).

¹⁶² See, e.g., *City of Philadelphia v. Canteen Co., Div. of TW Services, Inc.*, 135 Pa. Commw., 575, 581 A.2d 1009, 1013 (1990) (failure to follow bid instructions rendered bid nonresponsive).

¹⁶³ *Kokosing Constr. Co. v. Dixon*, 72 Ohio App. 3d 320, 594 N.E.2d 675, 680 (1991).

¹⁶⁴ *Id.*, 594 N.E.2d at 680.

¹⁶⁵ *Stafford Constr. Co. v. Terrebonne Parrish School Bd.*, 560 So. 2d 558, 560 (La. App. 1 Cir. 1990).

¹⁶⁶ *But see Leaseway Distribution Centers v. Department of Admin. Services*, 49 Ohio App. 3d 99, 550 N.E.2d 955, 960 (1988) (even though signature was missing from cover page as required, signature on addendum was adequate to bind the bidder to its bid as addendum was part of bid documents).

¹⁶⁷ *Department of Transp. v. Ronlee, Inc.*, 518 So. 2d 1326, 1328-29 (Fla. App. 3 Dist. 1987), *review denied*, 528 So. 2d 1183 (1988) (it was not inequitable for agency not to have informed bidder of bid error of less than 2 percent where bidder also discovered error on its own).

¹⁶⁸ 30 ILL. COMP. STAT. 500/20-10(f) (2001).

¹⁶⁹ Model Code, *supra* note 2, at § 3-202(6) and commentary.

¹⁷⁰ 895 F. Supp. 1483 (M.D. Ala. 1995).

¹⁷¹ *Id.* at 1491.

¹⁷² See *Building and Constr. Trades Council of Northern Nevada v. State ex rel. Public Works Bd.*, 108 Nev. 605, 836 P.2d 633, 636 (1992) (statute allows Public Works Board to negotiate with low bidder after it has notified other bidders that their bids have been rejected, that the project will not be

may be found invalid where post-bidding negotiations with the apparent low bidder result in awarding a contract on specifications that have been altered from those originally advertised.¹⁷³ Courts have been clear on the issue that a contract cannot be awarded on terms that are different from those in the invitation for bids.¹⁷⁴ This rule is based on one of the underlying policies of competitive bidding—assurance against favoritism, fraud, and corruption. In order to effectively guard against favoritism and corruption, all bidders must be equally situated, and there must be a common standard for evaluating bids. A contracting agency may not contract, even with the low bidder, for terms that were not included in the bid specifications.¹⁷⁵ Thus a low bidder could not attempt to modify its bid and attempt to negotiate a more favorable contract for itself, since to do so would give the bidder an unfair competitive advantage over other legitimate bidders, and post-bid negotiations would violate competitive bidding.¹⁷⁶

In *Arkansas Highway and Transportation Department v. Adams*, the transportation department's refusal to negotiate with the low bidder was upheld, as was the department's rejection of the low bid because of its failure to include either a unit price or an extended price on a specified item.¹⁷⁷ It was therefore impossible for the agency to discern what the unit price for that item was. The court noted that the department's published specifications authorized it to reject a bid that lacked a unit price on a bid item and that the department had a policy of not accepting a bid from which a unit price for

rebid, and that it intends to negotiate with low bidder, citing N.R.S. 341.145(3)).

¹⁷³ *Thelander v. City of Cleveland*, 3 Ohio App. 3d 86, 444 N.E.2d 414, 427 (1981).

¹⁷⁴ *Palamar Constr. v. Township of Pennsauken*, 196 N.J. Super. 241, 482 A.2d 174, 179 (A.D. 1983). The court held, however, that attachment of post-bid conditions by the agency that were more favorable to the agency was allowed if the contractor agreed to the conditions; the bidder was not required to concede to the added conditions as it was entitled to the contract as it had been bid. 482 A.2d at 181. *See also Transactive Corp. v. N.Y. State Dep't of Social Services*, 665 N.Y.S.2d 701, 705 236 A.D. 2d 48 (N.Y. App. 1997) (post-bid negotiations are proper if they do not involve a departure from the original specifications or require any concessions to the low bidder).

¹⁷⁵ *See Ariz. Board of Regents ex rel. University of Ariz. v. Main Street Mesa Assocs.*, 181 Ariz. 422, 891 P.2d 889, 893 (Ariz. App. Div. 1 1994) *review denied* (1995) (where sale of public land was governed by competitive bidding laws, the agency may not negotiate with the high bidder for terms not included in the bid specifications; court's holding was based on general rule of competitive bidding that agency may not negotiate with lowest bidder for terms that materially depart from the invitation for bids).

¹⁷⁶ *Lake Constr. & Dev. Corp. v. City of N.Y.*, 221 A.D. 2d 514, 621 N.Y.S.2d 337, 338 (1995).

¹⁷⁷ 300 Ark. 16, 775 S.W.2d 904, 905-06 (1989).

a bid item could not be determined.¹⁷⁸ Where the agency's specifications or regulations are rational, then the fact that the bidder did not follow them must be considered a "rational basis" for rejecting a bid.

The Arkansas court in *Adams* noted that the agency had previously waived the defect of failure to include a unit price where the unit price could be derived from the extended price. However, in Louisiana, the result was the opposite in *V.C. Nora, Jr. Building & Remodeling, Inc. v. State Department of Transportation & Development*.¹⁷⁹ The court held that based on the strict language of the statute, the agency did not have discretion to waive the failure to include a unit price, even though the unit price could be derived from the extended price.¹⁸⁰ The statute stated: "The provisions and requirements of this Section, those stated in the advertisement for bids, and those required on the bid form shall not be considered as informalities and shall not be waived by any public entity."¹⁸¹

The court noted that this was a harsh result, but found that the strict language of the statute left the agency with no discretion to waive such a defect in the bid.¹⁸²

h. Effect of Failure to Follow Required Procedures

Bidding procedures set forth in statutes and administrative rules are regarded as jurisdictional prerequisites for valid exercise of a contracting agency's authority. Courts have made it plain that they seek constructions of these rules that will fully carry out the intent of the law in varying situations, but will not weaken the effectiveness of the law through exceptions. Thus, the agency's failure to comply with all the specified steps before an award may result in failure to create any enforceable obligation or liability on the part of the public agency. Where an agency does not follow exactly its specified procedures, the resulting contract is void.¹⁸³

Abuse of discretion may be found when a contracting agency fails to furnish enough or the right sort of guidelines and instructions for bidders, which could prejudice the entire bidding process.¹⁸⁴ For example, an

¹⁷⁸ *Id.* at 905.

¹⁷⁹ 635 So. 2d 466 (La. App. 3 Cir. 1994).

¹⁸⁰ *Id.* at 472.

¹⁸¹ LSA-R.S. 38:2212(A)(1)(b) (2000).

¹⁸² *See* Section 5, *infra*, for further discussion of waivable and nonwaivable errors.

¹⁸³ *Failor's Pharmacy v. Department of Social and Health Services*, 125 Wash. 2d 488 886 P.2d 147, 153 (1994) (failure to comply with statutorily mandated procedures is ultra vires and renders contract void); *see also Spiniello Constr. Co. v. Town of Manchester*, 189 Conn. 539 456 A.2d 1199, 1202 (1983); *Terminal Constr. Corp. v. Atlantic County Sewerage Auth.*, 67 N.J. 403, 341 A.2d 327 (1975).

¹⁸⁴ *Dayton, ex rel. Scandrck v. McGee*, 67 Ohio St. 2d 356, 423 N.E.2d 1095 (1981).

agency that did not disclose its policy of preferring resident bidders until after bid opening was held to have modified its requirements without proper notice to bidders.¹⁸⁵ In another case, the award was set aside and the agency was required to readvertise the contract where the bid specifications gave incorrect directions to bidders regarding the required amount of the bid bond.¹⁸⁶ The specifications did not state that the amount of the bid bond would be 10 percent of the contract price, not to exceed \$20,000, as the statute required. Rather, they required 10 percent of the bid amount, which in the case of some bids was over \$40,000. Some contractors had referred instead to the statute, providing only the \$20,000 statutory bond amount. The court held that this gave some bidders an advantage over others, and set aside the award.¹⁸⁷

In other cases, the agency's own handling of the bids and of the award process may result in a material deviation from bidding laws. For example, the court in a New Jersey case found that even though the agency had posted bids on an electronic bulletin board shortly after bid opening, the agency's failure to total bid items and announce the bid totals warranted rejection of bids.¹⁸⁸ In another case, where the agency's bid documents indicated that it would accept the unit item price where there was a discrepancy between the unit price and the total, it was held to be an error to reject the low bidder whose unit price was not ambiguous.¹⁸⁹

Contractors who perform construction work or supply materials under an innocent impression that their contracts were awarded through correct procedures understandably complain of the hardship resulting from application of this rule. But even where the public agency accepts and uses the results of a contractor's work, the contractor may not recover in *quantum meruit*.¹⁹⁰ Allowing recovery in *quantum meruit* where the bidding requirements have been violated would undermine the policies of competitive bidding. In addition, the contractor may be required to repay to the agency any funds received under the arrangement. This is particularly so where the public contract has been obtained through

fraud or corruption, whether on the part of the agency official or the contractor.¹⁹¹ This harsh result has been found to be necessary to deter corruption and collusion in bidding.¹⁹²

Apparent exceptions to this rule have been noted, chiefly where courts have been able to find factual bases for enforcing an implied contract, or have found that in addition to noncompliance with bidding statutes, there was proof of fraud in the award.¹⁹³ In the absence of such findings, however, contractors have little prospect of recovering for work performed because theories of quasi-contract will not be applied to promises that are beyond the authority of a public agency to make.

Failure of a contracting agency to follow mandatory procedures in conducting bidding and award of contracts has been alleged in a variety of situations. An award was challenged where the agency did not compel the successful bidder on a highway construction contract to give assurance that it would pay prevailing wage rates as required by state law.¹⁹⁴ Also, the contracting agency's award was protested where the agency accepted an apparently late bid upon the bidder's claim that the bid clock was fast, and thereafter failed to notify the apparently successful bidder of a bid protest.¹⁹⁵

i. Permissible Types of Combined Bidding by Contractors

In contrast to combinations that arise from collusion, other types of combinations for purposes of bidding are permitted. Where contracting agencies have projects that are unusually large, or that have an unusually wide range of specialty requirements, it may be impossible for one contractor to undertake the work desired in a single contract. Under these circumstances joint bids by contractors who combine their resources to organize and perform this work provide a sensible solution.

Courts' acceptance of the practice of joint bidding by contractors has emphasized the distinction between these open agreements and the secrecy typically associated with collusive combinations. An early decision of a New York court illustrates this view:

[A] joint proposal, the result of honest cooperation though it might prevent the rivalry of the parties, and thus lessen competition, is not an act forbidden by public

¹⁸⁵ *Id.*, 423 N.E.2d at 1097.

¹⁸⁶ *Waste Disposal, Inc. v. Mayor and Council of Borough of Roselle Park*, 145 N.J. Super. 217, 367 A.2d 449 (1976).

¹⁸⁷ *Id.*, 367 A.2d at 450.

¹⁸⁸ *Statewide Hi-Way Safety, Inc. v. N.J. Dep't of Transp.*, 283 N.J. Super. 223, 661 A.2d 826 (A.D. 1995) (dismissed as moot, but DOT's argument was rejected as to future cases).

¹⁸⁹ *Pozar v. Department of Transp.*, 145 Cal. App. 3d 269, 193 Cal. Rptr. 202, 203 (1983).

¹⁹⁰ *J & J Contractors/O.T. Davis Constr., A.J.V. v. State*, by Idaho Transp. Board, 118 Idaho 535, 797 P.2d 1383, 1384-85 (1990) (contractor may not recover if contract is void, as opposed to voidable); *Trujillo v. Gonzales*, 106 N.M. 620, 747 P.2d 915, 917 (1987) (violation of Open Public Meetings Act); *Lanphier v. Omaha Public Power Dist.*, 227 Neb. 241, 417 N.W.2d 17, 21 (1987) (quantum meruit was available to the contractor where the city had authority to contract, but not where there was no authority).

¹⁹¹ *Curiale v. Capolino*, 883 F. Supp. 941 (S.D.N.Y. 1995). However, in *J & J Contractors*, *supra* note 190, the agency was prevented from recovering what it had paid the contractor because it had not appealed the determination made by the hearing officer on the contractor's claim. 797 P.2d at 1385.

¹⁹² *Id.* at 951.

¹⁹³ *Gerzof v. Sweeney*, 16 N.Y.2d 206, 211 N.E.2d 826, 264 N.Y.S.2d 376 (1965), *cited in* *Curiale v. Capolino*, 883 F. Supp. 941 (S.D.N.Y. 1995).

¹⁹⁴ *Lynch v. Devine*, 45 Ill. App. 3d 743, 359 N.E.2d 1137 (1977).

¹⁹⁵ *Washington Mechanical Contractors v. United States Dep't of the Navy*, 612 F. Supp. 1243 (N.D. Cal. 1984).

policy. Joint adventures are allowed. They are public and avowed and not secret. The risk as well as the profit, is joint and openly assumed. The public may obtain at least the benefit of the joint responsibility, and of the joint ability to do the service. The public agents know, then, all that there is in the transaction, and can more justly estimate the motives of the bidders and weigh the merits of the bid.¹⁹⁶

Subcontracts and joint ventures are both subject to scrutiny to assure that they are genuine, because either technique can be abused and become a threat to fair competition. It is contrary to public policy for bidders on a public works project to agree that some of them will refrain from bidding in favor of others. It is also contrary to many states' public bidding laws, as in Kentucky: "Any agreement or collusion among bidders or prospective bidders which restrains, tends to restrain, or is reasonably calculated to restrain competition by agreement to bid at a fixed price, or to refrain from bidding, or otherwise, is prohibited."¹⁹⁷

i. Joint Ventures.—Where construction work is carried out under a single contract, unusually large or complex projects may require assembling financial resources and administrative or technical workers on a scale greater than any single contractor can provide through its own efforts and resources, or through its own staff plus the use of subcontractors. A practical accommodation of the rules of competitive bidding to the needs of contractors and contracting agencies is offered in the practice of accepting bids from two or more contractors acting in a joint venture. In this type of bid, groups of contractors combine their assets, plant, and personnel in a joint effort.

Joint ventures are similar to ordinary business partnerships. The parties share the work, the prospects of profits, and the risks of loss. The terms on which the parties share the responsibilities and results of the work are set forth in written agreements.¹⁹⁸ The main difference is that joint ventures are created to perform one specific job, whereas partnerships are continuing arrangements.¹⁹⁹ In establishing a joint venture, it is not enough to merely adopt a particular joint name. One seeking to prove that a joint venture exists must show that there is a community of interest in the venture between the two contractors, an agreement to share the profits and losses in a project, and a mutual right of control or management over the project.²⁰⁰ A joint venture is not a legal entity apart from the two or more contractors comprising it. A joint venture was not

a "resident" for the purpose of taking advantage of a state preference statute where neither of the two joint venturers were resident corporations.²⁰¹

Remedies available to the parties in the event of a dispute are generally the same as those applicable to partnerships, with some differences. Among partners, the usual remedy is for the aggrieved partner to sue for an accounting. However, in joint ventures, one may sue the other for breach of the contract defining the terms of their cooperative undertaking, or for contribution to the plaintiff's losses.²⁰²

Joint venture bidding is permitted so long as it is a bona fide cooperative effort among its parties. Joint venture bids must fully disclose the terms of the cooperative effort the parties will undertake. Secret agreements under which several contractors undertake to share the work, risks, and profits of a project are not proper or enforceable, regardless of whether they result in a single bid for the parties to the arrangement or separate bids by all parties according to a prearranged plan.²⁰³

Joint venture bids have the advantage of pooling the capacity of several contractors and allowing prequalification for projects that no one of them is capable of performing individually. When such bids are filed, the bid should indicate what percentage of the dollar amount of the contract should be debited against the prequalification capacity rating of each joint venture. Where bidders do not allocate the proportions to be debited, the contracting agency should make this determination as it deems to be in its own best interest. Apportionment of the prequalification capacity rating debit among the parties to a joint venture bid does not in any way divide the responsibility of each for the execution and performance of the contract if it is awarded to them.

ii. Subcontracts.—Under a subcontract, all details of the subcontractor's work are defined in the agreement between the subcontractor and the prime contractor. The prime contractor is responsible to the contracting agency for the performance of the subcontract along with the rest of the contract work, except as to those requirements that state or federal law imposes directly and individually on both the prime contractor and the subcontractor. An example of such a requirement is the Contract Work Hours and Safety Standards Act, which requires both the prime and subcontractors to comply

¹⁹⁶ *Acheson v. Mallon*, 43 N.Y. 147, 151 (1870).

¹⁹⁷ KY. REV. STAT. § 45A.325 (1999).

¹⁹⁸ *But see Libby v. L.J. Corp.*, 247 F.2d 78 (D.C. Cir. 1957) (existence of a joint venture may be implied from the parties' conduct even if not in writing).

¹⁹⁹ *Ben Fitzgerald Realty Co. v. Muller*, 846 S.W.2d 110, 120 (Tex. App. 1993).

²⁰⁰ *Id.* at 121.

²⁰¹ *Bristol Steel and Iron Works v. State, Dep't of Transp. & Dev.*, 504 So. 2d 941 (1987), *writ granted*, 505 So. 2d 1131 and 505 So.2d 1132, *rev'd* 507 So. 2d 1233 (1987) (finding that one of joint venturers was resident and that employee stock option plan did not constitute a "change in ownership" so as to form basis for finding that contractor did not meet statutory requirement of not having had change in ownership in previous 2 years in which it had state license).

²⁰² *Alpine Constr. Co. v. Gilliland*, 178 N.W.2d 530, 23 Mich. App. 275 (1970).

²⁰³ *Hoffman v. McMullen*, 83 F. 372 (9th Cir. 1897).

with federal standards for hours of work and worker safety.²⁰⁴

j. Competitive Bidding Requirements for Federal and Federally-Aided Highway Construction Contracts

Selection of contractors for federal agency construction projects is governed by the requirements of 41 U.S.C. § 5, which provides that, unless otherwise specified in appropriation legislation or unless they come within an authorized exception, contracts for materials, supplies, or services for the government must be awarded through public advertisement and competitive bidding. The authorized exceptions to this rule include contracts in which (1) the amount involved does not exceed \$25,000; (2) immediate delivery of materials or performance of services is required because of “public exigencies”; (3) only one source of supply is available; or (4) the services required must be performed by the contractor in person and are of a technical or professional nature, or are under government supervision and paid for on a time and materials basis.²⁰⁵

A similar statute applies to federal-aid highway projects where construction is performed under contracts awarded by a state highway agency or a local government using federal funds.²⁰⁶ Exceptions to this requirement are not specified in the statute, as in the case of direct federal construction. However, the Secretary of Transportation is authorized to approve modifications of the usual methods of advertisement for proposals, provided that those methods “shall be effective in securing competition.”²⁰⁷ Alternatives to public bidding may be allowed where the state demonstrates that another method is more cost effective or that an emergency exists.²⁰⁸

FHWA regulations applying to projects that are in any part paid for with federal funds also address competitive bidding requirements.²⁰⁹ These regulations require that federal-aid highway construction work must be performed by contract awarded to the lowest responsible bidder, unless it is undertaken by the state as a force account activity, or unless the agency demonstrates that either an emergency or a more cost-effective method exists.²¹⁰ For work performed by contract, the state highway agency must assure the opportunity for free, open, and competitive bidding, including adequate publicity of the advertisement or call for bids, and must comply with the procedures in the regulation. State transportation agencies may not issue invitations for bids on such projects until compliance with the provisions of applicable FHWA regulations and directives

is approved by the FHWA division administrator.²¹¹ Arrangements for performance of work as force account projects require that the FHWA division administrator find that those arrangements are cost effective, and that the state determine that the project can be staffed and equipped satisfactorily and cost effectively.²¹²

FHWA regulations limit the extent to which subcontracting may be used and specify that prime contractors must perform at least 30 percent of the total contract price with their own personnel.²¹³ However, if any of the contract work requires “highly specialized knowledge, abilities or equipment not ordinarily available in the type of contracting organizations qualified and expected to bid on the contract,” that work may be designated as specialty work and may be deducted from the total contract price before computing the amounts for prime and sub contractors to perform.²¹⁴

The minimum time for advertisement of bids is prescribed by federal regulations as 3 weeks prior to the date for opening bids, except where shorter periods may be justified by special circumstances and approved by the FHWA division administrator.²¹⁵ Prior approval of the administrator must also be obtained if the agency issues any addenda setting out major changes to the approved plans and specifications during the advertising period, and the state transportation agency is required to give specific assurance that all bidders received such addenda.²¹⁶

A bidder must file an affidavit that it did not engage in any action in restraint of free competitive bidding in connection with the contract being awarded.²¹⁷ Finally, in the interest of increasing small business participation in federal-aid highway construction, state transportation agencies must schedule contract lettings in “balanced programs” as to size and type of contracts to assure opportunities for all sizes of contractors to compete in the federal-aid program.²¹⁸

k. Exceptions to the Competitive Bidding Rule

Statutes and regulations specify certain circumstances in which competitive bidding procedures do not apply. The most common exceptions are concerned with the amounts of money involved in a contract, the need for responding to emergency situations, and the impracticality of procuring certain services through price competition.

i. Statutory Minimum Amounts.—Most statutes and ordinances that impose competitive bidding requirements apply only to contracts that involve more than specified

²⁰⁴ 40 U.S.C. §§ 327–333(a) (1999).

²⁰⁵ 41 U.S.C. § 5 (1999).

²⁰⁶ 23 U.S.C. § 112(a) (1999).

²⁰⁷ *Id.* at § 112(b).

²⁰⁸ *Id.*

²⁰⁹ 23 C.F.R. § 635.104 (2000).

²¹⁰ 23 C.F.R. § 635.204(a) (2000).

²¹¹ 23 C.F.R. § 635.112 (2000).

²¹² 23 C.F.R. § 635.104 (2000).

²¹³ 23 C.F.R. § 635.116 (2000).

²¹⁴ 23 C.F.R. § 102 (2000) (definition of specialty work); 23 C.F.R. § 635.116 (2000).

²¹⁵ 23 C.F.R. § 112(b) (2000).

²¹⁶ 23 C.F.R. § 112(c) (2000).

²¹⁷ 23 C.F.R. § 112(f) (2000).

²¹⁸ 23 C.F.R. § 107 (2000).

minimum amounts of money. The rationale of this exception appears to be the practical consideration that when less than this minimum amount is involved, the cost of administering competitive bidding procedures is more expensive than the risk of loss to the public justifies. Minimum levels set by statute typically are low, so that only the most minor projects are within the scope of the exception.²¹⁹

Questionable contracting practices and ambiguities in contract language are responsible for a large share of the cases in which the application of this exception is challenged. Even with a clear statutory designation of the minimum amount required for competitive bidding, it is still possible for a contracting officer to be indefinite about the contract's total amount because unit prices rather than job prices are quoted. In such cases, evidence suggesting advance knowledge of the ultimate magnitude of the contract's cost, implying intent to circumvent the competitive bidding law, is important. Thus, where a contract was negotiated to purchase gravel at a fixed price per yard for use in road and street repair, and thereafter 74 separate purchases (each costing less than \$500) were made on identical terms over a period of 8 months, the court concluded that the arrangement violated the law requiring competitive bidding for all public contracts in excess of \$500.²²⁰ Stating that the legislature could not have intended to allow its main objective to be "circumvented by multiple small open-market purchases," the court emphasized that nothing in the record indicated that the contracting agency could not and did not realize the full extent of its need for road repair material.²²¹

Closely related to these cases are situations in which the agency has deliberately split a public construction project so that it can be performed under several contracts, some or all of which may fall below the statutory minimum amount for competitive bidding. Sound engineering, financial, and administrative reasons may support the decision to split a single project into segments for contracting. However, where it appears that this has been done for the purpose of evading a mandatory competitive bidding statute, the court may find the negotiated contracts invalid.²²²

ii. *Specialized Personal and Professional Services.*—Contracts for personal or professional services form another generally recognized exception to mandatory competitive bidding procedures.²²³ A leading case on this matter has explained the exception as follows:

The theory upon which the doctrine rests is that the competitive bidding statutes cannot be rationally or practically applied to contracts for the employment of architects or other persons whose services are required because of the special training, skill, and scientific or technical knowledge necessary to the object to be accomplished...The value of such services is not to be measured by a mere matching of dollars, so to speak; it is not to be determined upon the irrational assumption that all men in the particular class are equally endowed with technical or professional skill, knowledge, training, and efficiency, nor are such services rendered more desirable because afforded more cheaply in a competitive bidding contest. The selection of a person to perform services requiring those attributes calls for the exercise of a wise and unhampered discretion in one seeking such services, for it involves not only those attributes, but the qualities of reputation and personal and professional trustworthiness and responsibility as well.²²⁴

Similar views have been expressed about the services of artists,²²⁵ auditors and accountants,²²⁶ traffic engineers,²²⁷ and real estate appraisers.²²⁸ Contracts for insurance coverage have also been held to be contracts for "extraordinary, unspecifiable services" that fall outside the requirement for competitive bidding.²²⁹

Procurement of personal or professional services without competitive bidding is justified because it does not involve work that conforms to specifications that allow for contractors' performances to be evaluated by relatively objective standards. Accordingly, contracts calling for services that require personal or professional judgment, in which the contracting agency specifies an objective but not the methods of the desired work, have been exceptions to the competitive bidding mandate. This rule has been extended to include services requiring aesthetic, business, or technical knowledge and judgment, and professional or scientific skill and experience.²³⁰

²²⁴ *Louisiana v. McIlhenny*, 201 La. 78, 9 So. 2d 467, 471 (1942) (employment of landscape architect) (quoting *Gulf Bitulithic Co. v. Nueces County*, 297 S.W. 747, 753 (Tex. App. 1927)), *reh'g denied*.

²²⁵ *Adams v. Ziegler*, 22 Cal. App. 2d 135, 70 P.2d 537 (1937).

²²⁶ *Cochran County v. West Audit Co.*, 10 S.W.2d 229 (Tex. Civ. App. 1928).

²²⁷ *City and County of San Francisco v. Boyd*, 17 Cal. 2d 606, 110 P.2d 1036 (1941); *Flottum v. City of Cumberland*, 234 Wis. 654, 291 N.W. 777 (1940).

²²⁸ *Doverspike v. Black*, 535 A.2d 1217, 1219, 126 Pa. Commw. 1 (1988) *aff'd on reargument*, 541 A.2d 1191, 126 Pa. Commw. 11 (1988); *Parker v. Panama City*, 151 So. 2d 469 (Fla. Dist. Ct. App. 1963).

²²⁹ *Local 1081 of Communications Workers of America, AFL-CIO v. Essex County*, 255 N.J. Super. 671, 605 A.2d 1154 (N.J. Super. A.D. 1992).

²³⁰ *Attlin Constr. v. Muncie Community Schools*, 413 N.E.2d 281, 287 (Ind. App. 1980), (construction manager was acting similar to architect or engineer).

²¹⁹ See Appendix C.

²²⁰ *Fonder v. City of Sioux Falls*, 76 S.D. 31, 71 N.W.2d 618 (1955)

²²¹ *Id.*, 71 N.W.2d at 621.

²²² *Miller v. McKinnon*, 20 Cal. 2d 83, 124 P.2d 34 (1942).

²²³ *Amherst Columbia Ambulance Service Ltd. v. Gross*, 437 N.Y.S.2d 137 (1981).

In line with this reasoning, contracts for architectural and engineering services are regularly put into this category.²³¹ Under federal law, the Brooks Architects-Engineers Act allows the solicitation of architectural and engineering services based on factors other than price:

The Congress hereby declares it to be the policy of the Federal Government to publicly announce all requirements for architectural and engineering services, and to negotiate contracts for architectural and engineering services on the basis of demonstrated competence and qualification for the type of professional services required and at fair and reasonable prices.²³²

Although the Brooks Act does not require prequalification of engineering and architectural firms, it does encourage federal agencies to have firms submit annual statements of qualifications.²³³ After the agency considers the qualifications of interested firms, the Act requires the hiring agency to select the three most qualified firms after “conduct[ing] discussions with no less than three firms regarding anticipated concepts and the relative utility of alternative methods of approach for furnishing the required services.”²³⁴ The agency may then proceed to negotiate a contract with the top qualified firm at “compensation which the agency head determines is fair and reasonable to the Government. In making such determination, the agency head shall take into account the estimated value of the services to be rendered, the scope, complexity, and professional nature thereof.”²³⁵

Courts have not always agreed with contracting agencies that a particular contract was for personal services that should be contracted for in this manner. Contracts for architects and engineering services are usually not in question, as they will likely be covered either by the Federal Brooks Act or by a state “Little Brooks Act.” In contrast, a contract to film the construction of a major highway bridge was held not to be one for “personal services.”²³⁶ That contract was considered to be one for the purchase of the films rather than for professional services. A contract to manage the sale of advertising space and display facilities in an airport was also not considered a contract for specialty serv-

ices.²³⁷ The same result occurred where a public agency contracted for inspection and enforcement of an electrical code for building construction. Denying that it could be regarded either as “professional” or “extraordinary unspecifiable services” under the state’s public contracts law, the court reasoned that since inspection specifications had been issued for use in administration and enforcement of the law, the work may have required special skill but did not demand special knowledge or professional judgment and was thus subject to competitive bidding rules.²³⁸ In another case, contracts for feasibility studies of programs for environmental protection and rehabilitation of lakes were challenged because the specifications were very detailed and appeared to be conducive to an objective evaluation.²³⁹ The test is whether the nature of the work desired makes it impossible or impractical to draw specifications satisfactorily to permit competitive evaluation. Mere data collection without a requirement for analysis or opinion was looked upon more as something subject to competitive bidding.²⁴⁰

Less assurance of coming within the exception for specialized services exists for an individual hired to supervise actual construction operations. Where services under the contract involve overall management responsibilities, they generally are held to be within the exception. For example, in *Gulf Bitulithic Co. v. Nueces County*, the local government employed a contractor to act as its representative to supervise and manage an extensive road construction program.²⁴¹ Holding that the contracting agency was not required to award this contract through competitive bids, the court said:

If [the statute] be so construed as to bring...this case within its provisions, the very object of the statute would be defeated, for the obvious reason that, when a county does a given piece of construction work, paying for the materials and labor, the ultimate cost thereof is necessarily largely dependent upon the skill, experience, and business judgment exercised in the management and supervision of such work.

...It would be ludicrous indeed if a county should publish to the world that it desired to let to the lowest bidder a contract to supervise the building of an elaborate road system...Under such an advertisement, it might be compelled to place the supervision of this immense construc-

²³¹ *State v. Brown*, 422 N.E.2d 1254, 1256 (Ind. App. 1981) (field supervision and coordination of activities at construction site performed by construction manager were professional services, and did not have to be competitively bid).

²³² 40 U.S.C. § 542 (1999) (Brooks Architects-Engineers Act).

²³³ 40 U.S.C. § 543 (1999).

²³⁴ *Id.*

²³⁵ 40 U.S.C. § 544 (1999). The Model Code, § 5–205, contains similar requirements. Although price is still a factor in these agreements, the main difference between these statutes and competitive bidding statutes is the point in the process at which price is considered.

²³⁶ *Photo-Art Commercial Studies, Inc. v. Hunter*, 42 Or. App. 207, 600 P.2d 471, 474 (1979).

²³⁷ *Transportation Displays, Inc. v. City of New Orleans*, 346 So. 2d 359, 363 (La. App., 1977).

²³⁸ *Township of Burlington v. Middle Dep’t Inspection Agency*, 175 N.J. Super. 624, 421 A.2d 616, 622 (1980); *but see SCA Services of Georgia v. Fulton County*, 238 Ga. 154, 231 S.E.2d 774 (1977) (contract to provide garbage disposal service) and *Trane Co. v. County of Broome*, 76 A.D. 2d 1051, 429 N.Y.S.2d 487 (1980) (contract to provide air conditioning repair service by air conditioning unit manufacturer was held to involve use of specialized skill and expertise and so was exempt from competitive bidding).

²³⁹ *Aqua-Tech, Inc. v. Como Lake Protection and Rehabilitation Dist.*, 71 Wis. 2d 541, 239 N.W.2d 25 (1976).

²⁴⁰ *Id.*

²⁴¹ 11 S.W.2d 305 (Tex. Comm’n App. 1928).

tion program and disbursement of this vast sum of money under one of its local road overseers....²⁴²

Each construction management contract must be evaluated on its own merits. Where the amount of managerial discretion and responsibility is sufficient, the contract will be considered one of a technical or professional nature. Where this character cannot be established, the parties must comply with competitive bidding statutes applicable to the contracting agency. Where an arrangement called for a contractor to design a building and perform some of the functions of a construction manager—i.e., coordinating solicitation and acceptance of subcontracts, but not performing any construction or supplying any materials—it was held that competitive bids were not needed.²⁴³ However, where the construction manager had duties such as guarantee of a maximum price based on the subcontractor's bids, it was considered to be more like a general contractor, and competitive bidding was required.²⁴⁴

This problem is also illustrated where a public agency contracted with an engineering consultant to advise it on the best way to proceed in arranging for the design, construction, and operation of facilities for management and recycling of solid waste. Award of the consultant's contract by negotiation rather than competitive bidding was challenged, alleging that the consultant did not come within the "scientific knowledge and professional skill" exception because it did not itself design the plant, but merely acted as a "broker" of the services of others. The court disagreed, and held that as long as the services contracted for involved scientific knowledge and professional skill, it did not matter whether they were provided by an original source or through a broker.²⁴⁵ The court noted that: "Competitive bidding requires 'full, clear, definite [and] precise' specifications, for there must be a common standard by which to permit the comparison of bids...."²⁴⁶

The precise specifications necessary to competitive bidding of necessity may preclude innovation by bidders. Where the agency wanted bidders to propose the best system for a waste recycling program, this ability to submit innovative proposals was essential. It was thus found to be exempt from competitive bidding requirements.

Installation of computer networks was held to be an exception where the court characterized the contract in

question to involve "inextricable integration of a sophisticated computer system and services of such a technical and scientific nature" as to constitute a professional service within the statute.²⁴⁷ However, although the purchase of computer systems and hardware may be considered the purchase of technical equipment and services, courts are more likely to hold that they are equipment purchases that are governed by public bidding requirements.²⁴⁸

iii. Response to Emergencies.—Competitive bidding statutes may provide exceptions for emergency situations in which the temporary necessity for quick action to protect public safety and welfare overrides the interest in promoting competition. Generally, definitions stress imminent danger to life or destruction of property, or a similar expression of unforeseen, unusual, and unacceptable hardships or costs.²⁴⁹

Courts have required a showing that preventive measures could not have avoided or lessened the risk.²⁵⁰ Accordingly, resort to emergency procedures has been approved when an agency needed to take immediate action to restore interrupted supplies of water, heat, and electricity,²⁵¹ or to stop pollution of the public water supply.²⁵² On the other hand, courts have not fully sanctioned exceptions to competitive bidding where the purpose was to expedite construction of an addition to a courthouse to accommodate a new judge,²⁵³ or repair roads in spring following a normal winter.²⁵⁴

Economic advantage and convenience for the public agency are not enough to constitute an emergency, even though the contracting officer believes in good faith that these benefits can be more readily obtained for the public through direct negotiation than through advertisement for competitive bidding.²⁵⁵ Thus, it was invalid for an agency to declare an emergency and invoke the

²⁴⁷ *Autotote Limited v. New Jersey Sports and Exposition Auth.*, 85 N.J. 363, 427 A.2d 55, 59 (1981).

²⁴⁸ *Pacificorp Capital, Inc. v. State, Through Div. of Admin., Office of State Purchasing*, 612 So. 2d 138 (La. App. 1 Cir. 1992).

²⁴⁹ *Model Code*, *supra* note 2, at § 3-206.

²⁵⁰ *Grimm v. City of Troy*, 60 Misc. 2d 579, 303 N.Y.S.2d 170, 175 (Sup. Ct. 1969) (a resolution of the contracting agency reciting certain facts and declaring that they constitute an emergency is not conclusive, but is sufficient prima facie evidence of an emergency to shift the burden of proof to the party attacking the validity of the award).

²⁵¹ *Merchants Nat'l Bank & Trust Co. v. City of Grand Forks*, 130 N.W.2d 212 (N.D. 1964).

²⁵² *Northern Improvement Co. v. State*, 213 N.W.2d 885, 887 (N.D. 1973) (statute did not include exception for emergencies, court refused to imply one).

²⁵³ *Reynolds Constr. Co. v. County of Twin Falls*, 92 Idaho 61, 437 P.2d 14 (1968).

²⁵⁴ *Bak v. Jones County*, 87 S.D. 468, 210 N.W.2d 65 (1973).

²⁵⁵ *Reynolds Constr. Co. v. County of Twin Falls*, 92 Idaho 61, 437 P.2d 14, 23 (1968).

²⁴² *Id.*, 11 S.W.2d at 309–10.

²⁴³ *Mongiovi v. Doerner*, 24 Or. App. 639, 546 P.2d 1110 (Or. App. 1976); *Attlin Constr. v. Muncie Community Sch.*, 413 N.E.2d 281 (Ind. App. 1980).

²⁴⁴ *City of Inglewood-Los Angeles County Civic Center Auth. v. Argo Constr. Co.*, 7 Cal. 3d 861, 103 Cal. Rptr. 698, 500 P.2d 601, 604 (1972).

²⁴⁵ *Waste Management, Inc. v. Wisconsin Solid Waste Recycling Auth.*, 84 Wis. 2d 462, 267 N.W.2d 659, 665 (1978).

²⁴⁶ *Id.*, 267 N.W.2d at 665.

emergency exception to competitive bidding where it found that if the project were bid the prices would likely be unreasonable.²⁵⁶

In the absence of statutory emergency contracting procedures, the exception may be implied from the nature of the contract and other provisions of the public contracting laws.²⁵⁷ In such cases, the special circumstances of the case also are influential. Unexpected necessity requiring prompt action must be shown.²⁵⁸ An emergency situation has been described as one that demands immediate attention, and that threatens the public health and safety of a community.²⁵⁹ In that case, an excavator had been hired to excavate a malfunctioning sewer line. While the line was exposed, falling rock punctured the line. The excavator repaired the line and sought additional compensation. The court held that the district was authorized to allow the additional work to be done by that contractor on an emergency basis without advertising for new bids.²⁶⁰

Where emergency circumstances meet the criteria for an exception to the statutory competitive bidding rules, the extent of the exception and the alternative procedure generally are specified in the statute. To the extent the statute sets forth alternative procedures, such procedures must be complied with fully in order to produce valid contracts. Where the statutory requirements are not complied with, the contractor may not be entitled to payment either under the contract or in quasi-contract.²⁶¹ In other words, the emergency is not a defense to having failed to comply with the applicable statutes.

Emergency procedures generally allow the contracting agency to determine that the emergency exists; there is not a requirement for a formal declaration of emergency.²⁶² Such a finding may be challenged by a prospective bidder or by a taxpayer, depending upon the state's requirements for bid protests generally.²⁶³

Alternative emergency procedures vary substantially in detail. However, because the need for speedy action

is critical in an emergency, a common feature of all such procedures is the temporary suspension of the mandatory requirement for advertisement over a specified period. When freed of this requirement, some agencies have found it most advantageous to procure supplies, services, and construction through direct negotiation with contractors whose capabilities are known from past performance. In some instances, statutory provisions for emergencies specify this course. In others, the requirement of competitive bidding is retained in the emergency situation, but the contracting agency is authorized to compress the process into a shorter time period,²⁶⁴ or negotiate a contract subject to approval of the contract by the governor.²⁶⁵

In a few cases, special reporting and accounting requirements are established for expenditures of public funds in emergency situations where regular competitive bidding procedure was not followed. An example is the emergency exemption in the Illinois Procurement Code, which applies in emergencies involving public health, public safety, immediate repairs needed to avoid further loss or damage of state property, disruption to state services, or the integrity of state records.²⁶⁶ Under this law, an agency must report funds spent in emergencies to the state's Auditor General within 10 days after execution of the contract, with full details of the circumstances. Quarterly reports by the Auditor General to the Governor and Legislative Audit Commission permit both offices to thoroughly review these transactions and evaluate any apparent abuse of the emergency procedures.²⁶⁷

Statutory provisions for award of contracts to deal with emergencies involving construction or repair of public works wisely avoid restrictive definitions of situations in which the procedures for competitive bidding may be bypassed in favor of speedier action. But as courts have supplied the definition of emergency situations in questionable cases, they generally have insisted that a strong and direct danger to public health or safety be present. Accordingly, in cases where sewer lines were threatened by falling rocks and where sewer lines beneath a river needed repair to seal a break, the circumstances did not justify avoidance of competitive bidding rules.²⁶⁸ Similarly, the need to build a temporary floating bridge to replace a structure damaged by a windstorm did not justify limiting bidders by prequalification to the builder of the floating bridge, despite the fact that use of a major regional highway was interrupted until the temporary bridge was in place.²⁶⁹ Nor did the possible threat to public safety from prison riots

²⁵⁶ *Id.*, 437 P.2d at 23.

²⁵⁷ *See* General Building Contractors of N.Y. State v. State of N.Y., 89 Misc. 2d 279, 391 N.Y.S.2d 319, 322 (1977); *but see* Smith v. Graham Co. Comm. College Dist., 123 Ariz. 431, 600 P.2d 44, 47 (1979) (even if an emergency existed, college still needed authority to avoid competitive bidding in an emergency; in fact, leaky roof had existed for some time and college had had time to bid project); Northern Improvement Co. v. State, 213 N.W.2d 885, 887 (N.D. 1973) (statute did not include exception for emergencies; court refused to imply one).

²⁵⁸ *See, e.g.*, Martin Excavating, Inc. v. Tyrollean Terrace Water & Sanitation Dist., 671 P.2d 1329 (Colo. App. 1983).

²⁵⁹ *Id.*, 671 P.2d at 1330.

²⁶⁰ *Id.* at 1331.

²⁶¹ Bak v. Jones County, 89, S.D. 468, 210 N.W.2d 65 (S.D. 1973) (contractor not entitled to payment for work on rain-damaged roads did not comply with statutory requirement of filing plans and specifications).

²⁶² *See, e.g.*, WASH. REV. CODE § 47.28.170 (2000).

²⁶³ *See* Grimm, *supra* note 250.

²⁶⁴ *See, e.g.*, WASH. REV. CODE § 47.28.170 (2002).

²⁶⁵ FLA. STAT. tit. 26, § 337.11(6)(a) (2000).

²⁶⁶ 30 ILCS 500/20-30(c) (1999).

²⁶⁷ 30 ILCS 500/20-30(c) (1999).

²⁶⁸ Northern Improvement Co. v. State, 213 N.W.2d 885 (N. D. 1973); Martin Excavating, Inc. v. Tyrollean Terrace Water & Sanitation Dist., 671 P.2d 1329 (Colo. App. 1983).

²⁶⁹ Manson Constr. & Eng'r Co. v. State, 24 Wash. App. 185, 600 P.2d 643 (1979).

justify avoidance of competitive bidding in the award of a contract for construction of prison facilities to relieve overcrowding.²⁷⁰ While the court in that case acknowledged that the state had effectively documented the potential danger to public safety if the overcrowded conditions were not relieved, it explained that to be within the intent of the exemption, “an emergency must involve an accident or unforeseen occurrence requiring immediate action; it is unanticipated or fortuitous; it is a sudden or unexpected occasion for action and involves a pressing necessity.”²⁷¹

Whether an emergency exists for the purpose of entering into emergency contracts without competitive bids is an issue that is fully reviewable by the courts. Otherwise, agencies could claim to have emergencies in an effort to circumvent competitive bidding.²⁷² In an action challenging the negotiation of a pay phone contract for the state prison system on an emergency basis, the court held that the agency’s declaration of emergency is “clothed with a presumption of correctness,” and was reviewable only for whether it was arbitrary, capricious, or unreasonable.²⁷³ The court noted that the “emergency” declared in that case was one of limited duration and was intended only to cover the gap in time between the expiration of one contract and the finalization of a new one, and not to circumvent bidding.²⁷⁴

iv. Contracts of a Special Nature.—Most states recognize contracts for public utility services and contracts for land acquisition or lease by an agency as being among the situations in which it is impractical to insist on strict compliance with competitive bidding procedures. Exemption of contracts for supply of electricity, heat, water, and other public utilities from competitive bidding rules generally is explained in terms of the monopolistic nature of the utility and the public regulation of its prices. Another situation in which practical considerations have justified an exception to mandatory competitive bidding involves the purchase of real property for public use. Because the specific site and condition of land are among the chief factors that make it desirable or necessary for public use, the purpose of encouraging competition among suppliers is not served by the kind of bidding provided for in the statutes. Reference to the “uniqueness of land” generally suffices to justify an exception for purchases, rentals, and other acquisitions of land or rights in land.²⁷⁵

²⁷⁰ *General Bldg. Contractors of N.Y. State v. State*, 89 Misc. 2d 219, 391 N.Y.S.2d 319 (1977) (prison overcrowding was not an adequate basis for declaration of emergency, as it had been known since riot occurred at Attica in 1971).

²⁷¹ *Id.*, 391 N.Y.S.2d at 321.

²⁷² *Union Springs Tel. Co. v. Rowell*, 623 So. 2d 732 (Ala. 1993).

²⁷³ *Id.*, 623 So. 2d at 734.

²⁷⁴ *Id.*

²⁷⁵ *Massey v. City of Franklin*, 384 S.W.2d 505, 506 (Ky. App. 1964) (building purchase not subject to bidding require-

ments). Another exception occurs where complex construction tasks are part of a larger integrated project in which engineering plans, design, and construction phases must be coordinated within the framework of financing plans. Thus, the contract for construction of an underground parking garage for a retail shopping mall redevelopment project was held to be sufficiently special in its nature due to its financing to warrant award of the contract through negotiation rather than competitive bid.²⁷⁶

Depending on statutory language, capital improvements such as replacement of heating and air conditioning systems in buildings may not be within the scope of competitive bidding. In a Nebraska case, the statute required bids on “contracts for supplies, materials, equipment and contractual services.”²⁷⁷ The court found no specific requirement in that language requiring that a contract for capital improvements be competitively bid.²⁷⁸ However, most definitions of “public works” are likely to be broad enough to encompass capital improvements to public facilities.

When construction contracts required competitive bidding, the court held that the purchase and installation of prefabricated, portable buildings were not subject to that requirement.²⁷⁹ Work performed to assemble and attach the prefabricated pieces was incidental to delivery of the materials, all of which were easily relocatable at the option of the owner. Similarly, a court held that a contract for cartographic services to prepare tax maps for use in public works planning and land acquisition did not have to be awarded through competitive bids, because the work did not involve actual physical construction activity on publicly owned land or structures.²⁸⁰ With this rationale, the same statute was

ments). However, statutes that allow an agency to lease land that it owns may require that the land be leased to the highest bidder. *See, e.g., Sellitto v. Borough of Spring Lake Heights*, 284 N.J. Super. 277, 664 A.2d 1284 (1995) *cert. denied*, 143 N.J. 324, 670 A.2d 1065 (1995) (statute allowing county or municipality to lease land or buildings to person who will pay highest rent does not require competitive bidding; however, another controlling statute did require competitive bidding; remanded with order to lower court to enjoin lease with cell phone company).

²⁷⁶ *Graydon v. Pasadena Redevelopment Agency*, 104 Cal. App. 3d 631, 164 Cal. Rptr. 56, 64 (1980).

²⁷⁷ *Anderson v. Peterson*, 221 Neb. 149, 375 N.W.2d 901, 906 (1985).

²⁷⁸ *Id.*, 375 N.W.2d at 906 (“Nebraska statutes covering county expenditures and competitive bidding comprise a crazy quilt of legislation.”); N.R.S. § 23-324.03.

²⁷⁹ *Steelgard, Inc. v. Jannsen*, 171 Cal. App. 3d 79, 217 Cal. Rptr. 152, 161 (1985).

²⁸⁰ *Andover Consultants v. City of Lawrence*, 10 Mass. App. Ct. 156, 406 N.E.2d 711, 714 (1980).

construed to exclude contracts for repairing and resurfacing roofs of existing buildings.²⁸¹

Where statutes provide that public agencies shall give preference to certain charitable or quasi-public entities in awarding contracts for public work, the limits of such exceptions generally must be defined by the courts. Thus, a decision to call for competitive bids to make identification photographs for drivers licenses was successfully challenged as contrary to a statute requiring state offices to obtain needed services from charitable nonprofit agencies for handicapped persons whenever they were competent to provide the service at fair market value.²⁸² In another case involving the same nonprofit agency, the court held that it was proper to award a contract to the agency for the operation of rest areas prior to the statutorily-required determination of fair market price.²⁸³ The court reasoned that delay in award of the contract would have required closure of the rest areas, and the contract contained a termination for convenience clause that could be invoked if the determination of fair market price were reversed.

Where a preference or an exception to the competitive bidding statute is not specific, but is based on an implicit exception favoring organizations with programs that perform valuable services in the public interest, its limits are interpreted restrictively. In the case of a contract awarded for painting subway stations, the court rejected arguments that a law authorizing rehabilitation and development of job skills of persons with poor employment records due to alcoholism, drug addiction, imprisonment, or other socioeconomic disability had the effect of excluding contracts for this program from the competitive bidding rule. While this argument should not be taken lightly, the court said, "the countervailing policies embodied in...the Public Authorities Law run too deeply to permit the contract at bar to wade through them by implication."²⁸⁴

v. Extensions of Existing Contracts.—The necessity for competitive bidding may also be raised where an awarding authority executes an extension or renewal of a previous contract for those services rather than advertising for bids. In holding that such an extension was invalid because it was awarded by negotiation rather than bidding, the court distinguished between a right to renew an existing contract and an authorization for the parties to enter into negotiations at the

contract's expiration if the parties desire to do so.²⁸⁵ The right to renew an existing contract under identical terms is not the same as a provision that allows negotiations. The latter is inoperable where the contract is subject to competitive bidding.²⁸⁶ The court noted two Washington cases that made this distinction. *Miller v. State* involved a contract for purchase of light bulbs.²⁸⁷ At the expiration of the contract, the agency negotiated for the renewal of the contract with the vendor. The court held this new contract was void because the agency had not complied with competitive bidding requirements.²⁸⁸ However, in *Savage v. State*, the contract contained a provision allowing for extension of the contract, at the State's option, for 1-year periods up to 3 years, on the same terms.²⁸⁹ The court found this provision to be valid, as it was clearly an option-to-renew clause as opposed to a negotiation provision. The provision extended the existing contract, and did not create a new one.²⁹⁰

An agency may also run the risk of being accused of circumventing competitive bidding when it amends an existing contract, rather than advertising for a new contract at the end of the contract term. Generally, a competitively bid contract cannot be materially amended.²⁹¹ One method of analyzing whether amendment is justified, rather than advertising for a new contract, is to question whether there is justification for a sole source for that particular contract. If there is, then it makes sense for the agency to simply extend the existing contract and document its reasons for doing so. However, if the contract would not meet the criteria for a sole source, the agency should advertise for bids.

vi. Methods of Noncompetitive Award of Contracts.—Where an exception to the requirement for competitive bidding already exists, a contracting agency has a choice of several methods of awarding a contract. These include (1) procedures for soliciting bids from a limited number of selected potential bidders who are prequalified, sometimes wherein negotiations with one or more bidders may result in modifications of specifications, work methods, performance criteria, or price; and (2) negotiations with a sole source. The contracting agency is allowed substantial discretion in selecting the method that best serves the public interest. However, its judgment must always be consistent with the policies requiring that negotiated awards must be made with the maximum competition that is practicable, and that the use of a noncompetitive award should be limited to the minimum needs of the contracting agency. Also, a suffi-

²⁸¹ *Commonwealth v. Brown*, 391 Mass. 157, 460 N.E.2d 606, 609 (1984) (definition of "construction" did not include reconstruction, alteration, repair, or remodeling).

²⁸² *Pa. Indus. for Blind and Handicapped v. Larson*, 496 Pa. 1, 436 A.2d 122, 124 (1981).

²⁸³ *Pa. Indus. for Blind and Handicapped v. Department of General Services*, 541 A.2d 1164, 1166, 116 Pa. Commw. 264 (1988).

²⁸⁴ *District Council No. 9, Int'l Bhd. of Painters & Allied Trades v. Metropolitan Transp. Auth.*, 115 Misc. 2d 810, 454 N.Y.S.2d 663, 669 (1982).

²⁸⁵ *Browning-Ferris Indus. of Tenn. v. City of Oak Ridge*, 644 S.W.2d 400, 402 (Tenn. App., 1982); see also *Edwards v. City of Boston*, 408 Mass. 643, 562 N.E.2d 834 (1990).

²⁸⁶ *Id.*, 644 S.W.2d at 402.

²⁸⁷ 73 Wash. 2d 790, 440 P.2d 840 (1968).

²⁸⁸ *Id.*, 440 P.2d at 843.

²⁸⁹ 75 Wash. 2d 618, 453 P.2d 613 (1969).

²⁹⁰ *Id.*, 453 P.2d at 616.

²⁹¹ *Baxley v. State*, 958 P.2d 422 (Alaska 1998).

cient justification for the exception must always exist before a noncompetitive award is permitted, and should be documented.

vii. Sole Source Contracts.—When a contracting agency undertakes negotiations with a sole source, the agency must be able to show that the sole source possesses a unique capability to furnish the property, services, or performance required to meet the agency’s minimum needs.²⁹² The determination that a particular source is in fact the sole source available for specified products or services may not be based on the unsupported opinion of the agency’s contracting officer. It must be based on showing that the appropriate effort was made to investigate potential sources without success in finding any others. Generally, three requirements must be met: (1) the goods or service offered must be unique; (2) the uniqueness must be substantially related to the intended purpose, use, and performance of the goods or services sought; and (3) the entity seeking to be declared a sole source must show that other similar goods or services cannot perform those desired objectives of the agency seeking those goods or services.²⁹³ Uniqueness alone does not suffice, as any products may be shown to be “unique.”²⁹⁴

A distinction must be made between a sole source contract and one in which the specifications are so narrowly drawn that only one bidder will be able to meet them. While the former, if supported by the above criteria, is a legitimate method of avoiding competitive bidding, the latter is not.²⁹⁵ This is discussed more fully in Section 1-B regarding “or equal” clauses.

1. Alternate Bids

When engineering problems can be solved by alternative means, the contracting agency may face a dilemma in preparing its plans and specifications. The goal of competitive bidding is to achieve economy in construction costs, and engineering judgment may honestly differ on the best way to achieve this goal. Rather than designate one particular method of construction or one list of materials that must be used, contracting agencies may ask for proposals on alternative approaches, specifying only the end result, and leaving it to the bidders to select materials, methods, and other aspects of their bids. In some cases, this approach has official status in directives to the contracting officer to solicit proposals on all feasible methods as a basis for award-

ing a contract. In others, the highway agency’s governing legislation may not mandate the solicitation of alternative bids, but may accord the contracting officer the authority to proceed in this way where circumstances make it desirable.²⁹⁶ Bidding on alternatives may take the form of instructions to prepare bids on alternative methods or specifications for accomplishing the contracting agency’s objective. In such cases the bids are evaluated for returning the greatest value for the money spent. Success in using this type of bidding requires clear and complete specifications and instructions, and proposals that are carefully prepared and responsive.²⁹⁷

An illustration of the issues raised by another type of alternate bidding is provided by *L.G. DeFelice & Son, Inc. v. Argraves*, involving contracts for construction of the Connecticut Turnpike.²⁹⁸ In the notice to prospective bidders, the highway commissioner requested alternate bids, one for construction of reinforced concrete and one for bituminous concrete pavement. The notice stated that the agency would determine the type of pavement to be used after it received bids, and after it had fully investigated all factors, including costs. Plaintiff was the low bidder on bituminous concrete, and in this bid was lower than the lowest bidder on reinforced concrete paving. Accordingly, when the highway commissioner awarded the contract to the low bidder for the reinforced concrete paving, plaintiff sought to enjoin the award as being contrary to the legal requirement for award to the lowest responsible bidder. The court denied the injunction, stating:

[T]he great weight of authority supports the proposition that the awarding official may exercise his discretion to determine after the receipt of alternative bids which alternative to select and to select the lowest responsible bidder under that alternative...The court will not interfere with the exercise of discretionary powers vested in a public official in the absence of fraud, corruption, improper motives or influences, plain disregard of duty, gross abuse of power or violation of the law....²⁹⁹

The Connecticut court stressed the significance of statutory language granting the contracting agency discretion in calling for bids and selecting the lowest responsible bidder.

Projects that allow bidding in the alternative may raise questions regarding practices that are prohibited. They adversely affect the quality of competition in the bidding process, even though there is no corruption or conspiracy in the bids, and no actual loss or unnecessary extravagance suffered by the public agency. Where such practices are found, contracts involving them are

²⁹² See Model Code, *supra* note 2, at § 3-205.

²⁹³ *General Electric Co. v. City of Mobile*, 585 So. 2d 1311, 1315–16 (Ala. 1991).

²⁹⁴ *Id.* at 1315.

²⁹⁵ *Unisys Corp. v. Department of Labor*, 220 Conn. 689, 600 A.2d 1019, 1023 (1991) (question is whether specifications are drawn to the advantage of one manufacturer, not for reasons in public interest but to assure award to that manufacturer).

²⁹⁶ *Ericsson GE Mobile Communications v. Motorola Communications & Electronics*, 657 So. 2d 857 (Ala. 1995).

²⁹⁷ *V. C. Vitanza Sons v. Murray*, 90 Misc. 2d 893, 396 N.Y.S.2d 305 (1977).

²⁹⁸ 19 Conn. Supp. 491, 118 A.2d 626 (Super. Ct. 1955).

²⁹⁹ *Id.* at 496, 118 A.2d at 628.

considered unlawful or may be set aside.³⁰⁰ For example, a contract that allowed alternative proposals for all major bid terms was found to have allowed bidders to “rewrite the bid advertisement” and thus prevent fair competition by preventing an exact comparison of the bids.³⁰¹ The court found that under the circumstances, there was no fair and reasonable method to determine the highest bidder for a lease.

Other instances in which these results were considered to be present were where one submitted a high bid on one alternative and an excessively low bid on the other, with the intention of underbidding others on the total project and so securing contracts for all of the work. Bidders who use this practice to advance an “all or none” strategy may reduce the risk of having only their excessively low bid accepted by claiming it was made by mistake and must be rejected. However, the prospect that a “high-low” bidder may be able to manipulate the award and gain an advantage over other bidders might leave the bid vulnerable to challenge.

Circumstances may alter results, however, and were held to do so in *Sempre Construction Co. v. Township of Mount Laurel*.³⁰² An agency asked for bids on excavation work, reserving the right to award the contract on “base bids” or “base plus alternates.” One construction company, making no secret that it wanted all of the work or none of it, submitted a high base bid and an extremely low bid for the alternates. The contractor’s action was upheld by the court when challenged by a competing bidder, because the high-low bids were free from any technical defects by which the bidder might be relieved from its duty to accept an undesired contract.

Where contract specifications call for bidding on alternative materials or methods of work, such specifications sometimes have been challenged as being inadequate for competitive bidding. Where bidding on alternatives is permitted, the contracting officer has the advantage of comparing the bidders on a range of materials and technical aspects, as well as on price. It is to be expected that greater economy for the contracting agency will result. However, bidders may believe that the call for consideration of alternatives introduces too much uncertainty into bid preparation and evaluation.

Whether asking for alternate bids or modified alternatives, the contracting agency’s specifications must be full, accurate, and complete as to each of the alternatives. They must be presented in a manner that allows opportunity for free competitive bidding on each alternative. Where they meet these criteria, these methods of calling for bids are reconcilable with the principles of competition.³⁰³ It is not fatal to alternative bidding that the agency wants to reserve its selection of one alterna-

tive over the other after seeing the prices for each. “The very concept of alternative specification bids approved in these cases is calculated to allow the responsible government entity to weigh the costs and benefits of different types of proposals after the costs are known.”³⁰⁴

Under the best of circumstances, however, efforts at completeness and accuracy are subject to inadvertent discrepancies in the specifications. Where such discrepancies are discovered, a rule of reason applies. If they fail in some material aspect to inform potential bidders of the terms on which bids will be compared or performances required, the specifications are defective, and any contract awarded on them is subject to cancellation.³⁰⁵

Bidding on alternative specifications may be accomplished on separate proposal forms or in a single consolidated form. Instructions on the preparation of bids must be followed fully and exactly. Where a single combined bid form is used, it is customary for the instructions to require that all spaces must be filled, and all items of information must be furnished for each alternative. Failure to comply with this requirement exposes the bid to the risk of rejection because of its irregularity.³⁰⁶

m. Confidentiality of Contractor Records

Because of state and federal laws requiring full disclosure of records held by or used by public agencies, agencies and contractors must rely on specific exemptions from these statutes in order to assert that some contractor records are confidential. Some states provide exemptions for all documents submitted in the public bidding process.³⁰⁷ Others address only the financial information submitted in the prequalification process.³⁰⁸

In addition, agency records pertaining to the procurement process will ordinarily be publicly available unless protected by a specific exemption. In federal procurement in which the Federal Acquisition Rules apply, those rules prohibit the government from releasing any source selection information during procurement proceedings, including the ranking of bids, proposals, or competitors. The disclosure of this information to one bidder has been held to give that bidder an advantage over others.³⁰⁹

³⁰⁴ *Id.* at 371.

³⁰⁵ State ex rel. Hoeffler v. Griswold, 35 Ohio App. 354, 172 N.E. 438 (1930).

³⁰⁶ Baxter’s Asphalt & Concrete v. Liberty County, 406 So. 2d 461 (Fla. App. 1981).

³⁰⁷ D.C. Code § 2-303.17 (2002) (documents submitted in response to invitation for bids or request for proposals will be treated as confidential).

³⁰⁸ WASH. REV. CODE § 47.28.075 (2000).

³⁰⁹ Ralvin Pacific Properties, Inc. v. United States, 871 F. Supp. 468, 472–73 (D.D.C. 1994).

³⁰⁰ Owensboro Grain Co. v. Owensboro Riverport Auth., 818 S.W.2d 605, 608 (Ky. 1991).

³⁰¹ *Id.*

³⁰² 196 N.J. Super. 204, 482 A.2d 36 (1984).

³⁰³ See *J.J.D. Urethane Co. v. Montgomery County*, 694 A.2d 368, 372 (Pa. Commw. 1997) and cases cited therein (alternatives requested regarding elevator or stairway).

2. Alternative Contracting Methods

a. *The Design-Build Method*

Many state transportation agencies have obtained legislative authority to construct transportation projects using the “design-build” contracting method.³¹⁰ Agencies must have specific statutory authority to use this method, in order to be able to vary from the competitive bidding statutes. Although there is not much case authority for this proposition, it may be easily derived from the more general case law pertaining to when competitive bidding must be used.

The typical design-builder is a joint venture consisting of an engineering or design firm and a construction company. The agency has authority to contract with the design firm without competitive bidding, as that is a recognized exception for specialized work that does not require bidding. It may also be permitted under a State Little Brooks Act. However, the agency will be required to bid the construction work. In addition, the agency is required by its bidding statutes to prepare detailed plans and specifications on which the contract may be bid. In order to circumvent the requirements of (1) preparing detailed plans and specifications and (2) bidding the construction work, the agency must have specific statutory authority to use an alternative contracting method.

Procurement for design-build contracts uses a competitive selection process, or competitive sealed proposals.³¹¹ Proposals are solicited through publication of a request for proposals. The statute may set out a two-step request for proposal process, in which the first step is either submission of a conceptual proposal, along with a statement of qualifications, or just submission of a statement of qualifications.³¹² In the second step, the transportation agency selects the top qualified contractors to submit a detailed proposal, along with either a fixed price or a guaranteed maximum price. Agencies may then be allowed further discretion in selecting the best proposal, and are not required to select the lowest priced proposal. Unlike competitive sealed bidding, which requires agencies to select the lowest responsible bidder, agencies using competitive sealed proposals may select the proposal that is most beneficial to the state.

Because in the second step of the process the proposer is required to spend a significant amount of money in preparing a more detailed proposal, the statute may allow the agency to set a stipend for the second-step proposers. In exchange for the stipend, how-

ever, the agency should become the owner of the work product prepared by the proposer, even if that proposal is not ultimately selected.

Although the process of selecting a design-build contractor technically results in a negotiated contract, there is little negotiating that should remain at the end of the selection process. Items such as indemnifications, insurance requirements, environmental obligations, and anything else that would impact the fixed price being proposed must be included in the request for proposals so that the proposer can fairly price those items. Ideally, the entire form of the contract should be included with the request for proposals. This may also be required by the design-build statute.³¹³

i. Federal Approval for Use of Design Build.—Agencies seeking to use design-build or any other innovative contracting methods that vary from the competitive bidding requirement of the federal-aid highway statutes must obtain FHWA approval.³¹⁴ FHWA has a process for evaluating these projects known as Special Experimental Project Number 14, or SEP-14. This process is summarized on FHWA’s Web page.³¹⁵ This process is used to review innovative contracting methods including best value, life-cycle cost, qualifications-based bidding, and any methods where other factors in addition to cost are considered in the bidding process.

FHWA has described the goal of this project as follows:

The objective of SEP-14 is to evaluate “project specific” innovative contracting practices, undertaken by State highway agencies, that have the potential to reduce the life cycle cost of projects, while at the same time, maintain product quality. Federal statutes and regulations do set forth specific Federal-aid program requirements; however, some degree of administrative flexibility does exist. The intent of SEP-14 is to operate within this administrative flexibility to evaluate promising non-traditional contracting practices on selected Federal-aid projects.³¹⁶

Approval is required under this program for use of design-build, cost-plus-time bidding (also known as “A + B bidding”), and warranty clauses.³¹⁷ FHWA’s Web site contains additional information on these contracting methods as well as links to additional resources and studies.

³¹⁰ UTAH STAT. § 63-56-36.1 (2002); WASH. REV. CODE §§ 47.20.750–775 (1999); FLA. STAT. tit. 26, § 337.11(7).

³¹¹ Model Code, *supra* note 2, at § 3-203.

³¹² See UTAH STAT. § 63-56-36.1(4) (2002) (prequalification of potential contractors through a request for qualifications process).

³¹³ WASH. REV. CODE § 39.10.051(4)(e) (2003).

³¹⁴ See 23 U.S.C. § 112 (competitive bidding required for construction contracts in federal-aid projects). See 23 C.F.R. Part 636.

³¹⁵ See “FHWA Initiatives to Encourage Quality Through Innovative Contracting Practices, Special Experimental Projects No. 14-(SEP-14),” on FHWA’s Web page at http://wwwcf.fhwa.dot.gov/programadmin/contracts/sep_a.htm

³¹⁶ *Id.*

³¹⁷ *Id.*

b. General Contractor / Construction Manager

A number of cases have addressed the question of whether an agency may contract with a construction manager without competitive bidding. Given the extent of the construction manager's duties and the form of the contract, the question may be one of specific statutory authority, or may be one of whether the contract may be let as one for professional services.

Some public agencies have statutory authority to contract through the general contractor/construction manager, or GC/CM, method, in which the agency contracts with a general contractor who then not only acts as the prime contractor but also manages the construction project on behalf of the agency.³¹⁸ This type of contract generally includes either a fixed price for the construction or a guaranteed maximum price. In order to contract in this manner, an agency needs express statutory authority to deviate from competitive bidding rules. Such a statute generally authorizes the agency to solicit proposals and select the best proposal, similar to the manner in which it contracts with architects and engineers.

A sample statute is found in the State of Washington, which authorizes certain agencies (not including the Department of Transportation) to use this contracting method. The statute specifically authorizes the use of this method when (1) implementation of the project involves complex scheduling requirements; (2) the project involves construction at an existing facility that must continue to operate during construction; or (3) the involvement of the GC/CM during the design stage is critical to the success of the project.³¹⁹ The statute defines a GC/CM as follows:

For the purposes of this section, "general contractor/construction manager" means a firm with which a public body has selected and negotiated a maximum allowable construction cost to be guaranteed by the firm, after competitive selection through formal advertisement and competitive bids, to provide services during the design phase that may include life-cycle cost design considerations, value engineering, scheduling, cost estimating, constructibility, alternative construction options for cost savings, and sequencing of work, and to act as the construction manager and general contractor during the construction phase.³²⁰

Although the statute refers to "formal advertisement and competitive bids," it contemplates something other than the traditional invitation for bids and submission of unit price bids.

Contracts for the services of a general contractor/construction manager under this section shall be awarded through a competitive process requiring the public solicitation of proposals for general contractor/construction manager services. The public solicitation of proposals shall include: A description of the project, including programmatic, performance, and technical re-

quirements and specifications when available; the reasons for using the general contractor/construction manager procedure; a description of the qualifications to be required of the proposer, including submission of the proposer's accident prevention program; a description of the process the public body will use to evaluate qualifications and proposals, including evaluation factors and the relative weight of factors; the form of the contract to be awarded; the estimated maximum allowable construction cost; where applicable; and the bid instructions to be used by the general contractor/construction manager finalists....³²¹

It is still a competitive process; proposers must compete on the relative superiority of their proposals based on the factors set out in the statute:

Evaluation factors shall include, but not be limited to: Ability of professional personnel, past performance in negotiated and complex projects, and ability to meet time and budget requirements; the scope of work the general contractor/construction manager proposes to self-perform and its ability to perform it; location; recent, current, and projected work loads of the firm; and the concept of their proposal.³²²

Because the criteria to be evaluated are subjective, a different process is used than the usual determination of lowest responsive bid:

A public body shall establish a committee to evaluate the proposals. After the committee has selected the most qualified finalists, these finalists shall submit final proposals, including sealed bids for the percent fee, which is the percentage amount to be earned by the general contractor/construction manager as overhead and profit, on the estimated maximum allowable construction cost and the fixed amount for the detailed specified general conditions work. The public body shall select the firm submitting the highest scored final proposal using the evaluation factors and the relative weight of factors published in the public solicitation of proposals.³²³

Utah's agencies are authorized to adopt rules governing the use of the GC/CM contracting method. Utah's statute requires only that those rules must require competitive selection of the GC/CM, and also that where an additional subcontractor is procured by the GC/CM, it must be publicly bid in the same manner as if the agency were managing the construction.³²⁴

In *City of Inglewood - Los Angeles Civic Center Authority v. Superior Court*, the agency had entered into a contract that was similar to a GC/CM contract. In addition to requiring that the contractor coordinate the solicitation and acceptance of bids and supervise the construction, it also required the contractor to guarantee a maximum price for the entire project.³²⁵ The court held that the contract was not valid. By requiring that the contractor guarantee a maximum price, the agency went beyond the normal responsibilities of a profes-

³²¹ WASH. REV. CODE § 39.10.061(4) (2002).

³²² WASH. REV. CODE § 39.10.061(4) (2000).

³²³ WASH. REV. CODE § 39.10.061(4) (2002).

³²⁴ UTAH STAT. § 63-56-36(2) (2002).

³²⁵ 7 Cal. 3d 861, 103 Cal. Rptr. 689, 500 P.2d 601 (1980).

³¹⁸ See UTAH STAT. § 63-56-36(2) (2002).

³¹⁹ WASH. REV. CODE § 39.10.061(2) (2002).

³²⁰ WASH. REV. CODE § 39.10.061(1) (2002).

sional such as an engineer or architect. The contract was more in the nature of a prime contract, which had to be competitively bid and could not be negotiated.

However, in cases in which the construction manager's role does not include guaranteeing a maximum price, these arrangements have generally been upheld as legitimate exceptions to the requirements of competitive bidding without specific statutory authority. These arrangements are similar to the GC/CM contract, in that the rationale for the contract appears to be factors similar to those set out in the Washington GC/CM statute. They are distinct from the GC/CM contract, however, in that the construction manager does not also act as a general contractor and they do not include a fixed price guaranteed by the construction manager. For example, in *Mongiovi v. Doerner*, the contract was let to a construction manager in a project using a "fast track" method of construction contracting.³²⁶ There was to be no prime contractor; rather, the construction manager was to supervise the solicitation and acceptance of bids and then share supervisory authority over the construction with the architect. The construction manager did not perform any construction work nor did it supply materials. Because the contract involved only professional, personal services, it could be evaluated only by subjective criteria and was therefore held to be exempt from public bidding.

In another case, the hiring of a construction manager was found to be authorized by a school district's statutory authority to hire an architect or engineer to prepare plans, specifications, and estimates and to supervise construction.³²⁷ The district had no statutory authority to employ the GC/CM method, but rather contracted with a construction manager rather than a prime contractor. The construction manager then coordinated the solicitation and acceptance of bids for 27 different school addition projects. The construction manager shared general supervisory authority with the architect during construction. The unsuccessful bidder did not contend that the district could not hire architects and engineers to act as construction managers, but argued that the exception for architects and engineers did not allow the construction management contract to be let without bids.

The court held that although the statute allowing the employment of architects and engineers was silent on construction managers, the district had general authority to hire "such other personnel or services, all as the governing board considers necessary for school purposes."³²⁸ The construction manager function was consistent with the authority to hire architects and engineers, and was authorized by this catch-all provision.

³²⁶ 24 Or. App. 639, 546 P.2d 1110 (1976).

³²⁷ *Attlin Constr., Inc. v. Muncie Community Schools*, 413 N.E.2d 281, 287 (Ind. App. 1980).

³²⁸ *Id.*, 413 N.E.2d at 290.

c. Public Private Partnerships

This method involves not only one of the more innovative contracting methods, but also involves innovative financing for transportation construction, including private financing that is repaid with tolls or user fees collected on the transportation facility. Again, specific statutory authority is required in order to allow the agency to deviate from the competitive bidding requirement. The Model Code now provides for a type of project delivery known as design-build-finance-operate-maintain, which is a form of public-private partnership.³²⁹

One of the purposes of public-private initiatives in public contracting is to develop new sources of funds for public projects, providing an alternative funding mechanism for projects that are unlikely to be state-funded because of high cost.³³⁰ Another is to take advantage of efficiencies and cost saving mechanisms that the private sector may be able to use, while retaining functions that government agencies perform better.³³¹ The expectation of this program is that the private developer who contracts with the State will be responsible for the design, financing, construction, and operation of the new transportation facility. The agreement between the state and the developer will authorize the developer to collect tolls on the transportation facility in order to repay its financing.³³²

Where public bidding requirements otherwise apply, a public agency must have express statutory authority to deviate from standard public bidding requirements and to contract with a developer for a public-private project. Some public works statutes may still apply, as they may be not in conflict with the public-private contracting statute, or they may be specifically included in the statute.³³³

Washington's Public Private Initiatives in Transportation Act requires only that the "secretary [of Transportation]...shall solicit proposals from, and negotiate and enter into agreements with, private entities..."³³⁴ The Washington State Department of Transportation (WSDOT) chose to use a competitive process similar to that used for the selection of architecture and engineering firms, using a request for proposals.

The submitted proposals are technically considered public records under Washington's Public Records Act, but WSDOT took the position that they should not be subject to disclosure prior to final selection. Because of opportunities to modify the proposals, disclosure of the

³²⁹ Model Code, *supra* note 2, at §§ 3-203, 5-203.

³³⁰ 20 DEL. CODE § 2001 (2001).

³³¹ 20 DEL. CODE § 2001 (2001); WASH. REV. CODE § 47.46.010 (2001).

³³² 20 DEL. CODE § 2006 (2001); WASH. REV. CODE § 47.46.050 (2001).

³³³ See WASH. REV. CODE 47.46.040 (2002).

³³⁴ WASH. REV. CODE § 47.46.030(1) (2002).

proposals prior to selection would compromise the review and selection process. Also, there were portions of some proposals that were considered proprietary and that could have been used by a proposer's competitors here or in another state. The agency position was not challenged. After selection, selected proposals were made public, with the exception of material that was considered proprietary or a trade secret.

Selection of a contractor to move forward in negotiations with the agency does not in itself create a contractual right. Nonetheless, agencies should reserve the right to terminate negotiations in their requests for proposals.

Parties to a public-private venture may refer to their contractual arrangement as a "public-private partnership." However, it is not a partnership in the legal sense of the word. It is still an owner-contractor relationship, although there is a clearly stated effort to work cooperatively toward a common goal. Each party retains its own essential characteristics; the public agency must continue to carry out its statutory function as a public agency and act in the best interest of the public, and the private entity must continue to act in the best interest of its owners or shareholders.

An issue that affects many areas of the agreement is how risk will be allocated between the public agency and the private entity. Usually this will be a business and/or policy decision to be made by the agency and the developer, within the limits of the agency's authority. For example, the agency must have specific statutory authority to indemnify a contractor.³³⁵ Risks that the agency requires the developer to insure against or indemnify the agency may result in increased costs to the project, which will in turn be included in the amount that the developer may recover in tolls. These costs will therefore be passed on to the toll-payer. Risks that are borne by the State will be passed on to gas tax payers throughout the state. The agency must balance these as a policy matter.

Another issue is whether the program violates a state's "contracting out" statutes, which ordinarily prohibit an agency from doing work by contract that its employees customarily do. A statute in California that allowed the creation of public-private partnerships was challenged on the basis that it violated prohibitions against contracting out those services traditionally performed by state workers. The California appellate court held that because the program had as one of its major goals the procurement of state transportation facilities that could not otherwise be built with the usual funding mechanisms and was an "experimental" program, the contracting out statutes were not violated by this program.³³⁶

³³⁵ Barendregt v. Walla Walla School District No. 140, 26 Wash. App. 246, 611 P.2d 1385 (1980).

³³⁶ Professional Eng'rs v. Cal. Dep't of Transp., 13 Cal. App. 4th 585, 16 Cal. Rptr. 2d 599 (1993); CAL. GOV'T CODE § 19130(a). For discussions of when privatization is allowed or not allowed, see Colorado Ass'n of Public Employees v. Dep't of

Washington's statute was challenged on a number of constitutional grounds, including charges that it impermissibly delegated legislative power to a private corporation by allowing the private entity to set toll levels for the transportation facility. The court held that setting toll rates is an administrative function rather than legislative, and that the statute contained adequate safeguards to protect the public against arbitrary action by the private entity.³³⁷

B. ELEMENTS OF THE PUBLIC CONSTRUCTION CONTRACT

1. Agency's Responsibility for Contract Plans, Specifications, and Technical Information

a. Requirement for Detailed Plans and Specifications

A common feature of state competitive bidding requirements is that contracting agencies prepare plans and specifications for their construction projects.³³⁸ In addition, they must make these documents available to prospective bidders, along with other documentation to assist bidders in preparing and submitting proposals.³³⁹ Even without being specifically required by legislation, the agency's obligation to furnish detailed plans and specifications arises as a necessary implication of the requirement for competitive bidding. The objective of this policy cannot be achieved unless bidders are sufficiently well informed of the plans and specifications of the job to permit them to prepare their proposals intelligently and correctly. Whether based on statutory language or implications, the duty to provide definite plans, specifications, and technical information is strongly rooted in public policy and is consistently enforced by the courts.³⁴⁰

Standard specifications published by the various state transportation agencies show a similar pattern of statements relating to the interpretation of plans,

Highways, 809 P.2d 988 (Colo. 1991) (contracting out maintenance services violated constitutional and statutory civil service provisions; statutory authority to "reorganize" department did not confer authority to contract out); Moore v. State of Alaska, Dep't of Transp. and Public Facilities, 875 P.2d 765 (Alaska 1994) (because civil service provisions allowed for efficient management of agency, department could contract out functions for economic reasons). See also R. Cass, *Privatization: Politics, Law and Theory*, 71 MARQ. L. REV. 449 (1988), and following commentaries.

³³⁷ State ex rel. Peninsula Neighborhood Ass'n v. Wash. State Dep't of Transp., 142 Wash. 2d 328, 12 P.3d. 134 (2000).

³³⁸ Portions of this section are derived from *Competitive Bidding and Award of Highway Construction Contracts* by Dr. Ross D. Netherton, published by the Transportation Research Board in 1976 and included in the first edition of SELECTED STUDIES IN HIGHWAY LAW, vol. 3, p. 1125: supplemental, *Id.*, at pp. 1214-51.

³³⁹ See, e.g., WASH. REV. CODE § 47.28.040 (2002).

³⁴⁰ Sullivan v. State through Dep't of Transp. and Dev., 623 So. 2d 28, 30 (La. App. 1 Cir. 1993).

specifications, and technical information, in some instances going so far as to require bidders to examine the site of the proposed work as well as the technical documents describing the work required. Notwithstanding these disclaimers, state statutes emphasize the goal of opening up the bidding process to competition among all bidders on equal terms, including information about the job.

When courts have been called on to determine whether this duty has been met, they have adopted the same pragmatic approach. When the situation did not readily permit more precision or detail, they have found that the duty has been met by “substantial compliance.”³⁴¹ In one case, the Minnesota court was concerned with the actual effect of the language on the bidder’s ability to write its proposal:

The court has found that the plans and specifications were sufficiently definite and precise to afford a basis for competitive bidding. Witnesses for the respective parties differed as to the range above the minimum of 1200 horsepower which would be reasonable. They all admitted that some range would be reasonable. The question was one of fact, and the evidence sustains the court’s finding.³⁴²

Specifications that do not suffer from vagueness could, at the other extreme, become so restrictive as to preclude effective competition among bidders. However, the discretion of the contracting agency in drafting specifications for work normally will not be overruled unless it is shown to be arbitrary, oppressive, or fraudulent.³⁴³

The form and style in which plans, specifications, and technical information are prepared are influenced more by industry customs and agency practices than by conventions and case law. In many projects, each phase of the construction—such as earthwork, concrete, structural steel, masonry, and carpentry—is treated in a separate section of the bid documents. Likewise, equipment and machinery used in the work will be described separately, and each category of basic materials will have its own section. Although no fixed rules prescribe the organization of these elements, there is a preference for arranging them as closely as practicable to the sequence of the construction operations. In all cases the drafter should bear in mind that the method used must present the plans and specifications in a manner that enables any bidder relying on them to determine what is required in all important details of the work.

In preparing project plans and specifications, the drafter must also consider how the description of mate-

rials and methods will facilitate the inspection and testing that is required during the construction and prior to acceptance of the finished work. For projects involving major highways or structures, there is no practical way to determine by a single test or series of tests of the finished work whether it will perform its intended function throughout its expected service life. Therefore, it is customary to control the quality of materials and workmanship by testing components as they are assembled and installed. For most types of materials and construction, contracting agencies use standard specifications and test procedures. In this published form, they are incorporated by reference into project plans and specifications, subject to the special provisions or modifications for the project.

Where contracts do not involve subject matter that is unusual or complex, and advertisements for bids omit pertinent features or descriptive information, courts tend to take a pragmatic approach and accept substantial compliance where the defective specification does not result in any practical disadvantage in preparing or evaluating bids.³⁴⁴ A similar standard was applied in a case in which a document was identified as “plans,” even though it did not meet the technical definition of plans. The court found that the information included in the document provided boundaries, contents, and test results of borrow pits, and was provided to bidders to provide foundation material for the preparation of bids. It was thus considered part of the agency’s “plans and specifications” on which the bidders were entitled to rely, even though it did not meet the definition of “plans” in the standard specifications.³⁴⁵ However, in another case, where an agency specifically stated in the bid documents that pit test data was provided for information only and was not a special provision, the court held that the agency did not provide any warranty with the information. Rather, the contractor was required to determine for itself the nature of the material in the gravel pits and was not entitled to rely on the information.³⁴⁶

The same applies where bidders charge that a contracting agency has failed to furnish the latest and best technical information available. The limits of a contracting agency’s duty in this regard are illustrated where a union that had members who would have been hired by a bidder complained that the agency did not notify bidders of a forthcoming change in the official

³⁴¹ Scanlan v. Gulf Bitulithic Co., 44 S.W.2d 967, 970 (Tex. Comm’n App. 1932) (in order for specifications to be invalid, must be more than “deficient in the most trivial respect”).

³⁴² Otter Tail Power Co. v. Village of Elbow Lake, 234 Minn. 419, 425, 49 N.W.2d 197, 202 (1951).

³⁴³ See *infra* note 464 and accompanying text.

³⁴⁴ Plantation on the Green, Inc. v. Gamble, 441 So. 2d 299, 304 (La. App. 1983) (description of land by address and location within a larger public facility approved); Platt Electr. Supply, Inc. v. City of Seattle, Div. of Purchasing, 16 Wash. App. 265, 555 P.2d 421, 430 (1976) (failure to describe warranty or method of implementing warranty).

³⁴⁵ Jack B. Parson Constr. Co. v. State, by and Through Dep’t of Transp., 725 P.2d 614, 616 (Utah 1986).

³⁴⁶ Mooney’s, Inc. v. South Dakota Dep’t of Transp., 482 N.W.2d 43, 46 (S.D. 1992).

wage determination so that it could be reflected in bidding on a federally-funded construction project. The court dismissed the complaint with the following observation:

The plaintiff would expand [the highway] administrator's duty...compelling him to keep one ear pressed on the walls of the Department of Labor's Wages and Hours Division, straining to hear of prevailing wage modifications...as yet unborn, but which might issue within days or hours of an opening of bids. No such burden is imposed by [the law] as presently written, and none shall be manufactured by this court.³⁴⁷

Where the technical information in question is in the form of governmental actions, prospective bidders must, along with the rest of the public, monitor the official newspapers or publications where the information is announced.

An agency has no duty to disclose to bidders on a construction project facts in its possession when its superior knowledge or silence would convey a false impression, where the agency has made no affirmative misrepresentation.³⁴⁸ The agency has a duty only to provide bidders with information that will not mislead them.

Where a bid item is left out of the bid specifications, the agency may be found to have failed to provide sufficiently definite plans and specifications for the contract.³⁴⁹ In such a case, the agency will be liable for any additional costs incurred by the contractor in providing that item of work.

In addition to bidders, subbidders are entitled to rely on the plans, specifications, and other bid documents that are in existence at the time that their subbids are prepared.³⁵⁰

b. Responsibility for Accuracy of Specifications

When the agency sets out detailed plans and specifications for the construction of a public project, it warrants that those plans and specifications are adequate. The agency will thus bear the loss resulting from inadequate or inaccurate plans or specifications. The leading federal case on this issue is *United States v. Spearin*, a 1918 case that involved construction of a dry dock at the Brooklyn Naval Shipyard.³⁵¹ The dry dock

³⁴⁷ *Operating Eng'rs Local Union No. 3, Int'l Union of Operating Eng'rs v. Hurley*, 546 F. Supp. 387, 390 (D. Utah 1982).

³⁴⁸ *Hendry Corp. v. Metropolitan Dade County*, 648 So. 2d 140, 142 (Fla. App. 3 Dist. 1994) (DSC clause will be triggered only where there has been an inaccurate representation that is relied on, not where there has been no representation).

³⁴⁹ *Sullivan v. State, Through Dep't of Transp. and Dev.*, 623 So. 2d 28 (La. App. Cer. 1993) *writ denied*, 629 So. 2d 1179 (La. 1993).

³⁵⁰ *J.F. White Contracting Co. v. Department of Public Works*, 24 Mass. App. Ct. 932, 508 N.E.2d 637, 639, *review denied*, 400 Mass. 1104, 511 N.E.2d 620 (1987).

³⁵¹ 248 U.S. 132, 39 S. Ct. 59, 63 L. Ed. 166 (1918); *see also* K. Golden and J. Thomas, *The Spearin Doctrine: The False Dichotomy Between Design and Performance Specifications*, 25 PUB. CONT. L.J. 47-68 (1992).

construction necessitated relocation of a sewer line, which the contractor completed. A subsequent storm event caused failure of the sewer line due to the presence in the line of a dam that was not shown on the government's plans, and resulted in flooding of the area excavated for the dry dock. The contractor refused to rebuild the sewer, and it was unsafe to continue working in the area without doing so. The government then terminated the contract. The contractor sued for and recovered its lost profits. The United States Supreme Court held that the government was responsible for the accuracy of its specifications: "[I]f the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications."³⁵²

Further, the Court held that this responsibility was not overcome by the contractor's duty to inspect the site and to check the plans.

[T]he insertion of the articles prescribing the character, dimensions, and location of the sewer imported a warranty that, if the specifications were complied with, the sewer would be adequate. This implied warranty is not overcome by the general clauses requiring the contractor, to examine the site, to check up the plans, and to assume responsibility for the work until completion and acceptance.³⁵³

In other words, the duty to inspect the site did not include a responsibility to check it in such detail, including a review of the history of the site, so as to determine the presence of the dam located inside the sewer. The contractor was entitled to rely on the government's plans as being accurate and complete and as giving it sufficient information to build what was contemplated. The government was required to bear the loss for its plans being insufficient, as it was considered to have misrepresented the site conditions.

The contractor is not liable for any defects in the project built if the defects resulted from the plans and specifications furnished to the contractor.³⁵⁴ This rule, known as the doctrine of constructibility, or the implied warranty of constructibility, is not negated by the provision of a changes clause that allows for alterations in the plans and specifications.³⁵⁵

A Florida court applied the doctrine of constructibility, or the *Spearin* doctrine, in a case that involved fence construction along an Interstate highway, *Phillips & Jordan, Inc. v. State, Department of Transportation*.³⁵⁶ The court held that the rule that the agency is liable for unanticipated construction costs due to a la-

³⁵² *Id.* at 136 (citations omitted).

³⁵³ *Id.* at 137 (footnotes omitted).

³⁵⁴ *O&M Constr., Inc. v. State, Division of Admin.*, 576 So. 2d 1030, 1039-40 (La. App. 1 Cir. 1991), *writ denied*, 581 So. 2d 691 (1991).

³⁵⁵ *Gilbert Pacific Corp. v. State by and Through Dep't of Transp., Comm'n.* 110 Or. App. 171, 822 P.2d 729, 732 (Or. App. 1991), *review denied*, 830 P.2d 596.

³⁵⁶ 602 So. 2d 1310 (Fla. App. 1 Dist. 1992).

tent defect in the plans and specifications did not apply. The plans and specifications had provided for clearing and grubbing of a 10-foot wide strip along the highway. They did not specify what equipment should be used. The contractor found that the brush in the area was so dense that it needed to use heavier equipment for the clearing, and that equipment used 12-foot wide blades. The result was that the contractor ended up clearing a larger area than called for in the contract, and the Florida Department of Transportation refused to pay for the extra area.

The court held that there was not a latent defect in the plans. The contractor was aware of the site conditions, and knew that its equipment of choice would clear an area more than 10-feet wide. It submitted its bid with full knowledge of these facts, and could not later claim that there was a latent defect.³⁵⁷

i. Duty To Inquire Re Patent Defects or Ambiguities.— An exception to the general rule that the awarding agency warrants the adequacy of its design specifications is the principle that a contractor has a duty of inquiry with respect to a patent defect or ambiguity in the contract.³⁵⁸ This duty of inquiry is created regardless of the reasonableness of the nondrafting party's interpretation of the contract.³⁵⁹ A bidder has the duty to scrutinize the bid solicitation for potential problems prior to bidding.³⁶⁰ Upon finding an ambiguity, the contractor is charged with asking the contracting officer the true meaning of the contract. However, the contractor must inquire only as to major discrepancies, obvious omissions, or manifest conflicts in the contract provisions.³⁶¹ If the contractor fails to seek clarification of a patent ambiguity prior to submitting its bid, then it bears the risk of misinterpretation.³⁶²

One court has explained the reason for the doctrine of patent ambiguity as follows:

If a patent ambiguity is found in a contract, the contractor has a duty to inquire of the contracting officer the true meaning of the contract before submitting a bid. This prevents contractors from taking advantage of the Government; it protects other bidders by ensuring that all bidders bid on the same specifications; and it materially aids the administration of Government contracts by requiring that ambiguities be raised before the contract

is bid on, thus avoiding costly litigation after the fact....³⁶³

If different interpretations of a contract are plausible, then the court will inquire as to whether the discrepancy would be apparent to the reasonably prudent contractor. It is not the contractor's actual knowledge but rather the obviousness of the inconsistency under an objective standard that imposes the duty to make inquiry.³⁶⁴ The contractor's failure to notice an obvious ambiguity does not excuse the duty of inquiry.³⁶⁵ However, the contractor's actual knowledge of an ambiguity is sufficient to create the duty of inquiry.³⁶⁶

The purpose of allocating to contractors the burden to inquire about patent ambiguities is to allow the agency to correct any errors before contract award, and to ensure that all contractors bid on the basis of identical specifications.³⁶⁷ In providing an interpretation to the inquiring contractor, the response would be sent to all holders of bid packages so that all bidders have the benefit of the agency's interpretation. An essential element of public bidding is a common standard of competition among bidders. All conditions and specifications must apply equally to all prospective bidders, thus permitting contractors to prepare bids on the same basis.

It is to assure a level playing field that contractors are urged in bid documents to examine the documents thoroughly, make site visits, attend prebid conferences, and raise questions about the drawings, specifications and conditions of bidding and performing the work. To every extent possible, such questions should be addressed before bid opening.³⁶⁸

Where the contract contains an order of precedence clause, the contractor is entitled to rely on the representation in the document that has higher precedence, and is not required to resolve a patent discrepancy between that document and one of lower precedence.³⁶⁹ Generally, specifications will be identified in an order of precedence clause as governing over drawings where there is a discrepancy between the two. The clause is designed to excuse reporting of a patent ambiguity. It automatically removes the conflict *between* specifications and drawings by assigning precedence to the

³⁵⁷ *Id.* at 1313.

³⁵⁸ Department of Transp. v. IA Constr. Corp., 138 Pa. Commw. 587, 588 A.2d 1327, 1330 (1991).

³⁵⁹ International Transducer Corp. v. United States, 30 Fed. Cl. 522, 527 (1994), *aff'd*, 48 F.3d 1235 (1995).

³⁶⁰ Avedon Corp. v. United States, 15 Cl. Ct. 771, 777 (1988).

³⁶¹ *Id.*

³⁶² Delcon Constr. Corp. v. United States, 27 Fed. Cl. 634, 638 (1993).

³⁶³ Newsome v. United States, 230 Ct. Cl. 301, 676 F.2d 647, 649 (1982) (footnotes omitted).

³⁶⁴ Maintenance Eng'rs, Inc. v. United States, 21 Cl. Ct. 553, 560 (1990).

³⁶⁵ *Id.*; see also Troise v. United States, 21 Cl. Ct. 48, 58 (1990).

³⁶⁶ D'Annunzio Bros., Inc. v. N.J. Transit Corp., 245 N.J. Super. 527, 586 A.2d 301, 303–04 (1991).

³⁶⁷ *Id.*, 586 A.2d at 304.

³⁶⁸ D'Annunzio Bros., *supra* note 366, at 304 (citing Collins Int'l Serv. Co. v. United States, 744 F.2d 812, 814 (Fed. Cir. 1984)).

³⁶⁹ Hensel Phelps Constr. Co. v. United States, 886 F.2d 1296, 1299 (Fed. Cir. 1989).

specifications.³⁷⁰ However, discrepancies *within* either specifications or drawings must still be reported.

Whether the implied warranty of constructibility applies to specifications depends on whether they are design specifications or performance specifications. In making this determination, one must consider the language of the contract as a whole; the nature and degree of the contractor's involvement in the specification process; the degree to which the contractor is allowed discretion in carrying out performance of the contract; and the parties' usage and course of performance of the contract.³⁷¹

ii. Design Specifications.—The contractor's claim of defective design specifications is based on the *Spearin* principle that there is an implied warranty that design specifications, if followed, will lead to a successful product. A design specification is one that sets out in precise detail the materials to be used and the manner in which the work is to be performed.³⁷² The contractor has no discretion to deviate from a design specification.³⁷³ The contractor bears the burden of proving that a design specification is defective and that the defect cause the contractor's difficulties.³⁷⁴ Design specifications contain the implied warranty under *Spearin* that if they are followed an acceptable product will result.³⁷⁵

iii. Performance Specifications.—Performance specifications set forth objectives to be achieved, and the successful bidder is expected to exercise its ingenuity in achieving that objective, selecting the means and methods of accomplishing it and assuming responsibility for that selection.³⁷⁶ Performance specifications do not contain any implied warranty of constructibility.³⁷⁷ Only an objective or standard of performance is set out in the contract.³⁷⁸ Along with control over the choice of design, methods, and materials, there is a corresponding responsibility to ensure that the end product performs as the agency desires. The contractual risk of nonperformance is thus on the contractor.

For highway and bridge construction undertaken directly by the federal government and by state agencies under federal-aid funding programs, standard specifica-

tions for materials and workmanship provide accepted criteria for preparation of bids and, subsequently, evaluation of results. However, specifications expressed in terms of overall performance may still be used for certain items of equipment or machinery that may readily be tested prior to use by the contractor. Various types of heavy equipment, pumps, motors, generators, and other accessories may be considered as being necessary to qualify a contractor for particular work. In such cases, performance specifications for these items are frequently used, sometimes in conjunction with the additional requirement that the equipment or other items be warranted by the contractor or manufacturer to perform as proposed.

c. Use of Requests for Proposals

Statutes allowing the use of a request for proposals may allow more latitude to the agency in setting the requirements for bidding.³⁷⁹ For example, a county was found not to have violated the competitive bidding requirement for a performance bond where it used a request for proposals and limited participation to only those firms that had substantial financial resources, thereby providing reasonable assurance to the county to secure performance.³⁸⁰ Whether such deviations from basic public works project requirements will be allowed will depend on how broadly those requirements are written and on whether the authority allowing the use of requests for proposals allows those deviations.

Many states' transportation agencies have obtained statutory authority to use design-build contracting, in which the contractor assumes responsibility for both design and construction. These statutes allow the use of requests for proposals as an alternative to competitive bidding, recognizing the need to evaluate the qualifications of the design-build team in the same manner that other engineering contracts are evaluated.³⁸¹

2. Required Federal Clauses

Where procurement regulations require that a contract contain a particular clause, the contract will be read as though it contained that clause, even if it is omitted.³⁸² Federal regulations have the force and effect of law and must be deemed to be terms of the contract even if not set forth in the contract; the contractor is charged with knowledge of the regulations.³⁸³ Further, the regulations will apply even if inconsistent with a contract provision.³⁸⁴

³⁷⁰ *Id.* at 1298.

³⁷¹ *Fruin-Colnon Corp. v. Niagara Frontier Transp. Auth.*, 180 A.D. 2d 222, 585 N.Y.S.2d 248, 253–54 (1992).

³⁷² *Fla. Board of Regents v. Mycon Corp.*, 651 So. 2d 149, 153, *rehearing denied* (Fla. App. 1 Dist. 1995).

³⁷³ *Blake Constr. Co. v. United States*, 987 F.2d 743, 745, *rehearing denied* (Fed. Cir. 1993), *cert. denied*, 510 U.S. 963, 114 S. Ct. 438 (1993); *John Massman Contracting Co. v. United States*, 23 Cl. Ct. 24, 32 (1991).

³⁷⁴ *Edward M. Crough, Inc. v. Department of General Services of District of Columbia*, 572 A.2d 457, 468 (1990).

³⁷⁵ *Blake Constr. Co.*, *supra* note 374, 987 F.2d at 745.

³⁷⁶ *Id.*

³⁷⁷ *John Massman Contracting Co. v. United States*, 23 Cl. Ct. 24, 32 (1991).

³⁷⁸ *Fruin-Colnon Corp., Traylor Bros, Inc. and Onyx Constr. & Equipment, Inc. v. Niagara Frontier Transp. Auth.*, 180 A.D. 2d 222, 585 N.Y.S.2d 248, 253 (1992).

³⁷⁹ *See Model Code, supra* note 2, at § 3-203.

³⁸⁰ *Stapleton v. Berks County*, 140 Pa. Commw. 523, 593 A.2d 1323, 1331, *appeal denied*, 604 A.2d 251, 529 Pa. 660 (1991).

³⁸¹ *See* notes 311 through 318 and accompanying text.

³⁸² *District of Columbia v. Organization for Env'tl. Growth, Inc. (OFEGRO)*, 700 A.2d 185, 198–99 (D.C. App. 1997).

³⁸³ *Century Marine, Inc. v. United States*, 153 F.3d 225, 228 n.1 (5th Cir. 1998); *General Eng'g & Mach. Works v. O'Keefe*, 991 F.2d 775, 780 (Fed. Cir. 1993).

³⁸⁴ OFEGRO, *supra* note 382, at 199.

However, where statutes, regulations, or policies of the contracting agency require that certain provisions must be included in all of the agency's construction contracts, they generally are incorporated into standard forms that all bidders must use. Typically, some of these provisions are concerned with procedures to be followed during performance of the contract so that administrative processing will be facilitated. Others impose positive duties on the contractor in the performance of the contract that may affect its methods of operation, and therefore must be reflected in the contractor's bid.

Examples of both types occur in the required provisions for federal-aid highway construction contracts. Requirements for keeping records and making reports on acquisition of materials, supplies, and labor illustrate the type of provisions dealing with contract administration.³⁸⁵ Requirements that contractors comply with provisions of federal environmental protection laws and federal labor standards illustrate factors that must be considered in calculating bid prices.³⁸⁶ Contracts for direct federal construction projects require compliance with the Buy American Act and the Walsh-Healey Act.³⁸⁷

The federal regulations require that the required clauses be included in all prime contracts for federal-aid funded construction, and that the contractor be similarly required to include the clauses expressly in its subcontracts.³⁸⁸ It is not sufficient to incorporate the clauses by reference.³⁸⁹

a. Clauses Required in Form FHWA-1273

The major required federal clauses are set out in Form FHWA-1273, which is available from FHWA's Web site. The form sets out the essential requirements that its provisions must be set out in full and cannot be incorporated by reference, and that breach of any of the required stipulations will be grounds for termination of the contract.³⁹⁰ Further, breach of specific sections may be considered grounds for debarment; these are discussed in Section 2.

i. Labor Standards.—Labor standards that must be addressed include the agreement to refrain from discrimination against labor from other states and not to employ convict labor, with the exception of convicts on parole, probation, or work release.³⁹¹

In addition, clauses are required governing payment of prevailing wages and maintenance of payroll records so that prevailing wages may be verified.³⁹² Part VIII requires adherence to applicable federal, state, and local laws governing health, safety, and sanitation.

ii. Equal Employment Opportunity.—Part II of Form FHWA-1273 covers in detail the nondiscrimination requirements applicable to all federal-aid contracts, including equal employment opportunity, disadvantaged business enterprise requirements, and record keeping requirements. This is discussed in more detail in Section 4. In addition, Part III contains strict requirements for nonsegregated facilities, one of which is that the contractor and its subcontractors certify to FHWA that they do not utilize segregated facilities. A breach of this certification will be considered a violation of the EEO provisions.

iii. Subletting and Assignment.—Part VII establishes the conditions under which the contractor will be allowed to subcontract work or assign the contract. Generally, the contractor is required to perform at least 30 percent of the work with its own forces, excluding specialty items.³⁹³

iv. Compliance with Environmental Regulations.—Part X requires compliance with provisions of the Federal Clean Air Act³⁹⁴ and the Federal Water Pollution Control Act (the Clean Water Act).³⁹⁵ This particular section is presented as a stipulation that the contractor or subcontractor is in compliance with these provisions, the violation of which is grounds for termination under Part I.

v. Required Certifications.—Contractors and subcontractors are required under Part XI to certify that they are not presently debarred, suspended, or otherwise ineligible from participating in a federally-funded contract by any federal agency; that they have not within the previous 3 years been convicted or had a civil judgment imposed against them for offenses such as fraud, embezzlement, or false statements; and that they have not within the previous 3 years had a contract terminated for default. Part XII requires contractors to certify that no contract funds have been or will be used for lobbying elected officials or public employees.

b. Standardized Changed Conditions Clauses

In addition to the required clauses set out in Form FHWA-1273, the regulations contain additional required clauses regarding changed conditions.

i. Differing Site Conditions.—One of the longest utilized required federal clauses is the Differing Site Conditions (DSC) clause. It was preceded by a similarly-worded provision that was known as the Changed Conditions

³⁸⁵ Form FHWA-1273, Part VI, available on FHWA's Web page at <http://wwwcf.fhwa.dot.gov/programadmin/contracts/1273.htm>.

³⁸⁶ *Id.*, pts. IV and X.

³⁸⁷ 41 U.S.C. §§ 10a and 35 (1999).

³⁸⁸ 23 C.F.R. § 633.102(d), (e) (1999).

³⁸⁹ *Id.*

³⁹⁰ Form FHWA-1273, pt. I (2000).

³⁹¹ 23 C.F.R. § 635.117(a) (2001).

³⁹² 23 C.F.R. § 635.118; Form FHWA-1273, pts. IV and V.

³⁹³ 23 C.F.R. § 635.116(a) (2000).

³⁹⁴ 42 U.S.C. § 7401 *et seq.*

³⁹⁵ 33 U.S.C. § 1251 *et seq.*

clause. Cases interpreting these clauses date back almost half a century.³⁹⁶ The contractor generally accepts the risk that subsurface or other latent physical conditions may be difficult to determine prior to construction and that they may be adverse.³⁹⁷ The Supreme Court noted in that case that: “Where one agrees to do, for a fixed sum, a thing possible to be performed, he will not be excused or become entitled to additional compensation, because unforeseen difficulties are encountered....”³⁹⁸

The federal government has been concerned that because of this rule, contractors will have to price into their bids the risk that “unforeseen difficulties” such as adverse subsurface conditions will cause the project costs to exceed the bid price. In addition, contractors will have to factor into their bid prices the cost of investigating subsurface soil conditions.

The purpose of the changed conditions clause is thus to take at least some of the gamble on subsurface conditions out of bidding. Bidders need not weigh the cost and ease of making their own borings against the risk of encountering an adverse subsurface, and they need not consider how large a contingency should be added to the bid to cover the risk. They will have no windfalls and no disasters. The government benefits from more accurate bidding, without inflation for risks which may not eventuate. It pays for difficult subsurface work only when it is encountered and was not indicated in the logs.³⁹⁹

The use of the DSC clause shifts the risk of adverse subsurface or other latent physical conditions from the contractor to the government. Otherwise, if the contract is silent about the risk of unforeseen conditions, the contractor would bear the risk even though those conditions might significantly increase the cost of the project.⁴⁰⁰ Preventing contractors from bidding on a “worst-case scenario” basis is the goal of inclusion of the DSC clause.⁴⁰¹ The clause imposes on the government the risks for conditions that the contract documents fail to disclose, but leaves upon the contractor the costs of encountering conditions described in the contract.⁴⁰² The result is that the government should as a rule get lower bids, and only pay for DSCs when they actually occur, rather than funding a contingency in each contract.

The DSC clause applies only to those conditions that exist at the time of contract execution. It does not apply to conditions that develop during performance of the

contract.⁴⁰³ This is true even if this time limitation is not expressed in the clause itself or elsewhere in the contract.⁴⁰⁴ The DSC clause is addressed in greater detail in Section 5.

ii. Suspension of Work.—This clause allows the project engineer to adjust the compensation and/or schedule to account for delays that are ordered by the engineer and that are “an unreasonable period of time,” which is defined as “not originally anticipated, customary, or inherent to the construction industry.”⁴⁰⁵

iii. Significant Changes in Character of Work.—This clause defines “significant change” as:

(A) When the character of the work as altered differs materially in kind or nature from that involved or included in the original proposed construction; or

(B) When a major item of work, as defined elsewhere in the contract, is increased in excess of 125 percent or decreased below 75 percent of the original contract quantity.⁴⁰⁶

This clause reserves to the engineer the right “to make, in writing, at any time during the work, such changes in quantities and such alterations in the work as are necessary to satisfactorily complete the project.”⁴⁰⁷ It further provides that such changes “shall not invalidate the contract nor release the surety.”⁴⁰⁸ The contractor is entitled to an adjustment, including anticipated profit, in the event of a significant change.⁴⁰⁹ Change provisions are intended to compensate the contractor for burdens not contemplated by the contract.⁴¹⁰ To qualify for an adjustment under a changes provision, the contractor must prove that any increased costs arose from conditions differing materially from those indicated in the bid documents, and also that the changes were reasonably unforeseeable in light of the information available to the contractor.⁴¹¹

c. Noncollusion

The federal regulations require that the state agency provide a form to be executed by each bidder, and included in the contract, stating that the bidder has not engaged in collusive behavior:

Each bidder shall file a statement executed by, or on behalf of the person, firm, association, or corporation submitting the bid certifying that such person, firm, association or corporation has not, either directly or indirectly,

³⁹⁶ See, e.g., *United States v. Rice*, 317 U.S. 61, 66–68, 63 S. Ct. 120, 123–23, 87 L. Ed. 53 (1942) (interpreting Changed Conditions clause).

³⁹⁷ See Spearin, *supra* note 351.

³⁹⁸ *Id.* at 136.

³⁹⁹ *Olympus Corp. v. United States*, 98 F.3d 1314, 1317 (Fed. Cir. 1996) (quoting from *Foster Constr. C.A. & Williams Bros. Co. v. United States*, 193 Ct. Cl. 587, 435 F.2d 873, 887 (Ct. Cl. 1970)).

⁴⁰⁰ *Iacobelli Constr., Inc. v. County of Monroe*, 32 F.3d 19, 23 (2d Cir. 1994).

⁴⁰¹ *Id.*

⁴⁰² *Id.*

⁴⁰³ See *Olympus Corp. v. United States*, 98 F.3d 1314, 1317 (Fed. Cir. 1996); *John McShain, Inc. v. United States*, 179 Ct. Cl. 632, 375 F.2d 829 (1967).

⁴⁰⁴ *Olympus*, *supra* note 403.

⁴⁰⁵ 23 C.F.R. § 635.109(a)(2) (1999).

⁴⁰⁶ 23 C.F.R. § 635.109(a)(3)(iv) (1999). Changes are addressed in more detail in Section 5.

⁴⁰⁷ 23 C.F.R. § 635.109(a)(3)(i) (1999).

⁴⁰⁸ *Id.*

⁴⁰⁹ 23 C.F.R. § 635.109(a)(3)(ii) (1999).

⁴¹⁰ *Willamette Crushing Co. v. State By and Through Dep’t of Transp.*, 188 Ariz. 79 932 P.2d 1350, 1352 (1997).

⁴¹¹ *Id.*

entered into any agreement, participated in any collusion, or otherwise taken any action, in restraint of free competitive bidding in connection with the submitted bid. Failure to submit the executed statement as part of the bidding documents will make the bid nonresponsive and not eligible for award consideration.⁴¹²

d. Nondiscrimination

All contracts with participation by any branch of the U.S. Department of Transportation are required to comply with the nondiscrimination provisions of 49 C.F.R. Section 21, which implements Title VI of the Civil Rights Act of 1964 in federal transportation programs. Appendix C to this section provides illustrations of how this section applies to the various operations of the Federal Aviation Administration, FHWA, and the Federal Transit Administration (formerly the Urban Mass Transit Administration).

e. Prompt Pay

The 1999 FHWA Disadvantaged Business Enterprise (DBE) regulations were written to address the constitutional deficiencies identified in the program in *Adarand Constructors, Inc. v. Pena*.⁴¹³ Chief among these was the requirement that the program be “narrowly tailored” to address a compelling governmental interest. As part of the “narrow tailoring” requirement, FHWA included a number of “race-neutral” measures that are intended to benefit all small or new businesses, not just those owned by minorities or women. Among these is a requirement for prompt payment of subcontractors by prime contractors.⁴¹⁴ FHWA specifically found: “It is clear that DBE subcontractors are significantly—and, to the extent that they tend to be smaller than non-DBEs, disproportionately—affected by late payments from prime contractors. Lack of prompt payment constitutes a very real barrier to the ability of DBEs to compete in the marketplace....”⁴¹⁵

The regulation requires that federal-aid recipient agencies include in their DBE programs a requirement for a prompt payment clause to be included in every prime contract in which there are subcontracting possibilities.⁴¹⁶ The clause must require payment to be made within a certain number of days from the time that the prime contractor receives progress payments from the agency; the number of days may be established by the agency.

If an agency has a prompt payment rule of its own, it may utilize that requirement instead. The contractor need pay only for work that has been satisfactorily completed. This clause also requires prompt return of

any retainage withheld by the contractor at the satisfactory completion of the subcontractor’s work.

The regulation requires that agencies include in their prime contracts an enforcement mechanism for prompt payment of subcontractors. This may be either an alternative dispute resolution process for the resolution of payment disputes, or a provision stating that the prime contractor will not be paid for its work unless it ensures that subcontractors are promptly paid for their work, or any other mechanism consistent with the regulation and with state law.⁴¹⁷

A prompt pay clause does not preclude the prime contractor from withholding payments from the subcontractor based on identifiable claims.⁴¹⁸

i. “Pay when paid.”—The prompt-pay requirement would appear not to interfere with the prime contractor’s use of a “pay when paid” clause in its subcontracts, since it does not apply until the prime contractor has been paid by the agency. The “pay when paid” clause, or “pay if paid,” allows the prime contractor to condition its payment to the subcontractor on its prior receipt of payment from the agency.⁴¹⁹ Most jurisdictions that have considered these clauses do not construe them to release the prime contractor from its obligation to pay the subcontractor if the owner fails to perform. Rather the clause merely affects the timing of payments, regardless of whether the owner performs.⁴²⁰ Courts will not shift the risk of the owner’s nonperformance, or failure to pay, to the subcontractor unless the language of the clause clearly indicates that the parties intended to do so.⁴²¹ On the other hand, where the language expressly states that receipt of payment from the owner or the agency is a condition precedent to payment being owed to the subcontractor, the court will treat it as a condition precedent.⁴²² But because condition precedents are not favored, there must be clear contract language to create them.

f. Termination of Contract

The FHWA regulations require that state highway construction contracts using federal funds contain some

⁴¹⁷ 49 C.F.R. § 26.29(b) (2000).

⁴¹⁸ *Pottstown Fabricators, Inc. v. Manshul Constr. Corp.*, 927 F. Supp. 756, 757 (S.D.N.Y. 1996) (applying state prompt pay statute allowed prime contractor to withhold payments to satisfy claims, liens, or judgments against subcontractor where those had not been discharged).

⁴¹⁹ *See Urban Masonry Corp. v. N&N Contractors, Inc.*, 676 A.2d 26, 36 n.19 (D.C. App. 1996) (example of “pay when paid” clause).

⁴²⁰ *Koch v. Construction Technology, Inc.*, 924 S.W.2d 68, 71 and n.1 (Tenn. 1996).

⁴²¹ *Id.*; *see also Thomas J. Dyer Co. v. Bishop Int’l Eng’g Co.*, 303 F.2d 655, 660–61 (6th Cir. 1962).

⁴²² *See Urban Masonry, supra* note 419, at 36.

⁴¹² 23 C.F.R. § 635.112(f) (1999).

⁴¹³ 515 U.S. 200, 115 S. Ct. 2097, 132 L. Ed. 2d, 158 (1995).

⁴¹⁴ 49 C.F.R. § 26.29 (2000).

⁴¹⁵ 64 Fed. Reg. 5096, at 5105–06 (Feb. 2, 1999).

⁴¹⁶ *Id.*; 49 C.F.R. § 26.29(a) (2000).

provision for termination of the contract, both for default and for public convenience:

All contracts exceeding \$2,500 shall contain suitable provisions for termination by the State, including the manner in which the termination will be effected and the basis for settlement. In addition, such contracts shall describe conditions under which the contract may be terminated for default as well as conditions where the contract may be terminated because of circumstances beyond the control of the contractor.⁴²³

g. “Buy America” Requirements

Buy America requirements apply to federal-aid projects.⁴²⁴ This regulation requires that a state’s specifications require the use of domestic steel and iron products, and also requires that all manufacturing of these products have occurred in the United States.⁴²⁵ A state may obtain a waiver of this requirement from the FHWA Regional Administrator if the state can show that the product is not produced in the United States in sufficient and reasonably available quantities that are of a satisfactory quality. The requirement for Buy America is not affected by the United States’ participation in international trade agreements such as the World Trade Organization Government Procurement Agreement or the North American Free Trade Agreement, as Congress noted an exception for this requirement in its approval of these agreements.⁴²⁶

3. Examples of Required State Clauses

Many states’ public works or transportation construction statutes set out required clauses for inclusion in construction contracts, such as clauses for termination for convenience, liquidated damages, DSCs, suspension of work, and dispute resolution.⁴²⁷ Some of these are the same as or very similar to the required federal clauses. A few of these typical state clauses are examined here, along with some newer and more unusual requirements such as value engineering clauses.

⁴²³ 23 C.F.R. § 633.210 (1999).

⁴²⁴ 23 C.F.R. § 635.410. This program must be distinguished from “Buy American,” which applies to federal direct procurements. 41 U.S.C. 10a-10c.

⁴²⁵ 23 C.F.R. § 635.410(b)(1); *see also* FHWA’s Web page for a summary of Buy America requirements at <http://wwwcf.fhwa.dot.gov/programadmin/contracts/b-amquck.htm>.

⁴²⁶ *See* FHWA’s Web site, “Quick facts about ‘Buy America’ requirements for Federal-aid highway construction,” at <http://wwwcf.fhwa.dot.gov/programadmin/contracts/b-amquck.htm> and <http://www.fhwa.dot.gov/programadmin/contracts/corIIB>; *see also* C.F. Corr and K. Zissis, *Convergence and Opportunity: The WTO Government Procurement Agreement and U.S. Procurement Reform*, 18 N.Y. L. SCH. J. INT’L & COMP. LAW at 303 (1999), for a discussion of how the Buy American requirements applicable to direct federal procurement apply in light of international trade agreements.

⁴²⁷ *See e.g.*, D.C. CODE § 2-305.07 (2002); HAW. REV. STAT. § 103D.501 (1999).

a. Liquidated damages

Liquidated damages clauses are generally favored by the courts. They save the time and expense of litigating the issue of damages by fixing in advance the amount to be paid in the event of a breach. Liquidated damages clauses serve a particularly useful function “when damages are uncertain in nature or amount or are unmeasurable.”⁴²⁸ An example of this type of damages might be costs to “public convenience” or losses suffered by the traveling public where traffic patterns are interrupted beyond the time called for in the contract.

The test for the validity of a liquidated damages clause is whether it fairly compensates the party benefiting from it for actual damages, or whether it constitutes a penalty. A clause that results in a penalty will not be enforced. Liquidated damages may be used as a disincentive for late completion; however, they must fairly relate to the actual loss suffered by the agency.⁴²⁹ The challenger has the burden of proving that a liquidated damages clause creates an unenforceable penalty.⁴³⁰ If the liquidated damages clause is stricken as a penalty, actual damages may still be awarded.⁴³¹

A liquidated damages clause need not be specially tailored to a particular contract.⁴³² The clause will be enforced as long as the amount is not disproportionate to the loss, so as to prove that compensation was not the object, but rather that a penalty was intended.

An example of a liquidated damages clause that was found to be unenforceable as a penalty is in *Kingston Constructors v. Washington Metro Area Transportation Authority*.⁴³³ In that case, the Washington Metropolitan Area Transportation Authority (WMATA) was replacing transformers that contained PCB, a hazardous substance whose use is now prohibited. The contract included a liquidated damages clause charging \$1,000 per day to the contractor for late completion. WMATA had included this amount as a contingency against possible penalties that could have been imposed by the Environmental Protection Agency (EPA), even though WMATA knew that EPA did not plan to assess any penalties. The court found this to be a penalty.⁴³⁴

However, an agency may be obligated in a consent decree with EPA or another regulatory agency to see that particular work is completed, and may choose or be required by its public bidding statutes to do that work by contract. If the consent decree includes a penalty for late completion of the work to be assessed by EPA

⁴²⁸ *DJ Mfg. Corp. v. United States*, 86 F.3d 1130, 1133 (Fed. Cir. 1996) (quoting *Priebe & Sons v. United States*, 332 U.S. 407, 411, 68 S. Ct. 123, 92 L. Ed. 2d 32 (1947)).

⁴²⁹ *State of Ala. Highway Dep’t v. Milton Constr. Co.*, 586 So. 2d 872, 874 (1991).

⁴³⁰ *DJ Mfg.*, *supra* note 428, at 1134.

⁴³¹ *See Kingston Constructors v. Washington Metro. Area Transit Auth. (WMATA)*, 930 F. Supp. 651, 656 (D.D.C. 1996).

⁴³² *DJ Mfg.*, *supra*, at 1133.

⁴³³ 930 F. Supp. 651 (D.D.C. 1996).

⁴³⁴ *Id.* at 656.

against the agency, then it would appear to be reasonable to include that amount in the contract between the agency and the contractor as liquidated damages. The amount will be fixed in the consent decree and is certainly a liquidated amount from the agency's standpoint. Even though it is intended to be a "penalty" from EPA's standpoint, it would appear to be an item of damage from the transportation agency's standpoint in that the agency only has to pay the penalty if the contractor is late in completing the work. Thus the result in *WMATA* should not preclude an agency from passing along such stipulated penalties to a contractor as liquidated damages.

b. Dispute Resolution

A disputes resolution clause generally establishes one or more procedures for resolving disputes. These may include disputes review boards, typically composed of engineers or architects; mediation; arbitration, both mandatory and nonmandatory; and litigation. The clause will generally set time limits for each type of dispute resolution to be invoked, and the manner in which it is invoked. It will also establish what individual or group of individuals has jurisdiction at each particular stage of a dispute.⁴³⁵ In the absence of such a clause, a party cannot be compelled to arbitrate or to utilize other alternative dispute resolution methods.⁴³⁶

Parties may be held to have waived the right to compel arbitration by initiating litigation. A "no waiver" provision in the arbitration or dispute resolution clause will preserve the right to utilize arbitration where litigation is initiated to obtain interim relief, such as attachment or injunction.⁴³⁷ But protracted litigation of an arbitrable dispute will waive the parties' right to compel arbitration.

The authority to enter into binding arbitration pursuant to a disputes resolution clause will be implied in the agency's authority to contract. It need not be set out expressly in statute as it will be "necessarily or fairly implied."⁴³⁸

c. Value Engineering / Life Cycle Costs

Hawaii's public works statute requires the inclusion of a value engineering clause in contracts over \$250,000.⁴³⁹ The clause is required to provide:

⁴³⁵ See *Washington Metro. Area Transit Auth. v. Buchart-Horn, Inc.*, 886 F.2d 733, 735 (4th Cir. 1989).

⁴³⁶ *AJM Packaging Corp. v. Crossland Constr. Co.*, 962 S.W.2d 906, 911 (Mo. App. 1998). An exception will be if a statute required arbitration of claims within a certain dollar limit.

⁴³⁷ *S & R Co. of Kingston v. Latona Trucking, Inc.*, 159 F.3d 80, 85 (2d Cir. 1998).

⁴³⁸ *Carteret County v. United Contractors of Kinston, Inc.*, 120 N.C. App. 336, 462 S.E.2d 816, 820 (1995).

⁴³⁹ HAW. REV. STAT. § 103D-409 (1999).

(1) That cost reduction proposals submitted by contractors:

(A) Must require, in order to be applied to the contract, a change order thereto; and

(B) Must result in savings to the State or county, as the case may be, by providing less costly items than those specified in the contract without impairing any of their essential functions and characteristics such as service life, reliability, substitutability, economy of operation, ease of maintenance, and necessary standardized features; and

(2) That accepted cost reduction proposals shall result in an equitable adjustment of the contract price so that the contractor will share a portion of the realized cost reduction.⁴⁴⁰

d. Audit Rights

Illinois' public procurement statutes require that all contracts include the requirements for the contractor's recordkeeping that will facilitate audit of the contractor's books and records. Further, it requires the following:

Every contract and subcontract shall provide that all books and records required to be maintained under subsection (a) shall be available for review and audit by the Auditor General and the purchasing agency. Every contract and subcontract shall require the contractor and subcontractor, as applicable, to cooperate fully with any audit.⁴⁴¹

e. Use of State Products

State statutes may require the use of products produced in a particular location, similar to the Federal "Buy America" requirements. These statutes have been subject to the same constitutional challenges as state preference statutes. For example, the Pennsylvania Steel Products Procurement Act requires that any Pennsylvania public works construction contract require the use of steel that is produced in the United States.⁴⁴² The statute was challenged as being preempted by international trade agreements as well as by federal law, and as being violative of the Commerce Clause.⁴⁴³ The federal court held that the statute was valid because the State of Pennsylvania was acting as a market participant rather than as a regulator, and that the statute was not preempted.⁴⁴⁴

⁴⁴⁰ *Id.*

⁴⁴¹ ILL. COMP. STAT. 30 500/20-65 (b) (1999).

⁴⁴² 73 P.S. §§ 1881-1887.

⁴⁴³ *Trojan Technologies, Inc. v. Commw. of Pennsylvania*, 916 F.2d 903 (3d Cir. 1990), *cert. denied*, 501 U.S. 1212, 111 S. Ct. 2814 (1991).

⁴⁴⁴ *Id.* at 910 (citing *White Mass. Council of Constrs. Employees, Inc.*, 460 U.S. 204 at 210, 103 § 1042, 75 L. Ed. 2d (1983)).

State legislation has occasionally imposed limitations on the preparation of bids that raise questions regarding unconstitutional interference with Interstate commerce. Early consideration of state laws requiring contractors to give preference to local construction material usually took the view that such laws were discriminatory against material produced outside the state, and therefore a restraint of trade. The New York Court of Appeals explained this view:

It is a regulation of commerce between the states which the legislature had no power to make. The citizens of other states have the right to resort to the markets of this state for the sale of their products, whether it be cut stone, or any other article which is the subject of commerce...Under the Constitution of the United States, business or commercial transactions cannot be hampered or circumscribed by state boundary lines, and that is the effect of the statute in question....⁴⁴⁵

The cases that have raised this issue have presented a wide range of situations, and factual differences have distinguished permissible preferences from prohibited practices. Arizona's law relating to award of public works contracts illustrates a type of preference that has been upheld. With respect to contractors, it provides:

[B]ids of contractors who have not been found unsatisfactorily in prior public contracts, and who have paid state and county taxes within the state of Arizona for not less than two successive years immediately prior to the making of said bid...shall be deemed a better bid than the bid of a competing contractor who has not paid such taxes, whenever the bid of the competing contractor is less than five (5) per cent lower, and the contractor making such bid, as herein provided, to be deemed the better bid, shall be awarded the contract.... Ariz Stets. § 56-109, A.C.A. 1939.

The constitutionality of this act was upheld in *Schrey v. Allison Steel Manufacturing Co.*,⁴⁴⁶ with the Arizona Supreme Court speaking as follows:

All discrimination or inequality is not forbidden. Certain privileges may be granted some and denied others under some circumstances, if they be granted or denied upon the same terms, and if there exists a reasonable basis therefor...The principle involved is not that legislation may not impose special burdens or grant special privileges not imposed on or granted to others; it is that no law may do so without good reason...[A] statute may be allowed to operate unequally between classes if it operates uniformly upon all members of a class, provided the classification is founded upon reason and is not whimsical, capricious, or arbitrary.⁴⁴⁷

States are allowed to regulate public construction contracts so as to protect or promote legitimate public interests, provided constitutional standards of reasonableness and equal treatment are satisfied. In the *Schrey* case, the question of unreasonable burdens on Interstate commerce appeared to be secondary to the

question of whether the state law could be reconciled with constitutional requirements that public contracts must be awarded to the lowest responsible bidder.

4. Required Use of Exclusive Sources and "or Equal" Clauses

The contracting agency may also designate certain materials, products, or processes by standard brand names. Such designation is feasible where the items are obtainable on the open market and have been standardized by commercial use. In these cases, however, specifications must be drafted carefully because of the competitive aspects of patented or proprietary products and processes.

The agency must exercise care to assure that clear reference points are provided in the description of materials and workmanship. Then project specifications are not weakened by authorizing a measure of discretion by the contractor in selection of materials and performance of construction. This generally is done by use of the term "or equal" when describing quality or specifying materials or methods. It may also be done by stating "or other methods satisfactory to the Engineer," or "...commercial grades shown on the plans...and acceptable to the Engineer." Such terms introduce elements of discretion or negotiation into the standards of performance. However, they are controlled by the context of the language and the nature of the tasks involved.

The "or equal" clause may be phrased in terms of a "substantial equivalent." One court has held this term to mean a product that is equal in value in essential and material requirements. For competitive bidding purposes, equivalency is determined by whether the item bid is both functionally and qualitatively equal or identical to the specific product in the specification to which the equivalency standard applies.⁴⁴⁸ Such a specification is often used when a description of the technical construction of the component is not available. The practice is in effect a "shorthand" method of describing the type of product desired rather than spelling out the engineering specifications of the product.⁴⁴⁹

The principles of fair competition are subjected to further tension where contracting agencies specify in their bid invitations that the work must be performed with certain designated materials or processes. Where specifications require use of materials or processes that are patented or otherwise obtainable only from exclusive sources, it is arguable that monopolistic control over one element of the contract's specifications could easily lead to bid rigging.

Early state court decisions generally aligned with the "Wisconsin view" or the "Michigan view" of this question. The difference in these two approaches was explained thus:

⁴⁴⁵ *People ex rel. Treat v. Coler*, 166 N.Y. 144, 150, 59 N.E. 776, 777 (1901).

⁴⁴⁶ 75 Ariz. 282, 255 P.2d 604 (1953).

⁴⁴⁷ *Id.*, 255 P.2d at 606 (citation omitted).

⁴⁴⁸ *State ex rel. Polaroid Corp. v. Denihan*, 34 Ohio App. 3d 204, 517 N.E.2d 1021, 1026 (1986).

⁴⁴⁹ *Edward M. Crough, Inc. v. Department of General Services of D.C.*, 572 A.2d 457, 461 (D.C. App. 1990).

The keystone of the argument in support of the Wisconsin line of cases is that where the statute requires competitive bidding, after advertising, as a condition precedent to the power of the municipality to contract for street improvement, the statute is violated when the...contract specifications require the use of a patented or monopolized article, because there can be no real competition when the bidding is practically restricted to the individual or corporation controlling the patent; on the other hand, the fundamental reason supporting the Michigan line of cases is that, even where the statute requires competitive bidding, it...does not apply, when all the competition is allowed which the situation permits; that a municipality should not be denied the right, for the benefit of its citizens, to avail itself of useful inventions and discoveries, even though protected by patents; and that when a city exercising its power to make the public improvements in good faith decides to contract for the use of patented articles, there is created no monopoly and no abatement in competition beyond what necessarily results from the rights and privileges given the patentee by the federal government....⁴⁵⁰

In highway construction, contracts for paving and procurement of paving supplies have furnished a large proportion of the examples of patent and monopoly problems. The period 1920 to 1960 was one of noteworthy progress in this aspect of engineering; numerous patentable improvements were developed, and highway agencies naturally sought to obtain the benefits of their use. The weight of authority gradually swung to a position of approving the specification of patented or exclusive source items or their equal, provided there is no intent thereby to restrict the competition among bidders.⁴⁵¹ In addition, practical safeguards against hardships in preparing bids often are provided by the contracting agency through advance agreements with owners of patented products or exclusive sources to allow their use by all bidders on equal terms. The question of whether contractors' offers of materials are equal has been the subject of much litigation.

a. Warranty of Commercial Availability

This is an important consideration, as by including a brand name product or component in its specifications, the agency warrants the commercial availability of that product or component.⁴⁵² This warranty does not, however, relieve the contractor of the usual risks of nonperformance that result from the contractor's relationship with its subcontractors and suppliers, or the willingness of the supplier to provide the product within the time period specified by the contract.⁴⁵³ The agency war-

rants only that the sole source supplier will provide the product.

The warranty of commercial availability, in which the government warrants the commercial availability of brand name components, and the limits of the warranty, were discussed in *Edward M. Crough, Inc. v. Department of General Services of District of Columbia*.⁴⁵⁴ That case involved a specification for a particular type of roofing material, for which there were only two known suppliers and only one local supplier. In addition to requiring the particular roofing material, the District required a 5-year guarantee. Therefore, there was not a realistic option for the contractor to deal with anyone other than the one local supplier. The specification was thus considered to be a sole source specification. Initially, the supplier agreed to supply the product, but would not provide the 5-year guarantee because it believed that the roof design was inadequate. The District then agreed to redesign the roof to accommodate the supplier's concerns, and the supplier agreed to provide the guarantee.

The contractor attempted to argue that the warranty of commercial availability had been breached. However, where there was one supplier willing to meet the terms of the specification—providing the required material and the 5-year guarantee—commercial unavailability was not shown.⁴⁵⁵

The court contrasted this contractor's situation with the facts of *Aerodex, Inc. v. United States*, in which the contract called for a particular brand name component "or approved substantial equal."⁴⁵⁶ The contractor found that the sole supplier of the required part refused to sell the part to the contractor or to make its specifications available to the contractor so that they could be fabricated elsewhere. There was no way to obtain either the brand name or a "substantial equal." In that case, the court found that the government had the obligation either to ascertain the availability of the component, or to provide specifications so that the component could be duplicated by the bidder or other suppliers.

b. Challenging Sole Source Specifications

A party challenging the award of a contract who did not submit a bid will be found to have standing if it can prove that it would have submitted a bid but for the sole source specification, that its equipment was equivalent to that specified in the bid specifications, and that the restrictions of the sole source specification undermined the integrity of the competitive bidding process.⁴⁵⁷ A sole source specification may be found invalid and contrary to public bidding requirements if it

⁴⁵⁰ *Dillingham v. Mayor, et al., of City of Spartanburg*, 75 S.C. 549, 56 S.E. 381, 384 (1907).

⁴⁵¹ *Hoffman v. City of Muscatine*, 212 Iowa 867, 232 N.W. 430 (1931).

⁴⁵² *Edward M. Crough, Inc. v. Department of General Services of D.C.*, 572 A.2d 457 (D.C. App. 1990).

⁴⁵³ *Id.* at 463.

⁴⁵⁴ 572 A.2d 457 (D.C. App. 1990).

⁴⁵⁵ *Id.* at 461-62.

⁴⁵⁶ 189 Ct. Cl. 344, 417 F.2d 1361 (1969).

⁴⁵⁷ *Unisys Corp. v. Department of Labor*, 220 Conn. 689, 600 A.2d 1018, 1022-23 (1991).

can be shown that comparable products or systems were available.⁴⁵⁸

Generally, an agency should be able to advertise for bids for and ultimately purchase the type of products that they desire, within the confines of public bidding requirements. Public bidding laws do not require that specifications be so general in description that every supplier of a product can bid on the contract, thereby denying the agency of the type and quality of goods or services that it is accustomed to. Specifications are not illegal merely because they may be met only by one vendor. They may, however be objectionable if they are drawn to the advantage of only one manufacturer, not for satisfying the public interest but to ensure award to that particular vendor.⁴⁵⁹

Specifications cannot be so precise as to knowingly exclude all but one prospective bidder.⁴⁶⁰ If the agency should reasonably know that only one bidder can satisfy its specifications, then the agency should seek bids for a brand name or the equivalent of that product.⁴⁶¹ The “or equal” or “or equivalent” clause may serve to eliminate a challenge to specifications that the specification is proprietary or that the agency is seeking a sole source without adequate justification.

Where the choice of materials in a contract is not for a particular brand name but rather for a particular type of material over another, the agency is given greater latitude to choose the type of material that it wishes to be used in its project. Thus, there was no valid claim for an equal protection violation by a gravel supplier challenging bid specifications that called for the use of crushed stone rather than crushed gravel.⁴⁶² The Vermont DOT had rewritten its standard specifications to require the use of crushed stone rather than gravel where crushed stone was available, finding that crushed stone provided a stronger road base.⁴⁶³ There was no evidence in the case that the State’s exercise of choice between competing products as a consumer denied the supplier equal protection. There was no allegation in that case that there was only one available supplier of crushed stone, and there was not an argument that the specification called out a particular brand or supplier.

The agency has broad discretion to draft terms for a contract, and courts will not substitute their judgment for that of the agency in the absence of fraud or bad faith.⁴⁶⁴ This is particularly so where the agency shows

that the particular provision calling for a specific product is reasonably required in order to meet the desired performance requirements and is free from any intent to restrict or eliminate competitive bidding. The test is whether the specification is drawn to the improper advantage of any particular member or group of the relevant industry or occupation and is not for any reason that is in the public interest, but is rather intended to ensure the award of the contract to that particular member or group.⁴⁶⁵

Whether the use of sole source specifications is allowed at all depends on state law. New Jersey has a statute that specifically prohibits the use of a particular manufacturer’s brand in bid documents.⁴⁶⁶ The purpose of the statute is to maintain the policies underlying competitive bidding, which is guarding against favoritism and corruption.⁴⁶⁷ Each agency must determine whether its own state contracting statutes allow the use of brand names and “or equal” clauses.

c. Warranty of Specifications

Where an agency specifies a particular brand name product in its specifications, the contractor has no discretion but to use that product in order to comply with the contract. In such a situation, the brand name provision is considered a design specification that contains an implied warranty that satisfactory performance will result from adherence to the specification.⁴⁶⁸ However, if the contract provision contains an “or equal” clause, it is not considered a proprietary or design specification, but is rather a performance specification that does not contain an implied warranty of constructibility.⁴⁶⁹

5. Risk Allocation through Exculpatory Clauses

Clauses in construction contracts that limit damages are considered to be in the public interest, such as those that protect the agency from claims that the agency has caused unreasonable delay.⁴⁷⁰ A party may exculpate itself prospectively for its own conduct, whether intentional or unintentional. Exculpatory clauses contained in public contracts are subject to the general rules of contract law regarding exculpatory clauses. Clauses such as “no damages for delay” or “no pay for delay” are considered exculpatory clauses. One

Div. v. George’s Equipment Co., 105 Nev. 798, 783 P.2d 949, 953 (1989).

⁴⁶⁵ Construction Contractors, *supra* note 464, at 1000.

⁴⁶⁶ Morie Energy Management, Inc. v. Badame, 241 N.J. Super. 572, 575 A.2d 885, 887 (1990); N.J.S.A. 40A:11-13(d).

⁴⁶⁷ *Id.* at 888.

⁴⁶⁸ Florida Board of Regents v. Mycon Corp., 651 So. 2d 149, 153 (Fla. App. 1995). Note, however, that the specification may be challenged as proprietary if it does not allow “or equal.”

⁴⁶⁹ *Id.* at 153–54.

⁴⁷⁰ Calumet Constr. Corp. v. Metropolitan Sanitary Dist. of Greater Chicago, 163 Ill. Dec. 255, 581 N.E.2d 206, 209–10, 222 Ill. App. 3d 374 (Ill. App. 1 Dist. 1991), *appeal denied*, 587 N.E.2d 1012.

⁴⁵⁸ In re 1985 Washington County Annual Financial Report Surcharge, 529 Pa. 81, 601, A.2d 1223, 1226–27 (1992).

⁴⁵⁹ Unisys Corp., *supra* note 457, 600 A.2d at 1023.

⁴⁶⁰ Utilimatic, Inc. v. Brick Township. M.U.A., 267 N.J. Super. 139, 630 A.2d 862, 865–66 (1993).

⁴⁶¹ *Id.* at 866.

⁴⁶² Hinesburg Sand & Gravel Co., Inc. v. State, 166 Vt. 377, 693 A.2d 1048, 1049 (1997).

⁴⁶³ *Id.* at 1046–47.

⁴⁶⁴ Construction Contractors Ass’n of Hudson Valley v. Board of Trustees, Orange Community College, 149 Misc. 440, 565 N.Y.S.2d 997, 1000 (1991); *see also* Nev. State Purchasing

of the requirements for exculpatory clauses is that the clause must be conspicuous and cannot be buried in the middle of other contract language. A Texas court found that a “no damages for delay” clause was invalid because it violated the requirement that an exculpatory clause be conspicuous.⁴⁷¹ Whether a clause is conspicuous and meets the requirements for fair notice is a question of law. A clause is considered conspicuous if a reasonable person, against whom the clause is to operate, ought to have notice of it. The court found that a “no damages for delay” clause was inconspicuous where it was contained “in the midst of a multi-page, single-spaced contract.”⁴⁷² The clause contained no heading or warning, nor was it typed in a conspicuous form such as larger or bolder typeface. Another problem with conspicuousness was found in a contract in which the exculpatory clause was printed on the back of the contract.⁴⁷³

a. No Damages for Delay

Contracting agencies may include provisions for shifting to the contractor the risk of costs caused by delay. Typically, these clauses allow only for a time extension in the event of delay. Where a no-damages-for-delay clause is enforced, the contractor will not be entitled to any damages attributable to the delay, including increased labor costs, project overhead, idle equipment, and additional bond premiums.⁴⁷⁴

Also, as an exculpatory clause, the clause will not be enforced against the nondrafting party if it is ambiguous. Thus, where a no-damages-for-delay clause included in a subcontract provided for “only” a time extension, it did not bar damages for delay since it was ambiguous as to whether the “only” applied to time extensions or to damages.⁴⁷⁵

Another court has held that another exception to the enforceability of a no-damages-for-delay clause is when the delay is caused by the “active interference” of the agency or the agency’s bad faith.⁴⁷⁶ “Active interference” is defined as something more than mere negligence, and contemplates “reprehensible behavior” beyond a simple mistake, error in judgment, lack of total effort, or lack of complete diligence. The public agency must commit some affirmative willful act, in bad faith, that unreasonably interferes with the contractor’s compli-

ance with the contract schedule.⁴⁷⁷ Unless one of these exceptions applies, the clause will be strictly construed and enforced.⁴⁷⁸

The application of a no-damages-for-delay clause also may be limited if the arbitrary and capricious actions of the agency result in the delay.⁴⁷⁹ This is particularly true where the agency declines even to grant a time extension to compensate for the delay; such a refusal may be interpreted as active interference in the contract or as bad faith.⁴⁸⁰ The Connecticut court held in *White Oak Corp. v. Department of Transportation*⁴⁸¹ that while a no-damages-for-delay clause is generally enforceable and not contrary to public policy, it will not be enforced if (1) the delays were caused by the agency’s bad faith or willful, malicious, or grossly negligent conduct; (2) the delay was unanticipated at the time of contracting; (3) the delay was so unreasonable that it amounted to an abandonment of the contract and the project by the agency; and (4) the delay resulted from a breach of a fundamental obligation by the agency.⁴⁸²

Other states’ courts have found the clause to cover both anticipated and unanticipated delays.⁴⁸³ All appear to agree on the other three exceptions. A Maryland court in *State Highway Administration v. Griener Engineering Sciences, Inc.* considered the differences between these two lines of decisions, and found that the Maryland clause did apply to delays not contemplated by the parties at the time of contracting.⁴⁸⁴ The court analyzed the “New York” line of cases, which follow *Corrino Civetta Construction Corp. v. City of New York*.⁴⁸⁵ This case sets out the exceptions noted in the *White Oak* case above, including delays unanticipated

⁴⁷⁷ *Id.* at 526, A.2d at 1153.

⁴⁷⁸ *United States for Use of Wallace v. Flintco, Inc.*, 143 F.3d 955, 964 (5th Cir. 1998).

⁴⁷⁹ *Findlen v. Winchendon Housing Auth.*, 28 Mass. App. Ct. 977, 553 N.E.2d 554, 555 (1990).

⁴⁸⁰ *Miss. Transp. Comm’n v. SCI, Inc.*, 717 So. 2d 332, 339 (Miss. 1998).

⁴⁸¹ 217 Conn. 281, 585 A.2d 1199 (1991); *see also* *United States ex rel. Evergreen Pipeline Constr. Co. v. Merritt Meridian Constr. Corp.*, 95 F.3d 153, 167 (2d Cir. 1996); *Miss. Transp. Comm’n v. SCI, Inc.*, 717 So. 2d 332, 338 (Miss. 1998).

⁴⁸² *White Oak Corp. v. Department of Transp.*, 217 Conn. 281, 585 A.2d 1199, 1203 (1991); *see also* *Jensen Constr. Co. v. Dallas County*, 920 S.W.2d 761, 770 (Tex. App. 1996); *United States ex rel. Evergreen Pipeline Constr. Co. v. Merritt Meridian Constr. Corp.*, 95 F.3d 153, 167 (2d Cir. 1996); *Miss. Transp. Comm’n v. SCI, Inc.*, 717 So. 2d 332, 338 (Miss. 1998).

⁴⁸³ *Compare* *State Highway Admin. v. Griener Eng’g Sciences, Inc.*, 321 Md. 164, 577 A.2d 363, 370 (1990) (applies whether particular delay contemplated by parties or not) *with* *Department of Transp. v. Arapaho Constr., Inc.*, 257 Ga. 269, 357 S.E.2d 593, 594 (1987) (applies only to those types of delay contemplated by the parties).

⁴⁸⁴ *Greiner Eng’g*, *supra* note 483, 577 A.2d at 368–71.

⁴⁸⁵ 67 N.Y.2d 297, 502 N.Y.S.2d 681, 493 N.E.2d 905 (1986).

⁴⁷¹ *Argee Corp. v. Solis*, 932 S.W.2d 39, 61 (Tex. App. 1995).

⁴⁷² *Id.* at 61.

⁴⁷³ *Advance Elevator Co. v. Four State Supply Co.*, 572 N.W.2d 186, 188–89 (Iowa App. 1997).

⁴⁷⁴ *White Oak Corp. v. Department of Transp.*, 217 Conn. 281, 585 A.2d 1199, 1202–03 (1991).

⁴⁷⁵ *Ragan Enters. v. L & B Constr. Co.*, 221 Ga. App. 543, 472 S.E.2d 88, 89–90 (1996).

⁴⁷⁶ *Edwin J. Dobson, Jr., Inc. v. State*, 218 N.J. Super. 123, 526 A.2d 1150 (1987).

by the parties at the time of contracting. The New York court in *Corrino Civetta* based its conclusion on the concept of mutual assent, that a party could not be held to have bargained away a right to assert a claim resulting from delay that the parties did not contemplate.⁴⁸⁶

The court then considered the “literal” approach, under which all delays are covered by the no-damages-for-delay clause, whether they were contemplated by the parties or not. Relying on a Wisconsin case, *John E. Gregory & Son, Inc. v. A. Guenther & Sons Co.*, 147 Wrs. 2d 298, 432 N.W.2d 584 (1988) the court concluded that parties can mutually assent to such a clause without contemplating in particularity all potential causes of delay. The clause is included because parties realize that some delays cannot be contemplated.⁴⁸⁷ Indeed, one could argue that if a delay was contemplated it could be worked into the project schedule and a cost attached to it in the bid.

Other states have enforced similar clauses. A North Carolina court found a no-damages-for-delay clause to be valid and enforceable.⁴⁸⁸ The clause was unambiguous and provided that no contract provision would be construed as entitling the contractor to compensation for delays.⁴⁸⁹ A Georgia court found in *Holloway Construction Co. v. Department of Transportation* that the contract did not contain an implied warranty for the department to sequence the work of prime contractors, and that a no-damages-for-delay clause applied to bar claims for damages attributable to delays by other contractors.⁴⁹⁰ In a similar case, the Georgia court held that the grading contractor could not recover damages from the State resulting from the delay attributable to the bridge contractor’s performance.⁴⁹¹ The contract expressed the mutual intent that the State would not assume vicarious liability for delay caused by another contractor, and that a contractor’s sole remedy in the event of delay was an extension of time.⁴⁹² An agency may be found to have waived the benefits of a no-damages-for-delay clause by agreeing to pay delay claims of the prime contractor, and thereby subject itself to the delay claims of subcontractors.⁴⁹³

⁴⁸⁶ Greiner, *supra* note 483, 577 A.2d at 368–69.

⁴⁸⁷ *Id.* at 370.

⁴⁸⁸ APAC-Carolina, Inc. v. Greensboro-High Point Airport Auth., 110 N.C. App. 664, 431 S.E.2d 508, 516, *review denied*, 438 S.E.2d 197 (1993).

⁴⁸⁹ *Id.*

⁴⁹⁰ 218 Ga. App. 243, 461 S.E.2d 257, 260 (1995).

⁴⁹¹ Department of Transp. v. Fru-Con Constr. Corp., 207 Ga. App. 180, 427 S.E.2d 513 (1993).

⁴⁹² *Id.* at 514.

⁴⁹³ Findlen v. Winchendon Housing Auth., 28 Mass. App. Ct. 977, 553 N.E.2d 554, 556 (1990).

i. Effect of Suspension of Work Clause.—A suspension of work clause generally allows some compensation to the contractor where the work has been delayed. Where the contract incorporates the federally-required suspension of work clause, however, this does not necessarily operate to negate or to prohibit a no-damages-for-delay clause. The federal clause specifically provides that no equitable adjustment will be made for delays if they are excluded under any other provision of the contract.⁴⁹⁴

ii. Delay For Environmental Testing.—Where an agency knows that construction is occurring in an area that is or likely is contaminated and where environmental testing may need to be done to determine the method of disposal of excavated material, it may include a special provision addressing the potential for delay for testing. For example, the WSDOT has included such a provision for construction located in the vicinity of the Commencement Bay Nearshore/Tideflats site, which is an EPA-listed hazardous site. WSDOT’s contract included work for environmental cleanup, and provided that delays of up to 60 days could occur while the agency waited for test results in order to determine how to handle certain materials. In using such a clause, the agency should take into account the reasonable time needed to accomplish sampling, receipt of results, and determination of how to proceed in light of the results. The agency should be able to document the time needed for the delay.

ii. Prohibition Of No-Pay-for-Delay Clauses.—States may prohibit the use of no-pay-for-delay clauses by statute. For example, Oregon forbids the use of such a clause in a statute that states that such a waiver is against public policy:

Any clause in a public contract for a public improvement that purports to waive, release or extinguish the rights of a contractor to damages or an equitable adjustment arising out of unreasonable delay in performing the contract, if the delay is caused by acts or omissions of the public contracting agency or persons acting therefor, is against public policy and is void and unenforceable.⁴⁹⁵

b. Termination for Convenience

A provision in a highway construction contract allowing the state to terminate under certain specified conditions, such as for public convenience, with payment to be made only for work actually completed at the time of termination, is considered an exculpatory clause. As such, it is required to meet the requirements for such clauses.⁴⁹⁶

Ordinarily, a contract is considered to be irrevocable unless it contains terms allowing the parties to termi-

⁴⁹⁴ 23 C.F.R. § 635.109(a)(2) (1999); Calumet Constr. Corp. v. Metropolitan Sanitary Dist. of Greater Chicago, 222 Ill. App. 3d 374, 581 N.E.2d 206, 209, 163 Ill. Dec. 255 (1991).

⁴⁹⁵ OR. STAT. 279.063 (1) (1999).

⁴⁹⁶ Department of Transp. v. Arapaho Constr., Inc., 180 Ga. App. 341, 349 S.E.2d 196, 198 (1981) *aff’d*, 257 Ga. 269, 357 S.E.2d 593 (1987).

nate the contract.⁴⁹⁷ Clauses such as those allowing for termination for convenience must be explicitly set out in a contract between two private parties, and in the absence of such a clause the contract is presumed to be irrevocable.⁴⁹⁸

However, the doctrine of termination for convenience is an exception to the common-law requirement of mutuality of contract; the government is permitted to terminate the contract without being found to have breached the contract, if doing so is in the public interest. The United States Supreme Court has held that absent some contractual, statutory, or constitutional provision to the contrary, the government is entitled to terminate a contractor for any reason.⁴⁹⁹

This is easier to accomplish both in terms of authority and determination of compensation if the agency includes in its specifications a provision for termination of the contract for public convenience. In addition to setting out the fact that the contract may be terminated for public convenience, the clause should also establish how the contractor is to be compensated in the event of such a termination. Examples of such clauses may be found in the standard specifications of state transportation agencies and in the federal standard specifications.

A standard termination for convenience clause provides the agency with broad rights to terminate the contract whenever the agency deems termination to be in the public interest.⁵⁰⁰ Further, it limits the contractor's recovery to costs incurred as a result of the termination, payment for completed work, and costs of preparing the termination settlement proposal.⁵⁰¹ The contractor is not entitled to anticipatory profits as damages for breach of contract unless the agency acted in bad faith or abused its discretion.⁵⁰² In terminating the contract for convenience, the government limits its potential liability to the contractor to the value of the work completed at the time of the termination. The terminated contractor is entitled to its quantum meruit performance under the contract, but not to its anticipated profits for work not yet performed.⁵⁰³ The major impact of a termination for convenience clause is that it

relieves the agency from the obligation of paying the contractor's anticipated profits for unperformed work.⁵⁰⁴

In *Department of Transportation v. Arapaho Construction, Inc.*, the court found that a termination clause was an exculpatory clause, and was unenforceable where the contract failed to incorporate any language explicitly referencing the clause's application to breach of contract cases.⁵⁰⁵ Rather, the termination clause referred only to injunctions, and did not cover the agency's failure to provide required rights-of-way. Thus, the contractor was entitled to its lost profits.

A termination clause allowing the agency to terminate the contract in the event conditions arose that could prevent the contractor from proceeding with or completing the work was not considered to be the equivalent to the common law doctrine of impossibility of performance in *W.C. English, Inc. v. Commonwealth, Department of Transportation*.⁵⁰⁶ Rather, the court held that the department properly terminated the contract under that clause when the contractor's cost overruns depleted the funds available to complete the project.

An ambiguity in a termination clause will ordinarily be construed against the drafter.⁵⁰⁷ Thus where a contract contained two clauses, one a general termination for convenience clause and one a more specific clause that stated that the contract would be terminated only for failure to perform, inadequate performance, or lack of funding, the more specific clause controlled.⁵⁰⁸

c. Shortened Claim Filing Periods

Washington State has a statute pertaining to state highway construction that requires that any claims against the department arising out of a construction contract be filed in state court within 180 days of final acceptance of the contract by the state.⁵⁰⁹ This provision is also included in the state's standard specifications.⁵¹⁰ A court reviewing the validity of the standard specification found that the provision was not unenforceable on the grounds that it was unreasonable.⁵¹¹ Rather, the court found that legislative appropriations, budgetary constraints, federal funding concerns, the state's volume of public works contracts, and the overall highway

⁴⁹⁷ *Ham Marine, Inc. v. Dresser Indus.*, 72 F.3d 454, 460 (5th Cir. 1995).

⁴⁹⁸ *Id.*

⁴⁹⁹ *Board of County Comm'rs, Wabaunsee County, Kansas v. Umbehr*, 518 U.S. 668, 673-74, 116 S. Ct. 2342, 135 L. Ed. 2d 843 (1996).

⁵⁰⁰ *A.J. Temple Marble & Tile, Inc. v. Long Island R.R.*, 172 Misc. 2d 422, 659 N.Y.S.2d 412, 414 (1997).

⁵⁰¹ *Id.*

⁵⁰² *Id.* at 414-15; *see also Century Marine, Inc. v. United States*, 153 F.3d 225 (5th Cir. 1998).

⁵⁰³ *Hancock Electronics Corp. v. Washington Metro. Area Transit Auth.*, 81 F.3d 451 (4th Cir. 1996), *cert. denied*, 117 S. Ct. 299.

⁵⁰⁴ *D.C. v. Organization for Env'tl. Growth, Inc.*, 700 A.2d 185, 199-200 (D.C. App. 1997).

⁵⁰⁵ 180 Ga. App. 341, 349 S.E.2d 196, 198-99, *aff'd*, 357 S.E.2d 593 (1987).

⁵⁰⁶ 14 Va. App. 951, 420 S.E.2d 252, 254-55 (1992).

⁵⁰⁷ *Commonwealth of Pa. DOT v. Brozzetti*, 684 A.2d 658, 665 n.14 (Pa. Commw. 1996).

⁵⁰⁸ *Id.*

⁵⁰⁹ WASH. REV. STAT. §47.28.120 (2002).

⁵¹⁰ WASHINGTON, STANDARD SPECIFICATIONS FOR ROAD, BRIDGE, AND MUNICIPAL CONSTRUCTION, § 1-09.11(3) (2000).

⁵¹¹ *Yakima Asphalt Paving Co. v. Wash. State Dep't of Transp.*, 45 Wash. App. 663, 726 P.2d 1021, 1024 (1986).

funding scheme made the shorter limitation period reasonable.⁵¹²

6. Other Requirements

a. Subcontractor Listing Requirements

Unless a statute or the bid specifications require listing of subcontractors, none will be required.⁵¹³ However, some states have enacted statutes that require bidders to list in their bids the subcontractors that they will contract with for the work if they are awarded the contract. An example is California's Subletting and Subcontracting Fair Practices Act. The purpose of the statute has been set out within the act as follows:

The Legislature finds that the practices of bid shopping and bid peddling in connection with the construction, alteration, and repair of public improvements often result in poor quality of material and workmanship to the detriment of the public, deprive the public of the full benefits of fair competition among prime contractors and subcontractors, and lead to insolvencies, loss of wages to employees, and other evils.⁵¹⁴

A case interpreting a similar statute describes "bid shopping" as the bidder's use of a low subcontract bid already received to pressure potential subcontractors into submitting lower bids.⁵¹⁵ "Bid peddling" is an attempt by a subcontractor to undercut a known bid that has already been submitted to the bidder on the prime contract.⁵¹⁶ Proof of actual bid shopping is not necessary to show a violation of a subcontractor listing requirement.⁵¹⁷ However, where bid shopping is shown, it will be considered to have prevented formation of the subcontract.⁵¹⁸

The California statute requires that when a bidder on a street, highway, or bridge contract intends to subcontract to a particular subcontractor an amount "in excess of one-half of 1 percent of the prime contractor's total bid or...in excess of ten thousand dollars (\$10,000), whichever is greater," then the bidder must list the name and place of business of that subcontractor.⁵¹⁹ It

⁵¹² *Id.*

⁵¹³ See *Williams Bros. Constr. v. Public Building Comm'n of Kane County*, 243 Ill. App. 3d 949, 612 N.E.2d 890, 895, 184 Ill. Dec. 14 (1993), *appeal denied*, 152 Ill. 2d 582, 622 N.E.2d 1229, 190 Ill. Dec. 912 (1993) (Illinois Public Building Commission Act did not require subcontractor listing); *Pittman Constr. Co. v. Parish of East Baton Rouge*, 493 So. 2d 178, 181 (1986), *writ denied*, 493 So. 2d 1206 (La. App. 1 Cir. 1986).

⁵¹⁴ CAL. PUB. CONT. CODE § 4101 (2002).

⁵¹⁵ *Romero Excavation & Trucking, Inc. v. Bradley Constr.*, 121 N.M. 471, 913 P.2d 659, 662 (1996).

⁵¹⁶ *Id.* at 662; see also *R.J. Land & Assocs. Constr. Co. v. Kiewit-Shea*, 69 Cal. App. 4th 416, 81 Cal. Rptr. 2d 615, 617 (1999).

⁵¹⁷ *Ray Bell Constr. Co. v. School Dist. of Greenville County*, 331 S.C. 19, 501 S.E.2d 725, 731-32 and n.12 (1998).

⁵¹⁸ *Pavel Enterprises, Inc. v. A.S. Johnson Co.*, 342 Md. 143, 674 A.2d 521, 531 (Md. App. 1996).

⁵¹⁹ CAL. PUB. CONT. CODE § 4104(a)(1) (2002).

also requires that the agency must include the requirement for subcontractor listing either in its bid specifications or in its general conditions or standard specifications.⁵²⁰

New Mexico has a similar statute, the Subcontractors Fair Practices Act, modeled after the California statute.⁵²¹ It has the notable difference, however, of exempting highway construction work from its scope.⁵²² A case interpreting this statute is still instructive to the interpretation of similar statutes. In *Romero Excavation & Trucking, Inc. v. Bradley Construction*, a case that involved construction at a state university, the contractor was found to have violated the Act when it substituted itself for a subcontractor listed in its bid.⁵²³ The subcontractor listing statute required that the bidder list only one subcontractor per category of work. If none was listed, then the bidder was required to perform that category of work itself. The statute essentially required the bidder to commit when it submitted its bid to either using a specified subcontractor to do a category of work or to doing that work itself.

The statute provided for circumstances when a substitution of a listed subcontractor was allowed; however, none applied in this case. The court concluded that even though the statute was directed at preventing substitution of another subcontractor, that allowing the prime contractor to substitute itself for a listed subcontractor was contrary to the purpose of the Act and was a violation.⁵²⁴

Similarly, a prime contractor in California was not allowed to substitute a subcontractor listed for one category of work for a subcontractor listed for another category of work. The bid did not divide that category of work between two subcontractors, and therefore the only listed subcontractor for that category was entitled to the subcontract.⁵²⁵

The California statute confers a right on the listed subcontractor that it will be awarded the subcontract, even though no subcontract exists at the time of bidding.⁵²⁶ Unless statutory grounds for substitution are met, the prime contractor has no right to substitute another subcontractor for the one listed. The subcontractor's right to the subcontract may be enforced in an action against the prime contractor to recover the benefit of its bargain.⁵²⁷ California's statute also provides for substantial penalties in the event that a violation is found. The awarding authority may, in its discretion, cancel the contract or assess a penalty against the contractor in an amount not exceeding 10 percent of the

⁵²⁰ CAL. PUB. CONT. CODE § 4104 (2002).

⁵²¹ N.M.S.A. § 13-4-31 *et seq.* (1999).

⁵²² N.M.S.A. § 13-4-35 (1999).

⁵²³ 121 N.M. 471, 913 P.2d 659 (1996).

⁵²⁴ *Id.* at 663.

⁵²⁵ *R.J. Land & Assocs. Constr. Co. v. Kiewit-Shea*, 69 Cal. App. 4th 416, 81 Cal. Rptr. 2d 615 (1999).

⁵²⁶ *Id.* at 618.

⁵²⁷ *Id.*; CAL. PUB. CONT. CODE § 4103 (2001).

subcontract.⁵²⁸ In addition, a violation may be grounds for discipline by the state contractors' licensing board.⁵²⁹

A federal district court has interpreted the Nevada subcontractor listing requirement as creating "pseud contractual" obligations on the part of the prime contractor, even though the subcontractor and prime contractor have no contract with each other at bid opening.⁵³⁰ However, the statute makes them bound to one another in such a way as they may "disengage" only on specific statutory grounds. Under the statute, the subcontractor may obtain damages from the prime contractor for wrongful substitution.⁵³¹ It may also be entitled to injunctive relief against the prime contractor and the awarding agency, if it meets the standard for an injunction by showing that damages are insufficient relief. The subcontractor may meet this requirement by demonstrating that by not getting the subcontract, it will lose an opportunity to gain experience and enhance its reputation in the community. Damages cannot compensate for this loss.⁵³²

Where a statutory subcontractor listing requirement exists, it will be enforced even if not included in the bid specifications. A city was not estopped from enforcing the subcontractor listing requirement even though the bid package did not mention it, and even though the specifications referred to an American Institute of Architects provision requiring the identification of subcontractors following the contract award.⁵³³

b. Incorporation of Statutory Requirements

Any applicable statutory requirements in place at the time of contracting will be implied, even if not fully set out in the contract. The law existing at the time and place of the contract execution is part of the contract; this applies to public contracts as well as private.⁵³⁴

Statutory requirements may take the form of requiring a specific clause be included in a public contract, or may simply create an obligation for the contractor to comply with a particular legal requirement. Where valid regulations require the inclusion of a specific clause in a public contract, it will be deemed incorporated by operation of law even if it is omitted from the written contract.⁵³⁵ This is true only where the required clause is consistent with the governing statute under which the contract is entered into; an inconsis-

tent clause will not be incorporated by operation of law.⁵³⁶

c. Implied Terms and Warranties

All construction contracts have an implied warranty that they will be performed in a workmanlike manner.⁵³⁷ However, where the contract contains an express provision setting out the degree of competence required for the work, such an implied warranty is considered redundant, and the warranty will not be implied.⁵³⁸

Like all contracts, public contracts contain an implied warranty of good faith and fair dealing.⁵³⁹ The covenant is implied by law and "obligates the parties to cooperate with each other so that each may obtain the full benefit of performance."⁵⁴⁰

d. Contracts Must Be in Writing

Because most transportation construction contracts are large transactions whose performance will span more than a year's time, an oral contract would likely violate the statute of frauds. Also, each agency's authority to contract is limited by the statutory language granting that authority. State and local agencies are creatures of statute, and have only those powers that the legislature grants to them. Generally, they do not have authority to make oral contracts. In addition, where a bid was lacking the bidder's signature, acceptance of that bid and making it part of a contract would have violated the statute of frauds.⁵⁴¹

In *Scheckel v. Jackson County, Iowa*, the bidder and an assistant county engineer had a telephone conversation in which the assistant engineer informed the bidder that it was the low bidder and would get the award.⁵⁴² Ultimately, that bidder did not receive the award. The court held that the conversation between the assistant engineer and the bidder did not give rise to a contract. Under the statute, the contract required approval of the county board of supervisors, and neither the county engineer nor the assistant had authority to make an oral contract that would bind the county.⁵⁴³

Where there is a legal requirement that the contract be in writing and that it be approved by a particular

⁵³⁶ *Id.*

⁵³⁷ *Korte Constr. Co. v. Deaconess Manor Assoc.*, 927 S.W.2d 395, 404 (Mo. App. 1996).

⁵³⁸ *Id.* at 404.

⁵³⁹ *A.C. Shaw Constr., Inc. v. Washoe County*, 105 Nev. 913, 784 P.2d 9 (1989).

⁵⁴⁰ *Record Steel & Constr., Inc. v. Martel Constr.*, 129 Idaho 288, 923 P.2d 995, 999 (Idaho App. 1996) (quoting *Badgett v. Security State Bank*, 116 Wash. 2d 563, 569, 807 P.2d 356, 360 (1991)).

⁵⁴¹ *A.A.B. Electr., Inc. v. Stevenson Public Sch. Dist.*, 5 Wash. App. 887, 491 P.2d 684, 686-7 (1971).

⁵⁴² 467 N.W.2d 286, 288 (Iowa App. 1991).

⁵⁴³ *Id.* at 289.

⁵²⁸ CAL. PUB. CONT. CODE § 4110 (2002).

⁵²⁹ CAL. PUB. CONT. CODE § 4111 (2001).

⁵³⁰ *Clark Pacific v. Krump, Constr., Inc.*, 942 F. Supp. 1324 (D. Nev. 1996).

⁵³¹ *Id.* at 1346.

⁵³² *Id.*

⁵³³ *Gaglioti Contracting, Inc. v. City of Hoboken*, 307 N.J. Super. 421, 704 A.2d 1301, 1304-05 (1997).

⁵³⁴ *City of North Charleston v. North Charleston Dist.*, 289 S.C. 438, 346 S.E.2d 712, 715 (1986).

⁵³⁵ *United States v. Bills*, 822 F.2d 373, 377 (3d Cir. 1987).

individual or body, that requirement will be strictly enforced. In *Davis, Murphy, Niemiec and Smith v. McNett*, the court found that a county code section that provided that only county commissioners could enter into contracts for the county and required that the contracts be in writing was intended to prevent fraud against the county, and thus strict compliance was required.⁵⁴⁴

Modifications to the contract also must be in writing, and courts will strictly enforce prohibitions on oral modifications.⁵⁴⁵ Likewise, any efforts to extend a contract by oral agreement will be found to not be binding on the agency.⁵⁴⁶

An exception to this requirement is found in *PacOrd, Inc. v. United States*.⁵⁴⁷ In that case, the court found that the subcontractor was entitled to maintain an action against the United States in the absence of a written contract, because it was able to establish the existence of an implied-in-fact contract beyond the mere oral contract.

However, a North Dakota court did enforce an oral contract between a prime contractor and its subcontractor. In *Triton Corp. v. Hardrives, Inc.*, the street repair contractor who was interested in bidding on a city contract could not do so as it could not get a performance bond required by the city.⁵⁴⁸ It then entered into an oral agreement with another company that could qualify for the performance bond. Its arrangement was that the street repair contractor would prepare the bid, and the second company would obtain the performance bond and submit the bid to the city. In return, the second company would be paid 10 percent of the contract price. This company was awarded the contract, but then decided that because the street repair company could not get a bond, that it would subcontract the work to someone else. The street repair company sued to recover its lost profits. The court found that a valid oral contract existed between the two contractors, and awarded the lost profits.⁵⁴⁹

Authority to contract must be express; apparent authority cannot serve as a means of holding a governmental entity to a contract.⁵⁵⁰ A contractor relying on an individual's statement has no claim of entitlement to a contract. Further, the contractor has no claim of having been deprived of due process, as a legitimate

⁵⁴⁴ 665 A.2d 1322, 1325 (Pa. Commw. 1995), *appeal denied*, 543 Pa. 718, 672 A.2d 310 (1996).

⁵⁴⁵ *Greater Johnstown School Dist. v. Frontier Ins. Co.*, 252 A.D. 2d 617, 675 N.Y.S.2d 212, 215 (1998).

⁵⁴⁶ *Alco Parking Corp. v. Public Parking Auth. of Pittsburgh*, 706 A.2d 343, 348 (Pa. Super. 1998) (oral agreement to renew contract not binding on board where all contracts were required to be in writing and signed by the chairman).

⁵⁴⁷ 139 F.3d 1320, 1323 (9th Cir. 1998) (applying Federal Acquisition Regulations, 48 C.F.R. § 2.101).

⁵⁴⁸ 85 F.3d 343 (8th Cir. 1996).

⁵⁴⁹ *Id.* at 346.

⁵⁵⁰ *Hutchison v. City of Huntington*, 479 S.E.2d 649, 664 n.20 (W. Va. 1996).

claim of entitlement to the contract is necessary to establish a property interest.⁵⁵¹

e. Specifications are Not Rules

In *Alabama Department of Transportation v. Blue Ridge Sand & Gravel*, the aggrieved bidder challenged the department's standard specifications as "rules" that should have been adopted pursuant to the state Administrative Procedure Act.⁵⁵² The court found legislative intent to support its conclusion that the standard specifications were not "agency regulation, standard or statement of general applicability that implements, interprets, or prescribes law or policy."⁵⁵³ Each standard specification was found to be a term that may be incorporated into a contract between the department and another party. Competitive bidding laws in Alabama allow a prospective bidder to challenge the inclusion of a specification; this is inconsistent with the specifications being rules.

Similarly, a Florida court held in *Department of Transportation v. Blackhawk Quarry Co. of Florida* that the department's standard specifications for road and bridge construction were not rules and did not need to be promulgated under the state Administrative Procedure Act.⁵⁵⁴ Rather, the standard specifications set out standards for acceptance of materials, and were contract terms between the department and the agency.

Likewise, another court has held that the instructions to bidders included in the bid documents were not agency rules.⁵⁵⁵ The court noted that the legislature had directed the agency in its statute to develop "policy and procedure guidelines" for contract documents. This was found to be different from the situations in which agencies adopt "policies" that are in effect rules. The legislature used the specific terms "policy" and "guideline" where it could have used "rule."

The Florida court in the *Blackhawk Quarry* case did, however, find that the standard operating procedure adopted by the DOT for evaluating, approving, and controlling mineral aggregate sources was an administrative rule that had to be duly adopted under the Administrative Procedure Act. The operating procedure was an "agency statement of general applicability that implements, interprets or prescribes laws or policy."⁵⁵⁶ Where such a policy is adopted as a rule, the agency has broad discretion in drafting and the rule will be upheld unless arbitrary and capricious.⁵⁵⁷ Where administrative standards are adopted by the agency to govern construction projects and do not conflict with

⁵⁵¹ *Id.* at 664-5

⁵⁵² 718 So. 2d 27, 29-31 (Ala. 1998).

⁵⁵³ *Id.* (quoting ALA. ADMIN. CODE, ch. 450-1-1 *et seq.*).

⁵⁵⁴ 528 So. 2d 447, 450 (Fla. App. 1988), *review denied*, 536 So. 2d 243.

⁵⁵⁵ *Cleveland Constr., Inc. v. Ohio Dep't of Admin. Services*, 121 Ohio App. 3d 372, 700 N.E.2d 54, 68 (Ohio App. 1997).

⁵⁵⁶ *Blackhawk Quarry*, *supra* note 554, at 450.

⁵⁵⁷ *Dravo Basic Materials Co. v. State, Dep't of Transp.*, 602 So. 2d 632 (Fla. App. 1992).

statutes, they will be considered to have the force of law.⁵⁵⁸

Cases from two states—Oklahoma and Oregon—note that the transportation agency’s standard specifications in those states are actually adopted as agency rules.⁵⁵⁹

f. On-Call Contracts

In *Faulk v. Twiggs County*, the agency awarded a competitively bid contract to a contractor for on-call paving work.⁵⁶⁰ Although the contract was indefinite as to the ultimate quantity, it contained a unit item bid price for the paving. The agency wanted to be able to pave in designated areas as funds to pay for the work became available, without letting a new contract each time. The court held that it was sufficient if the key for determination of the sum to be paid—the unit price—and the service to be rendered were contained in the contract.⁵⁶¹

g. Express Warranties

An express warranty in a public contract to perform in a workmanlike and reasonable manner was not disclaimed so as to not to operate during construction and performance testing merely because the warranty period extended beyond acceptance for a period of 1 year.⁵⁶²

h. Agency May Not Contract Away Essential Governmental Powers

An agency may not contract away any of the essential powers of government, including the police power, the power of eminent domain, and the power to tax.⁵⁶³ Any contract provision that purports to do so will be considered void and unenforceable.⁵⁶⁴

⁵⁵⁸ *Hoar v. Aetna Casualty and Surety Co.*, 968 P.2d 1219, 1221 (Okla. 1998).

⁵⁵⁹ *Anderson’s Erosion Control, Inc. v. Oregon, ex rel Dep’t of Transp.*, 141 Ore. App. 221, 917 P.2d 537 (Ore. App. 1996); *Hoar v. Aetna Casualty and Surety Co.*, 968 P.2d 1219, 1221 (Okla. 1998).

⁵⁶⁰ 269 Ga. 809, 504 S.E.2d 668, 670 (Ga. 1998).

⁵⁶¹ *Id.*

⁵⁶² *Hennes Erecting Co. v. National Union Fire Ins. Co. of Pittsburgh, Pa.*, 813 F.2d 1074, 1081 (10th Cir. 1987).

⁵⁶³ *State Street Bank & Trust Co. v. Commw of Pa., Treasury Dep’t*, 712 A.2d 811, 813 (Pa. Commw. 1998).

⁵⁶⁴ *State ex rel. Devonshire v. Superior Court*, 70 Wash. 2d 630, 424 P.2d 913, 917–18 (1967) (city could not contract away power of eminent domain or bind itself to a restricted exercise thereof).

SECTION 2

CONTRACTOR LICENSING, QUALIFICATION, AND BOND REQUIREMENTS

A. LICENSING AND PREQUALIFICATION OF CONTRACTORS

1. Licensing and Prequalification Requirements

Where eligibility requirements are imposed on bidders by state law, they generally involve compliance with contractor licensing and prequalification rules.¹ Many states have requirements that all bidders must be licensed by the state and prequalified by the contracting agency as a condition to submission of a bid and award of a contract. These requirements have a direct relationship to determination of the lowest responsible bid. Application of these rules may vary depending on whether state or federal funding is involved. Licensing and prequalification requirements may apply to subcontractors as well as prime contractors.²

a. Public Policy Concerning Qualification of Bidders

Contractor qualification requirements are an important part of how transportation agencies carry out their statutory obligations to award construction contracts to the “lowest responsible bidder” in competitive bidding.³ The term “lowest responsible bidder” means the bidder whose price is the lowest and whose offer adequately demonstrates the quality, fitness, and capacity to perform the work.⁴ Determination of bidder qualifications and responsibility is largely a judgmental process.⁵ Thus, the contracting officer’s determination of responsibility is reviewed only for arbitrary and capricious action.⁶

¹ Portions of this section are derived from *Licensing and Qualification of Bidders* by Dr. Ross D. Netherton, published by the Transportation Research Board in 1976 and included in the first edition of *SELECTED STUDIES IN HIGHWAY LAW*.

² See 30 DEL. CODE §§ 2502 (1997); *PG Constr. Co. v. George & Lynch, Inc.*, 834 F. Supp. 645 (D. Del. 1997).

³ At least one court has held that even in the absence of a statutory requirement for doing so, public policy and economical conduct of government business require that contracts be awarded to the lowest responsible bidder. *City of Phila. v. Com., Dep’t of Env’tl. Resources*, 133 Pa. Commw. 565 577 A.2d 225, 228 (1990).

⁴ See 30 ILL. COMP. STAT. 500/1-15.80 (2001) for a statutory definition of responsible bidder.

⁵ *W. Va. Medical Institute v. W. Va. Public Employees Ins. Bd.*, 180 W. Va. 697 379 S.E.2d 501, 503–04 (1989) (statute requiring award to lowest responsible bidder required subjective evaluation of quality, service, and compatibility with other programs in addition to price).

⁶ See, e.g., *Advance Tank and Constr. Co. v. Arab Works*, 910 F.2d 761, 765 (11th Cir. 1990) (applying Alabama law); *State of Nev., State Purchasing Div. v. George’s Equip. Co.*, 105 Nev. 798, 783 P.2d 949, 954 (1989); *Grand Canyon Pipelines, Inc. v. City of Tempe*, 816 P.2d 247, 250 (Ariz. 1991) (agency’s decision regarding a determination of responsibility must not be arbitrary).

Cases provide varying definitions of responsibility. One definition is “the bidder’s apparent ability and capacity to perform the contract’s requirements.”⁷ Another states that responsibility addresses “performance, capability of bidder including financial resources, experience, management, past performance, place of performance, and integrity.”⁸ Responsibility is considered to be a qualitative term, and includes trustworthiness, quality, fitness, and capacity to perform the contract satisfactorily.⁹ Another court has allowed the consideration of financial ability, skill, integrity, business judgment, experience, reputation, and quality of previous work on public contracts.¹⁰

States may also define responsibility by statute. Oregon’s public works statute provides that in determining if a prospective bidder has met the standards of responsibility, the public contracting agency shall consider whether a prospective bidder has:

(i) Available the appropriate financial, material, equipment, facility and personnel resources and expertise, or ability to obtain the resources and expertise, necessary to indicate the capability of the prospective bidder to meet all contractual responsibilities;

(ii) A satisfactory record of performance. The public contracting agency shall document the record of performance of a prospective bidder if the public contracting agency finds the prospective bidder not to be responsible under this sub-subparagraph;

(iii) A satisfactory record of integrity. The public contracting agency shall document the record of integrity of a prospective bidder if the public contracting agency finds the prospective bidder not to be responsible under this sub-subparagraph;

(iv) Qualified legally to contract with the public contracting agency; and

(v) Supplied all necessary information in connection with the inquiry concerning responsibility. If a prospective bidder fails to promptly supply information requested by the public contracting agency concerning responsibility, the public contracting agency shall base the determination of responsibility upon any available information, or may find the prospective bidder not to be responsible.¹¹

Determination of these qualifications must be made by the contracting officer on a case-by-case basis. Historically, contracting officers have resorted to four basic methods, or combinations of methods, in carrying out this function. The earliest practice relied on the con-

⁷ *Applications Research Corp. v. Naval Air Dev. Center*, 752 F. Supp. 660, 682 (E.D. Pa. 1990).

⁸ *Bean Dredging Corp. v. United States*, 22 Cl. Ct. 519, 522 (1991).

⁹ *Stacy and Witbec, Inc. v. City and County of S. F.*, 44 Cal. Rptr. 2d 472, 483, 36 Cal. App. 4th 1074, *modified on denial of rehearing, review denied* (1995).

¹⁰ *La. Associated General Contractors, Inc. v. Calcasieu Parish Sch. Bd.*, 586 So. 2d 1354, 1363 (1991).

¹¹ OR. REV. STAT. § 279.029(6)(a)(B) (2002).

tracting officer's acknowledged authority to reject any (or all) bids if he or she deems it to be in the public interest to do so. Under this authority, a bidder's qualifications may be investigated and evaluated to the extent necessary. Courts have generally upheld the authority of contracting officers to investigate prospective contractors. They have also upheld the substantive determination of the administrative agency in the absence of any evidence of fraud, collusion, bad faith, or arbitrary and capricious conduct.¹²

A second method relies on the requirement that contractors must furnish performance bonds and other security for the protection of the general public and of individuals dealing with the contractors. Its rationale is that if a contractor can furnish the necessary bonds and sureties, the contracting officer may rely on the surety's investigation to verify the contractor's fitness.

A third method includes requirements that persons desiring to engage in general construction contracting or any of the various specialized branches of contracting must first obtain a license for this purpose. Licensing procedures normally call for a duly authorized public agency to examine the applicant and determine whether it is competent in its knowledge of engineering, construction, business administration, and laws applying to contracting, and has a good business reputation.¹³ The contracting officer may wish to rely on this license, reasoning that if an applicant is considered "responsible" enough to obtain a contractor's license, it is responsible enough to bid on and receive the award of a public works contract.

Because both surety bonding and licensing have their limitations, a fourth method—prequalification—is widely used by states to evaluate contractors' qualifications. Under this procedure, contractors wishing to bid on public works contracts must previously be determined by the contracting agency to be qualified for the category of work involved and for undertaking a project of the size advertised.

Each of these four methods, or any combination of them, may serve as the basis for a valid administrative determination that a particular low bidder is also the lowest responsible bidder. The choice of method to be used may be made by the legislature, or may be delegated to the governing body or chief administrative officer of the contracting agency.

Procedures for evaluating contractors' qualifications serve three major public interests, namely preventing or minimizing adverse consequences of contractor default or delay; maximizing the benefits of the competitive bidding system; and improving the quality of public construction work.

i. Prevention of Contractor Default or Delay.—Legislatures have sought to protect public investments in public works by requiring suretyship and indemnification provisions in all public works contracts. However, these efforts may not be enough to cover the costs that the public must bear. Bonding requirements generally protect public agencies from loss of funds invested directly in costs of preparation and construction of a project. But the indirect costs of the agency's added overhead expense and the public's added period of inconvenience cannot be recovered from the contractor's surety.

To some extent, public works agencies can minimize risks that contractors will overextend themselves by subdividing large contracts into segments, no one of which is likely to overtax the contractor to which it is awarded. However, in such situations a default or inexcusable delay inevitably affects not only the contractor directly involved, but also other contractors whose work schedules are planned with reference to the schedules of that contractor.

Public safety is also an important reason for insisting that construction contractors be qualified to perform according to contract standards and schedules. Moral, legal, and professional obligations call for transportation construction programs to provide safe and convenient facilities for public travel. Court decisions and statutes have eliminated or restricted some states' sovereign immunity from suits based on defects in design and workmanship. At the same time, statutory standards for safe working conditions in federal law apply to contractors on state construction projects using federal funds, and similar state laws apply to state-funded projects. Thus, competence to adhere to standards that protect the safety of the traveling public and of workers employed in construction activity is an important aspect of contractor qualification.

ii. Improvement of Competitive Bidding.—The competitive bidding system is intended to secure the highest quality work for the least cost. But it can do this only if individual bidders realistically analyze the requirements of a construction plan and make their proposals fully responsive to these requirements and to prevailing market conditions.

Reliance on market forces alone to eliminate those contractors who engage in irresponsible bidding is not practical. Mandatory qualification procedures are viewed by all segments of the construction industry as a means by which responsible contractors can promote the stability of the bidding process by assuring that bids will maintain a realistic relationship to sound engineering practices and market conditions.

¹² *Marvec Constr. Co. v. Township of Belleville*, 254 N.J. Super. 282 603 A.2d 184, 187 (1992); *City of Cape Coral v. Water Services of America, Inc.*, 567 So. 2d 510, 513, *review denied*, 577 So. 2d 1330 (Fla. App. 2 Dist. 1990); *Tasco Dev. & Building Corp. v. Long*, 212 Tenn. 96, 368 S.W.2d 65 (1963).

¹³ *See, e.g.*, IDAHO CODE § 54-1910(a) (2001).

iii. *Improvement of the Quality of Public Construction.*—Early proponents of contractor licensing and prequalification systems argued that such a system would result in higher quality highway construction. Contractors would be required to submit to examination of their qualifications prior to announcement of contracts. Also, the system included classification of contractors for certain types of work that they had demonstrated the ability to handle. Bidding would then be confined to those contractors whose competence was established.¹⁴

New or out-of-state contractors interested in doing work for transportation agencies may be allowed to bid only on small and less complex projects until they acquire the experience and financial resources to assure successful performance on larger projects. However, most states allow contractors wide latitude in the types of contracting work for which they may qualify. States assign capacity ratings to contractors according to fixed formulas that are applied uniformly to all applicants.

b. *The Legal Basis of Contractor Qualification Systems*

Many states require that persons engaging in general or specialized engineering or construction work must obtain licenses based on satisfactory demonstration of their professional competence. In addition, contractors intending to compete for public contracts for highway construction must, in most states, establish their qualifications for performing such work prior to being allowed to file their bids. In states that do not require prequalification, contractors who are low bidders on public projects must be certified as responsible and qualified to receive the contract award under a “postqualification” procedure. In both pre- and postqualification, the applicant is required to submit records of finances, management, and past relevant experience. Qualification is then based on a rating derived from evaluation of this evidence.

A distinction must be made between the mechanism of licensing and the various forms of bidder qualification. Licensing is required to authorize individuals or corporations to engage in the business of construction contracting within a particular state. In contrast, prequalification and postqualification are methods of establishing a bidder’s eligibility to bid on a public contract managed by a particular public agency, or to receive a particular contract as a result of competitive bidding. Licensing of contractors and certification under various qualification procedures must also be distinguished from that form of licensing that is in the nature of an occupational or privilege tax, which is chiefly for the production of tax revenue.¹⁵

i. *Limits On State Police Power Applied To Contractor Qualification.*—As in the regulation of businesses, trades, and occupations generally, the authority for licensing and qualification of contractors dealing with the public is based on the state’s police power. The states must, however, respect the supremacy of federal law where it applies, and refrain from imposing any limitations on Interstate commerce. Accordingly, federal regulations applying to federally-assisted highway projects declare that state procedures for qualification of contractors will not be approved by the Federal Highway Administrator if in his or her judgment they may operate to restrict competitive bidding.¹⁶ In addition to respecting the supremacy of federal laws, state contractor qualification requirements must avoid unfair discrimination among contractors, and must employ standards that are reasonably related to the legitimate objectives of the law.

Much of the early concern over possible discrimination is reflected in two Pennsylvania cases—*Harris v. Philadelphia*¹⁷ in 1930 and *Corcoran v. Philadelphia* in 1950.¹⁸ Both were taxpayers’ suits to enjoin the application of municipal ordinances requiring prequalification of bidders on city public works projects. In *Harris*, the prequalification procedure was declared to be discriminatory; in *Corcoran*, the ordinance was sustained.

In *Harris*, the prequalification questionnaires were filed with the head of the municipal department that would supervise the performance of the contract, and if he was satisfied the prospective bidder’s name was placed on a “white list” of “responsible bidders” entitled to submit bids without further inquiry. Others who were rejected by the department head were entitled to appeal his decision to a special board. In enjoining enforcement of this ordinance, the Supreme Court of Pennsylvania declared:

It is obvious that, even if this plan is, in some respects, an advance on the previous method, it nevertheless opens wide the door to possible favoritism. The awarding director can place upon the white list the name of any intending bidder whom he chooses to approve, however irresponsible in fact, and that decision is not reviewable. On the other hand, he may compel all bidders, who are not favorites of his, to go to the expense of an appeal to the board, which will have before it only the answers to the questionnaire by those the awarding director has excluded from bidding, with no way of knowing whether or not their plant, equipment, experience and financial standing are superior or inferior to those of the bidders whose names the director has placed on the white list.¹⁹

Suggesting a way out of this danger, the court stated that prequalification might not be objectionable if all bidders’ questionnaires were submitted to an independ-

¹⁴ See NETHERTON, *supra* note 1, at 1047.

¹⁵ See, e.g., WASH. REV. CODE § 18.27.030 (1999, 2003 Supp.)

¹⁶ 23 C.F.R. § 635.110(b) (Apr. 2002).

¹⁷ 299 Pa. 473, 149 A.722 (1930).

¹⁸ 363 Pa. 606, 70 A.2d 621 (1950).

¹⁹ 149 A. at 723–24.

ent committee having the expertise to properly analyze the evidence and advise on the classification and qualifications of the applicants. It insisted, however, that all bidders must be treated equally in order to comply with the law.

Twenty years later, the Pennsylvania Supreme Court was asked to pass on another ordinance by which Philadelphia sought to require prequalification of bidders on municipal contracts.²⁰ The court held that the city's prequalification requirements were entirely reasonable, and were applicable to all potential bidders without discrimination. Moreover, the court found no fault with the manner in which the system had been applied to the project advertised in this instance, and denied plaintiff's charge that the city had circumscribed the advertised project in such a way as to place it outside the scope of the work classification for which the plaintiff was certified.

c. Qualification of Contractors on Federal-Aid Highway Projects

A policy of protecting and encouraging competitive bidding for contracts to construct federal-aid highways is reflected in federal statutes and FHWA regulations. The basic mandate is the statutory requirement that federal-aid highway projects shall be performed by contracts awarded through competitive bidding, unless the Secretary of Transportation makes an affirmative finding that some other method better serves the public interest. Contracts shall be awarded only on the basis of the "lowest responsive bid submitted by a bidder meeting established criteria of responsibility."²¹ At the same time, the statute states:

No requirement or obligation shall be imposed as a condition precedent to the award of a contract to such bidder for a project, or to the Secretary's concurrence in the award of a contract to such bidder, unless such requirement or obligation is otherwise lawful and is specifically set forth in the advertised specifications.²²

The FHWA regulations require federal approval of any state prequalification requirements that will be applied in a federal-aid project.²³ The regulations further provide that there shall be no approval of qualification procedures that operate to restrict competition or prevent submission or consideration of bids by any responsible contractor.²⁴ "No contractor shall be required by law, regulation, or practice to obtain a license" before it may submit in a federal-aid project bid or have that bid considered.²⁵ As a result, some states exempt federally-funded transportation construction contracts from their state licensing requirement.²⁶ However, this

prohibition does not prevent states from requiring the successful bidder to obtain a business or professional license upon the award of a contract.²⁷ This rule is based in part on the constitutional doctrine that states may not subject nonresident contractors to requirements that impede their bidding and so create a barrier to Interstate commerce. However, it also reflects the practical consideration that licensing serves no purpose in the bidding phase of a public works project. Federal regulations permit states to apply this requirement to both resident and nonresident contractors bidding on federal-aid highway projects.²⁸

Federal regulations also require that states must allow sufficient time between the call for bids and the opening of bids.²⁹ This allows all potential bidders an opportunity to be prequalified after a full and appropriate evaluation of the contractor's experience, personnel, equipment, financial resources, and performance record.

In recognition of federal regulations designed to foster competition, and of the fact that contractors on federal-aid highway construction projects are everywhere subject to prequalification or postqualification requirements, states may accord special status to federal-aid highway contracts under their licensing laws. Idaho's Public Works Contractors License Act, for example, states:

It shall be unlawful for any person to engage in the business or act in the capacity of a public works contractor within the state without first obtaining and having a license. . . . No contractor shall be required to have a license under this act in order to submit a bid or proposal for contracts for public works financed in whole or in part by federal aid funds, but at or prior to the award and execution of any such contract by the state of Idaho, or any other contracting authority mentioned in this act, the successful bidder shall secure a license as provided in this act.³⁰

2. State Laws and Regulations Relating to Licensing of Public Works Contractors

By requiring persons who engage in public works construction to first obtain a license for this business, public agencies have an opportunity to screen applicants to assure that they have professional competence and other characteristics that favor high standards of workmanship and business integrity. Generally, these

²⁰ 70 A.2d at 623.

²¹ 23 U.S.C. § 112 (2001).

²² 23 U.S.C. § 112(b)(1) (2001).

²³ 23 C.F.R. § 635.110(a) (Apr. 1, 2002).

²⁴ *Id.*

²⁵ 23 C.F.R. § 635.110(c).

²⁶ MISS. CODE § 31-3-1(c) (2000).

²⁷ 23 C.F.R. § 635.110(c); *see also* 29 DEL. CODE § 6923(d) (contractor is required to have Delaware business license prior to execution of public works contract); *Thompson Elects. Co. v. Easter Owens/Integrated Systems, Inc.*, 702 N.E.2d 1016, 1020, 301 Ill. App. 3d 203, 234 Ill. Dec. 362 (Ill. App. 1998) (county did not abuse its discretion in accepting lowest bid even though bidder was not licensed in the state; decision was based on bidder's experience, its prequalification approval, and the fact that the bid specifications did not require a license prior to contract execution).

²⁸ 23 C.F.R. § 635.110(a) (Apr. 1, 2002).

²⁹ 23 C.F.R. § 635.110(c) (Apr. 1, 2002).

³⁰ IDAHO CODE § 54-1902 (2000, 2002 Supp.).

laws are completely separate in their operation from highway agencies' contractor qualification procedures, but in several states the licensing of contractors operates as part of the qualification process. A listing of state contractor licensing laws is included in Appendix D.

Some states' statutes make the undertaking or overseeing of construction work in violation of a contractor's licensing law a misdemeanor.³¹ Penalties for such violations generally consist of fines, although some states specifically authorize injunctions to restrain unlicensed persons from engaging in public works contracting.³²

Contractor licensing laws and rules are necessary parts of the public's defense against unreliable, fraudulent, and incompetent work.³³ Accomplishment of this objective has been held to require that the regulatory penalties apply as consistently to licensed contractors who undertake work beyond the scope of their licenses as to those who are unlicensed for any type of construction work.³⁴ Conditions of the license must be met regardless of any inconsistent arrangements made between private parties, even though the convenience of the construction process may be served by them.³⁵ While recognizing that strict adherence to licensing requirements limits the flexibility often desired by contractors to improvise responses to unforeseen construction problems, courts are very reluctant to relax compliance standards.³⁶

Although licensing laws may provide that intentional failure to comply is punishable as a misdemeanor, a parallel deterrent is the doctrine that courts will not enforce claims of contractors who do not comply with licensing laws.³⁷ This rule may be applied to defeat the

entire contract as being illegal where entered into by an unlicensed contractor.³⁸ It may also be applied to limit the right of recovery by a licensed contractor to the dollar limit of the work that the license authorizes it to undertake. Application of contractor licensing laws to bar an unlicensed contractor's action against a state has been held not to constitute a taking of property without due process of law.³⁹ The failure of the contractor to obtain the required license prior to the start of the work cannot be cured; a subsequently obtained license does not validate the contract.⁴⁰ However, where an individual corporate officer was licensed, even if the corporation was not, a state court did enforce the contract rather than create a windfall to the owner for the completed but uncompensated work.⁴¹ Most states require that the contractor be licensed at the time of contract execution, but do not require that it be licensed at the time of bid submission, opening, or award.⁴²

Parties may choose to voluntarily comply with the terms of a contract with an unlicensed contractor. A court may enforce an arbitration award in favor of an unlicensed contractor.⁴³ Also, an unlicensed contractor may be able to recover actual documented expenses in a court of equity, upon a showing of clear and convincing proof of those expenses, even though the court will not allow recovery in quantum meruit.⁴⁴

With only a few exceptions, contractor license fees are set at levels needed to defray, at least in part, the expenses of administering the regulatory features of the law.⁴⁵ Principles of tax equity apply, and have been

³¹ IDAHO CODE § 54-1920 (2000; 2002 Supp.), FLA. STAT. 489.127(2) (2001).

³² *State v. Summerlot*, 711 So. 2d 589, 592 (Fla. App. 1998) (contractor was criminally liable for contracting without a license).

³³ *Northwest Cascade Constr. Inc. v. Custom Component Structures*, 8 Wash. App. 581, 508 P.2d 623, 626 (1973), *modified*, 83 Wash. 2d 453, 519 P.2d 1 (1974); *Scientific Cages, Inc. v. Banks*, 81 Cal. App. 3d 885, 146 Cal. Rptr. 780, 781 (1978).

³⁴ *Alan S. Meade Assoc. v. McGarry*, 315 S.E.2d 69, 71-72 (N.C. App. 1984).

³⁵ *Hagberg v. John Bailey Contractor*, 435 So. 2d 580 (La. App. 1983) (where a contractor who was duly licensed to do business in his own name undertook to assist a street paving contractor by acting under the latter's name, court held that he acted as an unlicensed contractor, because the licensing law required him to do business only under the name by which he was licensed).

³⁶ *Scientific Cages, Inc. v. Banks*, 81 Cal. App. 3d 885, 146 Cal. Rptr. 780, 781 (1975).

³⁷ *Brady v. Fulghum*, 308 S.E.2d 327, 330 (N.C. 1983); *White v. Miller*, 718 So. 2d 88 (Ala. App. 1998) (unlicensed contractor could not recover under contract or quasi-contract, nor could it file a mechanics lien for work that required a contractor's license because contracts entered into by unlicensed contractor, whether express and implied, are void); *Fisher*

Mechanical Corp. v. Gateway Demolition Corp., 669 N.Y.S.2d 347, 247 A.D. 2d 579 (N.Y. App. 1998) (an unlicensed plumbing subcontractor could not recover in breach of contract action against general contractor on transit project even though the general contractor knew that the subcontractor was not licensed); *Cevern, Inc. v. Ferbish*, 666 A.2d 17, 22 (D.C. App. 1995) (no recovery in quantum meruit for unlicensed contractor); *see also* FLA. STAT. § 489.128 (2001).

³⁸ *See White v. Miller*, *supra* note 37.

³⁹ *Cameron v. State*, 15 Wash. App. 250, 548 P.2d 555, 557 (1976) (contractor sought recovery of bid bond and cost of parking lot construction).

⁴⁰ *Jenco v. Signature Homes, Inc.*, 468 S.E.2d 533 (N.C. 1996).

⁴¹ *Berkman v. Foley*, 709 So. 2d 628 (Fla. App. 1998).

⁴² *Thompson Elects. Co. v. Easter Owens/Integrated Systems, Inc.*, 301 Ill. App. 3d 203, 234 Ill. Dec. 362, 702 N.E.2d 1016 (1998).

⁴³ *Davidson v. Hensen*, 135 Wash. 2d 112, 954 P.2d 1327, 1331 (1998).

⁴⁴ *Roberts v. Houston*, 970 S.W.2d 488 (Tenn. App. 1997); *see also Cevern, Inc. v. Ferbish*, 666 A.2d 17 (D.C. App. 1995) (no recovery in quantum meruit even where contractor had complied with all licensing requirements except paying for the license).

⁴⁵ *See Lite House, Inc. v. North River Ins. Co.*, 471 S.E.2d 166 (S.C. 1996) (license bond was intended to apply toward health and safety concerns and not to cover supplier for non-payment of materials).

tested in cases where licensees pay differing rates according to classifications described in the law. Delaware's law provides that nonresident contractors must pay fees for each job performed, while resident contractors pay only a single annual license fee. A court held that this rate structure was not unconstitutional, despite the fact that nonresidents might pay considerably more fees annually than residents would.⁴⁶

a. Comparison of State Legislation

The structure and much of the content of state laws for licensing of public works contractors reflect general agreement on what these laws should try to accomplish, and how this can best be done. A comparative summary of these laws is given in Appendix C.

Some state legislatures have chosen to establish special bodies or boards to administer licensing requirements, and have delegated to them substantial rule-making authority for working out procedures and standards to assure that applicants have professional competence and other requisites. The separate status of these boards provides a degree of independence, which is considered important for impartial processing of license applications and administering disciplinary actions. As a result, little or no suggestion of favoritism or abuse of discretion in the issuance of licenses has occurred in the history of these laws. Coupled with provisions for formal review and appeal to the courts when rulings of the board are disputed, these laws have not been challenged on the constitutional sufficiency of their structure.⁴⁷

b. Scope of the Licensing Requirement

Statutory definitions of contracting agree in substance that a contractor is one who, for a fixed fee, commission, or other form of compensation except wages, undertakes, oversees, or bids to undertake the construction, alteration, repair, improvement, removal, or demolition of a building, highway, bridge, road, street, railroad, or other structure.⁴⁸ The licensing requirement may be limited to instances of this activity where the monetary value of the contract exceeds a stated minimum figure.⁴⁹

A number of other exemptions also appear in state contractor licensing laws. Typically, no contractor's license is required for the following:

- Public utilities engaged in construction, repair, or alteration of their own facilities.⁵⁰
- Duly licensed engineers and architects acting solely in their professional capacity.⁵¹

⁴⁶ American Paving Co. v. Director of Revenue, 377 A.2d 379 (Del. Super. 1977).

⁴⁷ See NETHERTON, *supra* note 1, at 1057.

⁴⁸ See, e.g., FLA. STAT. § 489.105(3) (2001).

⁴⁹ See IDAHO CODE § 54-1903(i) (2000).

⁵⁰ Westinghouse Elec. Corp. v. Rhodes, 97 Ariz. 81, 397 P.2d 61 (1964).

⁵¹ FLA. STAT. § 489.103(11) (2001).

- Persons engaged in building, altering, or repairing residential structures on their own property.⁵²

- Construction, alteration, or repair of structures on land owned by the federal government.⁵³

- Installation of products that are not actually fabricated into and become permanent parts of a structure.⁵⁴

- Mowing and litter removal on highways.⁵⁵

Judicial interpretation has also refined the legislative definition of the scope of these laws. Thus, where a person furnished equipment and labor on a day-to-day basis for construction of an industrial structure, he was not regarded as a contractor under the state's licensing act.⁵⁶ In the court's view, the statute's purpose was to insure the quality of contractors' work. For the license requirement to apply to a contractor, its role in a project must be a substantial one, both in terms of its size and its influence on the work performed.⁵⁷ Also, where the two entities that made up a joint venture were each licensed, no separate license was needed for the joint venture.⁵⁸

Consistent with their purpose to protect the public against unreliable, incompetent, or fraudulent construction practices generally, statutes requiring licensing of construction contractors describe the objects of their regulation in broad and inclusive terms. As a result, much of the litigation involving these laws is concerned with interpreting statutory definitions of the term "contractor." This has called for making distinctions between contractors and their employees. It also requires distinctions between general contractors and others performing the functions of subcontractors, material men, lessors of equipment, and fabricators of manufactured products used as fixtures.⁵⁹

In their interpretation of contractor licensing laws, the courts have distinguished between contractors and their employees according to the extent to which they

⁵² *But see* City of Seattle v. State of Wash., 965 P.2d 619, 136 Wash. 2d 693 (1998) (city program that used unemployed homeless adults to upgrade lighting fixtures in low income housing units violated state requirement for electrical contractor's license).

⁵³ IDAHO CODE § 54-1903(f) (2000).

⁵⁴ IDAHO CODE § 54-1903(d) (2000).

⁵⁵ Clancy's Lawn Care and Landscaping v. Miss. State Board of Contractors, 707 So. 2d 1080 (Miss. 1997).

⁵⁶ Messina v. Koch Indus., 267 So. 2d 221, *writ issued*, 263 La. 620, 268 So. 2d 678 (1972).

⁵⁷ See Vallejo Dev. Co. v. Beck Dev. Co., 24 Cal. App. 4th 929 (Cal. App. 1994) (execution of contract and exercising administrative and oversight functions is acting in the capacity of a contractor, thus licensing requirement applied); Interstate Commercial Building Services, Inc. v. Bank of America, 23 F. Supp. 2d 1166 (D. Nev. 1998).

⁵⁸ J. Caldarrera & Co. v. Hospital Service District, 707 So. 2d 1023 (La. App. 1998).

⁵⁹ See Farwest Steel Corp. v. Mainline Metal Works, Inc., 48 Wash. App. 719, 741 P.2d 58, 60, *review denied*, 109 Wash. 2d 1009 (1987) ("subcontractor" is one who takes from the prime contractor a specific part of the work, distinguished from materialman).

share in (1) determining the nature of the work to be done, (2) deciding on methods to be used, and (3) supervising the work. Therefore, in considering whether one who furnished a backhoe and operator must obtain a contractor's license, the court was persuaded he should not, because he was told by others where to dig, when to come to work, and what degree of care was needed, and the work was supervised by representatives of other contractors at the work site.⁶⁰

In contrast, where one has control over the manner in which details of the work are accomplished, purchases materials and equipment, hires labor, and supervises the construction process, one is subject to the licensing requirement. This is true notwithstanding that he or she is called an employee, and that the employer makes suggestions as to these matters and coordinates various parts of the total project.⁶¹

Where decision-making authority is divided, or is exercised jointly, the criterion of control must be applied cautiously. Even when the decisions of one are limited chiefly to accepting construction plans and specifications that another has been hired to prepare and supervise, both may be regarded as general contractors so as to require them to obtain licenses.⁶²

By the same criterion of control, one who undertakes to supply labor and materials to a general contractor may also be treated as a contractor. Where an entity was engaged in supplying temporary laborers to licensed contractors, retaining all payroll functions and ability to determine wages, that company was subject to contractor licensing requirements.⁶³ In another case, Arkansas' contractor licensing law was applied to a materials and labor subcontractor on the grounds that it had agreed to (1) do work to the owner's satisfaction, (2) indemnify the owner and general contractor for any claim resulting from the subcontractor's fault, (3) do work according to the owner's plans and specifications and be responsible for work and materials, and (4) restore damaged work.⁶⁴

Where employee status is not at issue, liability under construction contractor licensing laws may turn on how directly and substantially one's work contributes to the construction process and project result. One who merely supplies goods for others to install, or whose products are not permanently attached to a structure, has regularly been held not to be a contractor within the terms of the licensing law. The same applies to lessors of construction equipment.

The distinction between contractors and manufacturers of fabricated items used in highway construction or operations has been presented in various situations involving on-site assembly and installation of fixtures. The California court's approach to this problem is illustrated in *Walker v. Thornsberry*, where a general contractor purchased prefabricated metal restrooms from a manufacturer, to be delivered to the construction site and bolted to a concrete foundation furnished for them by the purchaser.⁶⁵ Plumbing, electrical hook-ups, roofing, and painting were to be done by the general contractor or other subcontractors. On these facts, the court held that the manufacturer was not engaged in construction that required obtaining a contractor's license. Its contribution to the finished construction project was "at most minor and incidental," and not sufficient to make the items installed a fixed part of the structure being built.

The test used by the California court in *Walker v. Thornsberry* may have different results in other circumstances. For example, where a sprinkler system and mounting for a sign were buried in the ground, and there was excavation and construction of concrete dug-outs, the court held that these actions constituted construction within the purview of the contractor licensing law.⁶⁶

Painting must always be considered carefully according to its particular circumstances. Often it is entirely incidental to the construction process, where in other cases it adds something necessary to the structure. Moreover, painters frequently have almost complete control over the way their work is done. In such cases, painters may be considered contractors for licensing purposes.⁶⁷

Contractor licensing laws may restrict their scope only to certain types of construction contracting. In the case of a contract to excavate and dispose of earth and rock, and to reclaim land at a sanitary landfill site, an Idaho court applying the state's licensing statute held that the work could be regarded as public works construction within the purview of the statute, even though no structures were involved in the project.⁶⁸

c. Examinations and Criteria for Licensing

State contractor licensing laws generally require applicants to submit statements regarding their qualifications with their license applications. Thereafter, applicants may be required to take oral and/or written examinations, or submit to a background investigation by the licensing board, in order to fully establish compliance with licensing criteria.

⁶⁰ *Dahl-Beck Electric Co. v. Rogge*, 275 Cal. App. 2d 893, 80 Cal. Rptr. 440 (1969).

⁶¹ *Campbell v. Smith*, 68 N.M. 373, 362 P.2d 523 (1961).

⁶² *Harrell v. Clarke*, 325 S.E.2d 33 (N.C. App. 1985).

⁶³ *Personnel Temp. Services v. W. Va. Division of Labor, Contractor Licensing Bd.*, 197 W. Va. 149, 475 S.E.2d 149, 153-54, 197 W. Va. 149 (W. Va. 1996).

⁶⁴ *Bird v. Pan Western Corp.*, 261 Ark. 56, 546 S.W.2d 417 (1977).

⁶⁵ 97 Cal. App. 3d 842, 158 Cal. Rptr. 862 (1979).

⁶⁶ *E.A. Davis Co. v. Richards*, 120 Cal. App. 2d 238, 260 P.2d 805 (1953).

⁶⁷ 19 A.L.R. 3d 1407, 1418

⁶⁸ *McKay Constr. Co. v. Ada County Bd. of County Comm'rs*, 99 Idaho 235, 580 P.2d 412 (1978).

Statements of criteria for licensing vary considerably in their details. Essentially they focus on the question of whether a contractor appears to have the ability to make practical applications of its knowledge of general contracting, and whether it has a good reputation for conducting business. Technical competence as a contractor must be shown in such matters as ability to read plans and specifications, estimate costs, and apply construction methods. Professionalism generally is also tested by reference to an applicant's knowledge of construction ethics and of the state's laws and regulations relating to construction, health, safety and liens, and the applicant's record in the business community.⁶⁹

3. State Practice Regarding Prequalification of Bidders

The process and standards for a state's contractor qualification system may not be fully set forth in its statutes. Some of the law relating to prequalification is in the form of administrative regulations and the related policy directives of the state transportation agency's governing body.⁷⁰ See Appendix E for statutes and regulations relating to qualification of bidders for state transportation agencies.

The question of whether specific enabling legislation is necessary to authorize and guide such administrative action arose relatively early in the history of prequalification. Generally this was satisfactorily resolved by reference to the language of the state transportation agency's authority for awarding construction contracts. There was considerable support for the view that the power to impose prequalification requirements may be implied in performing the statutory duty to select the lowest responsible bidder.⁷¹

However, the earliest court decisions on prequalification dealt with this matter in a way that inspired most public officials to desire some statutory authority for their system even though it might not be absolutely necessary. Statutory authority for a local school board to require prequalification was at issue in *J. Weinstein Building Corp. v. Scoville*.⁷² On its own resolution, the board required prospective bidders on its construction contracts to submit evidence of their qualifications before receiving copies of the project plans. The only state statute involved required that the contract be awarded

to "the lowest responsible bidder furnishing security as required by the board." The court held that this did not authorize the prequalification requirement, saying that it required legislative authority.⁷³

The critical issue for legislation is that it provide all the elements that courts have suggested are essential to assure fairness among bidders and promote competition. In this regard, seven main elements comprise the prequalification systems that typically apply to the states' transportation construction contracts.

1. Authority for establishment of prequalification requirements.
2. Definition of the scope of application of the requirements.
3. Designation of the agency responsible for certifying contractor qualification.
4. Description of the evidence of qualification to be submitted to the certifying agency, and procedure therefor.
5. Description of the criteria for evaluating contractor qualification.
6. Establishment of a system of classification for contractors, and methods for rating contractor qualifications.
7. Establishment of bases for revocation or disqualification of contractors' certification, and procedures for review or appeal of such actions.

a. Designation of Responsible Agency

Except where it is part of licensing public contractors, prequalification for highway construction contracts is the responsibility of the state agency that awards those contracts. In those states that combine prequalification with licensing, the licensing agency examines and certifies bidder applicants for the particular classes of work and assigns the capacity ratings it deems them qualified for.

In the majority of states, enabling statutes provide merely that the prequalifying agency shall be the state transportation agency. Taken literally, this may be open to the objection that possible favoritism may exist because the contract-awarding agency is in a position to control who may bid. Therefore, the regulations governing prequalification may specify that certification shall be by or on the recommendation of a separate committee or board appointed for this purpose by the chief administrative officer or governing body of the highway agency. Judicial approval of the use of these advisory bodies to evaluate contractor qualifications has encouraged the adoption of this approach as an alternative to spelling out standards and procedures in excessive detail in enabling legislation.⁷⁴

⁶⁹ See, e.g., IDAHO CODE § 54-1910 (2000, 2002 Supp.).

⁷⁰ Pursuant to the requirements of the Administrative Procedure Act (APA) in most states, prequalification requirements are rules of general applications that should be adopted in compliance with the APA, rather than being merely included in standard specifications or statements of agency policy. See *Department of Transp., State of Fla. v. Blackhawk Quarry of Florida, Inc.*, 528 So. 2d 447, *review denied*, 536 So. 2d 243 (1988), for a discussion of what type of procedure must be adopted as a rule under the APA rather than included as a contract specification that is not subject to the APA's procedures.

⁷¹ See Netherton, *supra* note 1, at 1050, 1055.

⁷² 254 N.Y.S. 384, 388, 141 Misc. 902 (Sup. Ct. 1931).

⁷³ *Id.*

⁷⁴ See *Harris v. City of Phila.*, 299 Pa. 473, 149 A. 722 (1930).

b. Scope of Requirements

Where limits are placed on the requirements for prequalification of contractors, they generally are stated in terms of minimum amounts of the contracts involved. Also, the prequalification requirement may be impliedly removed for emergency construction work where that work is statutorily exempt from competitive bidding.

Previous qualification in another state generally is considered in evaluating an applicant's experience and past record of performance, but with the single exception of the District of Columbia, out-of-state qualification is not accepted as an alternative to compliance with prequalification requirements.⁷⁵

State laws and policies on prequalification of subcontractors vary. Those that favor subcontractor prequalification point out that the need to assure competency and responsibility in construction work is as great in regard to subcontractors as for prime contractors.⁷⁶ One benefit is that prequalification of subcontractors may assist prime contractors in locating potential subcontractors whose work record and financial condition have been documented and evaluated by the agency. Also, where specialty work is contracted for separately, the same specialty contractor may bid as a prime contractor on one project and appear as a subcontractor in another.

These benefits have a practical price for the public works agency that must process the additional volume of subcontractor applications, annual reports, and other paperwork. Specialty contractors include a high proportion of small businesses, of which a certain number may have only minimal experience and capitalization. Transportation agencies may conclude that they cannot effectively monitor the number or range of specialty businesses that may wish to be prequalified, and may prefer instead to let the public interest be protected by the diligence of the prime contractor, backed up by its surety bonding company, each of which has a direct interest in seeing that the contract is performed satisfactorily.

Administration of prequalification programs, regardless of their scope, needs good working definitions of subcontractors for the variety of situations in which it may be necessary to distinguish them from other parties in the construction process. The distinction between subcontractors and employees is one that must

be made frequently. This was an issue in *Ro-Med Construction Company v. Clyde M. Bartly Co.*⁷⁷ Under Pennsylvania's regulations, contractors on state highway projects were required to use only subcontractors currently prequalified and classified by the DOT. The subcontractor had arranged to have its payroll carried by the prime contractor, and its key personnel listed with nonexistent job titles on the prime contractor's employee list. The genuineness of this apparent employee relationship was further brought into question by evidence of how labor actually was hired and supervised for the project in question. The court concluded that the doubtful employee-subcontractor relations precluded summary judgment on the legality of the contract under the department's prequalification regulations.

Distinctions may also have to be made between subcontractors and fabricators or suppliers of materials and structural units at work sites. Such cases generally turn on whether the party in question performs a substantial part of the contract as a "distinct part of the work" in such a way that it does not contemplate merely furnishing materials or supplying personal service.⁷⁸

When legislation specifies standards to be applied in prequalification, strict construction of the statutory language may limit what a contracting agency can do to modify or change its procedures. Even where emergencies occur, courts are wary of allowing any administrative modification of standards or procedures that may exceed delegated authority. This was the result where the WSDOT attempted to direct the manner in which temporary measures would be taken while a major bridge was being replaced, and included this in the standards for prequalification of bidders on the project.⁷⁹ WSDOT decided that a temporary floating structure should be installed to allow traffic operations to be maintained on a state highway while a permanent bridge for the highway was being built at a nearby location. WSDOT had had success with the design and methods used by a particular contractor, and when it published its notice for bids, it modified its usual prequalification criteria to require bidders to show "necessary experience, organization and technical qualifications to design and construct floating structures," and to provide "evidence of previous successful use...of the proposed floating bridge configuration."⁸⁰ The proposed configuration, as set forth in the bid specifications, essentially described the methods used by a particular contractor who had done previous work on floating bridges. Under the published criteria, that contractor

⁷⁵ While acknowledging savings of time and effort in processing certifications, the Department of Transportation noted that if certification by one state must be accepted by others on full faith and credit, it would be possible for fronts and firms of marginal eligibility to seek certification in states with the least effective programs for screening out ineligible businesses. This type of "forum-shopping" is not consistent with the objectives of the program. See 49 C.F.R. §§ 23.51, 23.53, and comments in 48 F.R. 33440 (July 21, 1983).

⁷⁶ See 30 DEL. CODE ANN. §§ 2502(a) (2001); PG Constr. Co. v. George & Lynch, Inc., 834 F. Supp. 645 (D. Del. 1993).

⁷⁷ 411 A.2d 790 (Pa. Super. 1979).

⁷⁸ See, e.g., *Druml Co. v. Knapp*, 6 Wis. 2d 418, 94 N.W.2d 615 (1959).

⁷⁹ *Manson Constr. and Eng'g Co. v. State*, 24 Wash. App. 185, 600 P.2d 643 (1979).

⁸⁰ 600 P.2d at 645.

was the only one qualified to bid, and other interested bidders appealed WSDOT's denial of their prequalification.

The court viewed WSDOT's action as inconsistent with the policy that public contracts must be awarded through competitive bidding. The court held that this policy already was limited by the prequalification standards contained in the state law, and that any attempt to introduce further limitations administratively must be solidly based on legislative authority.⁸¹ Admittedly, this put WSDOT in a difficult position, since its need to replace a major bridge destroyed by storm was both critical and immediate. Under the circumstances, WSDOT concluded that it did not have time to prepare a detailed bridge design and perform the customary engineering analysis before putting it into operational use. Therefore, it selected a solution that already had been demonstrated as safe for public use, and made the previous successful use of that design a requirement for prequalification of bidders. Notwithstanding this rationale, the court held that WSDOT lacked statutory authority to include an additional prequalification requirement, noting that "[b]y choosing to eliminate competent bidders at the prequalification stage, the salutary effect of truly competitive bidding was lost."⁸²

c. Evidence of Qualification

Current practice has achieved a substantial degree of standardization regarding the types of evidence contractors must submit to show their qualifications, and the format for their presentation. This result is due mainly to early efforts of the American Association of State Highway and Transportation Officials (AASHTO) and the Associated General Contractors (AGC) to develop uniform definitions for the items of information that were considered to be the minimum necessary to permit reliable contractor prequalification.⁸³ While most states adhere to a standard request for financial information and history of other projects, some states do have additional information requirements.

Practice varies regarding the necessity for an applicant's financial statement to be prepared by a certified public accountant. Regardless of this requirement, the evidence submitted by an applicant to document its qualifications is subject to verification by the state.⁸⁴ However, the agency is not necessarily required to do its own investigation of the contractor's financial status if its submission is incomplete.⁸⁵

Contractor prequalification statements, questionnaires, and related documents may be treated as confi-

dential information by the state officials who receive and handle such documents, so long as disclosure is not required under public disclosure laws.⁸⁶

Once they are determined to be prequalified bidders by the highway agency, contractors are periodically required to give evidence of their continuing eligibility for this status. Generally, this is done annually by submitting information on work performed during the previous year, an updated financial statement, and a description of current personnel and equipment. In addition, transportation agency regulations customarily require prequalified contractors to promptly notify the agency of any significant changes in their circumstances that might affect their capacity to perform work for which they have been prequalified. This requirement may be in general terms, or it may be particularized by referring to information called for in the agency's prequalification questionnaire.⁸⁷

Where joint venture bids are planned, the general rule is that all the joint venturers must be prequalified separately, although the combined current capacity of all may be used to determine whether the joint bid will be accepted and considered.⁸⁸ In this matter the desires of the joint venturers regarding the percentage of a contract to be charged to the capacity of each of the parties are normally carried out in determining qualification. On the other hand, where two or more firms under the same ownership are combined for purposes of bidding, they are treated as a single entity for qualification and bidding.

The possibility that information obtained and relied on for prequalification of bidders may have secondary legal significance was raised in a Michigan court in *E.F. Solomon v. Department of State Highways and Transportation*.⁸⁹ This suit sought to recover liquidated damages withheld from a prime contractor for a work delay resulting from the insolvency of a subcontractor during the course of construction. Under the department's regulations, subcontractors as well as prime contractors were required to be prequalified and to submit evidence of their ability to carry out the work. The prime contractor had selected a paving subcontractor from the department's list of prequalified bidders.

Referring to these prequalification procedures, the plaintiff argued that a warranty of accuracy accompanied prequalification approval and listing by the department, and the plaintiff had reasonably relied on this implied warranty to his detriment. The plaintiff cited cases in which contractor claims were allowed because of reliance on erroneous information supplied by the agency.

⁸¹ *Id.* at 646.

⁸² 600 P.2d at 647.

⁸³ See NETHERTON, *supra* note 1.

⁸⁴ *Dep't of Labor and Indus. v. Union Paving & Constr. Co.*, 168 N.J. Super. 19, 401 A.2d 698 (1979).

⁸⁵ *Kimmel v. Lower Paxton Township*, 633 A.2d 1271 (Pa. Commw. 1993) (contractor's failure to include "assets page" was legally disqualifying error that could not be cured after bid opening).

⁸⁶ For example, Washington's Public Disclosure Act specifically exempts financial records submitted to the Department of Transportation for the purpose of prequalification. WASH. REV. CODE 42.17.310(1)(m).

⁸⁷ *E. Smalis Painting Co. v. Commonwealth*, Dep't of Transp., 452 A.2d 601 (Pa. Commw. 1982).

⁸⁸ See OHIO REV. CODE § 5525.03.

⁸⁹ 131 Mich. App. 479, 345 N.W.2d 717 (1984).

While the court might have distinguished these cases, because in each case the state knew the unreliability of the information given to its contractor, it elected instead to meet the issue of an implied warranty of accuracy squarely. It stated that prequalification procedures were “simply a mechanism by which defendant determined who would be allowed to bid on state highway projects,” and emphasized that recovery of claims based on misrepresentation of information generally depended on the state having previous knowledge of the prequalified bidders’ erroneous character, or else having failed to take appropriate precautions that would have revealed the error in time to avoid it or the consequences of relying on it. The court also cited the state constitutional prohibition against using the credit of the state as a guarantee or surety in favor of a private individual and declared that the contractor’s attempt to find an implied warranty of accuracy in the prequalification process would accomplish precisely what the constitution prohibited.

d. Classification of Contractors

The certifying agency generally has a twofold responsibility. First, it must determine what type of construction work each particular contractor is qualified to perform. Second, it must assign to the contractor a maximum limit on the amount of work it has the apparent capacity to perform successfully at one time. The former is generally referred to as a contractor’s “classification,” and the latter as its “rating.” Customarily, the prequalification statute or regulations establish a list of classes of work, and instruct applicants to indicate those classes for which they wish to be certified.

The validity of classification lists, whether statutory or administrative, is likely to depend on their having a reasonably close relationship to the way the transportation agency organizes and advertises work to be performed through contract. Classification lists vary in detail, but generally reflect agreement on certain broad categories of construction, such as excavation and grading, paving, structures, and specialty work of all types. Classification systems that use these categories are readily defensible against possible charges that the certifying agency may arbitrarily and unfairly exclude contractors from bidding on work they desire. Among the categories of work listed, valid distinctions generally can be made on the basis of the types and amounts of equipment needed, the amount of working capital involved in acquiring and processing materials, technical and managerial skills, and organization required. In addition, contractors are not restricted from requesting that they be qualified for new classes of work.

e. Contractor Capacity Ratings

Certification of a contractor’s eligibility to bid on public construction work normally includes an evaluation of its capacity to perform such work, and designation of its maximum limit in terms of the total dollar

amount of work that the contractor may have underway for the contracting agency at any one time. Capacity ratings are individual, and are based on analysis of the contractor’s disclosures regarding its current financial circumstances and other business information. Review of state laws and practices reveals several approaches to this analysis.

In some states, the entire function of rating contractors’ capacity is treated as a matter of judgment by the contracting agency. Evaluation of contractors’ capacity is based on statements of financial resources, experience, and organization. But inevitably, heavy reliance is placed on the contractor’s record of past performance with the agency, and on the safeguard that it must furnish various bonds to indemnify the agency for any default in performance.

A contrasting practice is illustrated in those states where legislation or administrative regulations set forth mandatory formulas for establishing maximum capacity ratings for prospective bidders. Coupled with standard definitions and uniform accounting procedures, these formulas promote systematic, uniform comparison of contractors’ financial resources and other performance factors with a minimum of personal judgment by the rating officer.

Most states determine capacity ratings in a two-stage process. Typically, an applicant contractor’s financial resources are initially rated to reflect its presumed ability to finance the construction work called for. Adoption of uniform accounting definitions and procedures permit formulas for financial ratings to become quite precise. But regardless of form, ratings are designed to measure financial responsibility by standards that have practical acceptance in the market place, where the contractor must compete for labor, materials, and technical skill.

Once financial resources are rated, an applicant’s maximum capacity rating is established by evaluating its financial condition in conjunction with other relevant factors: (1) the types and amounts of equipment available, (2) the background of key personnel and structure of the organization, (3) previous experience, and (4) record of performance. Application of these factors to the applicant’s current financial base may be through use of a multiplier number, or a percentage of a hypothetical perfect standard. Selection of a multiplier or other modifying factor may be based almost entirely on the judgment of the certifying officer, or upon judgment channeled to a prescribed set of factors.⁹⁰

f. Rating First-Time Bidders and Out-of-State Contractors

Because the rating systems described above cannot entirely avoid using judgment based on an applicant’s past performance, special problems arise in the evaluation of the capacity of new businesses bidding for the

⁹⁰ See NETHERTON, *supra* note 1.

first time and of contractors whose base of operations and work record are outside the state. Because neither type of contractor has established any record of performance with the certifying agency, they may be given ratings of limited capacity until they demonstrate the capacity and reliability of their work.

In the case of out-of-state contractors, the normal practice is to relate their rating to their previous out-of-state experience. For example, the policy of the WSDOT is to award out-of-state contractors an initial prequalification rating of 2.5 times the highest value of the work the contractor has completed within that work class during the past 3 years.⁹¹

Where the state does not have a formula for rating out-of-state contractors and first time bidders, it must rely on administrative judgment based on information obtained from other agencies. These may be found objectionable because they depend so largely on judgment rather than on objective methods of measuring capacity and competency. Agency judgments may restrict competition or deal unequally with segments of the construction contracting industry. There is no history of litigation challenging these limitations on bidding capacity, and the apparent acceptance of prequalification practice under these rating formulas is largely attributable to a combination of careful initial handling of applications and effective use of administrative appeal procedures in the resolution of disputed ratings.

g. Conclusiveness of Prequalification

Courts are divided on the question of whether an agency may give further consideration to a prequalified contractor's responsibility when it submits a bid. The Alabama Supreme Court has held that the fact that a contractor is prequalified does not necessarily represent a finding of responsibility when a bid is submitted.⁹² An Indiana appellate court has held that a bidder is a "responsible bidder" if it is capable of performing the contract fully, has integrity and reliability, and is qualified under the Indiana statute.⁹³

4. State Practice Regarding Postqualification of Bidders

The practices of Minnesota, New York, and Rhode Island are based on a policy that favors examining a bidder's competence, financial responsibility, and other qualifications only if it is the low bidder on a public works contract. The proponents of this practice argue that it serves the general objective of encouraging as many contractors as possible to bid on a given project, and assures that the lowest responsible and competent bidder is awarded the contract. They assert that

postqualification is more advantageous because it renders judgment on contractor capacity as near to the award of the contract as possible. Events can and do sometimes change a bidder's qualifications within a short time. If an apparent low bidder is postqualified, the most recent developments and current circumstances may be considered, and will assure the best evaluation. Also, for smaller agencies that do less construction, it may be more efficient to evaluate only the low bidder rather than all potential bidders.

Prequalification systems recognize the necessity of evaluating bidders in the light of their current circumstances and prospects. In many states prequalification procedures provide for updating information filed earlier. Advocates of postqualification point to this, however, as a case of duplicating the effort of both the bidder and the contracting agency.

In a New Jersey case, the court considered whether the New Jersey Highway Authority had discretion to use a postqualification process in a contract for towing services on state highways. In *Sevell's Auto Body Company, Inc. v. New Jersey Highway Authority*,⁹⁴ the state sought to enter into a contract for towing services on state highways. The provision in the specifications allowing postqualification of bidders was challenged. The court held that the specification did not conflict with the principle that a bidder may not agree to supply an essential element of its bid after bids are opened. Bidders were required to meet detailed standards on the bid submission date, and were required to submit with their bids a certification stating that they were in full compliance with those standards as of that date.

After low bidders for each zone were identified, they were asked to submit evidence of qualification. The court held that the agency's decision to use this method was an appropriate exercise of its discretion, in that it sought to minimize the administrative burden for itself and bidders while at the same time assuring that all bidders were competing on an equal basis.

B. LICENSE REVOCATION, DISQUALIFICATION, SUSPENSION, AND DEBARMENT OF CONSTRUCTION CONTRACTORS

1. License Revocation

Because a contracting license represents a valuable business interest, it cannot lightly be withdrawn once it has been issued.⁹⁵ One protection against arbitrary action by a licensing agency in most states is the inclusion in the licensing laws of the acts or circumstances

⁹¹ WASH. ADMIN. CODE § 469-16-120(5).

⁹² *Crest Constr. Corp. v. Shelby County Bd. of Educ.*, 612 So. 2d 425 (Ala. 1992) (citing ALA. CODE § 41-16-50).

⁹³ *Koester Contracting, Inc. v. Board of Comm'rs of Warrick County*, 619 N.E.2d 587 (Ind. App. 1993) (citing A.I.C. 36-1-12-4(b)(8)).

⁹⁴ 703 A.2d 948 (N.J. Super. 1997).

⁹⁵ Portions of this section are derived from *License and Qualification of Bidders* by Dr. Ross D. Netherton, and from *Suspension, Debarment, and Disqualification of Highway Construction Contractors* by Darrell W. Harp, published by the Transportation Research Board in 1976 and included in the first edition of SELECTED STUDIES IN HIGHWAY LAW.

that may be cause for suspension or revocation.⁹⁶ A second protection against arbitrary or unfair suspension or revocation is the existence of mandatory statutory procedures that apply whenever such actions are taken. In general, these require notice of the charges involved, a hearing with opportunity to explain and clear the charges, and a right of judicial review in the event the licensee disputes the licensing agency's ruling.

Suspension or revocation of a contractor's license for cause is a form of disciplinary action administered by the licensing agency. As such, imposition of this penalty has no effect on the contractor's civil liability, even where its failure to adhere to a statutory duty or to follow specifications provides the cause for revocation. The conditions upon which a license is granted are imposed for protection of the public, and are enforced solely through the administrative action of suspending or revoking the license. No civil cause of action by one who suffers injury arises from the licensing agency's action. Similarly, revocation of a contractor's license because of bankruptcy does not have any effect on the collection of claims.⁹⁷ Nor does revocation because of a contractor's violation of a labor law give rise to any claim by the employees involved.⁹⁸

Because severe sanctions and penalties may be involved in the disciplinary provisions of contractor licensing laws, courts have been reluctant to construe these laws more broadly than necessary to achieve the statutory purpose.⁹⁹ This policy is regularly tested in determinations of whether a contractor's actions or omissions bring its conduct within any of the statutory grounds for suspension or revocation of its contractor's license. Judicial interpretations of contractor licensing laws have refined the list of the leading causes of disciplinary action.

Whether specifically required by statute or not, fairness requires that disciplinary action by a licensing agency be based on a hearing, with opportunity for the licensee to explain or contradict the evidence being considered. Normally, such a hearing is held prior to issuing any suspension order so that premature or unwarranted penalties may be avoided. Statutory procedures may, however, provide that where public health or safety justifies it, a temporary suspension order may be issued prior to holding a hearing on the matter.¹⁰⁰

Where statutory lists of grounds for disciplinary action specify that misconduct must be willful, this intent

is an essential element of proof. However, intent may be inferred from the nature of the act.¹⁰¹

Closely related to these cases are others involving the adequacy of performance regarding project plans, specifications, and estimates, or other conditions of work.¹⁰² A case-by-case approach to disciplinary action on these grounds is necessary because of the wide variety of conditions involved, including the use of performance specifications and the use of change orders during the progress of work. In practice, construction rarely can be performed without some deviation from the original plans and specifications, and determination of whether deviations reach a point of violating the licensing standard requires consideration of all the circumstances.

In this process, the courts have developed and applied the doctrine of substantial performance by the contractor. As described by the court that adopted this doctrine in California, the guiding principle is that

[T]here is substantial performance where the variance from the specifications of the contract does not impair the building or structure as a whole, and where after it is erected the building is actually used for the intended purpose, or where the defects can be remedied without great expenditure and without material damage to other parts of the structure, but that the defects must not run through the whole work so that the object of the owner to have the work done in a particular way is not accomplished, or be sure that a new contract is not substituted for the original one, nor be so substantial as not to be capable of a remedy, and the allowance out of the contract price will not give the owner essentially what he contracted for.¹⁰³

A certain amount of leeway has been allowed in holding contractors to the requirement that a valid license must be maintained at all times when their work is in progress. Thus, where a contractor's license expired after 90 percent of a project had been completed, and the remaining work was actually completed under the supervision of licensed professional personnel, the court held that the contractor was in substantial compliance with the licensing law.¹⁰⁴ In contrast, where a contractor's license expired while work was in progress, but the licensee failed to act promptly to renew it or have a licensed manager supervise the remaining work,

⁹⁶ A summary of state statutes regarding grounds for contractor license revocation is found in Appendix C.

⁹⁷ *Tracy v. Contractor's State License Board*, 63 Cal. 2d 598, 407 P.2d 865, 47 Cal. Rptr. 561 (1965).

⁹⁸ *Lee Moor Contracting Co. v. Hardwicke*, 56 Ariz. 149, 106 P.2d 332 (1940).

⁹⁹ *Peck v. Ives*, 84 N.M. 62, 499 P.2d 684 (1972).

¹⁰⁰ *State ex rel. Perry v. Miller*, 300 S.E.2d 622 (W. Va. 1983).

¹⁰¹ *Bailey-Sperber, Inc. v. Yosemite Inc. Co.* 64 Cal. App. 3d 725, 134 Cal. Rptr. 740 (1976) (court rejected the argument that the willfulness of the action must be proved under the California statute).

¹⁰² *J.W. Hancock Enterprises v. Ariz. State Registrar of Contractors*, 142 Ariz. 400, 690 P.2d 119 (1984); *Mickelson Concrete Co. v. Contractors State License Board*, 95 Cal. App. 3d 631, 157 Cal. Rptr. 96 (1979).

¹⁰³ *Tolstoy Constr. Co. v. Minter*, 78 Cal. App. 3d 665, 143 Cal. Rptr. 570, 573-74 (1978) (citing *Thomas Haverty Co. v. Jones*, 185 Cal. 285, 197 P. 105 (1921)); *see also First Charter Land Corp. v. Middle Atlantic Dredging Co.*, 218 Va. 304, 237 S.E.2d 145 (1977).

¹⁰⁴ *Barrett, Robert & Wood, Inc. v. Armi*, 296 S.E.2d 10 (N.C. App. 1982).

the court held that was not in substantial compliance with the licensing law.¹⁰⁵ In another case, the contractor was entitled to maintain a claim against the state even though it had not complied with the requirements of a nonresident contractors' registration statute, where the contractor had obtained the required performance bonds that covered payment of state and local taxes and the contractor had substantially completed the registration process prior to completing the project.¹⁰⁶ A low bidder with a class A license but no class B license satisfied the license requirement for the project where the agency had delayed its opinion calling for a class B license for the project.¹⁰⁷

Courts have been less inclined to apply doctrines of forgiveness where violation of licensing standards appeared to be deliberate or willful. Deliberate action has been found in cases of alleged diversion of funds given to contractors for specific construction work, or misrepresentation of information in license applications or business dealings, or failure to pay bills for labor or materials.¹⁰⁸

Diversion of funds advanced to assist commencement of construction or other purposes is treated seriously by all licensing agencies. New Mexico's contractor licensing law, which makes diversion of funds a cause for revocation, has been described as "imposing a fiduciary duty upon contractors who have been advanced money pursuant to construction contracts."¹⁰⁹

Among the causes for disciplinary action listed in typical contractor licensing laws, one of the most difficult to apply is the rule that contractors must perform construction in a workmanlike manner, in accordance with the plans and specifications and reasonably within the agreed or estimated costs. Standards for workmanship may be provided specifically either in the contract plans and specifications, or in a trade or industry code applicable to the work in question. Where these sources do not furnish suitable guidance for disciplinary action, licensing agencies and courts have defined "workmanlike manner" as doing the work in an ordinarily skilled manner, as a skilled worker should do it by reference to established usage and accepted industry practices prevailing where the work is performed.¹¹⁰

Where the licensing statutes require that failure to follow plans and specifications must be willful or deliberate, evidence of intent may be inferred from the conduct of the parties. Thus, where willful departure from workmanlike standards was charged, the decision of

the licensing agency to discipline the contractor was upheld when it was shown that the contractor failed to install an acceptable slab of concrete, and then represented that he could correct the defect by a "pour-over" technique, which only made matters worse.¹¹¹ The court found that this "indicates a purposeful departure from accepted trade standards which may be properly characterized as 'willful.'"

The contractor's failure to perform work within the contract price or cost estimate is often associated with failing to follow plans and specifications. Cost overruns are sometimes listed among statutory reasons for license revocation. They may also be associated with incompetent or negligent performance, which are also well-recognized grounds for revocation or suspension. In addition, courts regularly apply an indirect penalty in some instances of cost overrun, by limiting contractor recovery to the dollar ceiling of its license.¹¹²

Although contractors are not often disciplined because of assisting in the evasion of licensing laws, this possibility is illustrated where a contractor permits its license to be used by unlicensed contractors on a project in which it does not actively participate.¹¹³

2. Disqualification or Denial of a Bid Proposal

Loss of eligibility to bid on transportation construction projects may result from various causes set forth in state laws or regulations relating to licensing, prequalification, and conflict of interest.¹¹⁴ Suspensions or other forms of withdrawal of eligibility are based entirely on statutory or administrative authority and procedures. They are construed strictly, as they are considered regulatory in nature. Also, disqualification of one or more major contractors may have the practical result of significantly reducing the number of contractors capable of performing certain types of construction, and thus may reduce competition.

Procedures for judicial review of administrative actions denying prequalification or disqualifying certified bidders are essential features of the states' licensing and prequalification systems. Courts have been divided on whether the interest acquired by a low bidder is a constitutionally protected property interest or a liberty interest.¹¹⁵ However, courts finding either basis for a

¹⁰⁵ *Brown v. Solano County Business Dev., Inc.*, 92 Cal. App. 3d 192, 154 Cal. Rptr. 700 (1979).

¹⁰⁶ *Dep't of Transp., State of Ga. v. Moseman Constr. Co.*, 260 Ga. 369, 393 S.E.2d 258 (1990).

¹⁰⁷ *City of Phoenix v. Superior Court*, 909 P.2d 502 (Ariz. App. 1995).

¹⁰⁸ *Fillmore Products, Inc. v. Western States Paving, Inc.*, 561 P.2d 687 (Utah 1977).

¹⁰⁹ *In re Romero*, 535 F.2d 618, 621 (10th Cir. 1976).

¹¹⁰ *J.W. Hancock Enterprises v. Ariz. State Registrar of Contractors*, 142 Ariz. 400, 690 P.2d 119 (1984).

¹¹¹ *Mickelson Concrete Co. v. Contractors State License Board*, 95 Cal. App. 3d 631, 157 Cal. Rptr. 96 (1979).

¹¹² *Compare Alan S. Mead & Assoc. v. McGarry*, 315 S.E.2d 69 (N.C. App. 1984) (recovery allowed up to license limit) *with Martin v. Mitchell Cement Contracting Co.*, 74 Cal. App. 3d 15, 140 Cal. Rptr. 424 (1977) (recovery allowed beyond license limit).

¹¹³ *Moore v. Fla. Constr. Industry Licensing Bd.*, 356 So. 2d 19 (Fla. App. 1978).

¹¹⁴ A summary of state statutes indicating grounds for disqualification, suspension, and debarment is found in Appendix F.

¹¹⁵ *See Pataula Elec. Membership Corp. v. Whitworth*, 951 F.2d 1238 (11th Cir. 1992) (holding that under Georgia law a bidder may have a property interest in the award of a public

constitutional right have held that the contractor is entitled to the protections of procedural due process before the bidder can be disqualified on the grounds that it is not responsible.

There are three types of adverse actions: (1) denial of an application for prequalification, or for a change in classification or rating; (2) disqualification of a bidder or rejection of its bid on a particular project; and (3) suspension or revocation of a prequalification certificate for cause.

The statutes and regulations governing prequalification procedures do not make clear distinctions between the bases for these three types of actions. Thus, a finding of “inadequate” financial resources or equipment, or “unsuitable” experience, may be specified as grounds for denial of an initial application, and may also sustain the refusal to consider a contractor’s bid in the event that the decisive information on these matters comes to the contracting agency’s attention prior to the actual award of a contract. For example, a firm’s filing for Chapter Eleven reorganization in bankruptcy was a rational basis for making a determination of lack of responsibility, since financial stability is a factor in contractor responsibility.¹¹⁶

Similarly, lack of satisfactory progress or performance on a previous construction job may be cited as grounds for disqualifying a bidder from consideration for another contract.¹¹⁷ This mixture is illustrated by the standard specification for issuance of a proposal by the Connecticut Department of Transportation:

The Commissioner reserves the right to disqualify or refuse to issue a proposal form to any individual, partnership, firm or corporation for reasons including, but not limited to any of the following:

- (1) For having defaulted on a previous contract.

contract); *LaCorte Electrical Const. and Maintenance, Inc. v. County of Rensselaer*, 574 N.Y.S.2d 647 (1991) (low bidder does not have a property right in the award of the contract, but has a liberty interest that requires procedural due process if the low bidder’s bid is to be rejected); *Triad Resources and Systems Holdings, Inc. v. Parish of Lafourche*, 577 So. 2d 86 (La. App. 1990) (lowest responsive bidder has protected interest in award of contract requiring procedural due process before the bidder may be disqualified as not responsible).

¹¹⁶ *Adelaide Envtl. Health Assocs. v. New York State Office of General Services*, 669 N.Y.S.2d 975, 248 A.D. 2d 861 (1998). Note that New York uses a post qualification system; however, this rule should apply regardless of when the responsibility determination is made. *See also Lewis v. State Dep’t of Business and Professional Regulation*, 711 So. 2d 573 (Fla. App. 1998) (failure to satisfy civil judgment was grounds for license revocation even though contractor had filed for bankruptcy; however, evidence that the debt had been discharged in bankruptcy would allow contractor license to be reinstated).

¹¹⁷ *State, Dep’t of Transp. v. Clark Constr. Co.*, 621 So. 2d 511 (Fla. App. 1993); F.S.A. §§ 339.16, 339.16(1)(b). Such a finding may also sustain the certifying agency’s suspension of that contractor’s classification and rating for a specified period of time.

- (2) For having failed, without acceptable justification, to complete a contract within the contract period.

- (3) For having failed to prosecute work in accordance with contract requirements.

- (4) For having performed contract work in an unsatisfactory manner.

- (5) For having failed to prosecute work continuously diligently and cooperatively in an orderly sequence.

- (6) For having failed to file with the Department a recent sworn statement on the form furnished by the Department fully outlining the capital, equipment, work on hand and experience of the bidder; such statement to be valid, must be on file with the Department at least 20 calendar days before application for a proposal form is made.

- (7) For filing a sworn statement with the Department which, in the Commissioner’s judgment, indicates that the bidder does not have the required experience in the class of work to be bid on, does not have the proper labor and equipment to prosecute the work within the time allowed, or does not have sufficient capital and liquid assets to finance the work.¹¹⁸

A number of states specifically provide for suspensions or revocations of prequalification classifications or ratings, and have set forth the grounds required in their regulations. Pennsylvania’s regulations illustrate this type of provision in requiring the preparation of a “past performance report” to be used in prequalification and responsibility determinations:

The past performance report shall include evaluation of a contractor’s attitude and cooperation, equipment, organization and management, scheduling and work performance. Poor or unsatisfactory ratings for specific work classifications shall constitute justification for revoking classifications previously granted. A contractor who has an overall unsatisfactory rating on performance reports will not be prequalified.¹¹⁹

Less specific, but apparently sufficient, is Kentucky’s regulation.

Upon receipt of information or evidence that a holder of a certificate of eligibility has failed to perform satisfactorily or adhere to the laws, regulations administrative or specifications applicable to a contract or a subcontract, the department [of highways] may take action to suspend or revoke the certificate of eligibility or reduce the maximum eligibility amount.¹²⁰

Contractors who are dissatisfied with rulings of certifying officials can, by timely request, have the ruling reconsidered by those officials or by the higher administrative authority that has ultimate responsibility for the prequalification process. In some states contractors

¹¹⁸ *Connecticut Department of Transportation, Standard Specifications for Roads, Bridges, and Incidental Construction, Form 815, § 1.02.02* (1995).

¹¹⁹ PA. CODE § 457.10(b) (1999).

¹²⁰ 603 KY. ADMIN. RULES 2:015 § 8(1) (Aug. 15, 2000).

enjoy a right to judicial review on the merits.¹²¹ Some courts, however, have refused to examine the issue of disqualification in the context of a bid protest challenging the award of the contract.¹²²

Administrative reviews of contractor classifications and ratings for possible reconsideration or revision are usually informal. They are directed entirely to reexamination of the grounds for the disputed action cited in the prequalifying agency's letter of notification to the contractor. These proceedings, however, give the applicant an opportunity to submit further evidence in support of its qualifications. Where prequalification boards or committees make the initial determination of classifications and ratings, requests for review may go to the director of the transportation department or to the state transportation commission.¹²³ A New York court held that before a bidder may be designated as not responsible, it must be notified of the agency's reasons for its finding of nonresponsibility and must be given an opportunity to appear before the agency and present information or evidence to rebut the agency's finding.¹²⁴

The actions of boards of review and other reviewing authorities are generally declared to be final by the laws or regulations creating them. However, some states confer on the aggrieved applicant an additional right of judicial review. Massachusetts' statute allows for both administrative review within the agency, and for judicial review of the administrative board's determination.

Any prospective bidder who is aggrieved by any decision or determination of the prequalification committee or the commissioner which affects his right to bid may file a new application for qualification at any time, or within fifteen days after receiving notice of such decision the applicant may request in writing a hearing before an appeal board to reconsider his application or qualifications.

....

Such hearing shall be deemed to be an adjudicatory proceeding, and any bidder or prospective bidder who is aggrieved by the decision of the appeal board shall have a right to judicial review under the applicable provisions of said chapter thirty A.¹²⁵

Ohio's code states that

Any applicant, other than one who has been debarred, aggrieved by the decision of the director may file a new application at any time for qualification or, within ten days after receiving notification of such decision, the applicant may request, in writing, a reconsideration of the

¹²¹ See, e.g. WASH. REV. STAT. 47.28.070 (denial of prequalification may be appealed within 5 days of determination).

¹²² D.A.B. Constructors v. State Dep't of Transp., 656 So. 2d 940, rehearing denied, (Fla. App. 1995); Sabre Constr. Corp. v. County of Fairfax, 501 S.E.2d 144 (Va. 1998).

¹²³ See HAW. REV. STAT. § 103D-702(a), which allows a bidder an opportunity to be heard before prequalification is denied.

¹²⁴ N.Y. State Asphalt Pavement Ass'n v. White, 532 N.Y.S.2d 690, 141 Misc. 2d 28 (1988).

¹²⁵ MASS. GEN. L. ch. 29, § 8B (West 2001).

application by a prequalification review board, which the director shall create within the department of transportation with the request for reconsideration, the applicant shall submit additional evidence bearing on the applicant's qualifications. The review board shall consider the matter and either may adhere to or modify the director's previous decision.¹²⁶

Whatever the limits of judicial review prescribed by statute, one court has held that the appellant contractor may not enlarge the scope of that review beyond that created by the statute by alleging facts outside the prequalification process.¹²⁷

3. Criminal Offenses

Most statutes that provide for prequalification of bidders use standards that measure a contractor's ability and capacity to perform contracts in various categories of construction. Typically, financial condition, equipment, experience, and organization are the indicators used to establish eligibility. However, other matters that may affect a contractor's responsibility, such as business honesty and integrity, may also become grounds for rejection of the bid of a properly prequalified low bidder, or may be grounds for suspension or debarment. In practice, it may be difficult to maintain the distinction between prequalification and the determination of a low bidder's responsibility. This is illustrated in a series of cases growing out of New Jersey's landmark decision in *Trap Rock Industries v. Kohl*.¹²⁸

The New Jersey Supreme Court's first decision in *Trap Rock Industries v. Kohl* involved suspension of previously qualified contractors.¹²⁹ Indictments had been returned charging criminal offenses by the contractors, and the Commissioner of Transportation ordered suspension of their classification pending final disposition of these charges. No proof of the charges was offered to the Commissioner prior to his order, and the contractors declined an opportunity to present evidence to the Commissioner concerning the matter. The trial court ruled that the suspension was unlawful in the absence of this evidence.¹³⁰ The New Jersey Supreme Court reversed the lower court and affirmed the suspension.

The appeal provided an opportunity to discuss two basic issues: (1) the relationship of prequalification actions to the Administrative Procedure Act and (2) the constitutional guarantee of due process of law. In addition to charging that the Commissioner acted without affirmative evidence concerning the truth of the indictments, the contractor claimed that the state's prequalification standards did not specify the misdeeds that would disqualify a bidder. Stressing the legislative

¹²⁶ OHIO REV. CODE § 5525.07 (2000 Replacement Vol.)

¹²⁷ *Enertol Power Monitoring Corp. v. State*, 108 Or. App. 166, 814 P.2d 556 (1991).

¹²⁸ 63 N.J. 1, 304 A.2d 193 (1973).

¹²⁹ 59 N.J. 471, 284 A.2d 161 (1971).

¹³⁰ *Trap Rock Indus. v. Kohl*, 115 N.J. Super. 278, 279 A.2d 138, *rev'd*, 59 N.J. 471, 284 A.2d 161 (1971).

mandate that the Commissioner retained the right and duty to reject bidders that were not the lowest responsible bidder, the court declared:

These cases do not involve the right to engage in business. The contractors are free to do business with anyone willing to deal with them. The question is whether the state must do business with them despite the Commissioner's view that the public interest would be disserved by doing so.¹³¹

The court continued:

We find nothing in this statute to evidence a legislative departure from the basic principle that bidding statutes are intended for the benefit of the taxpayer rather than the bidder or prospective bidder. The statute simply provides, so far as feasible, for a determination of qualification before bidding rather than after the bids are in. The opportunity for hearing afforded by this statute merely parallels the right to hearing after the bids are in which the more conventional bidding statutes contemplate. We find no purpose to vest in a preclassified bidder any "right" which derogates the primary right of the state...to do business...with "the lowest responsible bidder."¹³²

The court affirmed that the legislative concept of a responsible bidder included moral integrity as much as a capacity to supply labor and materials, and that citizens expected their public officials to do business only with people of integrity, whether as individuals or as officers of corporations. However, important as this element might be in certifying contractor qualifications, neither the prequalification statute nor the Administrative Procedure Act required that the state specify in its rules all the factual patterns constituting actionable lack of moral responsibility. The court found that it was not only infeasible to do so, but that it was more desirable to permit administrative definitions to evolve on a case-by-case basis. For this purpose, the concept of moral responsibility as spelled out in judicial decisions is constitutionally sufficient. The court stressed the distinction between this action of suspension and those involving revocation of a contractor's license to do business, and noted cases where the latter actions were properly required to comply with the standards of the Administrative Procedure Act.¹³³

A year later, the Department ruled that this suspension also made Trap Rock ineligible to serve as a supplier of materials to a prime contractor whose contract with a local government was funded in any part by the department. Trap Rock argued that prequalification of suppliers was not required by statute, and that to try to do so in all cases would entail great difficulty. The court

upheld the suspension, declaring that the contracting agency could not on those accounts "ignore what it learns about those who seek to do business directly with the state."¹³⁴

New Jersey's prequalification statute required applicants to answer a questionnaire regarding financial ability, prior experience, adequacy of plant and equipment, organization, "and such other pertinent and material facts as may be deemed desirable."¹³⁵ By its ruling on the suspension of Trap Rock Industries, the New Jersey court raised the question of whether information that customarily is used to determine responsibility and fitness to receive a contract award can also properly be relied on to suspend eligibility to bid on future contracts. The court's decisions affirmed that the Commissioner of Transportation could do this, and could later reinstate the contractor as a qualified bidder when satisfied that the reason for disqualification was removed.

These cases were followed by another that reported the issue of whether the same grounds used to stop work on a project could also sustain a decision to suspend the contractor's eligibility to bid on future contracts with the department.¹³⁶ In this instance, the department in effect reversed an earlier decision to reinstate the contractor's eligibility to bid, and imposed a new suspension on the ground that one of the individuals responsible for the earlier corporate criminal acts had not disassociated himself sufficiently from the corporation's management to insulate the corporation from his lack of integrity.

The court found no fault with the department's power to reconsider and modify prior determinations of eligibility when it appeared necessary to protect the public interest, or with the grounds cited to justify suspension of bidding eligibility. But on review of the department's action, the court found that the Commissioner relied on the evidence presented at a prior hearing, and decided to reimpose suspension by applying a contrary and speculative interpretation to the conclusion reached by the previous Commissioner on the same evidence. Warning that "the power to reconsider must be exercised reasonably, with sound discretion reflecting due diligence, and for good and sufficient cause," the appellate court held that, under the circumstances, the department's action was not sustained by the evidence.¹³⁷

¹³¹ 284 A.2d at 164.

¹³² 284 A.2d at 166.

¹³³ *Id.* at 167. In distinguishing the decision in *Gonzalez v. Freeman*, 334 F.2d 570 (D.C. Cir. 1964), the court suggested that where a specific act in itself is deemed sufficient to justify the adverse action, it should be specified in the administrative standards.

¹³⁴ 305 A.2d at 194.

¹³⁵ *Id.* (quoting N.J. STAT. ANN. § 27i7-35.3).

¹³⁶ *Trap Rock Indus. v. Sagner*, 133 N.J. Super. 99, 335 A.2d 574 (1975), *aff'd*, 69 N.J. 599, 355 A.2d 636 (1976).

¹³⁷ 335 A.2d at 580. However, this could also have been considered to be an abuse of discretion based on the officer's failure to consider new evidence; generally an officer's failure to exercise his or her discretion at all is an abuse of discretion.

4. Suspension and Debarment

Where prequalification statutes permit consideration of factors bearing on bidder responsibility as well as ability and capacity, prequalification and debarment tend to be used as complementary processes. Contractors' efforts to assert a right to do business with public agencies have succeeded in some states, and have resulted in some procedural limits on agency discretion in debarment actions.¹³⁸

Legislative authority for prequalification of bidders normally includes authority for the certifying agency to suspend or revoke a contractor's certification for various enumerated causes and "for other good cause."¹³⁹ Consistent with their basic approach to review of administrative actions, courts generally are not inclined to second-guess the decision of an executive agency on its merits in the absence of a showing of fraud, bad faith, or arbitrary action. Yet because prequalification directly affects the right to have one's bid considered for a contract award, disciplinary action that results in suspension or revocation of a bidder's eligibility is taken seriously by all interested parties. Recognizing that the right to engage in business has important economic consequences, courts have insisted that disciplinary actions against qualified bidders must be handled in accordance with rules that assure fairness and equal treatment. Actions must be taken in strict compliance with applicable statutes and administrative regulations.

This is illustrated in *White Construction Company, Inc. v. Division of Administration, State Department of Transportation*.¹⁴⁰ In that case the prequalifying agency notified a contractor of its temporary suspension by letter from the agency's Director of Road Operations, citing apparent failures to follow certain procedures on the work site and relying on statutory authority to suspend for good cause. In an action for mandamus to restore the contractor's bidding status, the Florida Supreme Court found that the agency's intended suspension was not effective because it was not issued by the Secretary of Transportation, as required by the statute.¹⁴¹

The court in *White Construction Company* made it clear that where prequalification authority is conferred by statute, and the certifying agency promulgates rules, the agency must fully comply with those rules.¹⁴² Similarly, contractors must comply with these rules in order to protect their rights. For example, failure to make timely application for administrative review of a sus-

pension order has resulted in a holding that the right to such a hearing was waived.¹⁴³ Likewise, a contractor was found to have not timely filed exceptions to the administrative law judge's decision where it mailed them on the last day of the applicable time period.¹⁴⁴

a. Failure to Update Prequalification Records

Agencies may require the contractor to update or supplement its prequalification questionnaire or to notify the agency of significant changes in its status. For either type of requirement, however, interpretations of their scope differ. This is illustrated in *E. Smalis Painting Company v. Commonwealth, Department of Transportation*.¹⁴⁵ Department prequalification regulations required contractors to submit a statement of any felony convictions of its directors, principal officers, or key personnel, and also to notify the department of any changes in that information. Based on these requirements, and acting on information from a local prosecuting attorney's office that the petitioner's president had been convicted of a felony and was awaiting sentencing, the department suspended the contractor.

In contesting the suspension, the petitioner argued that the duty to submit a report of the conviction did not arise until sentencing was completed. The court disagreed. While conceding that the term "conviction" had both a popular usage and a technical usage, and that the technical usage should be used unless it would defeat the apparent intent of the law, the court felt that in this instance "conviction" was to be understood as meaning a verdict of guilty or a plea of guilty.¹⁴⁶

b. Debarment for Failure to Pay Prevailing Wages

In the mid-1930s, the Davis-Bacon Act was amended to provide that where a firm was found to have disregarded its obligation to pay prevailing wages to employees, no contract would be awarded to that firm for 3 years from the date of publication of the list containing the name of the firm.¹⁴⁷ Several courts have held that failure to pay prevailing wages is grounds for debarment. In *Electrical Contractors v. Tianti*, the contractor was debarred for 3 years for failure to pay prevailing wages, even though the failure was found to be negligent rather than intentional.¹⁴⁸ In other cases, the violation of the prevailing wage requirement was found

¹³⁸ *Sameena, Inc. v. United States Air Force*, 147 F.3d 1148 (9th Cir. 1998) (contractor was entitled to notice and a hearing before being debarred).

¹³⁹ *See, e.g., Lawrence Aviation Indus. v. Reich*, 28 F. Supp. 2d 728 (E.D. N.Y. 1998) (failure to promptly pay award of backpay and prejudgment interest to victims of sexual discrimination in hiring was grounds for debarment).

¹⁴⁰ 281 So. 2d 194 (Fla. 1973).

¹⁴¹ 281 So. 2d at 197.

¹⁴² 281 So. 2d at 197.

¹⁴³ *Dickerson, Inc. v. Rose*, 398 So. 2d 922 (Fla. App. 1981); *Latrobe Road Constr. Inc. v. Com. Dep't of Transp.*, 107 Pa. Commw. 54, 527 A.2d 214, *appeal denied*, 536 A.2d 1335 (1987) (failure to raise issue of whether prequalification provisions violated due process was waived when not raised before agency review board).

¹⁴⁴ *State Board of Registration v. Brinker*, 948 P.2d 96 (Colo. App. 1997).

¹⁴⁵ 452 A.2d 601 (Pa. Commw. 1982).

¹⁴⁶ *Id.* at 602.

¹⁴⁷ 40 U.S.C.A. § 3144 (6 (2003); 29 C.F.R. pt. 5 (2000)).

¹⁴⁸ 613 A.2d 281, 223 Conn. 573 (1992).

to be willful and therefore a basis for debarment.¹⁴⁹ In considering a claim that the bidder had violated overtime provisions, however, a court found that where the violation was not willful it did not render the contractor ineligible to bid.¹⁵⁰

In *Copper Plumbing & Heating Company v. Campbell*, the Secretary of Labor's power to debar for wage law violations was challenged.¹⁵¹ The court found that the regulations were not "penal" in nature and were necessary for effectuating compliance with and furtherance of the public policy represented by the labor acts. *Janik Paving & Construction v. Brock* also discussed the power of the Secretary of Labor to debar and cause such debarment to be listed with the Comptroller General.¹⁵²

c. Other Grounds for Suspension and Debarment

Several other statutory grounds for debarments relating to misconduct, such as bribery of public officials, fraud in the procurement of public contracts, or violation of the Buy America Act, were enacted at the federal and state levels starting in the 1930s and continuing up to the present.¹⁵³ Additional statutes did not specify suspension or debarment for violation, but such powers were found to be inherent within the powers to establish a program or the regulations to effectuate a program. For example, *L.P. Stewart & Bro., Inc. v. Bowles* dealt with presidential power under the Second War Powers Act.¹⁵⁴ The court determined that the President had the power to allocate materials or facilities, of which requirements for national defense created a shortage, in such manner, upon such conditions, and to such extent as he deemed necessary or appropriate in the public interest. This included the power to issue suspension orders against those who did not comply with the program.

i. Antitrust.—If the contractor has been found to have violated the antitrust laws, a suspension or debarment proceeding may be undertaken at the federal level and possibly at the state level. However, the following situations may result in nonresponsibility determinations prior to the actual suspension or debarment:

1. The antitrust matter predated the practice of having suspension or debarment proceedings at the federal level following conviction for antitrust violations;

2. There is or was insufficient evidence for criminal conviction, but there is sufficient evidence to find a contractor to be "nonresponsible";

3. The prosecutors strike a deal with the contractor, in exchange for plea bargaining or testimony, that suspension or debarment will not take place at the federal level;

4. The contractor is named as an unindicted coconspirator and there is no recovery for antitrust based on a civil action;

5. An antitrust indictment has been rendered against the contractor;

6. Principals of a firm were convicted of antitrust violations while they were with another firm and no suspension or debarment proceeding was undertaken against those principals on an individual basis;¹⁵⁵

7. The parent or the holding company of the contractor has been found guilty of antitrust violations somewhere else in the country.¹⁵⁶

ii. Collusive Bidding.—Public policy favoring award of public contracts through competitive bidding serves the interest of the contracting agency by assuring that it obtains needed goods and services at fair prices, and serves the interest of contractors by assuring that all bidders will have equal opportunity to bid and receive equal treatment in consideration of their proposals. This policy is implicit in statutes and regulations directing that competitive bidding be used, and is explicitly implemented in legislation prohibiting fraud and combinations in restraint of trade and competition. All these interests are endangered when there is collusion among bidders to submit noncompetitive or rigged proposals, or otherwise restrict competition and thereafter conceal the fact that such an unfair advantage exists.

Collusion of this sort may take the form of agreements among bidders to submit proposals that are artificially high, or to submit identical bids, or for some bidders to withhold or withdraw their bids in favor of others. The damaging effects of contractor combinations may sometimes be less direct and obvious.

Instances of unpermitted collusion in bidding are usually thought of in terms of restricting competition by secret arrangements among bidders. However, the issue may arise through arrangements between contractors and public agencies. Collusive contracting was charged where a municipality leased a parking lot from an attorney who did work for the city, where it obtained insurance from a company in which the mayor owned stock and was employed, and where it deposited funds in banks where city officials served as director. Under these circumstances, it was held that the purchase of insurance from a company employing the mayor was the only act that violated the state's competitive bidding requirement. The other actions were held to not

¹⁴⁹ *Hull Corp. v. Hartnett*, 568 N.Y.S.2d 884, 77 N.Y.2d 475, 571 N.E.2d 54 (1991).

¹⁵⁰ *Hull-Hazard, Inc. v. Roberts*, 517 N.Y.S.2d 824, 129 A.D.2d 348, *aff'd*, 532 N.Y.S.2d 748, 72 N.Y.2d 900, 528 N.E.2d 1221(1988).

¹⁵¹ 290 F.2d 368 (D.C. Cir. 1961).

¹⁵² 828 F.2d 84 (2d Cir. 1987).

¹⁵³ *See, e.g.*, 41 U.S.C. § 106.

¹⁵⁴ 322 U.S. 398, 64 S. Ct. 1097, 88 L. Ed. 1350 (1944).

¹⁵⁵ *State of N.Y. v. Hendrickson Bros.*, 840 F.2d 1065 (2d Cir. 1988), *cert. denied*, 488 U.S. 848, 102 L. Ed. 2d 101, 109 S. Ct. 129 (1988).

¹⁵⁶ *See HARP, supra* note 1, at 1124-N-22, 23.

constitute prohibited forms of collusion in public bidding.¹⁵⁷

Where there is evidence of a conspiracy to subvert a statutory requirement for award to the lowest responsible bidder through competitive bidding, the criminal nature and consequences of the conspiracy cannot be avoided by reliance on the contracting authority's statutory right to reject any or all bids "if it is in the public interest to do so."¹⁵⁸

iii. Improper or Unethical Conduct.—In connection with the DBE program, many situations arise where the contractor has transactions with a DBE firm that is later decertified or otherwise loses its status for fraud or illegal conduct. Some states have tried to undertake corrective action against the contractors who have transacted business with these DBE firms by finding the contractor "nonresponsible," entering into corrective action agreements, or attempting to suspend or debar the contractor. Such situations include:

1. The contractor has set up a DBE firm with which it deals exclusively (a front for the contractor).
2. The contractor has dealt with a DBE that it should reasonably know is a front based on the manner in which the DBE conducts its business.
3. The contractor has dealt with a DBE that it should reasonably know is not rendering a "commercially useful purpose."
4. The contractor has performed the DBE's work and given the DBE a percentage of the contract price.

By regulations published April 18, 1984, the United States Department of Transportation (USDOT) adopted a procedure to suspend or debar contractors for misconduct involving USDOT financial assistance contracts without the necessity for a prior conviction or indictment for a criminal offense.¹⁵⁹ Among the types of misconduct to which this applies are fraud, deceit, or other actions indicating serious lack of business integrity or honesty with respect to the eligibility of firms to participate in the DBE, WBE, or MBE programs. For example, a firm may be suspended or debarred if it acts as or knowingly makes use of a "front" company (i.e., a firm that is not really owned and controlled by minority or disadvantaged individuals or women, but poses as such in order to participate as a DBE in a federally-assisted contract). Even in the absence of a specific false statement that would subject a party to criminal liability under 18 U.S.C. 1001 (the federal "false statements" statute), a firm that acts as or uses a front may justifiably be viewed by acting so as to indicate a serious lack of business integrity or honesty.¹⁶⁰

To clarify that the debarment and suspension provisions of the USDOT regulations apply to the DBE pro-

grams, this same technical amendment referred to above amended Section 23.87 to read as follows:

(a) If, at any time, any person has reason to believe that any person or firm has willfully and knowingly provided incorrect information or made false statements, or otherwise acted in a manner subjecting that person or firm to suspension or debarment action under 49 CFR Part 29, he or she may contact the appropriate DOT element concerning the existence of a cause for suspension or debarment, as provided in 49 CFR 29.17.

(b) Upon the receipt of information indicating a violation of 18 U.S.C. 1001, or any other Federal criminal statute, the Department may refer the matter to the Department of Justice for appropriate legal action.¹⁶¹

When the DBE rules were rewritten in 1999, the provisions for possible suspension and debarment were retained.¹⁶²

Violations may also result in potential criminal action and/or debarment by the state involved. However, if the violation pertains to the federal MBE/DBE/WBE program, it is more likely to involve only a federal debarment unless the state has by statute also adopted or duplicated the federal program. To the extent that DBE violations also transgress state criminal statutes, independent or concurrent remedies could exist.

d. Right to Due Process in the Suspension, Debarment, or Disqualification Process

The law does not recognize that a contractor has a legally protected right to bid and be awarded a public contract merely because its qualifications as a potential bidder have been certified. However, revocation of a certificate of qualification is in the nature of a license revocation and is subject to due process requirements.¹⁶³ Thus, a certificate holder is entitled to notice and a hearing at which its representatives may explain or rebut the evidence giving rise to the agency's action.

Because the bidding and award process is based entirely on statutory authority, departmental administrative proceedings leading to suspension or debarment must adhere strictly to statutory requirements. Thus, statutes have been construed to require that contractors may be disqualified for unintentional violations of the law as well as for intentional actions.¹⁶⁴ Also, jurisdiction and authority for debarment by a contracting

¹⁶¹ *Id.*

¹⁶² 49 C.F.R. § 26.107 (2000).

¹⁶³ *Capeletti Bros. v. State Dep't of Transp.*, 362 So. 2d 346 (Fla. App. 1978) (delinquency on prior state contract); *North Central Util. v. Walker Community Water Systems, Inc.*, 437 So. 2d 922 (La. App. 1983) (failure to comply with public bid law); *Seacoast Constr. Corp. v. Lockport Urban Renewal Agency*, 339 N.Y.S.2d 188 (1972) (lack of qualification and experience record); *Couch Constr. Co. v. Dep't of Transp.*, 361 So. 2d 172 (Fla. App. 1978) (failure to attend pre-bid conference).

¹⁶⁴ *Dep't of Labor and Indus., Div. of Workplace Standards v. Union Paving and Constr. Co.*, 168 N.J. Super. 19, 401 A.2d 698 (1979) (repeated violations of prevailing wage laws).

¹⁵⁷ *McCloud v. City of Cadiz*, 548 S.W.2d 158 (Ky. App. 1977).

¹⁵⁸ *Commonwealth v. Gill*, 5 Mass. App. 337, 363 N.E.2d 267 (1977).

¹⁵⁹ 49 C.F.R. pt. 29; 49 F.R. 15197 (Apr. 18, 1984).

¹⁶⁰ 50 F.R. 18493 (May 1, 1985).

agency has had to be specifically authorized in applicable statutes.¹⁶⁵ Administrative proceedings must include the keeping of records showing that all jurisdictional elements of the case were addressed and sustained by factual findings developed in accordance with statutes and regulations.¹⁶⁶

Suspension and debarment of highway construction contractors and subcontractors on federal projects are governed by the Governmentwide Debarment and Suspension (Nonprocurement) process as well as by the rule-making provisions of the federal Administrative Procedure Act.¹⁶⁷ With respect to debarments, suspensions, or disqualifications at the federal level, when the appropriate processes provided for within the rules are followed, due process challenges to the validity of such actions have relatively little chance of succeeding.

The USDOT's suspensions or debarments of highway construction contractors undertaken pursuant to 49 C.F.R. part 29 are serious actions that are "used only in the public interest and for the Federal Government's protection and not for purposes of punishment."¹⁶⁸ In order to be eligible to receive federal aid for transportation projects, the states must abide by the federal actions or lose the federal aid.¹⁶⁹ In addition, consistent action by the states complements and effectuates the federal action. Federal suspension or debarment regulations also require that the General Services Administration (GSA) "shall compile, maintain, and distribute a list of all persons who have been debarred, suspended, or voluntarily excluded by agencies under Executive Order 12549 and these regulations, and those who have been determined to be ineligible."¹⁷⁰

However, state action of suspension or debarment cannot be undertaken by relying solely on federal suspension or debarment when states are administering projects with federal-aid, as doing so would violate the contractor's right to a hearing before the state agency. State agencies should not use the Federal Government's consolidated lists of suspensions, debarments, or disqualifications without considering the matter at the state level in an appropriate due process fashion. A violation of the contractor's rights may be found where one agency uses a clearinghouse or consolidated list of

agency determinations to take a new adverse action against the contractor or subcontractor, without giving the contractor any hearing or opportunity to rebut. Unless there are clear statutory authorizations that permit or authorize the list to be used to suspend, debar, or disqualify a contractor or subcontractor, clearinghouse lists should be used only to alert governmental agencies at the state level that there is some question of the contractor's or subcontractor's status. There must then be a review that complies with due process before a deprivation of rights takes place.

i. De Facto Debarment.—When responsibility determinations are made in case-by-case reviews, contractors have claimed that they were subjected to de facto debarment. However, the courts have upheld determinations of nonresponsibility even where such decisions were repeated several times based on the same facts, as long as an opportunity was given to the contractor each time to show corrective action. This issue was addressed in *Callanan Industries v. White*,¹⁷¹ where the court stated:

The ability of the Department to reject bids of irresponsible bidders is not frustrated by its inability to debar future bids. Once the Department finds a bidder to be irresponsible for a particular reason, assuming that such a finding was not arbitrary or capricious, it could proceed to reject each of that bidder's future bids, in effect creating the sort of debarment accomplished in the instant case. However, this would force the Department to consider anew the bidder's responsibility upon each bid and presumably, change its position when and if the bidder remedies the cause of the finding of irresponsibility.

¹⁶⁵ Dep't of Labor v. Berlanti, 196 N.J. Super. 122, 481 A.2d 830 (1984).

¹⁶⁶ Dep't of Labor v. Berlanti, 196 N.J. Super. 122, 481 A.2d 830 (1984); Seacoast Contr. Corp. v. Lockport Urban Renewal Agency, 339 N.Y.S.2d 188 (1972); Dep't of Labor and Indus., Div. of Workplace Standards v. Union Paving and Constr. Co., 168 N.J. Super. 19, 401 A.2d 698 (1979); Capeletti Bros. v. State Dep't of Transp., 362 So. 2d 346 (Fla. App. 1978).

¹⁶⁷ 5 U.S.C. § 700 *et seq.*

¹⁶⁸ 49 C.F.R. § 29.115(b) (1999).

¹⁶⁹ See Required Contract Provisions, Federal-Aid Construction Contracts, Form FHWA-1273 Part XI, Certification Regarding Debarment, Suspension, Ineligibility and Voluntary Exclusion (modified June 22, 1999).

¹⁷⁰ 49 C.F.R. § 29.500 (2001).

¹⁷¹ 118 A.D. 2d 167, 503 N.Y.S.2d 930, 933, *motion to modify denied*, 123 A.D. 2d 462, 506 N.Y.S.2d 287, *appeal denied*, 69 N.Y.2d 601 (1987).

ii. *Compliance with Rule-Making.*—*Callanan* addressed both the authorization to debar or suspend at the state level and the requirements of a rule-making process under a state Administrative Procedure Act. The New York State Department of Transportation was concerned about Callanan’s business relationship with two DBE firms. These firms, one of which Callanan had established, were found to be frauds and guilty of misconduct in the DBE program and were decertified. The next time Callanan was the lower bidder, the Department challenged the firm’s honesty, integrity, good faith, and fair dealings and indicated that the firm should show good cause why the award should be made to it for that project. The Department also declared its intention to suspend or debar the firm for up to 3 years for its past conduct. The Department set forth in its Manual of Administrative Procedures (MAP), a copy of which was given to Callanan with the notice, the notice requirements and the criteria that should be applied in any suspension or debarment decision. The MAP also established a Contract Review Unit (CRU) to effectuate the MAP process relative to contract awards and approvals. Prior to the meeting between the CRU and Callanan, the firm submitted the apparent low bid on another project and that too was reviewed by the CRU.

At the meeting, Callanan’s attorney did not address the contractor’s misconduct but, instead, challenged the authority of the CRU. After the meeting, the CRU determined on January 3, 1986, that Callanan should be debarred from receiving awards of future projects and from participating as a subcontractor, supplier, or provider of labor on future contracts for a period of 30 months.¹⁷²

The MAP was not promulgated as a rule under the State Administrative Procedure Act. The Department considered the procedures to be internal guidelines to assist the CRU’s decision-making process. The procedures did not dictate a particular result, but rather set out what should be considered by the CRU. The Department also did not have express legislative authority to suspend or debar contractors, but assumed it had such power from the legislative direction to award contracts only to the lowest responsible contractor as would best promote the public interest.¹⁷³

The court considered the main issue to be “whether the Department had the authority to provide for a means of debarring or suspending bidders on the ground of irresponsibility.”¹⁷⁴

[T]he authority given the Department with regard to awarding of contracts is in terms of rejecting or accepting bids. Certainly, the Department can and should consider past conduct by a bidder in making its decision as to whether the bidder on a particular contract is responsible...

However, in no statute has the Legislature granted the Department the authority to commence any sort of pro-

ceeding for the purpose of punishing an irresponsible bidder or debarring such a bidder from submitting bids in the future.

The power to investigate violations of a statute and to punish violators is a significant power and is penal in nature.¹⁷⁵

The court found that debarment was a punishment and, therefore, must be based on specific and express legislative terms with appropriate procedural safeguards before debarment can be undertaken. The court also concluded, “Nor can the power to debar bidders be necessarily implied from the authority to reject bids made by irresponsible bidders.”¹⁷⁶

The court also held that the debarment provisions were invalid because they were not adopted pursuant to the state Administrative Procedure Act. Where an administrator is undertaking some action relative to suspension, debarment, or disqualification of a contractor, the right affected will be deemed to be either a “property right” or a “liberty right,” or both. Therefore, the process must be subjected to appropriate rule-making.¹⁷⁷ Where the rules have been properly adopted, the suspension or debarment will be upheld if it is supported by substantial evidence.¹⁷⁸

Due process requirements relative to suspension, debarment, or disqualification of highway construction contractors at both the federal and state levels are now well established. The deprivation of a right, even on a temporary basis, must meet the constitutional requirement of notice and a meaningful opportunity to respond before the deprivation takes effect. At a minimum, this involves the right to be informed of the nature of the charges and of the relevant supporting evidence. In determining the adequacy of the deprivation procedures, there must be consideration of the government’s interest in imposing the deprivation, the private interests of those affected by the deprivation, the risk of erroneous deprivations through the challenged procedures, and the probable value of additional or substitute procedural safeguards.

Some cases state that depending on the circumstances and the interests at stake, an evidentiary hearing may be required before a legitimate entitlement may be terminated or suspended.¹⁷⁹ In more recent cases, the Supreme Court has held that procedures will be sufficient, even though they provide for less than a full evidentiary hearing, as long as they do provide for some kind of a hearing or meeting that ensures an effective initial check against mistaken decisions before the deprivation occurs, in addition to a prompt

¹⁷⁵ *Id.* at 932, 933.

¹⁷⁶ *Id.*

¹⁷⁷ *Id.* at 933, 934.

¹⁷⁸ *Adonizio Brothers v. Pa. Dep’t of Transp., Bd. of Review*, 529 A.2d 59 (1987).

¹⁷⁹ *See, e.g., Goldberg v. Kelly*, 397 U.S. 254, 90 S. Ct. 1011, 25 L. Ed. 2d 287 (1970).

¹⁷² *Id.*, 503 N.Y.S.2d at 932.

¹⁷³ *Id.*

¹⁷⁴ *Id.*

opportunity for complete administrative and possibly judicial review after the deprivation.¹⁸⁰

*Brock v. Roadway Express*¹⁸¹ brought much of the prior law on the requirements of due process in connection with deprivation of a right into focus. That case involved the temporary reinstatement with back pay of a truck driver who claimed that he was discharged in retaliation for complaining about safety violations. The Secretary of Transportation, pursuant to Section 405 of the Surface Transportation Assistance Act of 1982, ordered the reinstatement of the truck driver with back pay pending a final determination on his complaint.¹⁸² The central issue of the case was whether the Secretary of Transportation had provided Roadway appropriate due process when the driver's reinstatement and back pay were imposed on Roadway by the Secretary. Roadway was notified of the driver's charge and given an opportunity to meet with personnel in the Secretary's office, and was permitted to submit statements. However, it was not permitted access to the relevant evidence supporting the driver's complaint or to other information on which the reinstatement order was based. The Supreme Court stated:

We conclude that minimum due process for the employer in this context requires notice of the employee's allegations, notice of the substance of the relevant supporting evidence, an opportunity to submit a written response, and an opportunity to meet with the investigator and present statements from rebuttal witnesses. The presentation of the employer's witnesses need not be formal, and cross-examination of the employee's witnesses need not be afforded at this stage of the proceeding.¹⁸³

Due process thus does not require a full evidentiary hearing prior to invoking a deprivation, provided there is an adequate post-determination hearing at a meaningful time intended to resolve the disputes. Further, due process requires access to information upon which the deprivation of rights order was based.

The result in *Callanan Industries v. City of Schenectady* is consistent.¹⁸⁴ In that case, Callanan Industries had submitted the low bid, but the City of Schenectady awarded the contract to the second bidder, who was determined to be the lowest responsible bidder. Prior to the award, Callanan discussed its past performance with City officials in view of the City's claim that in the prior year a rehabilitation contract

had been performed by Callanan in a seriously deficient manner, and further that the corrections by Callanan were unsatisfactory to the City officials. Callanan claimed that the City's failure to provide it with a hearing prior to the rejection of the bid denied it due process. The court determined that Callanan's informal conferences with the City Council and other City officials as well as judicial review satisfied Callanan's due process rights.

This issue was also considered in *Inglewood Los Angeles County Civic Center Authority v. Superior Court of Los Angeles County*, in which the award was made to the second lower bidder on the basis of qualifications, but where the low bidder was not found to be nonresponsible.¹⁸⁵ The court found in that case that due process required giving the low bidder the evidence reflecting on its responsibility and affording it the opportunity to rebut adverse evidence and present evidence that it was qualified to perform the contract.

In *DeFoe Corporation v. Larocca*, the New York State Department of Transportation had rejected all bids for a project due to bidding irregularities.¹⁸⁶ In the second bidding for the project, the joint venture of Schiavone and North Star Contracting Company was the apparent low bidder. Schiavone had been part of a different joint venture that had been the apparent low bidder the first time the project had been advertised. Between the time of the first bid and the second bid, several officials in the Schiavone firm were indicted for MBE fraud. Because of the indictment, as well as the possible inability of the top officials of the corporation to perform the project while defending against the criminal charges, the Department found the Schiavone firm to be nonresponsible and awarded to the second low bidder.¹⁸⁷

Prior to the second bid letting on that project, the Schiavone firm was also the apparent low bidder on another large project in New York City, but was found to be nonresponsible for the same reasons given above. The matters were considered together in the State's Appellate Division in *Schiavone Construction v. Larocca*.¹⁸⁸ Upholding the State's decision, the Appellate Division made several important points relative to due process. First, it noted that Schiavone did not acquire a property right to the contracts.¹⁸⁹ Second, however, the court held that since the refusal to award the contracts to Schiavone "had a drastic effect upon their ability to carry on their business," Schiavone had a "cognizable liberty interest."¹⁹⁰ Lastly, the court noted that

¹⁸⁰ See, e.g., *Cleveland Board of Educ. v. Loudermill*, 470 U.S. 532, 105 S. Ct. 1487, 84 L. Ed. 2d 494 (1985) (public employee had property right in continued employment, was entitled to notice and opportunity for pre-termination hearing); *O'Hare Truck Service v. Northlake*, 518 U.S. 712, 116 S. Ct. 2353, 135 L. Ed. 2d 874 (1996) (public contractor entitled to same property right as public employee in continued performance of contract).

¹⁸¹ 481 U.S. 252, 107 S. Ct. 1740, 95 L. Ed. 2d 239 (1987).

¹⁸² *Id.* at 256.

¹⁸³ *Id.* at 264.

¹⁸⁴ 116 A.D. 2d 883, 498 N.Y.S.2d 490 (1986).

¹⁸⁵ 103 Cal. Rptr. 689, 500 P.2d 601 (1972).

¹⁸⁶ 488 N.Y.S.2d 532, 128 Misc. 2d 39 (1984), *aff'd*, 489 N.Y.S.2d 1017, 110 A.D. 2d 965 (1985).

¹⁸⁷ *Schiavone Constr. v. Larocca*, 503 N.Y.S.2d 196, 117 A.D. 2d 440 (1986).

¹⁸⁸ *Id.*

¹⁸⁹ *Id.*, 503 N.Y.S.2d at 197.

¹⁹⁰ *Id.* at 197-98.

[T]he procedures afforded petitioners [Schiavone and the joint venture of Schiavone and North Star] were adequate. Due process is flexible and is determined by a weighing of the interests at stake, the risk of erroneous deprivation, the probable value of additional safeguards and the cost of substitute procedures. In cases such as the one at bar, a formal trial-type hearing is not necessary. Here, petitioners were given notice of the [Contract Review] Unit's concern over their responsibility and the reasons for that concern. Petitioners were afforded an opportunity to rebut the charges both in writing and at informal hearings. They were informed of the reasons for denial of their contract bids and were afforded this review pursuant to CPLR article 78. We find that these procedures were adequate under the circumstances of this case.¹⁹¹

Whether the contractor succeeds in challenging a suspension or debarment might depend upon whether it asserts a property or a liberty interest in its ability to bid on public contracts. *Polyvend, Inc. v. Puckorius* demonstrates what a difficult time a contractor can have when it asserts a denial of due process in connection with a property interest.¹⁹² In that case, a license plate manufacturer had its bid for a license plate contract rejected pursuant to a state statute, which prohibited award of a government contract to a person or business that had been involved in the bribery of a state official or employee. The Circuit Court granted the state summary judgment. The Appellate Court reversed with a finding that the state statute was unconstitutional on due process grounds. The Supreme Court of Illinois reversed and decided in the state's favor. Polyvend had had the contract for the 3 prior years. The conviction for bribery occurred in 1974. The state statute concerning bribery became effective in 1977. The court found that Polyvend did not have a legitimate claim of entitlement to a future state contract. The case review was centered on a "property right" in the future state contract and no such property right was found.¹⁹³

Another issue is the length of time prior to the post-determination hearing. The time given to rebut a proposed action is set at 30 days by the Governmentwide Debarment and Suspension (Nonprocurement) process.¹⁹⁴ This procedure gives the contractor 30 days after receipt of notice to submit "in person, in writing, or through a representative, information and argument in opposition to the proposed debarment." The debarring official then has 45 days after submission of the relevant information to render a determination.¹⁹⁵

The Governmentwide Debarment and Suspension (Nonprocurement) process recognizes that suspension is a serious action to be imposed only when there exists adequate evidence of one or more of the causes set out

in the regulations, and immediate action is necessary to protect the public interest.¹⁹⁶ The regulations provide that a contractor may be suspended upon adequate evidence to suspect the commission of an offense listed in 49 C.F.R. § 29.305(a) or a cause for debarment under 49 C.F.R. § 29.305 may exist. The regulations further provide that, "Indictment shall constitute adequate evidence for purposes of suspension actions."¹⁹⁷

5. Established Time Periods Versus Flexible Time Periods for Suspensions, Debarments, or Disqualifications

When a statute directs suspension, debarment, or disqualification for a prescribed period of time upon a finding of violation of a governmental program, there is little discretion that has to be exercised by the governmental administrator relative to the length of time suspension, debarment, or disqualification is to be effective. The administrator's real function in those circumstances is to see that the determination of the violation is consistent with due process requirements. The courts, therefore, will examine such a statutorily mandated period to determine whether or not it is "penal or punitive" in nature versus being a period of ineligibility that is necessary and appropriate to protect a legitimate government interest.

In the flexible time situation, those statutes that provide that the suspension, debarment, or disqualification may be determined to be up to a certain maximum period of time leave considerable discretion in the administrator's hands to pattern the length of any suspension, debarment, or disqualification to the particular circumstances that exist relative to the violation, the contractor's or subcontractor's particular situation, and any governmental needs or objectives relative to the program. The most serious aspects that the courts will look at in flexible time matters are whether the period of ineligibility is established on an ad hoc basis, whether there is similar treatment of contractors under similar circumstances, as well as whether the length of the suspension, debarment, or disqualification is justified by the facts that are established by the administrative record.

Consistency of the administrator's handling of similar situations will be very important relative to any court challenge. Further, the court will apply a standard of "abuse of discretion" or "arbitrary and capricious" to its review of the period of the suspension, debarment, or disqualification. An administrator who blindly applies the maximum ineligibility period in each and every case may be found to have abused his or her discretion, because the legislative direction is to "determine" an appropriate length of time for the ineligibility, not to exceed the statutory maximum limit. The administrator is required to use discretion in fixing the period.

¹⁹¹ *Id.* at 198 (citations omitted).

¹⁹² 77 Ill. 2d 287, 32 Ill. Dec. 872, 395 N.E.2d 1376 (1979), *appeal dismissed*, 444 U.S. 1062 (1980).

¹⁹³ *Id.*, 395 N.E.2d at 1379.

¹⁹⁴ 49 C.F.R. § 29.313(a) (Oct. 1, 2001).

¹⁹⁵ 49 C.F.R. § 29.314(a) (2001).

¹⁹⁶ 49 C.F.R. pt. 29.

¹⁹⁷ 49 C.F.R. § 29.405(b) (2001).

C. SURETY BONDS AND INDEMNIFICATION

1. Introduction

Because public projects are not subject to mechanics or materialmen's liens, public agencies require successful bidders on construction projects to furnish security for satisfactory contract performance.¹⁹⁸ Additional requirements assure that laborers, materialmen, and subcontractors are paid for their goods and services.¹⁹⁹ Others require that taxes and other obligations are paid. Public agencies may also require indemnification for losses incurred because of a contractor's negligence or default. These requirements result in the formation of third-party beneficiary contracts, or suretyships. A summary of state requirements for contractor bonds is found in Appendix F.

Congress addressed this need by enactment of the Miller Act in 1935.²⁰⁰ The Miller Act requires that before a public works contract utilizing federal funds may be awarded, the contractor must furnish both a payment bond for the benefit of laborers, subcontractors, and materialmen, and a performance bond for the benefit of the United States. States have followed by enacting their own "Little Miller Acts" patterned after the federal statute, and also requiring the provision of payment and performance bonds by public works contractors. The bonds required by both federal and state law customarily are referred to as statutory bonds.

2. Basic Concepts of Suretyship

One of the distinguishing characteristics of suretyship is that it is always collateral to another contract. It is a tripartite agreement in which one party (the surety) agrees to assume liability for the debt or duty of another (the principal) to a third party (the obligee) in the event the principal does not perform its duty under the contract.²⁰¹ Under this separate agreement, the surety becomes liable notwithstanding the fact that it has no personal interest in the principal's duty to the obligee, and receives no benefit from it.²⁰²

Except where they arise by operation of law, suretyships must be created by express agreement of the parties. The agreement must be in writing, as suretyships

come within the statute of frauds.²⁰³ Once created, a suretyship remains in effect until terminated, or until the surety is discharged, or until changes in the basic contract by the principal and obligee alter it so substantially that it requires a different performance than was previously contemplated by the surety.

3. Public Policy Regarding Contractors' Bonds

a. Rationale of Contractor Bonds

The requirement for contractors' performance and payment bonds provides a way to protect the public against major deviations in public contract performance. The protection that these bonds offer, however, depends to some extent on the surety's choice among several options open to it in the event the agency terminates a contract for cause. First, the surety may elect to do nothing toward arranging for the completion of the contract and let the agency make arrangements for completing the work. In that event, the surety's liability is limited to the costs of completion less the contract funds held by the agency at the time of termination. Second, the surety may try to have the agency's termination rescinded and finance the contractor in the completion of the work. This course of action is rarely selected, because the fact that there was a termination suggests that the surety may not have found good business reasons for extending financial help earlier when termination might have been avoided. Third, the surety may enter into a takeover agreement with the agency and proceed to complete the contract work. Under such an agreement, the government pays the surety the balance of the contract funds that remain unpaid, and the surety hires another contractor, approved by the agency, to complete the work. If the new contractor's expenses exceed the unspent funds from the original award, the surety may solicit new bids to complete the contract and request the agency to enter into a new contract with the lowest responsible bidder. Again, if the costs of this new arrangement exceed the funds remaining unspent, the surety pays the difference.

From the surety's viewpoint, it is advantageous to cooperate with the agency in arranging for completion of a defaulted contract unless there are serious complicating circumstances. Moreover, most sureties will wish to avoid being placed between the government and the "takeover" contractor, and so will prefer to work out a method for creating a new direct contractual relationship between the government and the party who actually performs the completion work.

Statutes and bid specifications that require performance guarantees generally are satisfied by obtaining a surety bond. Whether cash or other assets may be substituted for a surety bond is a matter of state law. Even if allowed under state law, the use of assets other than cash may result in a dispute regarding whether the

¹⁹⁸ Portions of this section are derived from *Indemnification and Suretyship in Highway Construction Contracts* by Dr. Ross D. Netherton, and *Indemnification and Insurance Requirements for Consultants and Contractors on Highway Projects* by Darrell W. Harp, published by the Transportation Research Board and included in the first edition of *SELECTED STUDIES IN HIGHWAY LAW*.

¹⁹⁹ *First National Bank of Paonia v. K.N.J., Inc.*, 867 P.2d 152, 154 (Colo. App. 1993).

²⁰⁰ 40 U.S.C. § 3131 *et seq.* (formerly codified at 40 U.S.C. § 270a. *et. seq.*).

²⁰¹ 74 AM. JUR. 2D *Suretyship* § 3 (2001).

²⁰² *Miners' & Merchants' Bank v. Gidley*, 150 W. Va. 229, 144 S.E.2d 711 (1965).

²⁰³ WIS. STAT. § 241.02(1)(b) (2001).

value of the assets pledged is adequate. The substitution of other security for the customary three-party surety arrangement has been permitted as providing the functional equivalent of a surety and a reliable source of recovery to which the contracting agency had a right of direct recourse in the event of a contractor's default or insolvency.²⁰⁴

Requirements for providing payment and performance bonds are creatures of legislation and apply only to the parties and projects covered by the statute. So, where a state university was created in the state constitution and governed by its own board of regents outside the control of the legislature, it was held that its contracting process was not subject to the bonding requirements of statutes regulating other public agencies' contract procedures.²⁰⁵ Likewise, where a public garage was not built on land owned by the state or a public entity at the time the contract was executed, no bond was required.²⁰⁶

Statutes requiring payment and performance bonds will apply only to public projects. Thus, port authority facilities intended to be operated by private enterprise were not "public works" within the meaning of the statute.²⁰⁷ A similar result was reached in denying the claim of a concrete supplier to the subcontractor of a private telephone company that was replacing sidewalks at the direction of a local government after the company had removed the original sidewalks to install telephone cable.²⁰⁸

²⁰⁴ *Cataract Disposal, Inc. v. Town Board of Town of Newfane*, 440 N.Y.S.2d 913, 916, 423 N.E.2d 390, 53 N.Y.2d 266 (1981) (cash deposit in lieu of bond); *Central Arizona Water & Ditching Co. v. City of Tempe*, 680 P.2d 829, 831 (Ariz. App. 1984) (substitute security); *but see Cataract Disposal*, 440 N.Y.S.2d at 917 (dissent arguing that use of a surety relieves the contracting agency of the responsibility for obtaining a substitute if needed to complete performance, and gives the agency the benefit of the surety's independent assessment of the contractor's reliability).

²⁰⁵ *William C. Reichenbach Co. v. State*, 94 Mich. App. 323, 288 N.W.2d 622, 628 (1980).

²⁰⁶ *Murnane Assoc. v. Harrison Garage Parking Corp.*, 659 N.Y.S.2d 665, 239 A.D. 2d 882 (1997).

²⁰⁷ *James J. O'Rourke, Inc. v. Indus. Nat'l Bank of R.I.*, 478 A.2d 195 (R.I. 1984) (meat processing plant financed with port authority bonds but operated entirely by private industry, construing R. I. GEN. LAWS, § 37-13-14); *see also* Annotating 48 A.L.R. 4th 1163 (1986).

²⁰⁸ *Modern Transit-Mix, Inc. v. Michigan Bell Tel. Co.*, 130 Mich. App. 300, 343 N.W.2d 14, 15 (1983) (applying MICH. COMP. LAWS ANN., 129.201); *see also Davidson Pipe Supply Co. v. Wyo. County Indus. Dev. Agency*, 624 N.Y.S.2d 92, 94, 85 N.Y.2d 281, 648 N.E.2d 468 (1995) (energy cogeneration plant developed with assistance of industrial development agency not "public improvement" where all risks and benefits were borne by private entity); *Consolidated Elec. Supply, Inc. vs. Bishop Contracting Co.*, 205 Ga. App. 674, 423 S.E.2d 415 (1992) (YWCA building not a public work).

b. Agency's Duty Regarding Contractor Bonds

An agency's duty with respect to the contractor bond requirement is defined by statute. Generally, prior to contract award, the agency should verify that the agent signing the bond for the surety has authority to do so, and verify that the surety is registered to do business in the state.

Where a statute establishes an explicit duty to see that a bond or equivalent escrow arrangement is furnished for the protection of suppliers of labor or materials who would be entitled to claim a lien except for the public nature of the project, the public agency's failure to require that security may be negligence. Therefore, in *New England Concrete Pipe Corp. v. D/C Systems of New England, Inc.*, a sub-subcontractor was able to recover for materials and labor supplied for a housing project when the state housing finance agency was shown to have breached its duty to see that a payment bond or equivalent escrow was provided.²⁰⁹ An agency may also be found to have the duty to verify the validity of a bond rather than merely accepting what purports to be a valid bond. Such was the result in a Michigan case in which the agency provided a certified copy of the bond upon the subcontractor's request.²¹⁰ The court found that the agency's action had the effect of verifying the bond's validity. The agency would not have had this duty had it not provided a certified copy of the bond; had the subcontractor not requested a copy of the bond, then it would have borne the risk of the bond being invalid.

Another area that an agency should review is whether the surety is registered in the state. If the surety is incorporated under the laws of another state, it must generally obtain official authorization to do business in the state where the contract is let. This authorization generally involves registration with the Secretary of State or other appropriate state official, and designation of a resident agent of the corporation with an in-state address for receiving mail and service of process.²¹¹ In some cases, bonds issued by out-of-state sureties must be countersigned by this resident agent, and filed with a copy of the agent's power of attorney.²¹² Occasionally state laws require disclosures of other information about the surety or its resident agent.

²⁰⁹ 495 F. Supp. 1334, 1344-45 (D. Mass. 1980); *see also H-K Contractors, Inc. v. City of Firth*, 101 Idaho 224, 611 P.2d 1009, 1010 (1979) (construing IDAHO CODE, § 54-1926, and holding that general time limits for filing claims do not apply to claims based on failure to require payment bond); *George Weis Co. v. Dwyer*, 867 S.W.2d 520 (Mo. App. 1993); *Palm Beach County v. Trinity Indus.*, 661 So. 2d 942 (Fla. App. 4 Dist. 1995).

²¹⁰ *Kammer Asphalt Paving Co. v. East Chine Tp. Schools*, 443 Mich. 176, 504 N.W.2d 635, 641 (1994).

²¹¹ *See, e.g., WASH. REV. CODE* § 23B.15.070 (Supp. 2003).

²¹² *See Shrake Elec., Inc. v. Central Sur. & Ins. Corp.*, 185 Kan. 230, 342 P.2d 159 (1959) (extent of the authority given by power of attorney).

Explicit provisions that the surety must be approved by the contracting agency before its bond is acceptable are found in several states. However, even where statutes are silent on this matter, state agencies have claimed that such authority is implicit in their legal responsibility for managing public construction contracts with appropriate protection of the public interest. Whether based on explicit or implicit authority, the requirements established by state transportation agencies for federal-aid highway contracts must not be unduly or unfairly restrictive. Federal highway regulations provide that no procedure shall be required by states in connection with federal-aid highway contracts that operate to restrict competitive bidding by discriminating against the purchase of a surety bond or insurance policy from a surety or insurer outside the state and authorized to do business in the state.²¹³

Financial responsibility is implicit in the requirement that sureties must be “acceptable” to the contracting agency. Criteria for acceptance by the state may not be fully set forth in statutes or regulations. Such standards are often departmental policy, which may be applied with flexibility and administrative judgment. In some instances, however, minimum standards of financial condition are published by the state’s public works agencies. This concern extends beyond the question of a proposed surety’s initial financial rating, and prescribes limits on the dollar amount of a surety’s bond commitments at a given time.

Other items that should be reviewed include whether the principal contract has been incorporated into the bond by reference; whether the bond sets out the alternatives available to the surety in the event of contractor default; whether it includes a definition of who may claim under the bond and in what time period a claim must be filed; and whether it is signed by individuals authorized to bind the surety.²¹⁴

Under the Miller Act, the agency has a duty to provide a certified copy of the bond and the principal contract to any one who has furnished labor or materials and who submits an affidavit to the agency stating that he or she has not been paid.²¹⁵

c. Development of the Present Suretyship System

In 1894, Congress enacted the Heard Act, which required construction contractors for the federal government to provide a bond “with good and sufficient sureties, [and] with the additional obligation that such contractor or contractors shall promptly make payments to all persons supplying him or them labor and materials in the prosecution of the work provided for in such contract...”²¹⁶ However, under the Heard Act it was possible for subcontractors to bring suit before

completion of a project and exhaust the resources of a prime contractor and the surety under the bond before the government could move to protect its interest in assuring performance.²¹⁷ Congress then amended the law in 1905 to postpone creditors’ recourse to the surety bond until the Federal Government had adequate opportunity to enforce its claims.²¹⁸ The federal law remained substantially in this form until passage of the Miller Act in 1935.²¹⁹ In the Miller Act, Congress directed that the performance and payment features be executed in separate bonds, each with its own rights and rules for recourse to the surety.²²⁰

During the period before the Miller Act, a number of states passed legislation permitting a mechanic’s lien to attach to the funds earned by a public works contractor while recognizing that the public works themselves were immune from levy or attachment under the lien. Generally, however, state legislation for the protection of laborers, materialmen, and subcontractors before 1935 followed the pattern of the Heard Act in requiring contractors to furnish a surety bond conditioned on performance and payment of claims.²²¹ After passage of the Miller Act, states began to follow the federal model in amending their own bonding statutes.

4. Contractor Bonds in State and Federal Construction Contracts

a. Contractor Bond Coverage Under the Miller Act

The Miller Act provides that before the award of any contract exceeding \$100,000 and involving construction, repair, or alteration of a public building or public work of the United States, the contractor must furnish (1) a performance bond of sufficient amount to protect the United States Government, and (2) a payment bond “for the protection of all persons supplying labor and material in the prosecution of the work provided for in the contract.”²²² This section has been interpreted to limit recovery on a payment bond posted under the act to

²¹⁷ *United States v. American Sur. Co.*, 135 F. 78 (1st Cir. 1905); *American Sur. Co. v. Lawrenceville Cement Co.*, 96 F. 25 (C.C.D. Me. 1899); *Davidson Bros. Marble Co. v. United States ex rel. Gibson*, 213 U.S. 10, 29 S. Ct. 324, 53 L. Ed. 675 (1909) (jurisdictional problems); *United States Fidelity & Guar. Co. v. United States for the Benefit of Kenyon*, 204 U.S. 349, 27 S. Ct. 381, 51 L. Ed. 516 (1907) (jurisdictional problems).

²¹⁸ As amended, the law required creditors to refrain from suit on the bond for 6 months after completion of final settlement, and allowed the United States a priority over other claimants in the distribution of surety funds. Act of Feb. 24, 1905, ch. 778, 33 Stat. 811, 812.

²¹⁹ Act of Aug. 24, 1935, ch. 624, 49 Stat. 793 (formerly codified at 40 U.S.C. §§ 270a–270d (1970), now codified at 40 U.S.C. §§ 3131–134 (2003)).

²²⁰ NETHERTON, *supra* note 198.

²²¹ *Id.*

²²² 40 U.S.C. § 3131(b) (2003).

²¹³ 23 C.F.R. § 635.110 (2002).

²¹⁴ 17 AM. JUR. 2D *Contractors’ Bonds* § 3 (1990).

²¹⁵ 40 U.S.C. § 3133(a).

²¹⁶ Act of Aug. 13, 1894, ch. 280, 28 Stat. 278.

those materialmen, laborers, and subcontractors who dealt directly with the contractor or a subcontractor. The policy of limiting claimants who can sue under a Miller Act bond is to permit the prime contractor to protect itself by requiring the subcontractors who perform substantial portions of the prime contract to post bonds assuring that their particular materialmen, subcontractors, and laborers will be paid in the event the subcontractor defaults.²²³

The amount of the bond originally varied—one-half the contract price for contracts up to \$1 million; 40 percent of the price for contracts from \$1 million to \$5 million; and a maximum of \$2.5 million for contracts in excess of \$5 million.²²⁴ The statute was amended in 1999 to require a performance bond in an amount that the contracting officer deems adequate, and a payment bond in the total amount of the contract, unless the contracting officer determines that that amount is impracticable and sets a lesser amount. However, the payment bond may not be less than the performance bond.²²⁵

In a second section of the Miller Act, Congress specified that suit on the contractor's payment bond may be brought after 90 days following the final performance of labor or supplying of materials.²²⁶ During this 90-day period, any claimant "having direct contractual relationship with a subcontractor but no contractual relationship express or implied with the contractor" who furnished the bond must give written notice of its claim to the contractor.²²⁷ Also, no suit on the payment bond may be commenced by any claimant after the expiration of 1 year after the labor was performed or the materials supplied.²²⁸

These requirements were intended to strengthen the positions of the protected parties and provide reasonable procedures for exercising their rights. The legislative history of the statute recognized the widening circle of parties necessarily involved in the large, complex, and costly types of construction being undertaken. However, Congress was also sensitive to the inequity of exposing prime contractors and their sureties to "remote and undeterminable liabilities."²²⁹ In turn, the courts approached the questions arising under this act from the standpoint that its remedial character deserved a liberal construction, favoring achievement of

²²³ *J.W. Bateson Co. v. U.S. ex rel. Trustees of Nat. Automatic Sprinkler Indus. Pension Fund*, 434 U.S. 586 (1978); *H.H. Robertson Co. v. Lumberman's Mut. Cas. Co.*, 94 F.R.D. 578 (W.D. Pa. 1982).

²²⁴ Former 40 U.S.C. §§ 270a (1999) (historical notes).

²²⁵ Construction Industry Payment Protection Act of 1999, Pub. L. 106-49 § 2(a), 113 Stat. 231 (Aug. 17, 1999), codified at 40 U.S.C. § 3131(b) (2003).

²²⁶ 40 U.S.C. § 3133(b)(1) (2003).

²²⁷ 40 U.S.C. § 3133(b)(2) (2003).

²²⁸ 40 U.S.C. § 3133(b)(4) (2003).

²²⁹ *Clifford E. MacEvoy v. United States for Use and Benefit of Calvin Tompkins Co.*, 322 U.S. 102, 110, 646 S. Ct. 890, 88 L. Ed. 1163 (1944).

Congress's basic objectives. Yet, the rights of claimants under the Act were entirely statutory in their origin, and so could not be expanded beyond the plain meaning of the statute.²³⁰

b. Little Miller Acts

The Miller Act provided a model for states to enact their own statutes, or "Little Miller Acts," that would cover public works construction that was not covered by federal law.²³¹ State law establishing requirements for contractors' bonds or other security relating to performance of public construction projects may also be broader in scope than the federal law embodied in the Miller Act. For example, in addition to bonding requirements, state law may require that a certain percentage of the funds owed on the contract be retained by the contracting agency for the benefit of unpaid subcontractors or suppliers.²³² Many of the states' laws on public contractor bonding stem from early efforts to provide laborers and materialmen a form of protection similar to that which mechanic's liens provided in private construction projects.²³³ Many states' statutes also include requirements designed to protect the interests of public agencies in a wide range of other matters. These include guarantee of bids, satisfactory performance of contracts, payment of taxes, contribution to workmen's compensation or unemployment funds, performance of maintenance, and issuance of supplies.²³⁴

The Model Procurement Act also contains a section addressing the requirement of payment and performance bonds.²³⁵ These requirements are similar to the

²³⁰ Thus, the approach to construction of the law has been summed up as follows:

[Sections 270a-270b...are] remedial in nature and [are] to be liberally construed in order to properly effectuate the congressional intent to protect those who furnish labor or materials for public works, and the strict letter of [such sections] must yield to [their] evident spirit and purpose when this is necessary to give effect to the intent of Congress and to avoid unjust and absurd consequences, [citations omitted] such a salutary policy does not justify ignoring plain words of limitation and imposing wholesale liability on payment bonds.

United States for Use and Benefit of J.A. Edwards & Co. v. Bregman Construction Corp., 172 F. Supp. 517, 522 (E.D.N.Y. 1959); *see also United States ex rel. Ross v. Somers Constr. Co.*, 184 F. Supp. 563 (D. Del. 1959).

²³¹ *Norquip Rental Corp. v. Sky Steel Erectors, Inc.*, 854 P.2d 1185, 1188, 175 Ariz. 199, *review denied* (Ariz. App. 1993).

²³² *See, e.g., COLO. REV. STAT. § 38-26-107* (2000).

²³³ *See Western Metal Lath, a Division of Triton Group, Ltd. v. Acoustical and Const. Supply, Inc.*, 851 P.2d 875, 877 (Colo. 1993).

²³⁴ N.M. STAT. § 13-4-18 (A)(1) (2001) (performance bond); OHIO REV. STAT. § 9.31.1 (2001) (bid security); WIS. STAT. § 779.14(1e)(a) (2001) (including state taxes, workers' compensation, and unemployment insurance).

²³⁵ AMERICAN BAR ASSOCIATION, MODEL PROCUREMENT CODE FOR STATE AND LOCAL GOVERNMENTS § 5-302 (2000).

Miller Act requirement for separate payment and performance bonds, but require bond amounts to be 100 percent of the contract price.

c. Statutory Terms and Other Definitions

Much of the Miller Act's annotations interpret the language defining the parties protected and the types of contracts covered. They also discuss what constitutes "labor and materials" supplied "in the prosecution of the work provided for" under a contract. The courts have been asked to clarify the critical dates involved in the 1-year limitation on commencing suit, and the 90-day period for notice of claims, and the sufficiency of the content of the notice. These decisions have also helped shape the meaning of state and local contractor bonding laws or Little Miller Acts that have been patterned after the federal statute.

i. Public Buildings and Public Works.—Because the Miller Act applied to contracts "for the construction, alteration, or repair of any public building or public work of the United States," a threshold question concerned the definition of "public works." In *United States to the Use of Noland Co. v. Irwin*,²³⁶ the Supreme Court gave this phrase a broad scope, consistent with legislative history that contemplated application to public works projects under the contemporaneous National Recovery Act. In contrast to the view that had prevailed under the Heard Act, the Court stated that "the question of title to the buildings or improvements to the land on which they are situated is no longer of primary significance."²³⁷ A more important consideration was whether the structures were constructed for public use and paid for by the Federal Government. Neither was it technically necessary that the contract be made directly with the United States, provided that the work performed was done on behalf of the government under proper authority.²³⁸

Projects that involve public money but are ultimately privately owned and/or operated buildings also present problems for determining bond requirements under state Little Miller Acts. In *Milbrand Co. v. Department of Social Services*,²³⁹ a private developer purchased city-owned property under a contract to construct a building in accordance with plans received and approved by the city. The contractor defaulted on payments to a subcontractor, who then sued the city. The court held that the project did not involve a "public building" for which a statutory payment bond was required.²⁴⁰ A Connecticut

court held that whether a project is a "public work" must be determined on a case-by-case basis, and where a building is constructed with public money for private use, the determination depends on the degree of governmental involvement with the project.²⁴¹ A Georgia court found that mere receipt of public funds by a private organization did not require application of either the Miller Act or Georgia's Little Miller Act.²⁴² However, in a case involving construction of both public and nonpublic facilities, the surety was liable to the concrete supplier for concrete used in the nonpublic portion of the project, since the work was completed as part of the covered prime contract.²⁴³

ii. Labor Done or Performed.—Many questions regarding the labor covered by the Miller Act payment bonds have involved the requirement that the labor be performed "in the prosecution of the work provided for" in the contract. The language implies that certain services that benefit the contractor are so generalized that they cannot be traced to the contract specifications, and thus are not covered by the bond. However, these limits seldom result in denying a claim because of its remoteness.²⁴⁴ Claims for work done outside the scope of the contract specifications represent the category most vulnerable to denial, because requirement of their inclusion under the bond would alter the obligation of the surety.²⁴⁵ Claims for extra work may be allowed where the terms of the bond provide for it and the contractor initially authorizes the work.²⁴⁶

Where claims have been made for money withheld from laborers' wages to meet taxes, decisions have varied. Some argue for allowing such claims because the money in question was withheld from laborers' compensation and, in the absence of the withholding directive, would have been paid to the wage earner. Another

and Atomic Energy Commission). With respect to "public works," see Annotation, 48 A.L.R. 4th 1170.

²⁴¹ *L. Suzio Concrete Co. v. New Haven Tobacco, Inc.*, 28 Conn. App. 622, 611 A.2d 921 (1992).

²⁴² *Consolidated Elec. Supply, Inc. v. Bishop Contracting Co.*, 205 Ga. App. 674, 423 S.E.2d 415 (1992) (YWCA received federal funds, but provided no essential government services and was not a governmental agency).

²⁴³ *Dixie Bldg. Material Co. v. Liberty Somerset, Inc.*, 656 So. 2d 1041 (La. App. 4th Cir.) *rehearing denied*, 661 So. 2d 1346 (1995).

²⁴⁴ See, e.g., *Price v. H.L. Coble Constr. Co.*, 317 F.2d 312, 316 (5th Cir. 1963) (labor furnished for a subcontractor, involving overseeing and expediting construction work, recruiting workmen, making up payrolls, and reporting periodically to the subcontractor held covered by the payment bond).

²⁴⁵ *Sam Macri & Sons, Inc. v. United States for the Use and Benefit of Oaks Constr. Co.*, 313 F.2d 119, 123–24 (9th Cir. 1963); *United States for the Use and Benefit of Warren Painting Co. v. J.C. Boespflug Constr. Co.*, 325 F.2d 54, 61 (9th Cir. 1963).

²⁴⁶ *Cent. Gulf Elec. Contractor, Inc. v. M. P. Dunesnil Constr. Co.*, 471 So. 2d 1148 (La. App. 3rd Cir. 1985).

²³⁶ 316 U.S. 23, 62 S. Ct. 899, 86 L. Ed. 1241 (1942).

²³⁷ 316 U.S. at 29.

²³⁸ *United States ex rel. Westinghouse Electric Supply Co. v. National Sur. Corp.*, 179 F. Supp. 598 (E.D. Pa. 1959).

²³⁹ 117 Mich. App. 437, 324 N.W.2d 41 (1982) (construing MICH. COMP. LAWS, 129.201 (1963)).

²⁴⁰ 324 N.W.2d at 43; *but see United States ex rel. Hillsdale Rock Co. v. Cortelyou & Cole, Inc.*, 581 F.2d 239, 242 (9th Cir. 1978) (payment bond furnished jointly by Stanford University

viewpoint is that the correct way of looking at the role of the contractor in these circumstances is as a collector of the tax at the point where the laborer receives his or her wages. Wages withheld for taxes generally are not covered by the bond.²⁴⁷ However, wages withheld to make contributions to union health and welfare funds on behalf of employees are within the bond's coverage.²⁴⁸

Applying Iowa's statute, the state court agreed that contributions to health, welfare, and pension funds represented payment for labor or services performed in a construction project, and distinguished those funds from workers' compensation, social security taxes, and board and lodging for employees, which were not in the nature of payment for labor or services.²⁴⁹

Federal court decisions on Miller Act bonds have adopted a view that the scope of the phrase "labor and materials" includes those costs that are necessary to provide the products and services or add value to the project of which they are components. Thus, they hold that the statutory coverage of Miller Act bonds does not include attorneys fees, financial charges on overdue accounts, lost profits, cancellation charges, delay damages, escalated material costs, or penalties.²⁵⁰ State courts have reached the same conclusion under state law regarding personnel administration costs and security interests.²⁵¹

²⁴⁷ *United States v. Seaboard Sur. Co.*, 201 F. Supp. 630 (N.D. Tex. 1961).

²⁴⁸ *United States for the Benefit of Sherman v. Carter*, 353 U.S. 210, 219, 77 S. Ct. 793, 1 L. Ed. 2d 776 (1957).

²⁴⁹ *Dobbs v. Knudson, Inc.*, 292 N.W.2d 692, 695 (Iowa 1980) (construing IOWA CODE, 573.2 (1976)); *see also* *Trustees of Colo. Carpenters & Millwrights Health Bd. Trust Fund v. Pinkard Constr. Co.*, 199 Colo. 35, 604 P.2d 683, 685 (1979) (construing COLO. REV. STAT. § 38-26-105 (1973)); *Trustees, Fla. West Coast Trowel Trades Pension Fund v. Quality Concrete Co.*, 385 So. 2d 1163 (Fla. App. 1980) (construing Fla. Stat. Ann. § 255.05 (1978)); *see also* *Indiana Carpenters Cent. and Western Indiana Pension Fund v. Seaboard Sur. Co.*, 601 N.E.2d 352, 355-56, *rehearing denied, transfer denied*, 615 N.E.2d 892 (1994); *Alibrandi Building Systems, Inc. v. Wm. C. Pahl Constr. Co.*, 590 N.Y.S.2d 370, 371, 187 A.D. 2d 957 (1992); *Puget Sound Elec. Workers Health and Welfare Trust Fund v. Merit Co.*, 123 Wash. 2d 565, 870 P.2d 960 (1994).

²⁵⁰ *Can-Tex Indus. v. Safeco Ins. Co. of Am.*, 460 F. Supp. 1022 (W.D. Pa. 1978) (construing PA. STAT., tit. 8, § 193 (1967)); *Lite-Air Products, Inc. v. Fidelity & Deposit Co. of Md.*, 437 F. Supp. 801, 804 (E.D. Pa. 1977); *see also* *United States ex rel. Heller Elec. Co. v. William F. Klingsmith, Inc.*, 670 F.2d 1227 (D.C. Cir. 1982) (Miller Act claim for damages for contractor's delay and loss of anticipated profits); *Concrete Structures of the Midwest, Inc. v. Fireman's Ins. Co. of Newark*, 790 F.2d 41 (7th Cir. 1986) (claim for lost profits based on common law bond theory denied).

²⁵¹ *Primo Team, Inc. v. Blake Constr. Co.*, 4 Cal. Rptr. 2d 701, 3 C.A. 4th 801, *rehearing denied, modified, review denied* (Cal. App. 4th Dist. 1992) (personal administrator not "furnisher of labor"); *Union Asphalt, Inc. v. Planet Ins. Co.*, 27 Cal. Rptr. 2d 371, 21 C.A. 4th 1762 (1994) (holder of security interest not supplier of labor or materials).

Cases defining "labor in prosecution of the work" as used in the Miller Act have construed the term to include physical work and also activities of architects and other professionals who supervise work done at the project job site. Where the language of the bond is broad enough, it may cover work done by architects outside of the job site.²⁵² Activities of consulting engineers involving inspection of work being performed by others are within the scope of the statutory coverage.²⁵³ Where professional work does not involve services of a supervisory nature, inspections, job site consultations and job reviews, or similar activities, it is regarded as outside the statutory scope of the bond.²⁵⁴ In addition, work performed by architects or engineers prior to the construction contract are not covered by the bond.²⁵⁵ This narrow interpretation of "labor" in the federal cases contrasts with the argument that the Miller Act should be read to include all professional services under its protection, and that some states have given broader coverage under their analogous mechanics' lien laws.²⁵⁶

²⁵² *Herbert S. Newman and Partners, P.C. v. CFC Constr. Ltd. Partnership*, 236 Conn. 750, 674 A.2d 1313 (1996).

²⁵³ *See* *United States ex rel. Charles H. Thayer v. Metro Constr. Corp.*, 330 F. Supp. 386 (E.D. Va. 1971).

²⁵⁴ *United States ex rel. Naberhaus-Burke, Inc. v. Butt & Head, Inc.*, 535 F. Supp. 1155, 1160 (S.D. Ohio 1982) ("federal case law has adopted an admittedly somewhat narrow definition of the term...covering only skilled professional work which involves actual superintending, supervision or inspection at the jobsite.").

²⁵⁵ *Union Asphalt, Inc. v. Planet Ins. Co.*, 27 Cal. Rptr. 2d 371, 21 C.A. 4th 1762 (Cal. App. 2 Dist. 1994).

²⁵⁶ *See* *Annotation*, 3 A.L.R. 3d 573 (1965), 28 A.L.R. 3d 1014 (1969).

iii. *Material Furnished or Supplied.*—Under both federal and state law, the definition of “materials furnished or supplied” includes all types of materials, items, and substances that are incorporated into the public facility, or consumed in its construction.²⁵⁷ Other things may be included, however, if circumstances show that they were furnished “in the prosecution of the work provided for” in the contract. Materials may be considered to be furnished in the prosecution of the contract work even though they are not deposited at the construction site, or not wholly consumed in the construction work.²⁵⁸

State bonding statutes that use the language of the Miller Act (i.e., “furnished labor or materials in the prosecution of the work provided for in such contract”) generally are interpreted as imposing on the claimant a burden of showing only that the materials were “furnished” in connection with a particular project, but not that the specific items furnished were actually incorporated into the construction work. While proof of delivery to a job site is an important, and sometimes decisive, factor in proving that goods were “furnished” in connection with a particular project, it is not an absolute requirement or element of proof of the claim.²⁵⁹ Invoices and sales slips that itemize materials shipped and are adequately dated can meet the claimant’s burden of proof.²⁶⁰

Where the “materials furnished” are not consumed in the construction process or physically incorporated into the project, their use in the construction process cannot be easily measured.²⁶¹ Consequently, recovery for the value of signs and barricades for use during work on drainage structures, wooden forms for concrete pavement, and sheet pilings for lining ditches during excavation operations have been approved only where other rationale for recovery was available.²⁶²

²⁵⁷ *Quality Equipment Co. v. Transamerica Ins. Co.*, 243 Neb. 786, 502 N.W.2d 488, 492 (1993) (state law); *Poly-Flex, Inc. v. Cape May County Mun. Utilities Auth.*, 832 F. Supp. 889, 892 (D. N.J. 1993) (federal law).

²⁵⁸ *Montgomery v. Unity Elec. Co.*, 155 F. Supp. 179 (D. P.R. 1957); *United States ex rel. Purity Paint Products Corp. v. Aetna Cas. & Sur. Co.*, 56 F. Supp. 431 (D. Conn. 1944); *Commercial Standard Ins. Co. v. United States for Use of Crane Co.*, 213 F.2d 106 (10th Cir. 1954) (recovery allowed under a payment bond for pipe put in inventory to replace that which had been taken out to complete the contract; but recovery denied for stockpiled materials where there was no evidence to show which material actually had been used in the performance of public construction, and which had been used for other contracts); *United States for the Benefit and Use of Westinghouse Elec. Supply Co. v. Robbins*, 125 F. Supp. 25 (D. Mass. 1954).

²⁵⁹ *City Elec. v. Indus. Indem. Co.*, 683 P.2d 1053, 1057–58 (Utah 1984).

²⁶⁰ *Id.* at 1059.

²⁶¹ *Houston Gen. Ins. Co. v. Maples*, 375 So. 2d 1012 (Miss. 1979) (construing MISS. CODE, 31-5-1 (1972)).

²⁶² *Constr. Materials, Inc. v. Am. Fidelity Fire Ins. Co.*, 383 So. 2d 1291 (La. 1980) *writ granted*, 385 So. 2d 256 (liability

Contractors, subcontractors, and materialmen in their daily business practices often do not leave clear trails of the movement of labor, materials, and money in their transactions. Proof of problems resulting where contractual transactions are permitted to become casual is illustrated in *Adams v. Magnolia Construction Co.*²⁶³ A general contractor for construction of a municipal sewer system orally arranged with a subcontractor to have the latter furnish “shells” for the structural components needed in the project. The subcontractor obtained the shells from three sources and stockpiled them in the contractor’s storage yard, where they were mixed with other shells and used as needed for a series of projects. When a corporate officer of one of the subcontractor’s suppliers was unable to testify that any of its company’s shells were actually used by the subcontractor in the bonded project, there was no other trail of business records of physical evidence on which to rely, and the supplier’s claim was dismissed. In contrast, where purchase orders, invoices, and correspondence between the parties have been available to establish the transfer of materials from supplier to contractor, the claimant can more easily prove their use by the contractor and the payment for them.²⁶⁴

Recognizing the reasonable limits to which a supplier can be expected to go in determining what use is made of its materials once they are turned over to another party, courts have accepted proof of delivery to the work site as evidence that the materials were used in the construction.²⁶⁵ Where a supplier furnished towing services rather than materials, the proof that they were consumed or used in a bonded project was found through matching invoices with the transporter’s log book showing the routes used.²⁶⁶

In order to recover from the surety, a supplier must show that it delivered materials to the contractor or subcontractor in good faith, that it understood and intended that the materials were to be used in prosecution of the contract work, that the contractor or subcon-

based on language of bond broader than statute); *Slagle-Johnson Lumber Co. v. Landis Constr. Co.*, 379 So. 2d 479 (La. 1979) (forms destroyed following use); *R.C. Stanhope, Inc. Roanoke Constr. Co.*, 539 F.2d 992 (4th Cir. 1976) (lost sheet piling treated as rental equipment rather than as material consumed).

²⁶³ 431 So. 2d 38 (La. App. 1983) (applying LA. REV. STAT., § 38:2241); *see also* *School Dist. of Springfield R-12 ex rel. Midland Paving Co. v. Transamerica Ins. Co.*, 633 S.W.2d 238 (Mo. App. 1982) (invoices, weight tickets, account records).

²⁶⁴ *Carr Oil Co. v. Donald G. Lambert Contractor, Inc.*, 380 So. 2d 157 (La. App. 1979) (petroleum products and fuel delivered to contractor’s fuel storage tanks at work site and used there by contractor’s road equipment).

²⁶⁵ *Wal-Board Supply Co. v. Daniels*, 629 S.W.2d 686 (Tenn. App. 1981); *Carr Oil Co. v. Donald G. Lambert Contractor*, 380 So. 2d 157 (La. App. 1979).

²⁶⁶ *Harvey Canal Towing Co. v. Gulf South Dredging Co.*, 345 So. 2d 567 (La. App. 1977).

tractor diverted the materials from use in the intended project, and that the supplier did not have knowledge or authorize the diversion.²⁶⁷ Where materials fabricated for use in a tunnel construction project were delivered to the project site, but thereafter were converted by the contractor to other projects, it was held that the bond covered the converted materials originally intended for incorporation into the tunnel project.²⁶⁸ In this instance the state's bonding statute required that contractors' payment bonds cover "any material specially fabricated...as a component...so as to be unsuitable for use elsewhere."²⁶⁹

A common practice of contractors and subcontractors who must deal regularly with materialmen is to maintain open running accounts for the convenience of their employees to make purchases, as needed, during construction activities. This arrangement, however, increases the need to generate evidence of how the purchased materials were used.²⁷⁰

Where goods are rejected as unsuitable after delivery to the construction jobsite, courts have questioned whether the materialman is covered by the payment bond.²⁷¹ Holding that the materialman had stated a proper claim under the Miller Act even though it did not allege that its goods were supplied for use in a particular project, the federal court stated that for a materialman to recover under the Miller Act:

[I]t is necessary only that he show that the materials were supplied in prosecution of the work provided for in the contract, that he has not been paid therefore, that in good faith he had reason to believe that the materials were intended for the specified work, and that he complied with the jurisdictional requirements. It is immaterial to its right of recovery that the materialman deliver the materials to the jobsite or that such materials actually be used in...the work.²⁷²

²⁶⁷ Pennex Aluminum Co., A Div. of Metal Exchange Corp. v. International Fidelity Ins. Co., 818 F. Supp. 772, 782-84 (M.D. Pa. 1993) *see also* Solite Masonry Units Corp. v. Piland Constr. Co., 232 S.E.2d 759 (Va. 1977); AMOCO Oil Co. v. Capitol Indemnity Corp., 291 N.W.2d 883, 889-91 (Wis. App. 1980) (supplier should have been aware of diversion because of amount of material ordered).

²⁶⁸ CC&T Constr. Co. v. Coleman Bros. Corp., 8 Mass. App. 133, 391 N.E.2d 1256, 1259 (1979).

²⁶⁹ *Id.* (Construing MASS. GEN. L., ch. 149, § 29).

²⁷⁰ Villa Platte Concrete Service, Inc. v. Western Casualty & Surety Co., 399 So. 2d 1320 (La. App. 1981) (proof insufficient to show that items for which claimant sought recovery actually had been furnished under oral contract between claimant and general contractor); Cedar Vale Co-Op Exchange v. Allen Utilities, Inc., 10 Kan. App. 2d 129, 694 P.2d 903 (1985) (claimant's evidence was insufficient to show that items charged to contractor's account were used in project).

²⁷¹ United States ex. rel. Lanahan Lumber Co. v. Spearin, Preston & Burrows, Inc., 496 F. Supp. 816 (M.D. Fla. 1980).

²⁷² *Id.* at Supp. at 817-18 (quoting United States ex. rel. Carlson v. Continental Casualty Co., 414 F.2d 431, 433 (5th Cir. 1969)).

iv. Other Items.—In determining the coverage of payment bonds required under the states' Little Miller Acts, various marginal items have been considered by the courts. Where the question is whether particular items are materials or equipment, the nature of the item is a more important indicator than the form of the agreement involved. Thus, scaffolding used by a painting contractor was held to be part of its permanent "plant," or stock of tools, and equipment held on hand to perform its work.²⁷³ Under a statute requiring payment bonds for the protection of "all persons supplying labor and materials" in the prosecution of the work, items such as bulldozers, graders, tractors, trucks, and the like were held not to be "materials" that could be covered by the bond.²⁷⁴

The same issue arose where a claimant argued that pumps obtained by rent or purchase for use in constructing a municipal sewer system were "supplies used or consumed" by the contractor. Holding that the costs of renting and purchasing the pumps were not covered by the contractor's payment bond, the Colorado court noted that there was a split of authority on the treatment of tools, equipment, and "plant," but found that the majority did not allow recovery from the surety.²⁷⁵

Whether activities conducted away from the construction site can qualify as "work done" in completion of a project was considered where sand for a highway project was taken by dragline from a river and deposited at a loading yard, from which it was hauled by another subcontractor to the site of the road work. When a dragline operator sued to recover from the surety for its services, the court held that the claim was allowed.²⁷⁶ All links in the transportation chain from a protected materialman to the construction job site are covered by the bond, and so the cost of moving sand from the barges to the loading yard was covered.

Fuel furnished for operating machinery used in construction work on the jobsite generally meets the test of necessity.²⁷⁷ So does fuel used for heating buildings at the jobsite used in performing the work.²⁷⁸

²⁷³ Arthur J. Roberts & Co. v. Delfour, Inc., 14 Mass. App. 931, 436 N.E.2d 1246, 1248 (1982) (construing MASS. GEN. LAWS ANN. ch. 149, § 29).

²⁷⁴ Valliant v. State, Dep't of Transp. and Dev., 437 So. 2d 845 (La. 1983) (construing LA. REV. STAT. § 38:2241 (1980)); Rish v. Theo Bros. Constr. Co., 269 S.C. 226, 237 S.E.2d 61 (1977) (construing S. C. CODE § 33-224 (1975)).

²⁷⁵ CPS Distributors, Inc. v. Fed. Ins. Co., 685 P.2d 783, 785 (Colo. App. 1984) (construing COLO. REV. STAT. § 38-26-105 (1982)).

²⁷⁶ Javeler Constr. Co. v. Fed. Ins. Co., 472 So. 2d 258 (La. 1985) (construing LA. REV. STAT. § 38:2241 (1980)).

²⁷⁷ State for Use and Benefit of J.D. Evans Equip. Co. v. Johnson, 83 S.D. 444, 160 N.W.2d 637, 640 (1968) (includes gas and oil); United States for Use of United States Rubber Co. v. Ambursen Dam Co., 3 F. Supp. 548 (N.D. Cal. 1933).

²⁷⁸ Leo Spear Constr. Co. v. Fidelity and Casualty Co. of New York, 446 F.2d 439, 444 (2d Cir. 1971); United States for Use of Elias Lyman Coal Co. v. United States Fidelity & Guar. Co., 83 Vt. 278, 75 A. 280 (1910).

The obvious need for moving supplies and materials to the jobsite, sometimes over great distances, and within the jobsite has led to construing transportation as a form of “labor” furnished to the contractor, and therefore covered by payment bonds under the Miller Act and Little Miller Acts.²⁷⁹

v. Equipment Rental.—The regular use of rental equipment in public works construction has lead some states to list rental charges as items that are covered by statutory payment bonds. Other states, interpreting variously worded statutes that do not explicitly cover rental of equipment, have held that rental costs are included in the general language and legislative purpose of their laws.²⁸⁰ In the rationale for permitting claims to recover for use of rented equipment, it is the rental payments, as opposed to the value of the equipment as a capital item, that are “consumed” in the performance of the project. Rental payments represent the increment of the useful life of the equipment that is used up for the benefit of the bonded project. Accordingly, the contract agreement establishing the rental must be a genuine lease rather than a purchase and sale. Whether the agreement is for a lease or a sale must be determined by the facts of each case, and is not solely dependent upon the characterization of the transaction. In a Missouri case, the evidence indicated that the claimant’s equipment rental agreement was in fact a lease intended for the security of the seller while the claimant purchased the equipment through a series of monthly payments.²⁸¹ In another case, the transaction was considered a rental rather than a sale even though the form was entitled “purchase/rental order,” but the information filled in on the form was only the rental rate and not the purchase cost.²⁸²

In contrast, the federal court in *United States Fidelity and Guaranty Co. v. Thompson-Green Machinery Co.* held that the agreements for rental of heavy construc-

tion machinery to a highway contractor were genuine leases and not conditional sales.²⁸³

Perhaps the most revealing test is whether the so-called lessee is obligated to accept and pay for the property or is obligated only to return or account for the property according to the terms of the lease from which he may be excused only if he exercises the privilege of purchasing it. If the latter is the case the transaction is a true lease, but if the contract, whatever its form, imposes an absolute obligation to pay for and accept the property and the transferor may require its return only upon default of the transferee, the transaction is a conditional sale... [T]he intent of the parties is controlling and is to be ascertained from the whole transaction, not merely from the language employed.²⁸⁴

Essentially the same approach was used where liability for rental was challenged because the equipment was idle for part of the period it was in the lessee’s possession. Recognizing that in most construction projects rental equipment is used intermittently, the rented items are considered to be “substantially consumed” on the project during the amount of time they are immediately available to the subcontractor for its use.²⁸⁵

Where claims against a contractor for costs of equipment use are based on a conditional sales contract, the claimant cannot have recourse to a Miller Act payment bond. Regarding “rental-purchase” agreements, courts have stated that they will look to the substance rather than the form of these transactions. Thus, where the total rent on equipment substantially equals its purchase price, and a purchase option is exercisable for a nominal sum, the transaction has been held to be a conditional sale.²⁸⁶ In contrast, where the total rent agreed upon was substantially less than the purchase price of the equipment, and the cost of exercising a purchase option was substantial, the transaction was held to be a rental, and unpaid rental charges were covered by the contractor’s payment bond.²⁸⁷

²⁷⁹ *Standard Accident Ins. Co. v. United States for the Use and Benefit of Powell*, 302 U.S. 442, 585 S. Ct. 314, 82 L. Ed. 350 (1938); *Conesco Indus. Ltd. v. St. Paul Fire and Marine Ins. Co.*, 619 N.Y.S.2d 865, 210 A.D. 2d 596, *leave to appeal denied*, 628 N.Y.S.2d 52, 85 N.Y.2d 809, 651 N.E.2d 920 (1995) (freight costs included).

²⁸⁰ *See, e.g., Norquip Rental Corp. v. Sky Steel Erectors, Inc.*, 854 P.2d 1185, 1190–91 (Ariz. App. 1993); *McElhose v. Universal Sur. Co.*, 182 Neb. 847, 158 N.W.2d 288 (1968).

²⁸¹ *Public Water Supply Dist. No. 3 of Ray County ex rel. Victor L. Phillips Co. v. Reliance Ins. Co.*, 705 S.W.2d 190 (Mo. App. 1986) (construing MO. ANN. STAT. 107.170 (1987); rental of excavating machinery paid in five monthly installments with option “guaranteeing” conversion to purchase after 5 months’ rental). Regarding distinguishing lease and sale transactions, *see* MO. REV. STAT. 400.1-201(37) (1978) and U.C.C. § 1-201(37); *United States ex rel. Eddies Sales & Leasing, Inc. v. Fed. Ins. Co.*, 634 F.2d 1050, 1052 (10th Cir. 1980) (Miller Act).

²⁸² *Chadwick-BaRoss, Inc. v. T. Buck Constr.*, 627 A.2d 532 (Me. 1993).

²⁸³ 568 S.W.2d 821 (Tenn. 1978) (construing TENN. CODE ANN. § 54-519 (1978)).

²⁸⁴ 568 S.W.2d at 825.

²⁸⁵ *McGee Steel Co. v. State ex rel. McDonald Indus. Alaska*, 723 P.2d 611, 617 (Alaska 1986); *John A. Artukovich Sons, Inc. v. Am. Fidelity Fire Ins. Co.*, 72 Cal. App. 3d 940, 140 Cal. Rptr. 434 (1977).

²⁸⁶ *Oesterreich v. Comm’r Int. Rev.*, 226 F.2d 798 (9th Cir. 1955).

²⁸⁷ *Kitchen v. Comm’r Int. Rev.*, 353 F.2d 13 (4th Cir. 1965).

vi. Repairs and Replacement of Parts.—Where claims are based on repairs or replacement of parts in a contractor's equipment, a distinction is made between work needed to maintain the contractor's capital investment in equipment and work needed to replace items worn out in the performance of work. Capital expenditures by the contractor are not covered by payment bonds. Where failure of the equipment during its use requires that it be repaired, the bond under Alaska's Little Miller Act was held to cover repair for incidental damage to the equipment and ordinary wear and tear, but not for repair due to a subcontractor's negligence.²⁸⁸

In determining whether repairs and parts replacement must be treated as capital investments, the question of substantial consumption of the repaired or replaced items in the work performed under the contract has been one of the most important tests.²⁸⁹ It is readily applied to such equipment as tires, batteries, and other automotive accessories that regularly need replacement with wear.²⁹⁰ However, where the items in question cannot be shown to have been substantially consumed in the contract work, any claim for their repair or replacement is open to the objection that payment will have the effect of adding to the value of the contractor's equipment beyond the needs of the current contract and will be for the benefit of work on other contracts.²⁹¹

Consumption of materials in the course of construction work or integration into the final facility is not questioned in the case of many classes of materials. However, it has presented problems for the state courts in connection with claims based on supplying tires or other equipment not entirely worn out in the work performed. One approach that has received wide acceptance was described by the Pennsylvania court in *Commonwealth to the Use of Walters Tire Service v. National Union Fire Ins. Co.*²⁹²

[T]he proper test to be applied is whether or not in a particular case and bonded project there is a reasonable and

²⁸⁸ *McGee Steel Co. v. State ex rel. McDonald Indus. Alaska*, 723 P.2d 611, 617–18 (Alaska 1986) (applying ALASKA STAT. § 36.25.010 (1986)); see also *Sim's Crane Serv. Inc. v. Reliance Ins. Co.*, 667 F.2d 30, 32 (11th Cir. 1982) (holding surety not liable for crane damage that exceeded "expected consumption" of equipment and "unduly enlarged" the bond's intended coverage); *John A. Artukovich Sons, Inc. v. Am. Fidelity Fire Ins. Co.*, 72 Cal. App. 3d 940, 140 Cal. Rptr. 434 (1977) (modification of trencher to meet project specifications); *Conesco Indus., Ltd. v. St. Paul Fire and Marine Ins. Co.*, 619 N.Y.S.2d 865, 867, 210 A.D. 2d 596, leave to appeal denied, 628 N.Y.S.2d 52, 85 N.Y.2d 809, 651 N.E.2d 920 (1994) (repair costs allowed).

²⁸⁹ *United States for Use and Benefit of J.P. Byrne & Co. v. Fire Ass'n*, 260 F.2d 541 (2d Cir. 1958).

²⁹⁰ *United States for Use of United States Rubber Co. v. Ambursen Dam Co.*, 3 F. Supp. 548 (N.D. Cal. 1933).

²⁹¹ *United States for Use and Benefit of Wyatt & Kipper Eng'rs, Inc. v. Ramstad Constr. Co.*, 194 F. Supp. 379 (D. Alaska 1961); *Continental Cas. Co. v. Clarence L. Boyd Co.*, 140 F.2d 115 (10th Cir. 1944).

²⁹² 434 Pa. 235, 252 A.2d 593 (1969).

good faith expectation by the supplier at the time of delivery that the materials under all the circumstances would be substantially used up in the project under way.²⁹³

However, a year later the same court had to pass on a claim for replacement of the undercarriage of an item of multi-use equipment. The actual use of the equipment following replacement became the decisive factor. The claim was disallowed when it appeared that following its repair the machinery was used 75 percent of the time on other jobsites.²⁹⁴ Thus, in practice, the test of reasonableness and good faith is likely to be tempered by reference to whether expectations are validated by actual experience on the jobsite.²⁹⁵

"Substantial consumption" is the surest test for distinguishing materials from enhancement of capital investment. However, difficult questions of interpretation have remained in the form of claims based on frustrated expectations of the parties or services performed after the contractor or subcontractor completes work on a contract site. Thus, some courts have focused on the degree of consumption that was expected in connection with a particular job rather than the consumption that actually occurred.²⁹⁶ Also, the language of the contract may indicate an intent to cover a certain degree of repair or replacement. Where the contract called for rental of equipment at the "net cost" to the subcontractor, the subcontractor was entitled to the cost of repair from the payment bond.²⁹⁷

5. Enforcement of Payment Bonds

Before a party can recover for payment under the Miller Act, it must prove several elements: that it supplied materials or labor for the work in the contract at issue; that it has not been paid; and that the jurisdictional requirements for timely and adequate notice have been met.²⁹⁸ However, a threshold question in the enforcement of the remedies provided in the Miller Act concerns the definition of parties eligible to reach the contractor's payment bond. The Miller Act stated that this class consisted of persons who dealt directly with the prime contractor, or who lacked a direct contractual relationship, express or implied, with the prime contractor, but had a direct relationship with one of its

²⁹³ 252 A.2d at 595.

²⁹⁴ *County Comm'rs of Tioga County to the Use of L.B. Smith, Inc. v. C. Davis, Inc.*, 439 Pa. 285, 266 A.2d 749 (1970).

²⁹⁵ *Mountaineer Euclid, Inc. v. Western Cas. & Sur. Co.*, 19 Ohio App. 2d 185, 250 N.E.2d 768 (1969) (definition of "repair," discussion of whether it includes parts and labor or labor only).

²⁹⁶ *United States for Use and Benefit of Chemetron Corp. v. George A. Fuller Co.*, 250 F. Supp. 649 (D. Mont. 1965); *United States for Use and Benefit of J.P. Byrne & Co. v. Fire Ass'n*, 260 F.2d 541 (2d Cir. 1958).

²⁹⁷ *R.J. Russo Trucking and Excavating, Inc. v. Pa. Resource Systems, Inc.*, 573 N.Y.S.2d 95, 169 A.D. 2d 239 (1991).

²⁹⁸ See, e.g., *S.T. Bunn Constr. Co. v. Cataphote, Inc.*, 621 So. 2d 1325 (Ala. Civ. App. 1993).

subcontractors. There was, however, no statutory definition of a subcontractor.

State statutes vary in the scope of persons who may recover under the payment bond. For example, Kansas's bond statute limits recovery to the same persons eligible under the Miller Act.²⁹⁹ However, California's statute provides coverage to subcontractors at any tier.³⁰⁰

a. Parties Entitled to Claim

The Miller Act allows claims by subcontractors and by those in a contractual relationship with a subcontractor, including materialmen and suppliers of labor. Questions have thus arisen as to who is a subcontractor. The first guidance provided by the Supreme Court on the definition of subcontractor in the Miller Act came in *Clifford E. MacEvoy Co. v. United States for Use and Benefit of Calvin Tompkins Co.*³⁰¹ The court held that the term "subcontractor," as used in the Miller Act, was "one who performs for and takes from the prime contractor a specific part of the labor or material requirements of the original contract."³⁰² The claimant had sold building materials to one who resold them to the prime contractor for use in a federal construction project. The court held that the claimant was merely a supplier to a materialman, and thus too remote from the prime contractor to be eligible to reach the payment bond. The decision appeared to be consis-

²⁹⁹ See *Vanguard Products Corp. v. American States Ins. Co.*, 19 Kan. App. 2d 63, 863 P.2d 991 (1993) (applying KAN. STAT. § 60-1111; supplier to subsubcontractor not with scope of coverage of bond).

³⁰⁰ *Union Asphalt, Inc. v. Planet Ins. Co.*, 27 Cal. Rptr. 2d 371, 21 C.A. 4th 1762 (1994) (applying CAL. CIV. CODE §§ 3110, 3181, 3248(c)).

³⁰¹ 322 U.S. 102, 64 S. Ct. 890, 88 L. Ed. 1163 (1944).

³⁰² 322 U.S. at 109. See also *Aetna Cas. & Sur. Co. v. United States for Use and Benefit of Gibson Steel Co.*, 382 F.2d 615 (5th Cir. 1967) (fabricator of steel products who gave the contractor no performance bond, received no progress payments, and whose contract amounted to only 2 percent of the total cost of a project was denied status of subcontractor under the Miller Act); *United States for the Use of Wellman Eng'r Co. v. MSI Corp.*, 350 F.2d 285 (2d Cir. 1965) (firm that supplied hydraulic system for opening and closing roof of missile launcher held status of subcontractor even though it performed no installation work on jobsite); *Basich Bros. Constr. Co. v. United States for Use of Turner*, 159 F.2d 182 (9th Cir. 1946) (firm that supplied sand and gravel to a location leased by the prime contractor where the materials were further processed and delivered to the jobsite was held to be a subcontractor rather than a materialman; the element of privity was strengthened by the prime contractor's payment of the firm's payroll); *Brown & Root, Inc. v. Gifford-Hill & Co.*, 319 F.2d 65 (5th Cir. 1963); *United States for the Use and Benefit of F.E. Robinson Co. v. Alpha-Continental*, 273 F. Supp. 758 (E.D. N.C. 1967) (suppliers of labor, although not technically in privity with a prime contractor may be accorded the status of subcontractor); *Barton Malow Co. v. Metro. Mfg., Inc.*, 214 Ga. App. 56, 446 S.E.2d 785 (1994).

tent with the legislative history Congress had provided on this point and reflected the Court's acceptance of Congressional efforts to strike a balance that accommodated the needs of all the interests involved.³⁰³ The Court in particular cited the inability of the prime contractor to protect itself from claims that are too remote.³⁰⁴

The contractual basis of the parties' relationship appears to have been given more weight than the function being performed in the construction process. There is an argument that functional analysis may reduce the chance for use of sham subcontractors in order to limit liability on a payment bond. However, the United States Supreme Court has held that Congress imposed a structurally defined limitation on the right to sue on a payment bond, which was not to be overstepped by a functional examination of the relationships of the contracting parties.³⁰⁵ The necessary contractual basis of a claim is most readily shown by written agreements. However, contracts may be implied from the actions of the parties in the absence of a written agreement.³⁰⁶

This is illustrated in *United States ex rel. Parker-Hannifin Corp. v. Lane Construction Co.*³⁰⁷ The claimant was a manufacturer of hydraulic cylinders for operating the gates of an Army Corps of Engineers dam. It supplied these items to a subcontractor, and later sued on the prime contractor's payment bond when the subcontractor went bankrupt without having paid for the gates. Declaring that no general rule could be devised to dispose of cases of this sort, the court identified the following factors that should be considered in determining whether a claimant should be considered to be a subcontractor or material supplier. The first is the nature of the material or service supplied.³⁰⁸ For example, fungible goods that are part of general inventory (like sand and gravel), the production of which does not require use of a customized manufacturing process in order to meet the prime contractor's specifications, generally are treated as materials handled by a supplier or broker.

The second factor is whether the claimant had to make shop drawings of the items and supervise their

³⁰³ One Congressional committee's report had stated: "A Sub-subcontractor may avail himself of the protection of the bond by giving notice to the contractor, but that is as far as the bill goes. It is not felt that more remote relationships ought to come within the purview of the bond." H.R. Rep. No. 1263, 74th Cong. 1st Sess. 3 (1935).

³⁰⁴ 322 U.S. at 110.

³⁰⁵ *J.W. Bateson Co. v. United States ex rel. Bd. of Trustees of Nat. Automatic Sprinkler Indus. Pension Fund*, 434 U.S. 586 (1978).

³⁰⁶ *United States ex rel. Greenwald Indus. Products Co. v. Barlows Commercial Constr. Co.*, 567 F. Supp. 464, 466 (D.D.C. 1983) (contractor accepted delivery and used materials supplied by claimant).

³⁰⁷ 477 F. Supp. 400 (M.D. Pa. 1979).

³⁰⁸ *Id.* at 411.

fabrication.³⁰⁹ Items that are custom-made to specifications set out in the prime contract, by one who is responsible for the design, shop drawings, and fabrication of the items, generally are treated as the work of subcontractors. Custom manufacture by itself is not sufficient to establish subcontractor status, but is a major factor in the test.³¹⁰ In *Parker-Hannefin*, the court held that the claimant gate manufacturer qualified as a subcontractor whose work was incorporated into the bonded project, and so was eligible to sue on the project's payment bond.³¹¹

Interpreting definitions in Little Miller Acts, some states have undertaken a functional relationship test to determine whether a party is a subcontractor or a materialman who is too remote to recover under the bond. Under Arizona's statute, the court held that where a supplier was the "functional equivalent" of a subcontractor, it was entitled to the bond's protection.³¹² The court found that the correct test involved an examination of the nature of the dealings between the parties.

Some state courts have given their Little Miller Acts broader coverage based on apparent legislative intent.³¹³ The same result has been reached by treating material suppliers to sub-subcontractors as third-party beneficiaries, commenting that to hold otherwise would permit contractors and subcontractors to insulate themselves from liability by executing a series of subcontracts for that purpose and thwart the intent of the statute.³¹⁴

The Arizona court set out the following test of subcontractor status: (1) Does the custom in the trade consider the supplier a subcontractor or a materialman? (2) Are the items supplied generally available in the open market or are they "customized"? (3) In deter-

mining whether the material is "customized," do the plans and specifications call for a unique product, or are they merely descriptive of what is to be furnished? (4) Does the supplier's performance constitute a substantial and definite delegation of a portion of the performance of the prime contract?³¹⁵

Instances in which a surety takes over the completion of a construction project following default by the project's original prime contractor generally are handled by the surety's engaging another construction company to perform the unfinished work. In such a case, the surety is regarded as stepping into the place of the general contractor and the newly engaged contractor becomes a subcontractor for purposes of determining who is covered by the surety's bond.³¹⁶

The type of material or service supplied is not a reliable basis for determining whether a supplier is a subcontractor. Although suppliers of sand, gravel, and aggregate generally are not considered subcontractors, claims for furnishing these materials occasionally have been allowed on this basis.³¹⁷ On the other hand, suppliers of millwork and hardware items generally have been called contractors, while suppliers of brick, concrete blocks, curbstones, and similar stock items of building supplies have been treated as materialmen. Claims for furnishing fabricated steel items present a range of fact situations that have caused trouble for the courts. Normally the suppliers of these items do not perform any work at the jobsite following delivery, and where they do not, the assignment to them of a materialman's status is understandable. On the other hand, where they perform installation or other services in connection with the construction, their claim to subcontractor status is strengthened.³¹⁸

Viewing the cases as a whole, the results seem to reflect the use of a rather general test that ultimately turns on the degree that the prime contractor shifts or delegates its own responsibility to others. If the responsibility delegated merely entails furnishing or slightly altering standard materials or manufactured items without installing or incorporating them into the construction, the supplier is properly classified as a materialman. But where this responsibility includes installation as well as supply, or involves supplying a custom-built item or a product not generally available, the supplier may be classified as a subcontractor even

³⁰⁹ *Id.*

³¹⁰ See, e.g., *LaGrand Steel Products Co. v. A.C.S. Constructors, Inc.*, 108 Idaho 817, 702 P.2d 855 (Idaho App. 1985) (applying Idaho Code 54-1926) (fabricator was held to be a subcontractor where customized steel plates were a large item in the contract price); *Inryco, Inc. v. Eatherley Constr. Co.*, 793 F.2d 767 (6th Cir. 1986) (fabricator of highway sound barriers manufactured to dealer's specifications, where dealer in turn sold them to a subcontractor, was a supplier to a materialman).

³¹¹ 477 F. Supp. at 412.

³¹² *Trio Forest Products, Inc. v. FNF Constr., Inc.*, 182 Ariz. 1, 3, 893 P.2d 1, 3, *reconsideration denied, review denied* (1994).

³¹³ *State ex rel. W.M. Carroll & Co. v. K.L. House Constr. Co.*, 99 N.M. 186, 656 P.2d 236, 237 (1982) (construing N. M. STAT. ANN., § 13-4-19 (1978)) (statute includes a supplier of any subcontractor, is broader in scope than Miller Act); *State ex rel. Certain-Teed Products Corp. v. United Pacific Ins. Co.*, 389 A.2d 777 (Del. Super. 1978) (construing DEL. CODE, 29-6909 (1978)); *Union Asphalt, Inc. v. Planet Ins. Co.*, 27 Cal. Rptr. 2d 371, 21 C.A. 4th 1762 (1994) (CAL. CIV. CODE §§ 3110, 3181, 3248(c) apply to subcontractors at any tier).

³¹⁴ *Frost v. Williams Mobile Offices, Inc.*, 343 S.E.2d 441 (S.C. 1986) (temporary office furnished for staff while military hospital was renovated).

³¹⁵ *B.J. Cecil Trucking, Inc. v. Tiffany Constr. Co.*, 123 Ariz. 31, 597 P.2d 184, 187-88 (Ariz. App. 1979) (applying ARIZ. REV. STAT., § 32-1152 (1978)).

³¹⁶ *H&H Sewer Systems, Inc. v. Ins. Guar. Ass'n*, 392 So. 2d 430 (La. 1980).

³¹⁷ *Standard Accident Ins. Co. v. Basolo*, 180 Okla. 261, 68 P.2d 804 (1937) (claimant who supplied sand and gravel for highway construction and delivered it to a location near the jobsite held to be both a subcontractor and materialman); see also *People for Use and Benefit of Youngs v. United States Fidelity & Guar. Co.*, 263 Mich. 638, 249 N.W. 20 (1933).

³¹⁸ *Jesse F. Heard & Sons v. Southwest Steel Prods.*, 124 So. 2d 211 (La. Ct. App. 1960).

though its work is performed far from the prime contractor's jobsite.

b. Notification of Claim

i. Time for Providing Notice.—Claimants seeking recourse to a contractor's payment bond under authority of the Miller Act must give written notice of their claim to the contractor within 90 days after the date on which the last labor was performed or the last materials were furnished on which the claim is based. The Miller Act does not address whether notice must be mailed or received within 90 days. However, at least one court has held that notice must be received by the contractor prior to the end of the 90-day period.³¹⁹

State statutes have similar time limitations for filing notice.³²⁰ For example, Florida requires that a claimant have given the contractor notice within 45 days of beginning work on the project that it intends to look to the bond for protection against nonpayment, and must notify the contractor and surety of its claim within 90 days after completing its performance.³²¹

Compliance with the requirement for giving timely notice is a jurisdictional requirement for proceeding against the contractor's bond.³²² Where this requirement is in force at the time a contract is awarded and is incorporated by reference into the contract, it applies even though it subsequently is amended or repealed,³²³ or a contractor orally undertakes responsibility for a defaulting subcontractor's debts,³²⁴ or fails to object to lack of timely or proper notice of the claim at the commencement of the suit.³²⁵

A Miller Act claimant may avoid this requirement only by showing that it has entered into a "contractual relationship, express or implied" with the contractor.³²⁶

Such a showing must be unequivocal and must relate to the specific items that comprise the claim. For example, a subcontractor's supplier was excused from giving notice within the statutory period by showing that after the subcontractor's default the contractor executed an agreement to pay the supplier's unpaid balance, and thereafter issued checks made jointly payable to the supplier and subcontractor.³²⁷ In contrast, the claimant was not excused from complying with the notice period where it relied on the contractor's general declaration that it would pay for materials incorporated into the project, despite the fact that the contractor's checks were issued jointly to the supplier and subcontractor.³²⁸ Nor was the necessary contractual relationship present where a claimant relied on its status as a co-prime contractor on the project.³²⁹

Where a bond provides less stringent notification requirements than what the statute requires, then the terms of the bond will control.³³⁰ However, if the bond sets more stringent requirements than allowed by the statute, that provision in the bond may be held to be void and the time limits set by statute will control.³³¹

If a state has a requirement for recording the bond, then the notice requirement may apply only if the contractor has recorded the bond in the manner required by statute.³³² If the contractor has not recorded the bond where there is such a requirement, a supplier is not bound by the notice and time limitations.³³³

The difficulties of applying the notice rule arise from the variety of business and accounting arrangements under which materials and services are supplied in construction projects. Where a materialman supplies materials on several occasions, each occasion may be treated by the parties as separate orders, a continuing contract, a running open account, or some other type of

³¹⁹ *B & R, Inc. v. Donald Lane Constr.*, 19 F. Supp. 2d 217 (D. Del. 1998).

³²⁰ *Sharpe, Inc. v. Neil Spear, Inc.*, 611 So. 2d 66, *review denied*, 620 So. 2d 761 (Fla. App. 1 Dist. 1992) (applying FLA. STAT. § 255.05).

³²¹ FLA. STAT. § 255.05.

³²² *U.S. Fidelity & Guar. Co. v. Thompson and Green Machinery Co.*, 568 S.W.2d 821 (Tenn. 1978) (construing TENN. CODE § 54-519 (1975)); *Mid-County Rental Service, Inc. v. Miner-Dederick Constr. Corp.*, 583 S.W.2d 428 (Tex. Civ. App. 1979) (construing TEX. CIV. STAT. art. 5160 (1987)); *U.S. Fidelity & Guar. Co. v. Couch, Inc.*, 472 So. 2d 614 (Ala. 1985) (construing ALA. CODE § 39-1-1 (1975), delaying suit until 45 days after notice to surety and contractor's failure to pay within 45 days).

³²³ *United Plate Glass Co., Div. of Chromalloy Am. Corp. v. Metal Trim Indus.*, 505 A.2d 613 (Pa. Super. 1986) (construing 8 PA. STAT. § 194(b)).

³²⁴ *Barboza v. Aetna Cas. & Sur. Co.*, 18 Mass. App. 323, 465 N.E.2d 290, 293 (1984) (construing MASS. GEN. L. ch. 149, § 29).

³²⁵ *Travelers Indem. Co. v. Munro Oil & Paint Co.*, 364 So. 2d 667 (Miss. 1978) (construing MISS. CODE § 31-5-13 (1972)).

³²⁶ 40 U.S.C. § 3133.

³²⁷ *United States ex rel. Billows Elec. Supply Co. v. E.J.T. Constr. Co.*, 517 F. Supp. 1178, 1182-83 (E.D. Pa. 1981).

³²⁸ *Noland Co. v. Armco, Inc.*, 445 A.2d 1079 (Md. App. 1982) (construing MD. CODE, art. 21, § 3-501 (1980)).

³²⁹ *Aetna Cas. & Sur. Co. v. Doleac Elec. Co.*, 471 So. 2d 325 (Miss. 1985) (construing MISS. CODE, § 31-51-1 (1972)); *see also Fleisher Eng'r & Constr. Co. v. United States for Use and Benefit of George S. Hallenbeck*, 311 U.S. 15, 61 S. Ct. 81, 85 L. Ed. 12 (1940); *State Roads Comm'n to the Use of Mobil Oil Corp. v. Contee Sand & Gravel Co.*, 308 F. Supp. 650 (D. Md. 1970).

³³⁰ *Trustees for Michigan Laborers' Health Care Fund v. Warranty Builders, Inc.*, 921 F. Supp. 471, 475-76 (E.D. Mich. 1996), *aff'd*, 137 F.3d 427 (6th Cir. 1998) (applying Michigan Public Works Act, M.C.L.A. § 129.201).

³³¹ *Town of Pineville v. Atkinson/Dyer/Watson Architects, P.A.*, 114 N.C. App. 497, 442 S.E.2d 73 (1994); *Dutchess Quarry & Supply Co. v. Firemen's Ins. Co. of Newark, N.J.*, 596 N.Y.S.2d 898, 190 A.D. 2d 36 (1993).

³³² *See, e.g., Martin Paving Co. v. United Pacific Ins. Co.*, 646 So. 2d 268 (Fla. App. 5 Dist. 1994) (applying FLA. STAT. § 255.05 (1, 2, 4)).

³³³ *Martin Paving Co. v. United Pacific Ins. Co.*, 646 So. 2d 268 (Fla. App. 5 Dist. 1994).

purchase arrangement. Contracts calling for supply, installation, testing, and training of others in the use of equipment or components may also make it difficult to determine at what point the notice period begins.³³⁴ In contracts requiring a series of steps, some of the steps may be separated by more than 90 days, and recovery for the earlier shipments may be barred.³³⁵ Cautious suppliers who must make a series of deliveries adopt the practice of filing claims within 90 days following each delivery, rather than relying on the argument that the series is integrated or that it is part of an open account transaction.³³⁶

Where it was necessary to determine the last date on which material was supplied, arguments have been made to adopt the rule of commercial codes that recognize “constructive delivery” of specially manufactured goods to a subcontractor once those goods are segregated and stored by the manufacturer or supplier pending actual delivery to the work site. The Georgia appellate court rejected the analogy to the Uniform Commercial Code, and held that state law contemplated actual delivery of material to the subcontractor rather than constructive delivery.³³⁷

Where statutory time limits for giving notice of claims start running from the date of final acceptance of a completed project, that date needs to be identified with certainty, generally by execution of a formal certification of acceptance.³³⁸ Where no benchmarks are provided, determination of whether a notice is given within 90 days after completion and acceptance of a project becomes a factual question of when contract performance was actually finished and the completed facility was accepted by word or conduct of the contracting agency.³³⁹

³³⁴ See, e.g., *Johnson Serv. Co. v. Transamerica Ins. Co.*, 349 F. Supp. 1220 (S.D. Tex. 1972), *aff'd*, 485 F.2d 164 (5th Cir. 1973).

³³⁵ *United States for Use and Benefit of I. Burack, Inc. v. Sovereign Constr. Co., Ltd.*, 338 F. Supp. 657 (S.D. N.Y. 1972); *United States for Use and Benefit of J.A. Edwards & Co. v. Bregman Constr. Corp.*, 172 F. Supp. 517 (E.D. N.Y. 1959).

³³⁶ *Compare Noland Co. v. Allied Contr., Inc.* 273 F.2d 917 (4th Cir. 1959) *with United States for Use and Benefit of J.A. Edwards & Co. v. Peter Reiss Constr. Co.*, 273 F.2d 880 (2d Cir. 1959), *cert. den.*, 362 U.S. 951, 80 S. Ct. 864, 4 L. Ed. 2d 869 (1960).

³³⁷ *F.L. Saino Manufacturing Co. v. Fireman's Fund Insurance Co.*, 173 Ga. App. 753, 328 S.E.2d 387 (1985).

³³⁸ *Maxson Corp. v. Gary King Constr. Co.*, 363 N.W.2d 901, 902-03 (Minn. App. 1985) (citing Minn. Dep't of Transp. Standard Specifications for Highway Constr. (1978), as incorporated by reference into the contract).

³³⁹ *Alexander Constr. Co. v. C&H Contracting, Inc.*, 354 N.W.2d 535, 538 (Minn. App. 1984) (construing MINN. STAT. 574.31 (1982), streets and sewers); *but see Honeywell, Inc. v. Jimmie B. Guinn, Inc.*, 462 So. 2d 145 (La. 1985) (installation of automatic temperature control system held to be necessary to complete the original project); *Worcester Air Conditioning Co. v. Commercial Union Ins. Co.*, 14 Mass. App. 352, 439 N.E.2d 845, 847 (Mass. App. 1982) (installation of additional ducts, done by subcontractor 4 months after punch list was

As a jurisdictional requirement, a timely notification of a claim must be alleged in the claimant's pleadings.³⁴⁰ Although circumstances may afford a contractor actual notice of a claim in a timely and sufficient manner, statutes based on the Miller Act are strictly construed to require timely written notice.³⁴¹ Actual knowledge of an unpaid account or of the presence of the claimant on the project is not sufficient.³⁴²

iii. Sufficiency of Notice.—The Miller Act specifies that notice to the prime contractor shall state “with substantial accuracy the amount claimed and the name of the party to whom the material was furnished or supplied, or for whom the labor was done or performed.”³⁴³ Inevitably, questions have arisen over the status of correspondence where either the intent or the factual accuracy of the contents were not clear. A rule of reason is applied to these cases, based on the underlying purpose of the notice requirement that the prime contractor should be made aware of the claims of those with whom it has no direct contractual relationship, or presumably, any regular contact during its supervision of the contract work.³⁴⁴ The essential character of the notice must be a positive presentation of a claim, stated clearly and comprehensively enough for the prime contractor to know its amount, to whom it is owed, and to whom the labor or material was furnished.³⁴⁵

Federal courts construing the Miller Act have not insisted on any particular form of notice, but rather have looked to see if the message given to the contractor informed it of the amount owed, the party to which it was

completed and project was accepted, held to be new work under a new contract).

³⁴⁰ *Continental Contractors, Inc. v. Thorup*, 578 S.W.2d 864 (Tex. Civ. App. 1979).

³⁴¹ *Square D Envtl. Corp. v. Aero Mechanical, Inc.*, 119 Mich. App. 740, 326 N.W.2d 629, 631 (1982) (notice statute required only a following of “specific step-by-step procedures” and should be strictly construed; legislature did not use the term substantial compliance).

³⁴² *Spetz & Berg, Inc. v. Luckie Constr. Co.*, 353 N.W.2d 233 (Minn. App. 1984) (construing MINN. STAT., § 574.31 (1979)); *Barboza v. Aetna Cas. & Sur. Co.*, 18 Mass. App. 323, 465 N.E.2d 290, 293 (1984) (construing MASS. GEN. L. ch. 149, § 29 (1972)); *Posh Constr., Inc. v. Simmons & Greer, Inc.*, 436 A.2d 1192 (Pa. Super. 1981).

³⁴³ 40 U.S.C. § 3133 (2003).

³⁴⁴ *Fleisher Eng'r & Constr. Co. v. United States for Use and Benefit of Hallenbeck*, 311 U.S. 15, 61 S. Ct. 81, 85 L. Ed. 12 (1940).

³⁴⁵ *United States for Use and Benefit of J.A. Edwards & Co. v. Thompson Constr. Corp.*, 273 F.2d 873 (2d Cir. 1959), *cert. denied*, 362 U.S. 951, 80 S. Ct. 864, 4 L. Ed. 2d 869 (1960); *see also United States for the Use of Old Dominion Iron & Steel Corp. v. Massachusetts Bonding & Ins. Co.*, 272 F.2d 73 (3d Cir. 1959) (doubtful language); *United States for Use and Benefit of Hopper Bros. Quarries v. Peerless Cas. Co.*, 255 F.2d 137 (8th Cir. 1959); *cert. denied*, 358 U.S. 831, 79 S. Ct. 51, 3 L. Ed. 2d 69 (1958); *United States for Use and Benefit of Franklin Paint Co. v. Kagan*, 129 F. Supp. 331 (D. Mass. 1955) (accuracy of claim); *Dover Elec. Supply Co. v. Leonard Pevar Co.*, 178 F. Supp. 834 (D. Del. 1959).

owed, the basis of the debt, and if the message actually got to the contractor.³⁴⁶ The amount claimed need not be stated with absolute precision, but it must be substantially accurate, or else any discrepancies must be explained so as to make the correct amount ascertainable.³⁴⁷ Also, courts have recognized the practical limits of requiring copies of billing documents, invoices, and orders identifying parts of claims for multiple items of labor and materials where they are to be paid for on a lump sum basis.³⁴⁸ State statutes may also specify formalities such as making sworn statements or transmitting notice by registered mail.³⁴⁹ Where statutory language allows it, courts may construe formalities more liberally, in accordance with the statute's remedial nature.³⁵⁰ Accordingly, where a contractor was in fact informed of a claim, the notice was not invalid because it was sent in advance of the 45-day notice period,³⁵¹ or because the notice was sent by regular mail instead of registered mail,³⁵² or because the wrong contract number was referenced.³⁵³ Similarly, even where the statute required that an affidavit be submitted by the claimant, a document that contained the required information and included a notarized signature of the claimant was held to be sufficient.³⁵⁴

³⁴⁶ *United States ex rel. Joseph T. Richardson, Inc. v. EJT Constr. Co.*, 453 F. Supp. 435 (D. Del. 1978).

³⁴⁷ *United States ex rel. Honeywell, Inc. v. A&L Mechanical Contractors, Inc.*, 677 F.2d 383 (4th Cir. 1982).

³⁴⁸ *Sims v. William S. Baker, Inc.*, 568 S.W.2d 725, 730 (Tex. Civ. App. 1978) (construing TEX. ANN. CIV. STAT. art. 5160, sub. B(a)(2) (1978)); *see also* *Featherlite Building Products Corp. v. Constructors Unlimited, Inc.*, 714 S.W.2d 68 (Tex. App. 1986).

³⁴⁹ *Bastianelli v. National Union Fire Ins. Co.*, 36 Mass. App. Ct. 367, 631 N.E.2d 566, 568 n.4, (1994); *San Joaquin Blocklite, Inc. v. Willden*, 228 Cal. Rptr. 842 (1986) (notice by first class, certified, or registered mail to contractor, or personal service); *Space Building Corp. v. INA*, 389 N.E.2d 1054 (Mass. App. 1979) (sworn statement).

³⁵⁰ *Cinder Products Corp. v. Schena Constr. Co.*, 22 Mass. App. 927, 492 N.E.2d 744 (1986) (citing M.G.L. c. 149 § 29, requiring service by certified or registered mail; failure to use certified or registered mail was not fatal if actual timely notice is proved).

³⁵¹ *School Board of Palm Beach County v. Vincent J. Fasano, Inc.*, 417 So. 2d 1063 (Fla. App. 1982).

³⁵² *Vacuum Systems, Inc. v. Washburn*, 651 A.2d 377 (Me. 1994); *Bob McGaughey Lumber Sales, Inc. v. Lemoine Co.*, 590 So. 2d 664 (La. App. 3 Cir. 1991); *Consolidated Concrete Co. v. Empire West Constr. Co.*, 596 P.2d 106, 108-09 (Idaho 1979) (construing Idaho Code, § 54-1929 (1979)); *but see* *F.L. Saino Mfg. Co. v. Fireman's Fund Ins. Co.*, 173 Ga. App. 753, 328 S.E.2d 387 (1985) (construing GA. CODE ANN., § 36-82-104(b) (1987) (notice by regular mail is effective when received, while registered mail notice is effective when mailed).

³⁵³ *Dixie Bldg. Material Co. v. Liberty Somerset, Inc.*, 656 So. 2d 1041 (La. App. 4 Cir. 1995).

³⁵⁴ *Acme Brick, a Div. of Justin Industries v. Temple Assocs.*, 816 S.W.2d 440, *writ denied* (Tex. App. 1991) (McGregor Act requires only substantial compliance).

The Miller Act previously required the claimant's pre-claim notice to either be served in the same manner as a summons, or sent by registered mail.³⁵⁵ Amendments to the Miller Act in 1999 allow a claimant to send its pre-claim notice by "any means which provides written, third-party verification of delivery."³⁵⁶ This allows use of other delivery options such as certified mail or overnight delivery services.

c. Limitation on Suit

The second major procedural requirement that claimants must meet under the Miller Act is the provision that suit against the payment bond must be filed within 1 year of the "date of final settlement" of the contract. As in the application of the requirement for filing notice of claims, the courts have recognized circumstances in which strict compliance with the limitations on filing suit must be relaxed to achieve the broad objective of the law. The strongest cases for allowance of filing after 1 year have involved major repairs or replacements of components of the facilities supplied, so extensive that the earlier installation does not qualify as performance of the supplier's contract obligation.³⁵⁷ Administrative work, inspections, testing, and corrective work conducted after delivery do not extend the dates when the limitation period begins to run.³⁵⁸

A federal court examined when the statute of limitations begins to run under the Miller Act in *United States v. Fidelity Co. and Deposit of Maryland*.³⁵⁹ The court compared cases in which the statute was held to begin running at the time of substantial completion, which it found to be the minority view, with those in which the statute began at the time of completion of all of the original requirements of the contract, as opposed to corrections or repairs, which was the majority view.³⁶⁰ Under the majority view, an uncompleted contract requirement tolls the time for filing, while corrective work does not. Where substantial completion is used as the operative date, the filing period is not extended by insignificant work, even if that work is required under the contract and is not corrective work. The court applied what it called a "middle ground" approach in deciding in favor of allowing a supplier's claim.³⁶¹ It did not follow the rule that repair work does not toll the

³⁵⁵ Former 40 U.S.C. § 270b(a) (1999).

³⁵⁶ 40 U.S.C. § 3133(b)(2)(A) (2003).

³⁵⁷ *Compare* *United States for the Use of General Electric Co. v. Gunnar I. Johnson & Son, Inc.*, 310 F.2d 899 (8th Cir. 1962) *with* *United States for Use of McGregor Arch Iron Co. v. Merritt-Chapman & Scott, Corp.*, 185 F. Supp. 381 (M.D. Pa. 1960).

³⁵⁸ *Honeywell, Inc. v. Arnold Constr.*, 134 Ariz. 153, 654 P.2d 301 (1982); 17 AM. JUR. 2D *Contractors Bonds* § 207 (1990).

³⁵⁹ 999 F. Supp. 734 (D. N.J. 1998).

³⁶⁰ *Id.* at 742.

³⁶¹ *Id.* at 745.

time period, but rather based its decision on the value of the materials involved, the requirements of the original contract, the unexpected nature of the work, and the importance of the materials to the operation of the system.³⁶²

Once the period of limitation on filing suit begins to run, it is not interrupted or tolled by the occurrence of negotiations between the claimant and the prime contractor over whether the subcontract was duly completed and payment for it was due.³⁶³ Nor is the running of the limitation period changed by amendment of the bond statute to prescribe a different date for its commencement.³⁶⁴ Where this occurred under Connecticut's Little Miller Act, the court held that the amendment was not retroactive and the provisions of the law in force at the time the claimant's contract was executed were the controlling factor in determining compliance with the filing date.³⁶⁵

State bonding statutes with provisions similar to those in the Miller Act prior to 1959 set the time limit for starting suits at 1 year or another specified period after the "final settlement" of the contract.³⁶⁶ Final acceptance of a project by the public works agency generally is considered as the administrative action constituting final settlement.³⁶⁷ Exceptions to this rule are recognized, however, where an acceptance is found to be premature because essential work remained to be done after formal acceptance.³⁶⁸ In order to constitute a final settlement, the public works agency's acceptance must relate to the entire project in order to avoid the risk that the security will be exhausted before the full number of unpaid creditors and their claims are known.³⁶⁹

³⁶² *Id.*

³⁶³ *Visor Builders, Inc. v. Devon E. Trantor, Inc.*, 470 F. Supp. 911 (M.D. Pa. 1978).

³⁶⁴ See CONN. GEN. STAT. §§ 49-41, 49-42 (1987).

³⁶⁵ *Am. Masons Supply Co. v. F.W. Brown Co.*, 164 Conn. 219, 384 A.2d 378 (1978); *Manges Printing Co. v. Joseph Bucheit and Sons Co.*, 601 F. Supp. 776 (D.C. Pa. 1985).

³⁶⁶ *W.B. Headley v. Housing Auth. of Prattville*, 347 So. 2d 532 (Ala. Civ. App. 1977); *Medical Clinic Bd. of City of Birmingham-Crestwood v. E.E. Smelley*, 408 So. 2d 1203 (Ala. 1981); *City of San Antonio v. Argonaut Ins. Co.*, 644 S.W.2d 90 (Tex. App. 1982) ("final completion of contract").

³⁶⁷ *Transamerica Ins. Co. v. Housing Auth. of City of Victoria*, 669 S.W.2d 818 (Tex. App. 1984).

³⁶⁸ *Honeywell, Inc. v. Jimmie B. Guinn, Inc.*, 462 So. 2d 145 (La. 1985); see also *Cortland Paving Co. v. Capital District Contractors, Ltd.*, 490 N.Y.S.2d 51 (1985) (parties agreed to reasonable delay to allow contractor to obtain funds from state); *Valley Forge Indus., Inc. v. Armand Constr., Inc.*, 394 A.2d 677 (Pa. Commw. 1978) (correction of defects required substantial repetition of work).

³⁶⁹ *Maurice E. Keating, Inc. v. Township of Southampton*, 149 N.J. Super. 118, 373 A.2d 421 (1977); *Safeco Ins. Co. of America v. Honeywell, Inc.* 639 P.2d 996, 1001-02 (Alaska 1981) (dispute arose over which one of a series of inspections, certifications, notices, and reports constituted "final acceptance;" court ruled that final settlement required a specific

A common practice among agencies contracting for public works construction is to issue a certificate of substantial completion when all work has been performed, inspected, and accepted subject to completion of a "punch list" agreed upon by the parties. In a case under Arizona's Little Miller Act, however, a subcontractor hired to furnish and install an automatic temperature control element of a fire alarm system continued work on punch list items for several months after the certificate of substantial compliance was issued.³⁷⁰ When a subcontractor later filed suit for unpaid charges, it was held that the period for filing suit started running when the claimant finished work on the punch list. Drawing on federal cases under the Miller Act, the court stated:

The applicable test asks whether the work was done in furtherance of the original contract, or whether it was for the purpose of correcting defects or making repairs. Work done solely to effect repairs, make corrections or complete final inspection is insufficient to qualify as work pursuant to the original contract and is not considered work performed or material supplied within the one year statutory limitation.³⁷¹

Bankruptcy of the prime contractor does not toll or extend the running of the time limit for subcontractors to file suit against the surety bond.³⁷² Nor does the substitution of a new contractor after default by the original prime contractor affect the running of the time limit.³⁷³ However, the surety may extend its liability for claims arising from an abandoned job by making a specific undertaking to do so when it takes over from the defaulting contractor.³⁷⁴

Where the provisions of a surety bond regarding the time for starting suit differ from the terms of the bonding statute, the difference may be treated as converting the surety's statutory liability into a common law liability. The effect of such a conversion was explained in the Florida court in *Motor City Electric Co. v. Ohio Casualty Insurance Co.*, where a claim for rental of heavy equipment was sustained even though barred by the statutory limit on filing suit.

administrative act bearing on the completeness of the contract and approving payment; approval of final pay estimates fit criteria of the law and carried out the purpose of the applicable statute, ALASKA STAT. § 36.25.020); *Hall v. U.S. Fidelity & Guar. Co.*, 436 A.2d 863 (Me. 1981) (where sand and gravel were supplied for highway construction, the necessary administrative act that marked the last date of furnishing labor or materials was the highway agency's final determination of the quantities of materials used in the construction project).

³⁷⁰ *Honeywell, Inc. v. Arnold Constr. Co.*, 134 Ariz. 153, 654 P.2d 301, 304 (1982) (applying ARIZ. REV. STAT. § 34-223 (1987)).

³⁷¹ 654 P.2d at 304 (citations omitted).

³⁷² *Fountain Sand & Gravel Co. v. Chilton Constr. Co.*, 578 P.2d 664, 665 (Colo. App. 1978).

³⁷³ *Adamo Equip. Rental Co. v. Mack Dev. Co.*, 122 Mich. App. 233, 333 N.W.2d 40, 42 (1982).

³⁷⁴ *Argonaut Ins. Co. v. M&P Equip. Co.*, 269 Ark. 302, 601 S.W.2d 824 (1980).

[N]ot every bond furnished incident to a public works project falls within the ambit of the statute...courts recognize a distinction between a statutory bond issued in connection with such a project and a common law bond. A bond...will be construed as a common law bond if it is written on a more extended basis than required by Section 255.05, Florida Statutes (1975)... Moreover, ambiguities in the form of such a bond must be construed in favor of granting the broadest possible coverage to those intended to be benefited by its protection.³⁷⁵

d. Claimant Has Not Been Paid

In addition to showing that labor or materials are furnished for the project in question, it must be shown that the claimant has not been paid for them. Where a public works agency makes progress payments at predetermined intervals, disputes may occur over allocation of those payments to the creditor's accounts. Generally those disputes arise in the absence of instructions by the debtor at the time of payment, leaving it to the creditor's discretion to say how they shall be applied. This discretion, however, is not unlimited. The rule evolved from Miller Act cases is stated in *St. Paul Fire and Marine Insurance Co. v. United States ex rel. Dakota Electric Supply Co.* as follows:

If a debtor is under a duty to a third person to devote funds paid by him to the discharge of a particular debt, the payment must be so applied if the creditor knows or has reason to know of that duty. This is so despite the debtor's contrary direction.³⁷⁶

Federal courts have not imposed a duty on a claimant to inquire about the source of a payment in litigation under the Miller Act. Nor have state courts read this duty into their state bonding laws for public works construction projects.³⁷⁷ The reluctance to enforce a duty to demand designation of the source and disposition of payments into an open account, or circumstances where the debtor has several project accounts with the creditor, has not prevented courts from rigorous examinations of the parties' transactions and critical appraisal of whether the creditor knew or had reason to know the source of its payment. If the history and circumstances of an unpaid account make prudent in the course of exercising business judgment to inquire about the debtor's sources and expectations of funds, the court may well find there is sufficient knowledge of the "principal source" of the funds to require the creditor to apply the payment to that project account. Therefore, in *School District of Springfield R-12, ex rel. Midland Paving Co.*, the court held that the creditor's failure to apply a partial payment to the bonded project's account

was, while not done in bad faith, done "prematurely and without proper precaution."³⁷⁸

e. Waiver of Payment Bond Remedies

Prior to the 1999 amendments, the Miller Act did not address whether a potential claimant could waive its payment bond remedies. The amendment allows such a waiver, so long as it is (1) in writing, (2) signed by the potential claimant, and (3) executed after the potential claimant has first furnished labor or material for use in performance of the contract.³⁷⁹ Thus a subcontractor or materialman could submit a release form with its invoice, so long as it meets these requirements.

6. Enforcement of Performance Bonds

a. Agencies' Remedies

Actions to enforce the obligations of performance bonds are taken at the initiative of the state.³⁸⁰ They may be brought at any time within the statutes of limitations for actions on written contracts. As a practical matter, however, the state's action of declaring a contractor in default generally is followed by negotiations between the surety and the contracting agency for the purpose of deciding how the contract can be completed by any of the several options open to the parties. Because both the surety and the contracting agency are better off if they complete the contract, recourse to the courts for enforcement of bonds running in favor of the public is relatively rare. More frequently, suits involving performance bond obligations arise through the initiative of the surety, who has become subrogated to a claim on monies held by the contracting agency as retainage or as partial payment earned but not yet paid under a contract.

The determination that a contractor is in default is a matter of judgment by the contracting agency. An act of default by a contractor does not impose upon the contracting agency any duty to declare it in default of its contract if, despite appearances, the agency believes that it will complete the work satisfactorily.³⁸¹ Nor may a surety compel the government to shut down a contractor on the basis of information that satisfied the surety that default may be either imminent or inevitable. Although the surety may sincerely wish to conserve the funds remaining in the government's hands so that those funds may be used to complete the defaulted work, the contracting agency is entitled to a reasonable opportunity to investigate the situation thoroughly.

Once a contractor has been declared in default, and its surety has completed the contract, there may be

³⁷⁵ 374 So. 2d 1068, 1069 (Fla. App. 1979).

³⁷⁶ 309 F.2d 22, 25 (8th Cir. 1962).

³⁷⁷ *Trans-American Steel Corp. v. J. Rich Steers, Inc.*, 670 F.2d 558 (5th Cir. 1982); *Geneva Pipe Co. v. S&H Ins. Co.*, 714 P.2d 648, 651 (Utah 1986) (citing UTAH CODE ANN. § 58A-1a-12 (1985)).

³⁷⁸ 633 S.W.2d 238, 253 (Mo. App. 1982).

³⁷⁹ 40 U.S.C. § 3133(c) (2003).

³⁸⁰ *Town of Melville v. Safeco Ins. Co. of America*, 651 So. 2d 404, writ denied, 654 So. 2d 333 (La. App. 3 Cir. 1995).

³⁸¹ *United States v. Continental Cas. Co.*, 346 F. Supp. 1239 (N.D. Ill. 1972).

competition for the agency's remaining funds. Differing results have sometimes occurred in federal decisions relating to the Miller Act, and in decisions under state laws. In Miller Act cases where the Federal Government is a claimant (as, for example, where collection of unpaid taxes is sought), it may claim taxes as a setoff against the surety's share of the retained funds. *United States v. Munsey Trust Co.* established the doctrine for federal law on this question, holding that the government was in the same position as a secured creditor, and so entitled to withhold what it owed the contractor until its own claims were satisfied.³⁸² The surety, subrogated to the contractor's position, is regarded as never having acquired any superior right to the retained funds.

Such a rule had obvious disadvantages for the surety who elected to complete a defaulted contract, for it could never be sure that it could obtain the full amount of the unpaid funds under the original contract. In the surety's view, it was better off to let the agency complete the contract, and let its suretyship liability be limited to the difference, if any, between the contract price and the actual cost of completion.³⁸³ When this matter was carefully considered, however, the *Munsey* doctrine was not extended beyond the setoff of delinquent taxes. In *Massachusetts Bonding & Insurance Company v. New York*, the New York court discussed the position of subrogated sureties:

It is settled law that a surety which undertakes to complete a construction contract after its principal has defaulted...becomes entitled to payments due the principal....This right to "first" priority attaches not only to moneys due the principal at the time of default, but to so-called "unearned" moneys which arise from the surety's activities in completing the contract after this principals default.³⁸⁴

The same rule for priority of claims on unpaid contract funds has been applied where the surety's lien for payment of defaulted debts is subrogated to the contractor's claim on the retained funds. Tax liens in favor of the government have not been given priority over the surety since the latter's equitable right is viewed as arising at the time the surety posted its bond. Subsequent tax liens against the contractor therefore could not reach funds to which the contractor himself had no claim.³⁸⁵

Attempts to enforce liability under performance bonds for failure to meet construction contract specifications may be complicated when they are based on

discovery of latent defects in materials or workmanship after a project has been completed and accepted. Some state courts have held that statutory bonds do not cover defects that are known or discoverable by reasonable inspection prior to acceptance. The Florida court initially held that as a matter of law a performance bond surety was not liable for construction defects discovered after the project was certified and accepted as substantially complete and the statute of limitations on the bond had run.³⁸⁶ Subsequent review of this question, however, has resulted in a holding that acceptance and payment do not necessarily constitute a waiver of rights to claim damages or an estoppel to suit against the surety. Thus, if a contracting agency can prove failure to perform the construction according to the contract, and that it was unaware of this failure at the time the project was accepted, and the defects were not apparent by reasonable inspection, the surety's liability is not as a matter of law ended by the project's acceptance.³⁸⁷

Where suits against performance bond sureties because of latent defects are permitted, federal courts have allowed recovery of the costs of redoing the defective workmanship and overpayment of the contractor.³⁸⁸ Liquidated damages owed by a defaulting contractor were recovered from a performance bond where the language of the contract providing for those damages was specifically incorporated into the bond by reference.³⁸⁹ Disputes may occur over whether particular types of costs or losses should be regarded as liquidated within the meaning of the contract, and thus may make interpretation of the scope of the bond more difficult. Relying on federal court applications of the Miller Act, recovery from the surety was allowed for damages due to delay in performance, spoilage of stored materials, replacement of inferior fixtures, and losses due to vandalism, but not for "unabsorbed overhead" or disputed supervisory activities by the contractor.³⁹⁰

Suits to recover from performance bonds are subject to estoppel by judgment or *res judicata*. A valid judgment in a previous action between the same parties on the same claim bars another action on the issues raised in that previous suit, and any others that might have been raised at that time. The same result occurs where estoppel by verdict or collateral estoppel prevents the

³⁸⁶ *Florida Bd. of Regents v. Fidelity & Deposit Co. of Md.*, 416 So. 2d 30 (Fla. App. 1982); *see also* *Sch. Bd. of Volusia County v. Fidelity Co. of Md.*, 468 So. 2d 431 (Fla. App. 1985) (construing FLA. STAT. § 95.11(2) (1983)).

³⁸⁷ *School Bd. of Pinellas County v. St. Paul Fire & Marine Ins. Co.*, 449 So. 2d 872 (Fla. App. 1984), *review denied*, 458 So. 2d 274 (Fla. 1984).

³⁸⁸ *City of New Orleans, et al. v. Vicon, Inc.*, 529 F. Supp. 1234 (E.D. La. 1982) (defective airport runway construction and overpayment due to fixing weight ticket printer to show greater weight than actually received).

³⁸⁹ *Pacific Employers Ins. Co. v. City of Berkeley*, 158 Cal. App. 3d 145, 204 Cal. Rptr. 387 (1984).

³⁹⁰ *Hartford Accident and Indem. Co. v. Dist. of Columbia*, 441 A.2d 969 (D.C. App. 1982).

³⁸² 332 U.S. 234, 67 S. Ct. 1599, 91 L. Ed. 2022 (1947).

³⁸³ *Standard Accident Ins. Co. v. United States*, 119 Ct. Cl. 749, 97 F. Supp. 829 (1951) (government was permitted to set off damages to a surety's claim under a performance bond); *see also* *Gen. Cas. Co. of America v. United States*, 131 Ct. Cl. 818, 127 F. Supp. 805 (1955), *cert. denied*, 349 U.S. 938, 75 S. Ct. 783, 99 L. Ed. 1266 (1955).

³⁸⁴ 259 F.2d 33, 37 (2d Cir. 1958).

³⁸⁵ *United States Fidelity and Guaranty Co. v. Tribourgh Bridge Auth.*, 297 N.Y. 31, 74 N.E.2d 226 (1947).

parties from relitigating an issue that was decided in an earlier proceeding between the same parties but on a different cause of action. Such a situation occurred where a claimant supplied materials to a subcontractor on a housing project and sued for a mechanic's lien on the subcontractor's default of payments.³⁹¹ This suit was voluntarily dismissed with prejudice, but subsequently, when the local public housing authority took over the unfinished project, the claimant sued to recover from the payment and performance bond. The Illinois court held that on these facts the claimant had a cause of action on the bond. It stated:

Under the doctrine of estoppel by verdict, a former judgment barred only those questions *actually decided* in the prior suit—The scope of the bar is narrower than under the doctrine of estoppel by judgment...If there is any uncertainty...that more than one distinct issue of fact is presented to the court, the estoppel will not be applied, for the reason that the court may have decided upon one of the other issues of fact.³⁹²

Takeover and completion of a construction project by the surety following the contractor's default places the surety in the position of the contractor in relation to the contracting agency, and so entitles it to all the compensation earned by performance of the contract. Thus, where the contracting agency for a highway construction project objected to releasing funds retained to offset damages due to the contractor's default, the Louisiana court held that the agency's takeover agreement with the surety made the latter eligible for the full amount of the contract price once a satisfactory performance was accepted.³⁹³ In this instance, the state and the federal government had provided the construction funds and had claims against the contractor for funds it had diverted, but these were separate matters that could not be set off against the retainage.

Failure of a subcontractor to perform work for which it earlier received partial payment in advance, and replacement of the subcontractor with another, allows the surety on the performance bond to be subrogated to the contractor's rights and remedies. The subrogated surety, however, is also subject to defenses that may arise from the contractor's action. Thus, where a subcontractor performed sporadically and eventually was replaced, the surety sued to recover the advance partial payment and damages for delay of the project. The subcontractor argued that it was excused because the con-

tractor had subsequently been replaced for its default, and the surety had refused to pay further claims against the contractor thereafter. The Michigan court held, however, that the subcontractor's failure to perform was not excused by the contractor's subsequent default or the surety's refusal to pay the costs of modifying the subcontract.³⁹⁴

7. Discharge of Surety Obligations

The surety who has furnished a contractor's performance bond or payment bond is discharged upon the successful completion of the contract. However, questions may arise concerning the time and circumstances for termination of the surety's liability. Orderly termination of a suretyship relating to a public construction project typically involves procedures specified in statutes or regulations that must be strictly complied with.

The varying circumstances of construction contracts and contractors' methods may make it difficult to determine precisely when a contractor has completed the "full and faithful performance" and "prompt payment of all claims" that contractors' bonds generally designate as the condition upon which the surety's obligation will be discharged. Accordingly, it is typical for public construction contracts to stipulate that completion will be shown by official acceptance of the work and issuance of a certificate of acceptance by the engineer or other official representative of the contracting agency. Once issued, the overseeing official's acceptance and certificate are conclusive on the parties for all matters within the certificate's scope and the certifying official's authority. In the absence of fraud, arbitrariness, or such gross mistakes as to imply bad faith, the correctness of the certification may not be disputed and establishes the time of completion of the construction contract.³⁹⁵

Aside from the discharge of sureties by this procedure, state laws recognize certain other situations in which the actions of contracting officers may have the effect of releasing a surety from liability on a contractor's bond, even though such a result is not intended. Suretyship doctrine provides that sureties should be protected in their right to rely on the terms of obligations as originally agreed upon. Therefore, any subsequent agreements between the contracting agency (the obligee) and contractor (the principal) that materially alter the surety's obligation without its consent has the effect of releasing the surety from its obligation, if it chooses to exercise this right by giving reasonable notice to the other parties involved in the contract.

Alteration of the surety's obligation occurs when there is a material change in the terms of the underlying contract, or an action by one of the parties that con-

³⁹¹ Decatur Housing Auth. ex rel. Harlan E. Moore Co. v. Christy-Foltz, Inc., 117 Ill. App. 3d 1077, 454 N.E.2d 379 (1983); *but see* Rawick Mfg. Co. v. Talisman, Inc., 706 S.W.2d 194 (Ark. App. 1986) (claim of materialman for turnkey housing project, arising while construction was privately owned and funded, was not divested when project was taken over by public agency).

³⁹² Decatur Housing Auth., *supra* note 391, 454 N.E.2d at 383 (emphasis in original; citations omitted).

³⁹³ Reliance Ins. Co. v. Dep't of Transp. and Dev., Office of Highways, 471 So. 2d 248 (La. App. 1985).

³⁹⁴ Sentry Ins. v. Lardner Elevator Co., 153 Mich. App. 317, 395 N.W.2d 31, 34-35 (1986).

³⁹⁵ State Highway Dep't v. MacDougald Constr. Co., 189 Ga. 490, 6 S.E.2d 570, 137 A.L.R. 520 (1939); Sioux City v. Western Asphalt Paving Corp., 223 Ia. 279, 271 N.W. 624, 109 A.L.R. 608 (1937).

stitutes a material deviation from the contract terms.³⁹⁶ Most courts determine the materiality of a deviation by considering whether the surety is prejudiced or injured in any way.³⁹⁷ Some others, however, have linked materiality to the extent that the contract is altered, or that a new agreement is substituted for the old one.³⁹⁸

Premature payment of a contractor or subcontractor by the contracting agency provides an illustration of how alteration of surety obligations may occur. Deciding in favor of allowing premature disbursement of progress payments or retainage funds to authorize release of the surety, state courts have held that these actions destroy the security represented by the continued retention of these funds. Thus they have the effect of reducing the contractor's incentive to complete the work to its last detail.³⁹⁹ Similar results may follow where the surety can show that the time of performance was changed or a different performance was called for, constituting a material change to which the surety did not consent. Thus, where a contractor and subcontractor, without the surety's knowledge or consent, agreed to reduce the time for completing the performance of the subcontract from 80 to 45 days, the surety objected. Noting that the contract contained a provision for liquidated damages of \$100 per day for delays, the surety claimed the change in time for performance increased its risk of liability. The court in this case agreed with the surety, and allowed its release.⁴⁰⁰

The same case-by-case scrutiny of the parties' circumstances and the language of the documents concerned typifies the approach to cases where the specifications for the work are changed. For example, a contracting agency may instruct the contractor to use a type of paving material not listed in the contract specifications. If the change does not alter the essential character of the contract, the surety will remain obligated on its bond, even though it has not consented to the change.⁴⁰¹

Some standard contract forms for public works construction projects provide that the contractor and contracting agency may make changes during the course of the work without releasing the surety. This language

raises the question of whether the courts will uphold public agencies in efforts to hold sureties to obligations that are not fully and finally spelled out when the surety executes its bond. Where the agencies have complied with their own procedures for making authorized changes, the courts generally have denied sureties' request for release. In most instances, this result has been based on the surety's consent to changes that must reasonably be expected in the course of construction work.⁴⁰² Indeed, the public interest may be served by allowing some latitude for modification of plans that were based on advance estimates of needs and working conditions.

The extent to which contracts may be altered after they have been executed is, however, always subject to scrutiny if the surety feels that the net effect of a change is to substitute a new and different agreement for the one it undertook to guarantee.⁴⁰³ In such circumstances, the language of the bond becomes the focal point of inquiry.

Release of a surety because of material alteration of its obligation without its consent depends on the surety's own action in asserting and justifying its demand by showing injury. In connection with this latter requirement, disagreement exists over the extent of injury that must be shown, and over the consequences of the occasional case in which it is shown that the alteration actually benefited the surety.⁴⁰⁴ From the surety's viewpoint, however, this burden may become a formidable one, as many of the changes that occur in the course of a construction project cannot conveniently be brought to its prior attention or delayed until submitted for its consent.

Although release of the contractor-principal from liability on the construction contract has the effect of also releasing the contractor's surety from further liability on its performance and payment bonds, this result is permitted only where the contractor's release is full and final. If payment of less than the amount demanded is used to satisfy a claim, that payment must be tendered only on condition that it will be accepted in full payment of that claim. Unless the intent of both the tender and acceptance are clearly shown, the payment cannot extinguish the liability of the principal or its surety.⁴⁰⁵

The fact that a contractor-principal has been paid in full by the contracting agency, and has paid its subcontractors in full, is not a defense against liability to the supplier who has not been paid by the subcontractor. This may occur where the subcontractor becomes bankrupt or abandons the project before it pays its creditors

³⁹⁶ *Ferguson Contr. Co. v. Charles E. Story Constr. Co.*, 417 S.W.2d 228 (Ky. Ct. App. 1967); *Gruman v. Sam Breedon Constr. Co.*, 148 So. 2d 759 (Fla. App. 1963).

³⁹⁷ 74 AM. JUR. 2D *Suretyship* § 208 (2001).

³⁹⁸ *City of Peekskill v. Continental Ins. Co.*, 999 F. Supp. 584 (S.D. N.Y. 1998) (issuance of new and materially different site plan approval to new developer after expiration of original plan approval, without surety's knowledge and consent, extinguished surety's obligations under bond).

³⁹⁹ *Gibbs v. Hartford Accident & Indem. Co.*, 62 So. 2d 599 (Fla. 1952).

⁴⁰⁰ *Bopst v. Columbia Cas. Co.*, 37 F. Supp. 32 (D. Md. 1940); *but see Phoenix Assurance Co. of New York v. City of Buckner*, 305 F.2d 54 (8th Cir. 1962) (surety was not prejudiced by extension of time, not released).

⁴⁰¹ *State for Use of County Court v. R.M. Hudson Paving & Constr. Co.*, 91 W. Va. 387, 113 S.E. 251 (1922).

⁴⁰² *Honolulu Roofing Co. v. Felix*, 49 Haw. 578, 426 P.2d 298, 314-15 (1967).

⁴⁰³ *Trinity Universal Ins. Co. v. Gould*, 258 F.2d 883 (10th Cir. 1958).

⁴⁰⁴ *Maryland Cas. Co. v. Eagle River Union Free High School Dist.*, 188 Wis. 520, 205 N.W. 926 (1925); *Village of Canton v. Gobe Indem. Co.*, 201 820, 195 N.Y.S. 445 (1922).

⁴⁰⁵ *Envirex, Inc. v. Cecil M. Garrow Constr., Inc.*, 473 N.Y.S.2d 63, 99 A.D. 2d 307 (1984).

in full,⁴⁰⁶ or where the subcontractor had several unpaid accounts with the claimant and failed to specify to which account its payment should be applied.⁴⁰⁷

Liability of a contractor may be extinguished where its contract is determined to be illegal, but the illegality must be of a nature as to make the contract void. Thus, where a contract was not submitted to the Attorney General for approval before being awarded, the court held that the contract was not void and the surety was not discharged.⁴⁰⁸

8. Indemnification for Loss or Liability

In some states, statutory bonding requirements specify that contractors must furnish security to save the contracting agency harmless from costs resulting from specified acts or omissions of the contractor or its employees or subcontractors. These contracts are in the nature of indemnification rather than suretyship. Indemnity differs from suretyship in several essential respects. It is likely to be an original undertaking, whereas suretyship is always accessory to another basic agreement between the principal and obligee of the surety bond. Indemnity is a two-party transaction, whereas suretyship is a tripartite agreement. Indemnity contemplates a duty to make good the losses or costs suffered because of the way the contract was performed when default or negligence occurs. An indemnitor becomes liable when efforts to avoid or recoup losses have been unsuccessful. A surety is directly and immediately liable for the performance of the duty it has undertaken.

The distinction between a contract of indemnity and one of surety was made by the California court in *Leatherby Insurance Company v. City of Tustin*.⁴⁰⁹ Here the issuer of a performance bond and payment bond for a street widening project paid five claims against the prime contractor and sought to recover from funds withheld by the contracting agency. The agency refused, citing the provisions of the state Department of Public Works' Standard Specifications, incorporated by reference into the city's contract, that the contractor "shall protect and indemnify [the city] against any claims, and that includes the duty to defend...." But the California court concluded that this incorrectly charac-

terized the position of the surety. It said that execution of the performance and payment bonds created two duties, namely: to assure performance of the contract according to specifications, to the point of stepping into the contractor's place to complete the work if necessary, and to see that all laborers and materialmen were paid if the contractor failed to pay them. These were duties to the contracting agency and to the laborers and materialmen, not to the contractor, and were limited in their extent by the amount of the bond. The language of the state's standard specifications was interpreted as the basis for the requirement that the contractor provide a surety bond to see that the laborers and materialmen were paid.

Where defective workmanship or materials are due to negligence and result in loss to a public agency through tort damages, the agency generally has no chance of being indemnified for those damages by the negligent contractor's performance bond. In Texas, liability on statutory performance bonds was held not to extend to indemnification for tort damages, and would be allowed only where the language of the bond or other agreement was sufficient to turn the statutory bond into a common law bond.⁴¹⁰ In the absence of such language, the Texas court ruled that the bond was entirely a statutory creation for the purpose of assuring the contracting agency that the construction would be done according to plans, specifications, and contract documents, and liability under it was limited to the statute's scope and purpose. A similar restrictive interpretation of the surety's liability applies to one who is not a party to the bond. Where the owner of land adjacent to the site of a water system project filed suit because construction operations caused flooding and loss of business when access was blocked, the court denied the claimant's right to sue, explaining that to allow tort claims to share in the bond might reduce to nothing its ability to perform its function.⁴¹¹

In most states, sovereign immunity no longer shields public agencies and officials from suit, particularly with regard to negligence claims. Most states have methods by which claimants can obtain adjudication of claims arising out of public construction work. Accordingly, expansion of the contractor's bond obligation to include indemnification of the contracting agency for damages that it may have to pay because of the contractor's negligence is one way to protect the public.

The same objective is achieved by requiring contractors to carry insurance against various types of third party liability. Requirements concerning insurance coverage of the principal parties involved in a public works construction project are customarily set out in the contract specifications. Typically such an insurance pack-

⁴⁰⁶ *D.W. Clark Road Equip., Inc. v. Murray Walter, Inc.*, 469 A.2d 1326 (N.H. 1983); *see also* *Naylor Pipe Co. v. Murray Walter, Inc.*, 421 A.2d 1012 (N.H. 1980); *City of Chicago ex rel. Charles Equipment Co. v. U.S. Fidelity & Guar. Co.*, 142 Ill. App. 3d 621, 491 N.E.2d 1269 (1986).

⁴⁰⁷ *Trans-American Steel Corp. v. J. Rich Steers, Inc.*, 670 F.2d 558 (5th Cir. 1982); *Sumlin v. Hagan Storm Fence Co.*, 409 So. 2d 818 (Ala. 1982).

⁴⁰⁸ *State v. Am. Motorists, Inc. Co.*, 463 N.E.2d 1142, 1148 (Ind. App. 1984) (statute requiring attorney general's signature on contracts was enacted to protect public funds, therefore could not be invoked by surety to avoid paying under performance bond).

⁴⁰⁹ 76 Cal. App. 3d 678, 143 Cal. Rptr. 153 (1977).

⁴¹⁰ *City of Marshall v. American General Ins. Co.*, 623 S.W.2d 445 (Tex. App. 1981) (construing TEX. REV. CIV. STAT. ANN. art. 5160, sub'd. A(a)).

⁴¹¹ *Long v. City of Midway*, 169 Ga. App. 72, 311 S.E.2d 508 (1983) (construing GA. CODE ANN. § 36-82-104).

age is comprehensive, including workmen's compensation insurance, public liability for personal injury and property damage, and various special coverages suggested by the type of construction involved. A contractor's failure to provide the required insurance may entitle the owner to common law indemnification.⁴¹²

Beyond the threshold question of why provisions for indemnification are desirable in contractor's bonds, others arise concerning the scope of the obligation required by the statutes. In the language of indemnification law, guaranty against "damage" differs significantly from guaranty against "liability." In the case of the former, the obligation to indemnify cannot be enforced until and unless actual damage is shown to have been sustained by the indemnitee. In the latter case the obligation is enforceable as soon as the indemnitee's legal liability is established.

Enforcement of statutory requirements for indemnification of public works agencies may involve questions of whether enforcement is barred because of the presence of negligence on the part of the indemnitee. Courts have tended to deny the enforceability of indemnity bonds where the indemnitee's own negligence is a factor.⁴¹³ Some courts have indicated that active negligence is not necessary, but that an indemnitee may be barred from enforcing an indemnity bond where it merely acquiesced in allowing a dangerous condition on a work site to persist for an unreasonably long period of time, during which a third party suffered injury.⁴¹⁴ In Mississippi, the impropriety of enforcing indemnification for the benefit of one whose own negligence was a cause of its loss is recognized in legislation declaring such agreements contrary to public policy.⁴¹⁵

The nature of transportation facilities and construction create other factual situations regarding the effects of negligence by employees of subcontractors, materialmen, or other third parties. Contractors view these situations as risks over which they generally have little practical control. Clauses for "holding harmless" are viewed as far too general to enable contractors to measure their risks precisely, or to obtain insurance that fully covers their potential liability. Competitive bidding is likely to reflect errors on the side of over-insurance and indemnity bonding as contractors seek to protect themselves against these risks.

Although not as specific in its reference to the contractor's bond, a Wisconsin statute raises the question of whether suit could be brought under a contractor's performance or payment bond for wrongful application of funds. This statute recites that

All moneys, bonds or warrants paid or become due to any prime contractor or subcontractor for public improvements are a trust fund only in the hands of the prime contractor or subcontractor and shall not be a trust fund in the hands of any other person. The use of the moneys by the prime contractor or subcontractor for any purpose other than the payment of claims on such public improvement, before the claims have been satisfied, constitutes theft...and is punishable under Section 943.20. This section shall not create a civil cause of action against any person other than the prime contractor or subcontractor to whom such moneys are paid or become due. Until all claims are paid in full, have matured by notice and filing or have expired, such money, bonds and warrants shall not be subject to garnishment, execution, levy or attachment.⁴¹⁶

Although liability on a subcontractor's bond may be, and usually is, limited by the language of the bond to payment of claims that comply with statutory notice requirements, these requirements can be waived. Thus, where a subcontractor by separate agreement undertook to protect, indemnify, and save the general contractor from "all claims, suits and actions of any kind and description," and the contractor paid several of the subcontractor's unpaid creditors, it was held that the more restrictive liability provided for in the language of the bond was waived.⁴¹⁷

⁴¹² *Isnardi v. Genovese Drug Stores, Inc.*, 662 N.Y.S.2d 790, 791, 242 A.D. 2d 672 (1997).

⁴¹³ This seems particularly true where the language of the indemnity agreement is broad in describing the obligation. *See, e.g., Arnold v. Stupp Corp.*, 205 So. 2d 797 (La. Ct. App. 1967), *petition for cert. not considered*, 251 La. 936, 207 So. 2d 540 (1968); *Kansas City Power & Light Co. v. Federal Constr. Corp.*, 351 S.W.2d 741 (Mo. 1961); *Southern Pacific Co. v. Layman*, 173 Ore. 275, 145 P.2d 295 (1944); *Kroger Co. v. Giem*, 215 Tenn. 459, 387 S.W.2d 620 (1964).

⁴¹⁴ *Whirlpool Corp. v. Morse*, 222 F. Supp. 645 (D. Minn. 1963).

⁴¹⁵ MISS. CODE § 31-5-41 (2003).

⁴¹⁶ WIS. STAT. § 779.16 (2001).

⁴¹⁷ *Miner-Dederick Constr. Co. v. Mid-City Rental Services, Inc.*, 603 S.W.2d 193 (Tex. 1980).

SECTION 3

BIDDER MISTAKES AND REMEDIES

A. BID MISTAKES

1. Bid Irregularities

A public contract cannot be awarded on terms that vary from those contained in the invitation for bids.¹ A bid must conform in all material respects to the invitation for bids; a bidder cannot be allowed after bid opening to supply an essential element that was missing from its bid.² However, not every irregularity in a bid requires rejection of the bid. In order for rejection to be required, a variation from the bid specifications or instructions must be of a type that essentially destroys the competitive nature of bidding. The variation must be substantial, and in order to be substantial, it must affect the amount of the bid and give the bidder an advantage or benefit not allowed other bidders.³ In order to be waived by the contracting agency, a deviation from the specifications or instructions must be inconsequential; in other words, it must not provide that bidder with an advantage over other bidders, and must not otherwise defeat the goals of public contracting in insuring proper use of public funds and avoidance of corruption.⁴ Generally, the test applied is to determine whether waiver of the irregularity would deprive the agency of its assurance that the contract will be entered into, performed, and guaranteed according to the specifications, and whether the irregularity is such that it undermines competitive bidding by giving one bidder an advantage over others.⁵

a. Major vs. Minor Irregularities

A material defect in the bid is one that would allow the bidder to avoid the binding nature of its bid without

forfeiting its bid bond, and it cannot be waived.⁶ The distinction between waivable and nonwaivable bidding requirements sometimes may be spelled out in the language of applicable statutes. For example, Louisiana's Public Bid Law specifically states that the requirements of the statute, requirements in the advertisement for bids, and substantive requirements stated on the bid form may not be considered informalities and may not be waived by the agency.⁷ Nonwaivable statutory requirements may be as detailed as inclusion of the bidder's certificate of responsibility number on the outside of its bid envelope.⁸ But frequently, the distinction between waivable and nonwaivable deviations must be discerned through a careful evaluation of the actual impact of the irregularity.⁹

Frequently bids are prepared under circumstances that increase the chance of innocent error. It is common for bidders to wait as long as possible before the filing deadline to complete their bids, for by so doing they may be able to take advantage of late price changes for materials.¹⁰ In other instances, this longer time also may be used beneficially to analyze the project specifications and verify the technical data upon which the contracting agency has based its estimates. Preparation and submission of bids under pressure increases the danger of many types of error. Typical of the irregularities that may have to be evaluated by contracting agencies are the following:

- Bid is not signed or is not dated.¹¹
- Bid does not include corporate resolution authorizing representative to sign bid.¹²
- Bid does not disclose bidder's stockholders where required by statute.¹³

¹ Portions of this section are derived from *Competitive Bidding and Award of Highway Construction Contracts* by Dr. Ross D. Netherton, published by the Transportation Research Board in 1976 and included in the first edition of SELECTED STUDIES IN HIGHWAY LAW.

² *Sevell's Auto Body Co. v. N.J. Highway Auth.*, 306 N.J. Super. 357, 703 A.2d 948, 951 (A.D. 1997); *L. Pucillo & Sons, Inc. v. Township of Belleville*, 249 N.J. Super. 536, 592 A.2d 1218, 1224, *certification denied*, 127 N.J. 551, 606 A.2d 364 (1991) (citing *Palomar Constr., Inc. v. Township of Pennsauken*, 196 N.J. Super. 241, 482 A.2d 174 (A.D. 1983)).

³ *Wilson Bennett, Inc. v. Greater Cleveland Regional Transit Auth.*, 925, 67 Ohio App. 3d 812, 588 N.E.2d 920, *jurisdictional motion allowed*, 53 Ohio St. 3d 717, 560 N.E.2d 778, *cause dismissed*, 57 Ohio St. 3d 721, 568 N.E.2d 1231 (1990).

⁴ *Ghilotti Constr. Co. v. City of Richmond*, 53 Cal. Rptr. 2d 389, 390, 45 C.A. 4th 897, *review denied* (1996); *see also* AMERICAN BAR ASSOCIATION, MODEL PROCUREMENT CODE FOR STATE AND LOCAL GOVERNMENTS § 3-202(6) (2000).

⁵ *United States v. Joint Meeting of Essex & Union Counties*, 997 F. Supp. 593, 600 (D. N.J. 1998); *Matter of Protest of Award of On-Line Games Production and Operation Services Contract*, Bid No. 95-X-20175, 279 N.J. Super. 566, 653 A.2d 1145, 1160 (1995) (both citing *Meadowbrook Carting Co. v. Borough of Island Heights*, 138 N.J. 307, 650 A.2d 748 (1994)).

⁶ *Spawglass Constr. Corp. v. City of Houston*, 974 S.W.2d 876, 885 (Tex. App. 1998).

⁷ *Boh Bros. Constr. Co., L.L.C. v. Department of Transp. and Dev.*, 698 So. 2d 675, 678 (La. App. 1 Cir. 1997); La. R.S. § 38:2212 subd. A(1)(b). However, the agency may still waive deviations that are not substantive in nature. *Id.*

⁸ *City of Durant v. Laws Constr. Co.*, 721 So. 2d 598, 602 (Miss. 1998).

⁹ *A.A.B. Elec., Inc. v. Stevenson Public School Dist.*, 5 Wash. App. 887, 491 P.2d 684, 686-87 (1971).

¹⁰ *See City of Atlanta v. J.A. Jones Constr. Co.*, 370, 260 Ga. 658, 398 S.E.2d 369, 370, *on remand*, 198 Ga. App. 345, 402 S.E.2d 554, *cert. denied*, 111 S. Ct. 2042 (1990).

¹¹ *See, e.g., A.A.B. Elec., Inc. v. Stevenson Public School Dist.*, 5 Wash. App. 887, 491 P.2d 684, 686 (1971) (bid was rejected because it was unsigned, bidder could have accepted or rejected the award in retrospect, which gave that bidder an advantage over other bidders).

¹² *George W. Kennedy Constr. Co. v. City of Chicago*, 135 Ill. App. 3d, 306, 481 N.E.2d 913, 916 (1985) (corporation secretary's signature was not sufficient to bind bidder where the bid did not include a certified copy of the corporate by-laws or other authorization for secretary to bind corporation).

¹³ *George Harms Constr. v. Borough of Lincoln Park*, 161 N.J. Super. 367, 391 A.2d 960, 965-66 (1978).

- Bid papers do not acknowledge the bidder's receipt of changes in plans, additions to specifications, or other addenda.¹⁴

- Bidder does not include lists of current equipment, a description of previous experience, or an updated financial statement.¹⁵

- Bidder fails to list subcontractors as required by statute or the invitation for bids.¹⁶

- Arithmetical errors occur in estimating materials or extending unit prices to derive total prices.¹⁷

- Bid papers are not submitted on the right forms or in the required number of copies.¹⁸

¹⁴ *George & Benjamin General Contractors v. Virgin Island Dep't of Property and Procurement*, 921 F. Supp. 304, 309 (D. V.I. 1996) (failure to acknowledge receipt of addendum may be waived as minor informality if the bid clearly indicates that the bidder received the amendment, such as when the addendum adds an item of work and the bidder has included a bid for that item).

¹⁵ *J.H. Parker Constr. Co. v. Board of Aldermen, City of Natchez*, 721 So. 2d 671, 677 (Miss. App. 1998) (city had discretion to waive prequalification statement where bidder omitted statement from response); *TEC Electric, Inc. v. Franklin Lakes Board of Educ.*, 284 N.J. Super. 480, 665 A.2d 803, 806 (1995) (omitted prequalification statement was waivable as an immaterial defect and it was an abuse of discretion to deny the waiver; statement that was omitted would have duplicated what had already been submitted with respect to assurances regarding financial responsibility, plant, and equipment, and there was no evidence of advantage to the bidder); *Gunderson v. University of Alaska, Fairbanks*, 922 P.2d 229, 235 (Alaska 1996) (permitting use of different hauling equipment from that specified in request for proposals was harmless); *Peninsula Correctional Health Care v. Department of Corrections*, 924 P.2d 425, 428 (Alaska (1996)) (submission of resumes of employees as representative sample of who would be working on project, and not as commitment that those employees would be assigned to project, did not render bid nonresponsive); *Arakaki v. State of Haw.*, 87 Haw. 147, 952 P.2d 1210, 1214 (1998) (it was error for agency to reject all bids and determine that low bidder was nonresponsive on the grounds that the low bidder had requested permission to supplement its bid with its qualification and experience list). *But see City of Durant v. Laws Constr. Co.*, 721 So. 2d 598, 602 (Miss. 1998) (bidder's failure to include statutorily required certificate of responsibility number on outside of bid envelope is nonwaivable deviation).

¹⁶ *Ray Bell Constr. Co. v. School District of Greenville County*, 331 S.C. 19, 501 S.E.2d 725, 729-30 (1998) (bid was nonresponsive as listing alternative subcontractors was contrary to subcontractor listing law requirements; alternatives gave bidder opportunity to choose among listed subcontractors, which was an advantage not enjoyed by other bidders).

¹⁷ *See, e.g., Department of Transp. v. Ronlee, Inc.*, 518 So. 2d 1326, 1328 *review denied*, 528 So. 2d 1183 (Fla. App. 3 Dist. 1987).

¹⁸ *George & Benjamin General Contractors v. Virgin Islands Dep't of Property and Procurement*, 921 F. Supp. 304, 309 (D. V.I. 1996); *see also Sedor v. West Mifflin Area School District*, 713 A.2d 1222, 1225 (Pa. Commw. 1998) (laches may apply to action to enjoin an award to a bidder who used wrong bid form).

- Prices submitted are for an alternate item in lieu of an item specified.¹⁹

- Prices are not given for an alternative called for in the invitation for bids.²⁰

- Bidder does not include its plan of operation with the bid, including completion date.²¹

- Bidder has failed to attend the pre-bid meeting.²²

- Cost item is omitted.²³

- Bidder fails to include affirmative action plan.²⁴

Consistent with the rule that there must be strict adherence to formal specifications and procedures in the submission, opening, and acceptance of bids, courts have upheld the rejection of bids that are irregular when submitted.²⁵ On the other hand, where an irregularity is determined to be minor and has no adverse effect on the competition among bidders, con-

¹⁹ *Bodies by Lembo v. Middlesex County*, 286 N.J. Super. 298, 669 A.2d 254, 256 (A.D. 1996); *see also Southern Foods Group, L.P. v. State, Dep't of Educ.*, 974 P.2d 1033, 1042, 89 Haw. 443 (1999) (alternate bids submitted where they were not called for, in violation of bidding regulations, was properly rejected as nonresponsive).

²⁰ *Hall Constr. Co. v. N.J. Sports Auth.*, 295 N.J. Super. 629, 685 A.2d 983, 988 (A.D. 1996) (failure to submit bid on alternate renders bid nonconforming).

²¹ *Kokosing Constr. Co. v. Dixon*, 72 Ohio App. 3d 320, 594 N.E.2d 675, 680 (1991).

²² *Scharff Bros. Contractors, Inc. v. Jefferson Parish Sch. Bd.*, 641 So. 2d 642, 644, *reconsideration denied*, 644 So. 2d 398 (La. App. 5 Cir. 1994).

²³ *Matter of Protest of Award of On-Line Games Production and Operation Services Contract, Bid No. 95-X-20175*, 279 N.J. Super. 566, 653 A.2d 1145, 1163-64 (1995).

²⁴ *Kokosing Constr. Co. v. Dixon*, 72 Ohio App. 3d 320, 594 N.E.2d 675, 680 (1991). However, the bidder's failure to include a signature on the affirmative action plan was not a material deviation. *Id.*, 594 N.E.2d at 680.

²⁵ *Ardmare Constr. Co. v. Freedman*, 191 Conn. 497, 467 A.2d 674, 676 (1983) (use of rubber stamp rather than handwritten signature on bid); *Colombo Constr. Co. v. Panama Union Sch. Dist.*, 136 Cal. App. 3d 868, 186 Cal. Rptr. 463, 466 (1982) (bidder who made a mistake in original bid is prohibited from further bidding on same project); *E.M. Watkins & Co. v. Board of Regents*, 414 So. 2d 583, 587 (Fla. App. 1982) (failure to list subcontractors in bid); *Gibbs Constr. Co. v. Board of Supervisors, La. State Univ.*, 447 So. 2d 90, 92 (La. App. 1984) (failure of bidder to attend pre-bid conference); *Williams v. Board of Supervisors, La. State Univ. and Agricultural and Mechanical College*, 388 So. 2d 438, 441 (La. App. 1980) (failure to describe equipment according to instructions); *Grace Constr. Co. v. St. Charles Parish*, 467 So. 2d 1371 (Fla. App. 1985); *George W. Kennedy Constr. Co. v. City of Chicago*, 135 Ill. App. 3d 306, 481 N.E.2d 913, 916 (1985) (omission of bidder's president's signature on corporate signature and acceptance pages); *Matter of Bayonne Park, Lincoln Park and James J. Braddock-North Hudson Park Bikeway System, Hudson County*, 168 N.J. Super. 33, 401 A.2d 705, 709 (1979) (successful low bidder delayed return of executed contract beyond period permitted in bid instructions).

tracting agencies have been upheld in their waiver of the defect.²⁶

Materiality of a particular specification is a question of law.²⁷ Whether irregularities in bidding and acceptance may be waived by the contracting agency generally has been determined by consideration of their practical effect on the basic purpose of the competitive bidding system. Thus, the question of waiving a bidder's failure to file certain forms with the bid is evaluated in terms of the risk that an unfair advantage may be granted by allowing this oversight to be corrected after bid opening.²⁸ Similarly, waiver of oversights in the formalities of opening bids requires consideration of whether the action will result in giving any bidder an advantage that the others do not have.²⁹

Determination of when a bid is accepted must be made by reference to the contracting agency's rules of procedure. Where bids for a construction contract were the subject of several motions at the same meeting of the agency's governing body, it was held that the last action in the continuous session of the commission's meeting was controlling, and earlier motions to accept a particular bid did not give rise to a bidding contract at that time and by that act.³⁰ Also, where a contracting agency's rules of procedure require that acceptance is not completed until the bidder is formally notified, the time of notification is controlling, even though the successful bidder was represented at the county commission meeting at which the contract was awarded.³¹

Among the consequences of acceptance of a bid is the general rule that the bidder may not thereafter make changes in the list of subcontractors that it has submitted without the approval of the contracting agency.³²

²⁶ See, e.g., *Lovisa Constr. Co. v. N.Y. State Dep't of Transp.*, 435 N.Y.S.2d 123 (1980) (low bidder did not list mobilization costs separately for particular facilities, but inserted one gross figure for all mobilization costs).

²⁷ *George Harms Constr. v. Borough of Lincoln Park*, 161 N.J. Super. 367, 391 A.2d 960, 965 (1978).

²⁸ *Excavation Constr., Inc. v. Ritchie*, 230 S.E.2d 822, 825 (W. Va. 1976) (refusal to waive failure to file a "free competition affidavit" with original bid papers was not abuse of discretion).

²⁹ *Butler v. Federal Way School Dist. No. 210*, 17 Wash. App. 288, 562 P.2d 271, 276 (1977) (contracting agency mislaid bid and did not open it until 15 minutes after others were opened in the presence of other bidders, irregularity could be waived); *Farmer Constr., Ltd. v. State Dep't of Gen. Admin.*, 98 Wash. 2d 600, 656 P.2d 1086 (1983) (omission of signature on bid form was not material where bid bond was signed and bid bond and proposal referred to each other and were connected by internal reference; bidder would be bound by bid and lack of signature on cover page was not an advantage).

³⁰ *Berry v. Okaloosa County*, 334 So. 2d 349, 350 (Fla. App. 1976).

³¹ *Id.* at 351.

³² *But see McCandlish Elec., Inc. v. Will Constr. Co.*, 107 Wash. App. 85, 25 P.3d 1057 (2001) (subcontractor listing statute did not provide listed subcontractor with cause of action when prime contractor substituted another subcontractor;

Some states have specific legislation to discourage bid shopping or bid peddling in connection with construction contract awards.³³ This promotes the dual purposes of maintaining fairness in dealings between prime and subcontractors as well as protecting public works projects from excessive costs.³⁴ However, where a bid statute does not require listing of subcontractors and the invitation for bids does not have such a requirement, then a bidder's failure to do so may be waived.³⁵ This is particularly so where the court has determined that the subcontractor listing would not have prevented bidders from bid shopping.³⁶ However, where a statute requires listing of subcontractors, the bidder's failure to do so is a nonwaivable deviation, even if the invitation for bids is silent on that requirement.³⁷

An agency may require subcontractor listing in its invitation for bids where it is not necessarily required by statute, or may set out more detailed requirements than are required by statute. In such a case, the bidder's failure to comply with the more stringent requirements may be grounds for determining that the bid is nonresponsive. A California court in *MCM Construction v. City and County of San Francisco* held that the City acted within its discretion when it rejected the low bid as nonresponsive for not complying with its requirement that it provide the subcontract price of all of its listed subcontractors, even though this requirement went beyond the requirements of California's subcontractor listing statute.³⁸

In addition to not being able to change the individual subcontractors or prices listed, a bidder also cannot change the subcontractor percentages in its bid after bid opening. Where the specifications permitted only 50 percent of the work to be subcontracted and the bidder proposed to subcontract over 80 percent, the higher amount could not be waived, nor could the bidder alter the percentages.³⁹ Many of these irregularities cannot

subcontractor's remedy was to try to enjoin award and execution of contract).

³³ CAL. PUB. CONT. CODE § 4101 *et seq.* (1999).

³⁴ See *Bay Cities Paving & Grading, Inc. v. Hensel Phelps Constr. Co.*, 128 Cal. Rptr. 632, 634, 56 C.A. 3d 361 (1976) ("Bid shopping is the use of the lowest bid already received by the general or prime contractor to pressure other subcontractors into submitting even lower bids; bid shopping is prohibited by the statute after the award of the prime contract.").

³⁵ *Williams Bros. Constr. v. Public Bldg Comm'n of Kane County*, 243 Ill. App. 3d 949, 612 N.E.2d 890, 895, *appeal denied*, 152 Ill. 2d 582, 622 N.E.2d 1229 (1993).

³⁶ *Id.* at 897.

³⁷ *Gaglioti Contracting, Inc. v. City of Hoboken*, 307, N.J. Super. 421, 704 A.2d 1301 (1997).

³⁸ 78 Cal. Rptr. 2d 44, 51, 66 Cal. App. 4th 359 (Cal. App. 1998).

³⁹ *Valley Crest Landscape, Inc. v. City Council of City of Davis*, 49 Cal. Rptr. 2d 184, 190, 41 C.A. 4th 1432 (1996) (the agency cannot permit changes in subcontractor percentages after bid opening; specifications permitted only 50 percent of

adversely affect the competitive bidding process. Others, such as failure to submit a plan of operation or an updated financial statement, might affect a contract award.

In practice, the character and consequences of a bid's variance influence the disposition of the bid. Where the variances are minor, and the bid conforms substantially to the specifications, courts have held that acceptance of the bid as originally submitted does not destroy the competitive character of the bidding. Rejection appears to be required only where the bid variance would create a substantial difference between the terms of the bid and the announced specifications of the project, and would give that bidder an advantage not enjoyed by other bidders.

Difficulties arise in practical application of the rule to individual cases, since variances may result from a wide range of fact situations. The reported cases have concerned all major types of specifications—quantity, quality, and condition of materials; schedules for work and deliveries; geometric and structural design; organization of work; and numerous special provisions.⁴⁰ They have also disclosed a wide variety of language used in both bids and specifications. The courts have approached these cases with a pragmatic objective of preventing situations in which any bidder is allowed to bid in a way that gives its proposal an advantage that is not also enjoyed by the other bidders. The impact on bid prices is, therefore, the pivotal point in distinguishing allowable and prohibited variances. Those that have a minimal effect or no effect on price may be permitted to remain in the competition for the contract award. It is not important to the rule that the variant bid might provide an additional benefit to the contracting agency. If it contemplates a material change, and thus departs from the basis on which the other bids are evaluated, the variance must be rejected.

b. Unsigned Bids

Normally, the lack of a signature is a material defect that cannot be waived. In the absence of a signature of a person that can bind the bidder to its bid, the bidder is free to refuse to execute the contract without forfeiting its bid bond should it decide that it is in its interest to do so.⁴¹ This is an advantage not enjoyed by other bidders, and so constitutes a material and substantial deviation. However, where the cover page was not signed but the addendum was signed, the court held that the lack of a signature on the cover page was not a

the work to be subcontracted, and a higher percentage could not be waived).

⁴⁰ Annotation, 65 A.L.R. 835 (1930); Annotation, 69 A.L.R. 697 (1930); Annotation, 114 A.L.R. 1437 (1938).

⁴¹ A.A.B. Elec., Inc. v. Stevenson Pub. Sch. Dist., 5 Wash. App. 887, 491 P.2d 684, 686 (1971) (bid was rejected because it was unsigned, bidder could have accepted or rejected the award in retrospect, which gave that bidder an advantage over other bidders).

material and substantial deviation, as the signature on the addendum was sufficient to bind the bidder.⁴²

Likewise, where there was a signature in three other places in the bid, including the bid bond, the lack of a signature on the cover page was waivable; the bid and bid bond could be treated as one signed instrument.⁴³ However, whether a signature on the bid bond is enough to bind the bidder to its bid must be determined with reference to the documents. Where the bid bond and the bid are internally connected and make references to one another, they may be held to be one document. In such a case, the signature on the bid bond will bind the bidder, even if the signature on the cover page of the bid is lacking.⁴⁴ However, if they are not so connected as to make the bid bond part of the bid and thus part of the offer itself, then the signature on the bid bond alone may be insufficient.⁴⁵

Another material defect occurs when the bid does not include a corporate resolution authorizing a representative to sign the bid.⁴⁶ As in the case of a missing signature, the bidder would have the opportunity to refuse to execute the contract by claiming that the signer did not have authority to bind the corporation. This is considered a material and substantial deviation that cannot be waived by the contracting agency.

c. Late Bids

Whether an agency must reject a late bid or may waive the lateness as an informality depends on the degree of discretion given the agency in its bidding statutes.⁴⁷ Most states require that a late-submitted bid must be rejected.

The Virginia Supreme Court in *Holly's, Inc. v. County of Greenville* held that the second lowest bidder was entitled to reversal of the award of the contract to a lower bidder whose bid had not been timely submit-

⁴² *Leaseway Distribution Centers, Inc. v. Department of Admin. Services*, 49 Ohio App. 3d 99, 550 N.E.2d 955, 960–61 (1988) (addendum is part of bid package to which bidder is bound).

⁴³ *Spawglass Constr. Corp. v. City of Houston*, 974 S.W.2d 876, 885 (Tex. App. 1998) (bid was signed in three other places including bid bond; bid and bond were connected by internal references and could be treated as one signed instrument).

⁴⁴ *Farmer Constr., Ltd. v. State Dep't of Gen. Admin.*, 98 Wash. 2d 600, 656 P.2d 1086 (1983) (omission of signature on bid form was not material where bid bond was signed and bid bond and proposal referred to each other and were connected by internal reference; bidder would be bound by bid and lack of signature on cover page was not an advantage).

⁴⁵ *A.A.B. Elec., Inc. v. Stevenson Public School Dist.*, 5 Wash. App. 887, 491 P.2d 684, 686–87 (1971) (bid bond was not part of bid, but rather was condition precedent to acceptance of offer).

⁴⁶ *George W. Kennedy Constr. Co. v. City of Chicago*, 135 Ill. App. 3d 306, 481 N.E.2d 913, 916 (1985).

⁴⁷ See B. Waagner and E. Evans, *Agency Discretion in Bid Timeliness Protests: The Case for Consistency*, 29 PUB. CONT. L.J. 713, 724–37 (2000).

ted.⁴⁸ The court stated that the requirement in the invitation for bids fixing the time for submission of bids was one that had to be strictly complied with, and non-compliance was not a minor defect or informality that may be waived. Rather, it was a material and formal requirement to be complied with. The court in *J.A. Jones* discussed the reason for adhering strictly to the time set for submission of bids, noting that a contractor may adjust its prices up until the last minute that the bid is submitted. Therefore, even a 3-minute delay in submission of a bid was considered to be an unfair advantage not enjoyed by other bidders.⁴⁹

However, not all states take such a strict position regarding timeliness of bids. For example, the Wisconsin Court of Appeals held that a city had discretion to accept a late bid, where the statute under which it advertised for bids did not preclude the opening of a late-submitted bid.⁵⁰

A bid officer's declaration of the time at bid opening is presumed to be correct unless the protester shows clearly that the time was inaccurate.⁵¹ In *Washington Mechanical Contractors v. Department of the Navy*, a federal district court found that where the agency itself had shown that its bid clock was fast, it was not error to accept a late bid as timely when it was timely when the adjustment was made for the fast clock. The protester who would have been the low bidder otherwise could not show that the Navy was wrong in determining that its clock was fast.⁵²

A more unusual situation is the one in which the bidder delivers the bid to the right place at the right time, but through some oversight of the agency staff it is not "received" on time. Two courts reached different results in this situation. In *Statewide Roofing v. Eastern Suffolk Board of Cooperative Educational Services*,⁵³ the parcel delivery service had delivered the bidder's bid prior to the deadline for submission, but had placed it on the administrator's desk rather than delivering it to the room in which bid opening would occur, and the package was not discovered until after all other bids had been opened and announced. The agency subsequently opened the bid in the presence of others; the agency had confirmed that it had arrived prior to the deadline, which precluded any inference of dishonesty, favoritism, or fraud. The New York court held that it was not error for the agency to award the contract to that bidder, who was the lowest responsible bidder.⁵⁴

⁴⁸ 250 Va. 12, 458 S.E.2d 454, 458 (1995).

⁴⁹ See, e.g., *City of Atlanta v. J.A. Jones Constr. Co.*, 260 Ga. 658, 398 S.E.2d 369, 370 *on remand*, 198 Ga. App. 345, 402 S.E.2d 554, *cert. denied*, 111 S. Ct. 2042, 500 U.S. 928 (1990).

⁵⁰ *Power Systems Analysis v. City of Bloomer*, 197 Wis. 2d 817, 541 N.W.2d 214, 216 (Wis. App. 1995).

⁵¹ *Washington Mechanical Contractors, Inc. v. United States Dep't of the Navy*, 612 F. Supp. 1243 (S.D. Cal. 1984).

⁵² *Id.*

⁵³ 661 N.Y.S.2d 922, 173 Misc. 2d 511 (N.Y. Supp. 1997).

⁵⁴ See also *Butler*, *supra* note 29.

There had been no benefit to the bidder, and it remained on the same footing as the other bidders. However, in another case in which the bid was delivered to the correct place but was not "received" by the contracting officer in time for bid opening, the court held that the bid was properly rejected as untimely.⁵⁵

d. Balanced and Unbalanced Bids

Where project advertisements specify that bids must be expressed in unit prices, contracting agencies must be prepared to deal with unbalanced bids. The distinction between balanced and unbalanced bids lies in the extent to which the unit price assigned to each bid item realistically reflects the item's share of the total cost or work. A balanced bid for a particular cost item carries its full and correct share of the total price. An unbalanced bid does not, so that some items are overpriced and others are low or only nominally priced.⁵⁶ Thus, without changing the total price, a contractor may arrange the unit prices for the specifications of a project so as to achieve unusually favorable, and sometimes unintended, results.

The attractiveness of unbalanced bidding in certain situations is easy to understand. A contractor who needs to build up or recoup working capital as soon as possible may unbalance a bid by setting high prices on items of work performed early in the project. In this way the contractor can ease the financial strain incurred in mobilizing the construction plant and equipment, purchasing materials, and the general costs of starting up the project. These are all expenses that the contractor otherwise could not expect to liquidate until the work progressed over a substantial period of time. There is, however, a risk to the public if this practice is abused. An unscrupulous or unqualified bidder may unbalance a bid in a way that results in excessively high payments early in the work, only to default and leave the surety or the contracting agency to finish the project and pay for those items that were underestimated in the bid.

A mathematically unbalanced bid is not necessarily nonresponsive. A reasonably unbalanced bid may be perfectly proper.⁵⁷ However, a bid may be considered nonresponsive when it is mathematically and materially unbalanced.⁵⁸ When the bid is so grossly unbalanced that it results in an advance payment, it is materially unbalanced and must be rejected. In *McKnight Const. Co. v. Department of Defense*,⁵⁹ the agency concluded that items with exceptionally high prices would be done early in the project, while the later work was

⁵⁵ *Holly's, Inc. v. County of Greensville*, 250 Va. 12, 458 S.E.2d 454, 457 (1995).

⁵⁶ *Turner Constr. Co. v. N.J. Transit Corp.*, 296 N.J. Super. 530, 687 A.2d 323, 327 (1997).

⁵⁷ 687 A.2d at 327.

⁵⁸ *SMS Data Products Group, Inc. v. United States*, 900 F.2d 1553, 1557 (Fed. Cir. 1990).

⁵⁹ 85 F.3d 565, 570-71 (11th Cir. 1996).

priced “ridiculously low.” Thus it was not an abuse of discretion to reject the bid.

Unbalanced bidding may also be used where a bidder believes that the contracting agency’s estimates for quantities of certain items are low, and that these quantities will have to be increased as the work progresses. In those circumstances the contractor can increase profits by unbalancing the bid in favor of these items without increasing the total price of the proposal. In other instances, inaccurate estimates may work to the disadvantage of a contractor, because any substantial increase or reduction in the quantity of materials or work after construction operations have commenced may distort the factors that determine a contractor’s actual cost, so that the unit price submitted in the bid is thrown out of balance, with resulting loss of profits.

Because of these possibilities for unanticipated profits or losses, and the susceptibility to fraud and collusion, unbalanced bids are not favored. Bidding specifications sometimes provide for permissive rejection of unbalanced bids.⁶⁰ In this way, unbalanced bidding may be scrutinized case-by-case, and its effect on the cost to the contracting agency can be analyzed. This approach is to be preferred to outright prohibition of unbalanced bidding. Unbalanced bids are not per se fraudulent, nor are they always evidence of substantial error. The rule appears to still be:

An unbalanced bid that does not materially enhance the aggregate cost of the work cannot be complained of. If there is no deception or mistake as to the quantities, and if the ordinances have fairly been complied with, and the quantity and quality of the work has been estimated as nearly as practical, there is no ground for alleging substantial error merely because of an unbalanced bid under which the contract was let, and if the cost of the work has not thereby been enhanced, there is no ground for alleging fraud.⁶¹

Cooperation between the contractor and the contracting agency should eliminate the risk of unfair practice and minimize the area in which inaccuracies exist. Such a policy is sometimes set forth in the transportation agency’s own standard specifications.

The distinction between genuine and apparently unbalanced bids was made in *Department of Labor and Industries v. Boston Water and Sewer Commission*,⁶² in which the complainant protested a bid for construction of underground sewer lines. The Commission’s specification for the work called for the contractor to install temporary sheeting, for which the apparent low bidder listed a unit price of a penny per square foot. Although it determined that this bid was not unbalanced, “front-

end loaded,” or otherwise inflated; was made in good faith; and did not violate any of the State’s public contract laws; the Department of Labor and Industries instructed the defendant Commission to reject the bid as unresponsive and contrary to the Department’s policy.⁶³ The trial court explained that the Department of Labor and Industries had taken the position that penny bidding of certain items of the contract is unlawful even where the bid is not facially unbalanced. This position was taken as a result of the department’s interpretation of the law and a longstanding and publicly known policy against any form of penny bidding. The basis of this policy was a conclusion that “because of the potential bid manipulation and the possible resulting harm to the awarding authority and the general public...unrealistic bids must be rejected as unresponsive to the bid requirements.”⁶⁴ On appeal, however, the Massachusetts Appellate Court reversed this ruling. It held that the Department lacked authority to promulgate rules or regulations that controlled the bidding process, and its announced policy could not be permitted to have the practical effect of law.⁶⁵ The court also distinguished the practice of “penny bidding” from the case where the “equal footing” of bidders was destroyed by artificially low bids that conferred special advantages on one of the bidders.⁶⁶

In another case, *Turner Construction Company v. New Jersey Transit Corporation*,⁶⁷ the bidder had submitted a bid of zero for one item. Rather than construe this as a failure to submit a unit price on an individual bid item, which would be a material defect, the court construed it as an unbalanced bid, which is not defective merely because it is unbalanced. In this case, a bid of zero was comparable to a nominal or penny bid. The court stated: “Every contractor may apply his own business judgment in the preparation of a public bid, and his willingness to perform one of the items for a nominal amount is but his judgmental decision in an effort to underbid his competitors.”⁶⁸

The court thus found that the zero bid for one bid item was a waivable defect.

e. Qualified Bids

Serious difficulties may arise when bids do not conform fully or precisely to the plans, terms, or specifications in the project announcement. When bids are at variance with these aspects of the project announcement, it is unlikely that the contracting agency will receive the end product it desires. It is also not possible

⁶³ *Id.* at 66.

⁶⁴ *Id.*

⁶⁵ *Id.* at 67.

⁶⁶ *Id.* at 68. The court noted that in the instant case, at least five other contractors had listed bids of one penny per square foot for temporary sheeting. 469 N.E.2d at 66.

⁶⁷ 296 N.J. Super. 530, 687 A.2d 323, 327 (1997).

⁶⁸ 687 A.2d at 327 (quoting *Riverland Constr. Co. v. Lombardo Contracting Co.*, 380 A.2d 1161, *aff’d*, 388 A.2d 626 (1978)).

⁶⁰ See, e.g., Washington State Department of Transportation, 2000 Standard Specifications for Road, Bridge, and Municipal Construction § 1-02.13(2)(b) (bid may be considered irregular and may be rejected if “[a]ny of the unit prices are excessively unbalanced (either above or below the amount of a reasonable bid) to the potential detriment of the Contracting Agency.”).

⁶¹ *In re Anderson*, 109 N.Y. 554, 17 N.E. 209 (1888).

⁶² 18 Mass. App. 621, 469 N.E.2d 64 (1984).

to fairly compare all bidders on a common set of work standards. Bids may be inconsistent with advertised plans, terms, and specifications, but still offer an acceptable end product. However, such bids should be treated as counterproposals, which are not responsive. This was the result in *Bodies by Lembo v. Middlesex County*,⁶⁹ a New Jersey case in which the second low bidder's alternative for an "equivalent" product that was less than the price of the low bidder was declared invalid. The court ordered that the low bidder be awarded the contract as it was advertised and did not allow the county to readvertise.⁷⁰

A bidder's conditional response to a request for proposals also will generally be considered nonresponsive. A responsive bid is considered an offer to contract with the agency; a bid that proposes something other than that requested in the invitation for bids or that conditions its response will be considered a counter-offer, and a nonresponsive bid. For example, a bidder's conditional response to one item of a request for proposals for the supply of reflective sheeting materials and supporting services for reflective license plates was considered a nonwaivable material deviation from the request for proposals.⁷¹ This was found to create a situation in which the agency could not be assured that the contract would be performed, and gave the bidder a competitive advantage.

f. Improper Bid Bonds

An example of a material deviation that could not be waived is found in a case in which the bid was submitted with a letter from the surety stating that it did not anticipate any difficulty in providing bonds, rather than guaranteeing that the bonds would be provided.⁷² The court found this defect to be a substantial deviation from a material condition because there was no guaranty that the surety would issue the bonds on the date that bids were due.⁷³

g. Failure to Acknowledge Addenda

In *George & Benjamin General Contractors v. Virgin Island Department of Property and Procurement*, the court noted that the applicable regulations allowed that failure to acknowledge receipt of addendum may be waived as a minor informality if the bid clearly indicated that the bidder received the amendment, such as when the addendum added an item of work and the

bidder included a bid for that item.⁷⁴ Adherence to this requirement insures that bidders are all submitting bids on the basis of the same information.

h. Other Material Deviations

Where the invitation for bids specifically required the prospective bidders to attend a pre-bid meeting at the construction site, the court held that the bidder's failure to attend was adequate grounds for the agency's rejection of its bid.⁷⁵ The agency's reason for requiring attendance was to ensure that all bidders had adequate notice of the site conditions and could take those conditions into account in their bids. Although the bidder who had not attended the pre-bid meeting submitted a lower bid than the bidders who did attend the meeting, the agency was justified in concluding that the second low bid was the more realistic one, more likely taking into account the actual site conditions. The court did not, however, determine whether the agency was required to reject the bid because of the bidder's failure to attend the meeting, only that it was not arbitrary to have done so. If the bidder's failure to attend gave it more of an opportunity to claim that it was entitled to additional compensation due to changed conditions, then it could be considered a deviation that gave it an advantage over other bidders, requiring rejection. However, under most changed condition clauses, the bidder would probably be held to knowledge of the information provided in the pre-bid conference whether it had a representative at the meeting or not. In addition, requiring that the bidder inspect the site does not protect the agency from changed condition claims.⁷⁶ Failure to attend the pre-bid conference is most likely a nonmaterial deviation that the agency could choose to waive in an appropriate case, as it is not a factor that likely affects the price of the bid or that gives the non-attending bidder an advantage over other bidders.⁷⁷ However, where the agency was concerned about the bidders being informed about the specific site conditions, for the purpose of avoiding claims of changed conditions, it was not arbitrary for the agency to enforce that requirement in the invitation for bids and reject the nonconforming bidder. The agency has discretion to determine whether a deviation is material or nonmaterial, and its decision generally will be upheld if supported by a rational basis.⁷⁸

⁷⁴ 921 F. Supp. 304, 309 (D. V.I. 1996)

⁷⁵ *Scharff Bros. Contractors v. Jefferson Parish Sch. Bd.*, 641 So. 2d 642, 644, *reconsideration denied*, 644 So. 2d 398 (La. App. 5 Cir. 1994).

⁷⁶ *R.J. Wildner Contracting v. Ohio Turnpike Comm'n*, 913 F. Supp. 1031 (N.D. Ohio 1996).

⁷⁷ *See Terminal Constr. Corp. v. Atlantic County Sewerage Auth.*, 67 N.J. 403, 341 A.2d 327, 332 (1975) (failure to attend federally-required pre-award conference was for bidder's benefit, and was waivable).

⁷⁸ *Varsity Transit, Inc. v. Board of Educ. of City of N.Y.*, 515 N.Y.S.2d 520, 521, 130 A.D. 2d 581, *appeal denied*, 519 N.Y.S.2d 1029, 70 N.Y.2d 605, 513 N.E.2d 1309 (1987).

⁶⁹ 286 N.J. Super. 298, 669 A.2d 254, 256 (A.D. 1996). In addition to including an alternative product, the bid also contained deficiencies that the bidder had been permitted to correct after bids were opened.

⁷⁰ *Id.*, 669 A.2d at 260.

⁷¹ Matter of Request for Proposals No. 98-X-29314 Reflective Sheeting License Plates, 315 N.J. Super. 266, 717 A.2d 998, 1001 (A.D. 1998).

⁷² *DeSapio Constr., Inc. v. Township of Clinton*, 276 N.J. Super. 216, 647 A.2d 878 (1994).

⁷³ *Id.* at 880-81.

Another case in which the bidder was rejected for failure to attend the pre-bid conference went even further in supporting the agency's rejection, holding that the contractor did not even qualify as a "bidder" due to its failure to attend.⁷⁹ The advertisement and contract documents had set the time, date, and place for the pre-bid meeting, and had provided that "no bid shall be accepted from any contractor who does not have a responsible representative attend this meeting." Only one contractor attended, and it was awarded the contract. The court again did not determine whether the agency had the power to waive this requirement, only that it was proper to have rejected the bid on that basis.

i. Nonmaterial Deviations

Where the agency finds that the bidder's deviation from the instructions or specifications will not affect its price and will not give that bidder an advantage over other bidders, the deviation may be waived. A common example is an mathematical error, such as in extending unit prices to derive total prices. A patent error in the statement of a unit price as \$400 rather than \$4 was found to be a waivable, nonmaterial error where the bidder's intent was obvious from the computed total for the quantity of that item.⁸⁰

In *Colonnelli Bros., Inc. v. Village of Ridgefield*,⁸¹ however, the bid specifications stated that unit prices would prevail over extended totals. The bidder had written the numerical amount of \$10,000 for "maintenance of traffic during construction," but had written out "one hundred dollars no cents." The bidder then added \$10,000 into the total price. The agency engineer had estimated that item at \$5,000, and the bids had ranged from \$2,000 to \$15,000. When the bid was recalculated using the unit prices, it was found that that bid was in fact the lowest bid. However, the agency rejected the bid as nonresponsive. The trial court held that the fact that the totals were in error was a waivable defect. The appellate court reversed, holding that the trial court had improperly interfered with the agency's discretion, and upheld the rejection.⁸² The court distinguished this case from cases in which the error is obvious and the bidder's intent is easily discerned from the bid document. In this case, the error was not obvious, and allowed the bidder to choose which number to use after bid opening.⁸³

A similar situation arises when figures are transposed. This was considered a minor error that could be corrected by the agency, because the error was so obvious it was easily determined what the bidder's intent

was.⁸⁴ Also, an error in the estimation of the amount of waste material to be generated was considered waivable where the quantity was intended to be an estimate and the possibility of error was contemplated by the parties.⁸⁵

Another error deemed waivable was a bidder's deviation in submitting the name of one subcontractor in the wrong envelope.⁸⁶ Also, the bidder's failure to file a biennial corporate report or pay nominal corporate taxes was not a material defect requiring rejection, as it did not give that bidder an advantage over others.⁸⁷

A number of cases address whether a bidder's failure to include prequalification information with its bid is a material defect requiring rejection. In most of these cases, the bidder already has filed its prequalification materials and has been prequalified in order to submit a bid in the first place. Therefore, courts have found these defects to be waivable in that they do not give that bidder an advantage over others and do not affect the bidder's price.⁸⁸ However, the requirement of prequalification itself is not considered a mere formality. Where a bidder had no prequalification statement on file, the fact that it did not include the prequalification information with its bid could not be waived.⁸⁹ In some states, a bidder is not even entitled to receive the bid package and submit a bid unless it has first been prequalified, so this would not be an issue.⁹⁰

2. Bidder Remedies

When errors occur in cost calculations, or the terms of the project advertisement or bid are not correctly construed, the resulting confusion may seriously delay or jeopardize the contract award. In the case of contracts for large and complex highway construction projects, this risk is increased by the sheer size of the task of checking the plans, specifications, and estimates to detect mistakes. It may also be complicated by the fact that state codes and administrative regulations rarely provide comprehensive procedures for correcting mistakes. Thus, where controversies cannot be settled administratively by the contracting agency, the parties must adjudicate their claims in court.

⁸⁴ *George & Benjamin General Contractors v. Virgin Island Dep't of Property and Procurement*, 921 F. Supp. 304, 309 (D. V.I. 1996).

⁸⁵ *R.J. Wildner Contracting v. Ohio Turnpike Comm'n*, 913 F. Supp. 1031, 1041-42 (N.D. Ohio 1996).

⁸⁶ *MCM Constr., Inc. v. City & County of S.F.*, 78 Cal. Rptr. 2d 44, 54-55, 66 C.A. 4th 359, *review denied* (1998).

⁸⁷ *Lower Kuskokwim School Dist. v. Foundation Services*, 909 P.2d 1383, 1387-88 (Alaska 1996). Note that the filing requirement here was one that is considered to be a revenue mechanism as opposed to a licensing requirement specific to contractors, or a prequalification requirement.

⁸⁸ *See supra* note 15.

⁸⁹ *Modern Continental Constr. Co. v. City of Lowell*, 391 Mass. 829, 465 N.E.2d 1173, 1180 (1984).

⁹⁰ *See WASH. REV. CODE* § 47.28.070 (2001).

⁷⁹ *Gibbs Constr. Co. v. Board of Supervisors*, La. State Univ., 447 So. 2d 90, 92 (La. App. 1984).

⁸⁰ *Spina Asphalt Paving Excavating Contractors v. Borough of Fairview*, 304 N.J. Super. 425, 701 A.2d 441, 443 (A.D. 1997).

⁸¹ 665 A.2d 1136, 284 N.J. Super. 538 (1995).

⁸² 665 A.2d at 1138-39.

⁸³ *Id.*

a. Bid Protests

i. *Protests Prior to Bid Opening.*—A bid protest filed prior to bid opening is the appropriate means for a bidder to challenge the legality of the bid instructions or specifications included in the invitation for bids. Such a challenge allows the agency to save expense to bidders, assure fair competition among them, and correct or clarify plans and specifications prior to bid opening.⁹¹ The challenge must be directed at specifications that are so vague that bidders cannot formulate an accurate bid based on them, or that are unreasonable in that they are impossible to comply with or too expensive to comply with and remain competitive in the bidding process.⁹²

A challenge to the bid specifications must be brought in a timely manner or may be deemed waived. A bidder cannot wait until after bid opening and then challenge a specification if the bidder is unsuccessful. A timely challenge will give the agency the opportunity to correct a flawed specification, either by addendum or by rejecting all bids and re-advertising. It will also allow other bidders to modify their bids if necessary to conform to the corrected or clarified specification.⁹³

Although this type of protest is generally used to challenge special provisions in the contract specifications, a bidder in an Alabama case attempted to prevent the Department of Transportation from applying its standard specifications in a contract. In *Alabama Department of Transportation v. Blue Ridge Sand and Gravel*, the court balanced the potential public harm of premature road failures against the bidder's potential loss of profits, and upheld the use of the department's standard specification requiring that gravel for use in hot mix asphalt have a specific bulk gravity.⁹⁴

ii. *Standing to Protest Award.*—States vary in whether they allow a disappointed bidder to challenge an award where that bidder is not also a state taxpayer.⁹⁵ For example, Pennsylvania, Colorado, and Washington courts have required that one must be a taxpayer in order to enforce the requirements of public bidding laws, such as that public contracts be awarded to the lowest responsible bidder.⁹⁶ In Washington, the court has held that in order to prove taxpayer status, the bidder must show that it pays the type of taxes that are funding the project, and that it asked for the Attorney General's Office to take action before filing suit.⁹⁷

However, many states do allow the bidder to protest the award where it contends that the contract was awarded to a higher bidder because the bidding procedure did not permit the bidders to compete on equal terms.⁹⁸ For example, Florida's courts have held that a person who has at least some potential stake in the contract to be awarded will have standing to challenge the bidding process.⁹⁹ In New York, an Ohio contractor was found to have standing to challenge the contract award on the basis that it alleged noncompliance by the agency with its procedures, and the contractor had suffered injury in fact that was different from that suffered by the public at large.¹⁰⁰

One federal court has held that a disappointed bidder may challenge the contract award only if it is "within the zone of active consideration" for the award of the contract.¹⁰¹ Because the federal Administrative Procedure Act (APA) is written in somewhat broader terms than many state APAs, federal courts are more likely to allow a bidder who is not also a taxpayer to challenge

⁹¹ *Capeletti Bros. v. Department of Transp.*, 499 So. 2d 855, 857 (Fla. App. 1 Dist. 1986).

⁹² *Advocacy Center for Persons with Disabilities, Inc. v. State, Dep't of Children and Family Services*, 721 So. 2d 753, 756 (Fla. App. 1998) (challenge must be to specifications themselves, and not to policy decisions to privatize services).

⁹³ *See Optiplan, Inc. v. School Board of Broward County*, 710 So. 2d 569, 572 (Fla. App. 4th Dist. 1998) (unsuccessful bidder waived its right to challenge race-based selection criteria by submitting bid based on specifications that it later sought to challenge).

⁹⁴ 718 So. 2d 27, 32 (Ala. 1998).

⁹⁵ For a discussion of whether aggrieved bidders should have standing to protest awards regardless of taxpayer status, see David Sullivan, *Disappointed Bidder Standing To Challenge A Government Procurement Contract Award: A Proposal For Change In Kentucky*, 88 KY. L. J. 161-82 (1999).

⁹⁶ *Ray Angelini, Inc. v. City of Phila.*, 984 F. Supp. 873, 884 (E.D. Pa. 1997).

⁹⁷ *Dick Enterprises, Inc. v. Metro/King County*, 83 Wa. App. 566, 922 P.2d 184, 187 (1996).

⁹⁸ *Metropolitan Express Services, Inc. v. City of Kansas City, Mo.*, 23 F.3d 1367, 1370-71 (8th Cir. 1994), *rehearing denied, appeal after remand*, 71 F.3d 273 (1995).

⁹⁹ *Advocacy Center of Persons With Disabilities, Inc. v. State, Dep't of Children and Family Services*, 721 So. 2d 753, 755, *rehearing denied* (Fla. App. 1 Dist. 1998).

¹⁰⁰ *AEP Resources Service Co. v. Long Island Power Auth.*, 686 N.Y.S.2d 664, 669, 179 Misc. 639 (1999).

¹⁰¹ *Ellsworth Assocs. v. United States*, 926 F. Supp. 207, 211 (D.D.C. 1996); *Ralvin Pacific Properties, Inc. v. United States*, 871 F. Supp. 468, 472 (D.D.C. 1994); see also *Transactive Corp. v. N.Y. State Dep't of Social Services*, 665 N.Y.S.2d 701, 704, 236 A.D. 2d 48 (N.Y. App. 1997) (contractor who merely filed intention to bid lacked standing to challenge award, without a showing that it met the qualifications set out in the request for proposals) and *Brem-Air Disposal v. Cohen*, 156 F.3d 1002, 1003 (9th Cir. 1998) (contractor lacked standing to challenge award after end of bid proposal period as it could no longer qualify as a prospective bidder).

an award.¹⁰² The United States Supreme Court's general test for standing is generally relied upon to determine whether a bidder has standing: "The essence of the standing question, in its constitutional dimension, is 'whether the plaintiff has "alleged such a personal stake in the outcome of the controversy" as to warrant his invocation of federal-court jurisdiction and to justify exercise of the court's remedial powers on his behalf.'"¹⁰³

Whether other bidders who responded to the invitation for bids are entitled to notice of the protest, and may participate in the proceeding, is another question. Generally, the bidder who has been awarded the contract should be considered to have standing, and to have an interest sufficient to support intervention in a court proceeding or recognition of its interests by the agency in an administrative proceeding. However, a proposed rule in Florida that would have required the agency to forward copies of a bid protest and notice of hearing to all other bidders was held to be arbitrary and an invalid exercise of its rule-making authority.¹⁰⁴

A Georgia court has held that taxpayers lacked standing to challenge the award of a contract and to enjoin payment to a contractor who had been awarded an on-call contract for paving. In *Faulk v. Twiggs County*,¹⁰⁵ the contractor had obtained a competitively bid unit price contract, but the contract was indefinite as to quantity; the county intended to designate areas for paving as funds became available. In a similar case, the court ruled that unsuccessful bidders did not have standing to challenge an award as taxpayers because the injury that they suffered was private and not shared by the public at large.¹⁰⁶

Generally, a bidder must at a minimum be one who is within the zone of active consideration for the award in order to have standing. However, in *L. Pucillo & Sons v. Belleville Township*,¹⁰⁷ a New Jersey case, a potential bidder was found to have standing to protest where it alleged that it was deterred from submitting a bid by the size of the performance bond required, and the amount of the bond specified was subsequently waived for another bidder.

iii. Standard and Scope of Review.—Generally, contracting agencies have broad discretion in evaluating bids and awarding contracts. Therefore, a disappointed bidder must show that the contract award had no rational basis, or that it involved a clear and prejudicial violation of an applicable statute or regulation.¹⁰⁸ A disappointed bidder bears a heavy burden to show that the award decision had no rational basis.¹⁰⁹ One court has described the review for abuse of discretion in these terms: "The awarding agency has the right to be wrong in the exercise of its discretion, but not the right to be 'unfairly, arbitrarily wrong.'"¹¹⁰

Other courts have stated the standard of review as being whether the agency's decision on who is the lowest responsible bidder was arbitrary, unreasonable, or capricious.¹¹¹ The agency's compliance with its own bidding regulations will be reviewed for whether the agency's decision is correct as a matter of law.¹¹² The agency and its officials and employees are presumed to have acted in good faith, and any party challenging the agency's action must present strong evidence of bad faith in order to overcome this presumption.¹¹³ The agency's findings of fact will generally not be reversed unless a reviewing court concludes that a finding is clearly erroneous in view of the entire record.¹¹⁴

The court's standard of review will have to take the statutory language into account. For example, where the statute allows the agency to select the lowest *and best* responsive bid, the agency may be held to have a higher degree of discretion than one that is obligated by its statute to select the lowest responsive bid. One court has held that where the statute allowed the agency to award the contract to the bidder submitting the lowest and best bid, the bid selection is solely within the sound discretion of the agency, and its decision will be reviewed only for fraud or abuse of discretion.¹¹⁵

¹⁰² See 5 U.S.C. § 702 ("person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action").

¹⁰³ *Village of Arlington Heights v. Metropolitan Housing Dev. Corp.*, 429 U.S. 252, 260–61 (1977) (quoting *Warth v. Seldin*, 422 U.S. 490, 498–99 (1975) (emphasis in original)).

¹⁰⁴ *Division of Admin. Hearings v. Department of Transp.*, 534 So. 2d 1219, 1220 (Fla. App. 1 Dist. 1988).

¹⁰⁵ 504 S.E.2d 668, 670 (Ga. 1998).

¹⁰⁶ *Mid-Missouri Limestone v. County of Callaway*, 962 S.W.2d 438, 441 (Mo. App. 1998).

¹⁰⁷ 592 A.2d 1218, 1222 (N.J. Super. A.D. 1991).

¹⁰⁸ *Latecoere Intern. Inc. v. United States Dep't of the Navy*, 19 F.3d 1342, 1356 (11th Cir. 1995); *Robert E. Derektor of Rhode Island, Inc. v. United States*, 762 F. Supp. 1019, 1022 (D.R.I. 1991).

¹⁰⁹ *Saratoga Dev. Corp. v. United States*, 21 F.3d 445, 456, 204 U.S. App. D.C. 351 (D.C. Cir. 1994).

¹¹⁰ *Williams v. Board of Supervisors, La. State Univ. and Agricultural and Mechanical College*, 388 So. 2d 438, 441 (La. App. 1980).

¹¹¹ *Matter of Protest of Award of On-Line Games Prod. and Operation Services Contract, Bid No. 95-X-20175*, 279 N.J. Super. 566, 653 A.2d 1145, 1158 (1995).

¹¹² *State Contracting and Eng'g Corp. v. Department of Transp.*, 709 So. 2d 607, 610 (Fla. App. 1 Dist. 1998).

¹¹³ *China Trade Center, L.L.C. v. Washington Metro. Area Transit Auth.*, 34 F. Supp. 2d 67, 70–71 (D.D.C. 1999).

¹¹⁴ *Southern Foods Group, L.P. v. State, Dept. of Educ.*, 89 Haw. 443, 974 P.2d 1033, 1042 (1999).

¹¹⁵ *Wilson Bennett, Inc. v. Greater Cleveland Regional Transit Auth.*, 67 Ohio App. 3d 812, 588 N.E.2d 920, 925, *jurisdictional motion allowed*, 42 Ohio St. 3d 717, 560 N.E.2d 778, *cause dismissed*, 57 Ohio St. 2d 721, 568 N.E.2d 1231 (1990).

Although no formal contract exists prior to the acceptance of a bid by the agency, the agency may be considered to have an implied-in-fact contract with bidders to consider all bids fairly. Its failure to do so may result in the awarded being voided. In considering whether an agency has breached this duty, a court will look at (1) whether there is evidence of subjective bad faith on the part of the agency, (2) whether there is a reasonable basis for the agency's decision, (3) the amount of discretion afforded by the statutes and regulations, and (4) whether there is proof that the statutes or regulations have been violated.¹¹⁶

Ordinarily, the scope of a court's review will be limited to the record in existence before the agency.¹¹⁷

iv. Procedures and Evidence.—When a disappointed bidder invokes a statutory review process, the agency must follow the statute's procedural steps.¹¹⁸ In addition to protecting the due process rights of the disappointed bidder, these statutory requirements may be held to be necessary to further public policy goals such as ensuring public confidence in the public bidding system, and ensuring that all who participate in the public procurement process are treated fairly and equitably.¹¹⁹ This is also consistent with the requirements that the agency follow its own procedures prior to the submission of bids and in the consideration of bids.

Likewise, the aggrieved bidder is held to compliance with any statutory filing requirements for challenging the award of a contract. In a Virginia case, these requirements were held to be a limitation imposed on a substantive right rather than mere procedural requirements, and the unsuccessful bidder's failure to comply with the filing requirements warranted dismissal of its case with prejudice.¹²⁰ Requirements may include filing an administrative claim prior to filing in court. Failure to do so may be considered a failure to exhaust administrative remedies, and will bar pursuit of the protest in court.¹²¹

Where the rules pertaining to protests require that it be filed within a certain time period, the bidder's failure to comply with the timeliness requirement will bar its challenge.¹²² The disappointed bidder must plead that it has timely complied with the filing requirements; its failure to include in its protest the facts needed to determine the timeliness of its filing required

dismissal of its protest.¹²³ A Mississippi court has held that where award is subject to approval by FHWA, the time for appeal runs from the time that the contract is executed, and not from the time of award.¹²⁴

Even where another bidder had filed a timely protest, the California court held that a bidder's failure to comply with mandatory procedures regarding the timing and manner of its own protest that were set forth in the bid instructions required dismissal of its protest.¹²⁵ In other words, the fact that the agency was not prejudiced by the late filing, due to the fact that there was already a protest pending, did not relieve the bidder from compliance with the filing requirements.

In a bid protest proceeding, an unsuccessful bidder could not bring in evidence of issues that were not included in its notice of protest, even if the other parties stipulated to admission of the evidence.¹²⁶

v. Injunctive Relief.—Injunctive relief may be available to the protesting bidder, providing that it can meet the standard requirements for such relief, namely that it will suffer irreparable harm and that it has a likelihood of success on the merits.¹²⁷ However, in order to pursue injunctive relief, a contractor must act in a timely manner. A bidder that does not pursue injunctive relief in a timely manner, even though it has readily ascertainable facts sufficient for such a request for relief, may be barred by laches. Further, a bidder may waive its rights to pursue any relief if it does not first ask the court to enjoin the award and execution of the contract to the higher bidder.¹²⁸ The rationale for this is that the agency should be allowed to correct any errors, or if necessary, rebid the project.¹²⁹ A Louisiana court held that an aggrieved bidder may seek to have the contract declared null and void without first obtaining an injunction, but may not seek damages unless it has either

¹²³ *Widnall v. B3H Corp.*, 75 F.3d 1577, 1585 (Fed. Cir. 1996).

¹²⁴ *J.H. Parker Constr. Co. v. Board of Aldermen, City of Natchez*, 721 So. 2d 671, 674 (Miss. App. 1998).

¹²⁵ *MCM Constr., Inc. v. City and County of S.F.*, 78 Cal. Rptr. 2d 44, 55-57, 66 C.A. 4th 359 (Cal. App. 1998), *review denied*.

¹²⁶ *Pacificorp Capital, Inc. v. State Through Division of Admin., Office of State Purchasing*, 612 So. 2d 138, 139 (La. App. 1 Cir. 1992).

¹²⁷ *San Diego Beverage & Kup v. United States*, 997 F. Supp. 1343, 1345 (S.D. Cal. 1998); *Tri-State Asphalt Corp. v. Com. Dep't of Transp.*, 135 Pa. Commw. 410, 582 A.2d 55, 60, appeal denied, 527 Pa. 659, 593 A.2d 4429 (1990).

¹²⁸ *South Lafourche Metal Bldgs., Inc. v. Grand Isle Fire Dep't Through Jefferson Parish Fire Dist. No. 10*, 582 So. 2d 970 (La. App. 5 Cir. 1991); *Hartman Enters. v. Ascension--St. James Airport and Transp. Auth.*, 582 So. 2d 198, 200-01, *writ denied*, 582 So. 2d 195, *reconsideration denied*, 584 So. 2d 669 (La. App. 1 Cir. 1991); *Webb Constr., Inc. v. City of Shreveport*, 665 So. 2d 653, 656 (La. App. 2 Cir. 1995).

¹²⁹ *Hard Rock Constr., Inc. v. Parish of Jefferson*, 688 So. 2d 134, 137 (La. App. 5 Cir. 1997).

¹¹⁶ *Southfork Systems, Inc. v. United States*, 141 F.3d 1124, 1132 (Fed. Cir. 1998).

¹¹⁷ *China Trade Center, L.L.C.*, *supra* note 113, at 70.

¹¹⁸ *Alexander & Alexander, Inc. v. State*, 596 So. 2d 822, 828 (La. App. 1 Cir. 1991), *rehearing denied* (1992).

¹¹⁹ *Id.* at 828.

¹²⁰ *Sabre Constr. Corp. v. County of Fairfax*, 501 S.E.2d 144, 146-47 (Va. 1998).

¹²¹ *See Mosseri v. FDIC*, 924 F. Supp. 605, 608 (S.D. N.Y. 1996).

¹²² *Sabre Constr. Corp.*, *supra* note 120, at 146-47.

timely filed for an injunction or shown that timely suit for an injunction was impossible.¹³⁰

Washington's courts have held that unless an injunction is issued prior to execution, a disappointed bidder does not have standing to enjoin performance of the executed contract.¹³¹ Once the contract is signed, the bidder lacks standing to enjoin performance.

Another question is whether the bidder is entitled to a mandatory injunction, ordering the agency to award it the contract. In *Clark Construction Company v. Pena*,¹³² the federal district court held that the contractor was entitled to such a mandatory injunction, compelling the Alabama Department of Transportation to award the contract to the protesting bidder. In that case, the FHWA had refused to concur in the award to the lowest responsible bidder, on the grounds that a traffic control note had been omitted from the approved plans and specifications. The court found that this was an immaterial omission, and was not grounds for rejecting all bids and readvertising.¹³³

Because the granting of a mandatory injunction ordering the award of the contract is an extraordinary measure, the contractor must prove its entitlement to such relief, and such a remedy will ordinarily be granted only if the disappointed bidder can show that it is clear that it would have been awarded the contract "absent the flawed nature of the bidding process."¹³⁴ One federal court refused to order that remedy, choosing instead to defer to the agency's expertise and discretion and noting somewhat curtly, "This Court does not desire to become a GSA contracting officer."¹³⁵ In such a case, the proper remedy was rejection of all bids and readvertisement of the project.¹³⁶ In a California case, the court held that because the state has a statutory right to reject all bids, the lowest bidder does not have a right to compel award by writ of mandate.¹³⁷ However, the Louisiana Supreme Court has held that while a wronged bidder does not have a cause of action for damages due to the fact that there is no contract between it and the awarding agency, it may be entitled to injunctive relief, including an action to compel award of the contract to that bidder.¹³⁸

Courts are more likely to order award of a contract in a case where the court has found that there have been violations of statute or bidding rules by the agency. The District of Columbia Circuit has held that the court may order the contract awarded to a particular bidder when it is clear that but for the illegal behavior of the agency, the contract would have been awarded to that bidder.¹³⁹ In another case, the First Circuit ordered that the agency award the contract to the next low bidder rather than readvertise the project.¹⁴⁰ The court held that the agency's violations of federal regulations required invalidation of the award. But for those violations, one of the other bidders would have obtained the award.¹⁴¹ The court explained why it was ordering award to the next low bidder rather than resolicitation: "To have a set of bids discarded after they are opened and each bidder has learned his competitor's price is a serious matter, and it should not be permitted except for cogent reasons."¹⁴²

Where a statute authorizes injunctive relief, it may not necessarily entitle the unsuccessful bidder to any further relief beyond enjoining the execution of the contract. For example, an Alabama statute that allows an aggrieved bidder to bring an action to enjoin execution does not also entitle the bidder to damages.¹⁴³

In addition to seeking injunctive relief, the bidder may also ask for declaratory relief or may bring a mandamus action against the agency. In a declaratory judgment action, the court would be asked to rule that the award to a bidder other than the low bidder was invalid, with essentially the same result — and the same standards applicable — as in an action for injunctive relief. However, in a mandamus action, the bidder may seek only an order directing the agency to carry out a ministerial function. Because the selection of the lowest responsible bidder involves the exercise of discretion, a mandamus action will ordinarily not lie.

Some courts have held that a low bidder has a property interest in the award of the contract, and is entitled to due process. This may be established by showing that it was actually awarded the contract and then subsequently deprived of the contract, or that the agency had limited discretion and that the bidder should have been awarded the contract.¹⁴⁴ Establishment of such an entitlement may further entitle the wronged bidder to a mandatory injunction.

¹³⁰ *B.F. Carvin Constr. Co. v. Jefferson Parish Council*, 707 So. 2d 1326, 1327–28 (La. App. 5 Cir. 1998).

¹³¹ *Dick Enters. v. Metro/King County*, 83 Wash. App. 566, 922 P.2d 184, 185–87 (1996).

¹³² 930 F. Supp. 1470 (M.D. Ala. 1996).

¹³³ *Id.* at 1492.

¹³⁴ *Ralvin Pacific Properties, Inc. v. United States*, 871 F. Supp. 468, 475 (D.D.C. 1994).

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ *Rubino v. Lolli*, 89 Cal. Rptr. 320, 321, 10 Cal. App. 3d 1059 (1970) (citing CAL. GOV'T. CODE § 14335, which provides that if acceptance of lowest responsible bid is not in best interest of state, agency may reject all bids and readvertise).

¹³⁸ *Webb Constr., Inc. v. City of Shreveport*, 714 So. 2d 119, 122 (La. App. 2 Cir. 1998).

¹³⁹ *Delta Data Systems Corp. v. Webster*, 744 F.2d 197, 204 (D.C. Cir. 1984).

¹⁴⁰ *Ulstein Maritime, Ltd. v. United States*, 833 F.2d 1052 (1st Cir. 1987).

¹⁴¹ *Id.* at 1058.

¹⁴² *Id.* at 1058–59 (quoting *International Graphics v. United States*, 4 Cl. Ct. 515, 518 (1984)).

¹⁴³ *Jenkins, Weber and Assocs. v. Hewitt*, 565 So. 2d 616, 618 (Ala. 1990) (citing ALA. CODE §§ 41-16-1, 41-16-31, state procurement statutes).

¹⁴⁴ *Cleveland Constr., Inc. v. Ohio Dep't of Admin. Services*, 121 Ohio App. 3d 372, 700 N.E.2d 54, 69 (Ohio App. 1997).

vi. Requests to Invalidate Executed Contracts.—Most courts have held that unless contract execution is enjoined, the disappointed bidder has no remedy; it must act to enjoin execution in order to preserve its opportunity to challenge the award to another bidder. However, some courts have held that the executed contract may be challenged by an unsuccessful bidder so long as that bidder does not delay its action. Otherwise, its action may be barred by laches. In *Western Sun Contractors Co. v. Superior Court*, the Arizona Court of Appeals held that a bidder's challenge was not barred by laches where it was not filed until the day after the contract was executed, but the bidder had sought reconsideration 2 days earlier.¹⁴⁵

b. Withdrawal of Bids Before Bid Opening

Mistakes discovered prior to the opening of bids are easily handled. Standard specifications published by state highway and transportation agencies typically provide for withdrawal and revision of proposals, or filing of new ones, prior to the time and date scheduled for opening the bids. In some instances the right to correct the mistake and file a revised bid or new proposal is denied in order to avoid any appearance of collusion. In others, the contracting agency requires that if a bidder is granted the privilege of withdrawing its bid because of an alleged mistake, it may not file a revised bid or substitute a new bid in any subsequent round of bidding on that same contract.

Essentially, all procedures established for handling bid mistakes discovered before bid opening are designed to facilitate the withdrawal of erroneous bids, and thereafter, depending on the contracting agency's policy, to facilitate correction of the mistake or substitution of a new bid. In this process the main concern of the law is to maintain the integrity of the competitive bidding process and avoid the appearance of collusion or unfair advantage in any form.

c. Withdrawal of Bid After Bid Opening

When a mistake is not discovered until bids have been opened, or where for other reasons a bid containing an error is not withdrawn prior to opening, the consequences are more serious. When bids are opened they are considered to be formally tendered offers, and each bidder is obligated to accept and perform a contract if it should be selected as the lowest responsible bidder. Moreover, the bid forms used by most public highway agencies contain specific statements by the bidder that it will accept a contract and execute it within a specified time if one is offered. Both by law and by contract, therefore, the bidder is obligated to stand by the offer it has made in its bid. Where relief is available to prevent excessive hardship from forcing a bidder to perform a contract based on a mistake, it comes through the courts' application of equitable principles and remedies to the claims of the parties involved.

In a few instances, special legislative procedures facilitate this recourse to equity. One illustration is provided by Wisconsin legislation relating to municipal public works contracting. Under this legislation, if a mistake is discovered and the contracting officer is notified prior to the bid opening, the erroneous bid is returned unopened to the bidder, with the restriction that it is not entitled to bid again on that contract unless it is readvertised. If, on the other hand, the mistake is discovered after bids are opened, the bidder who desires to withdraw must give notice of this fact without delay, and must produce evidence that its mistake was not caused by carelessness or lack of care in examining the project plans and specifications. In the event its bid bond or security deposit is forfeited, the statute provides that it may be recovered by proving to a court of competent jurisdiction that the mistake was not due to "carelessness, negligence, or inexcusable neglect."¹⁴⁶

California legislation for the relief of bid mistakes is similar to Wisconsin's law in its essential features and design. It denies the bidder any direct relief for an erroneous bid, and prohibits the bidder from any further bidding on the project on which the erroneous bid was made. But it authorizes court action for the recovery of forfeited security deposits upon proof that (1) a mistake was in fact made; (2) the contracting agency was notified in writing within 5 days after the opening of bids, with a detailed description of how the mistake occurred; (3) the mistake makes the bid materially different than was intended by the bidder; and (4) the mistake was made in preparing the bid form, and was not due to poor judgment, or carelessness in inspecting the work site or in reading the plans and specifications.¹⁴⁷

d. Equitable Relief for Bid Mistakes

In litigation involving bid mistakes, the bidder's remedy generally is rescission of the bid, or the contract, if it has been awarded, or recovery of a forfeited bid security. Where action is brought by the contracting authority, it generally is for recovery on a surety bond posted as bid security. In these cases, the rights of the public agencies and private contractors are determined by the same principles of equity that apply to analogous situations involving private parties.

i. Reformation.—It is a general rule that the remedy of reformation of a bid or contract, frequently given to relieve against the consequences of a mutual mistake, will not be given to relieve against a unilateral mistake. The distinction between the two situations is said to be in the danger that in the latter case one of the parties would be forced into an agreement that was foreign to its intention. Rather, reformation is appropriate where the contract fails to express the intent of the parties as the result of a mutual mistake, or in the event of a

¹⁴⁵ 159 Ariz. 223, 766 P.2d 96, 100 (1988).

¹⁴⁶ WIS. STAT. § 66.29(5) (1999).

¹⁴⁷ CAL. PUB. CONT. CODE § 5103 (1999).

unilateral mistake coupled with the inequitable conduct of the other party.¹⁴⁸

In *Iversen Const. Corp. v. Palmyra-Macedon Central School District*, the court relied on Federal Court of Claims cases where the remedy of reformation had been extended beyond cases of mutual mistake to cases in which the agency knew or should have known of the error.¹⁴⁹ In that case, the bidder had made a clerical error of nearly \$800,000 on a \$5.5 million bid. Architects who were present at the bid opening had expressed surprise at the low bid, and had discussed the possibility of error. Later that day, the bidder discovered the error—one sheet of subbids had not been included in the total bid. The bidder immediately notified the architects and the school district of the error, submitted documentation of how the error occurred, and sought to withdraw its bid.¹⁵⁰

The district did not respond, but rather several days later awarded the bid to Iversen, who again tried to withdraw its bid. The bidder then sought rescission. The court concluded that it was unconscionable to require the bidder to perform at the mistaken bid price.¹⁵¹ The district responded asking for reformation of the contract. The court found that all prerequisites for equitable relief were met: (1) the mistake was of such consequence that enforcement of the contract would be unconscionable, (2) the mistake was material, (3) the mistake occurred despite the use of ordinary care, and (4) the other parties could be placed in the status quo.¹⁵² In deciding between ordering rescission or reformation, the court found that reformation would place all parties in the status quo, because even the reformed bid was still the lowest bid. In addition to relying on federal cases, the court noted the rule that an agency cannot take advantage of an inaccurate bid if the agency is notified promptly of the mistake. Also the court noted that reformation gave the greatest benefit to the taxpayers, as it would allow the work to be done at the lowest cost.¹⁵³

The prohibition against negotiating with bidders generally precludes reformation of the bid after bid opening. In unusual circumstances, a bidder may be allowed to correct its mistake after bid opening, or to reform its bid. However, a high standard of proof may be required by the agency in order for it to allow reformation, provided that it has the statutory ability to do so.¹⁵⁴ For example, if a bidder has made a mistake and the agency's conduct is determined to be inequitable, then the bidder may be entitled to reform the contract.

However, in *Department of Transportation v. Ronlee, Inc.* the court described the standard that the bidder must meet in order to show that the agency's conduct was inequitable.¹⁵⁵ In that case, which involved bids for an interchange construction project, the second low bid exceeded the low bid by about 5 percent. Five days after bid opening, the low bidder advised the Department that it had made an error of about \$300,000, or around 2 percent of its total bid price, due to an erroneous transcription of a unit price. The Department responded to the bidder that it was aware of the unbalanced price, but that it was unable to make a price adjustment. The bidder made no effort to withdraw its bid on the grounds of having made an error in its bid, but rather executed the contract and performed for 21 months.

In seeking additional compensation, the contractor then asserted that it was entitled to reform the contract to correct the erroneous unit price in its bid, on the grounds that the Department's conduct had been inequitable in that it had failed to inform the contractor of the error. However, the court held that the contractor waived any right that it had to either reformation or rescission when it had knowledge of its error 10 days prior to the start of construction, but chose to perform the contract rather than attempt to withdraw its bid.¹⁵⁶ Further, the court held that the Department's conduct was not inequitable when it failed to call the bidder's attention to its error, because the bidder discovered its own error at about the same time that the Department discovered it.¹⁵⁷

ii. Rescission.—Rescission may be the appropriate remedy in the event of a bid mistake that is “so material and fundamental that it precluded a meeting of the minds necessary for the creation of a contract.”¹⁵⁸ A significant number of cases in which relief has been granted for a unilateral mistake in bidding have evolved a general rule regarding the criteria for successful recourse to equity in such cases. The Maryland court in *City of Baltimore v. De Luca-Davis Construction Company* discussed this matter as follows:

The general rule as to the conditions precedent to rescission for unilateral mistakes may be summarized thus: 1, the mistake must be of such grave consequences that to enforce the contract as made or offered would be unconscionable; 2, the mistake must relate to a material feature of the contract; 3, the mistake must not have come about because of the violation of a positive legal duty or from culpable negligence; 4, the other party must be put in statu quo to the extent that he suffers no serious prejudice except the loss of his bargain.¹⁵⁹

¹⁴⁸ *Department of Transp. v. Ronlee, Inc.*, 518 So. 2d 1326, 1328 *review denied*, 528 So. 2d 1183 (Fla. App. 3 Dist. 1987).

¹⁴⁹ 539 N.Y.S.2d 858, 861, 143 Misc. 2d 36 (1989).

¹⁵⁰ 539 N.Y.S.2d at 859.

¹⁵¹ *Id.* at 860.

¹⁵² *Id.*

¹⁵³ *Id.* at 861.

¹⁵⁴ *McKnight Constr., Inc. v. Department of Defense*, 85 F.3d, 565, 570 (11th Cir. 1996).

¹⁵⁵ 518 So. 2d at 1328.

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ *Naugatuck Valley Dev. Corp. v. Acmat Corp.*, 10 Conn. App. 414, 523 A.2d 924, 927 (1987) (citing *Geremia v. Boyarski*, 107 Conn. 387, 140 A. 749 (1928)).

¹⁵⁹ 210 Md. 518, 527, 124 A.2d 557, 562 (1956).

In *De Luca-Davis*, the erroneous cost estimate resulted from copying unit prices incorrectly on the bidder's worksheets, and the contracting agency was notified of the mistake as soon as it was discovered at the bid opening. In addition, 5 days after the bid opening, a complete written explanation of the mistake was presented to the proper agencies of the city in support of a request for rescission of the bid and return of the bid deposit. Such prompt action by the bidder strengthened its claim for relief by forestalling action on the part of the contracting agency that would have been irreparable, and similar instances of early notification have been noted in other cases where rescission has been allowed.

In a leading California case, a majority of the court took the position that clerical errors in bid preparation did not come within the scope of the equitable rule denying relief.¹⁶⁰ The court said:

There is a difference between mere mechanical or clerical errors made in tabulating or transcribing figures and errors of judgment, as, for example, understanding the cost of labor or materials. The distinction between the two types of error is recognized in the cases allowing rescission and in the procedures provided by the state and federal governments for relieving contractors from mistakes in bids on public work...Generally relief is refused for error in judgment and allowed only for clerical or mathematical mistakes...Where a person is denied relief because of an error in judgment, the agreement which is enforced is the one he intended to make, whereas if he is denied relief from a clerical error, he is forced to perform an agreement he had no intention of making.¹⁶¹

A dissenting opinion in this case presented the opposing view of the effects of mistakes in this way:

When it is necessary for a person to make calculations or estimates, in order to determine the sum which he will bid for an offered contract, or to determine the cost to him of a proposed contract, or whether or not it will be advantageous to him to enter into it, he must assume the risk of any error or oversight in his computations, and cannot have relief in equity on the ground of mistake, if he reaches a wrong conclusion through inadvertence, misunderstanding of that which is plain on its face, or mathematical error.¹⁶²

Among the other criteria for granting equitable relief from the penalties of a unilateral bid mistake, the courts have frequently stressed the requirement that the error must relate to a material feature of the contract, and must be of such magnitude or character as to make enforcement of the offer or contract unconscionable.¹⁶³ This requirement generally is found in conjunction with the corollary rule that equity will not allow

withdrawal of an erroneous bid or return of a forfeited security deposit unless it appears that reasonable diligence and care were used in preparing the bid, and that the contracting agency will suffer no serious injury, except the loss of its original contract.

These propositions reflect the concern of equity for the essential qualities of fairness and realism in judging the bidder's claim for relief. Diligence and care in preparing bids are essential to success in claiming equitable relief, but they are requirements that must be applied in the light of each bidder's circumstances. For example, errors in calculating the expenses of excavation were considered in the light of evidence that when the bidder's representatives visited the construction site, they were misled by old right-of-way stakes and flags, which suggested the highway was to be built through loose dirt rather than through a rocky area that was the correct route.¹⁶⁴ Clerical errors, such as omitting digits or decimal points, are recognized as likely to occur in spite of diligent efforts to prevent such errors, and so are not automatically equated with negligence. If the circumstances include factors that reasonable persons would expect to make the bidding process more difficult or increase the chance of error, the standard of care to which bidders must conform reflects this fact.¹⁶⁵

"Negligence" or its equivalent lack of care in bid preparation, as this concept is applied to claims for equitable relief for bid mistakes, means carelessness that exceeds the tolerance that the business and governmental community typically allow themselves in carrying on their own affairs. Reasonably understandable failure to calculate or present bid information correctly and completely will not bar equitable relief unless obvious carelessness or lack of good faith are present. When claims of mistake suggest that either carelessness or lack of good faith are present, the bidder is considered as having violated its duty to compete in good faith, and its claim to equitable relief generally is fatally weakened.

In *Puget Sound Painters v. State*,¹⁶⁶ the bidder underestimated the area of bridge towers to be painted by about half. The court held that it would be entitled to equitable relief if it acted in good faith and without gross negligence; was reasonably prompt in giving notice to the agency of the error in its bid; would suffer substantial detriment by forfeiture of its bid bond; and if the agency's status was not greatly changed.¹⁶⁷

In a much more recent Colorado case, *Powder Horn Constructors v. City of Florence*, the court also imposed a good faith standard in limiting the requirement that

¹⁶⁰ *M. F. Kemper Constr. Co. v. City of L.A.*, 37 Cal. 2d 696, 235 P.2d 7 (1951).

¹⁶¹ *Id.*, 235 P.2d at 11-12.

¹⁶² *Id.* at 14, citing BLACK, ON RESCISSION & CANCELLATION, § 142.

¹⁶³ See *Department of Transp. v. American Ins. Co.*, 491 S.E.2d 328, 331 *reconsideration denied* (Ga. 1997).

¹⁶⁴ *State By and Through its Road Comm'n v. Union Constr. Co.*, 9 Utah 2d 107, 339 P.2d 421 (1959).

¹⁶⁵ *M. F. Kemper Constr. Co. v. City of L.A.*, 37 Cal. 2d 696, 235 P.2d 7, 11 (1951).

¹⁶⁶ 45 Wash. 2d 819, 278 P.2d 302, 304 (1954).

¹⁶⁷ *Id.*

the bidder prove that its error was not negligent.¹⁶⁸ In that case, Powder Horn Constructors was the low bidder on a water treatment facility. The day after bid opening, the City's project engineer noticed that one bid item was substantially lower than the same item in the other bids, and notified Powder Horn, suggesting that it review that item. The following day, Powder Horn informed the project engineer that it had mistakenly omitted the cost of one major item in that bid item, at a cost of \$66,000, or about 10 percent of its bid. Powder Horn also submitted a letter to the engineer, stating that a subtotal from one worksheet had been inadvertently omitted from the final bid amount, and advised the engineer that the bid and bid security were being withdrawn.¹⁶⁹

However, the city council voted to award the contract to Powder Horn anyway, which then refused to accept the award. The City then awarded to the second low bidder. The City sued Powder Horn and its surety, asserting that they were entitled to the amount of the bid bond as liquidated damages, to partially compensate the City for the difference between Powder Horn's bid and the second low bid.¹⁷⁰

The trial court had found that Powder Horn did not exercise reasonable care in preparing its bid, and that it was liable to the City in the amount of its bid bond. However, the court also found that there had been a unilateral material mistake, that requiring Powder Horn to perform the contract would be unconscionable, and that the City was not prejudiced by the withdrawal of the bid. However, the court found that Powder Horn's negligence prevented rescission of its bid. The Court of Appeals affirmed.¹⁷¹

The Colorado Supreme Court reversed, disagreeing with the lower courts that the right of rescission could be conditioned on the exercise of reasonable care by the bidder in these circumstances.¹⁷² The court noted the distinction between mathematical or clerical errors and errors of judgment, pointing out that it was undisputed that the error in this case was clerical and not an error of judgment. The court noted the policies underlying the requirement to prove an absence of negligence, including protection of the integrity of the bidding process, fostering consistency in bid preparation, and discouraging fraud and collusion. But the court distinguished the case in which the mistake is discovered prior to award:

However, requiring a bidder to demonstrate freedom from negligent conduct when the bid has not been accepted and the bid contains a mechanical error, as distinguished from an error of judgment, will significantly restrict the availability of this equitable remedy in cir-

cumstances wherein recognition of the remedy would not undermine those policies.¹⁷³

The court pointed out that the term "mistake" necessarily implies some degree of negligence, and that it would be extremely difficult to prove that the mistake was both material and that it was nonnegligent. Rather, the court chose to impose a standard of whether the bidder made an honest or good faith mistake, and to consider "gross or extreme negligence" as evidence of the bidder's lack of good faith.¹⁷⁴ Therefore, the court allowed rescission, without forfeiture of the bid bond, where the bidder's mistake was made in good faith and the public agency did not rely to its detriment on the mistaken bid.¹⁷⁵

In considering a choice between a standard of simple negligence or gross negligence, the Connecticut court chose to adopt neither. Rather, the court held only that the degree of negligence involved was an equitable factor to be considered by the agency, and ultimately by the court, in determining whether the bidder could withdraw without forfeiting its bond. In that case, *Naugatuck Valley Devel. Corp. v. Acmat Corp.*,¹⁷⁶ the agency had been awarded liquidated damages in the amount of the bid bond because of the bidder's failure to execute the contract. The bidder had become aware of a mistake in its bid 14 days after bid opening, but had notified the agency at that time. The bidder wanted to negotiate with the agency, but the agency was precluded from doing so. In trying the issue of liquidated damages, the trial court required the bidder to prove that its mistake was free from negligence in order to avoid the damages. The appellate court reversed, holding that whether the bidder was entitled to relief for its mistake was based on equitable principles, and that the bidder's degree of negligence was one equitable factor to be considered.¹⁷⁷

The duty to deal in good faith is, of course, as binding on the contracting agency as on the bidder. Where a bid clearly discloses that in all probability it contains a mistake, the contracting agency is charged with that knowledge. Later, if it is shown that a mistake in fact has occurred, the agency may not take advantage of the bidder by acting in reliance on a bid when there is evidence or suspicion of error.¹⁷⁸ "An offeree 'will not be permitted to snap up an offer that is too good to be true;

¹⁷³ *Id.* at 361.

¹⁷⁴ *Id.* at 362.

¹⁷⁵ Although the agency had awarded the contract to Powder Horn, it did so with full knowledge of the mistaken bid and could not be said to have relied to its detriment on the mistake. *Id.* at 361.

¹⁷⁶ 10 Conn. App. 414, 523 A.2d 924 (1987).

¹⁷⁷ *Id.*, 523 A.2d at 927.

¹⁷⁸ *But see* Department of Transp. v. Ronlee, Inc., 518 So. 2d 1326, 1329, *review denied*, 528 So. 2d 1183 (Fla. App. 3 Dist. 1987) (agency's failure to call to bidder's attention a 2 percent error in calculations, where bidder learned of error shortly after agency did, was not fraud or inequitable conduct that would entitle bidder to reformation).

¹⁶⁸ 754 P.2d 356 (Colo. 1988).

¹⁶⁹ *Id.* at 358.

¹⁷⁰ *Id.*

¹⁷¹ *City of Florence v. Powder Horn Constructors, Inc.*, 716 P.2d 143 (Colo. App. 1985).

¹⁷² *Powder Horn Constructors, Inc. v. City of Florence*, 754 P.2d 356 (Colo. 1988).

no agreement based on such an offer can...be enforced by the acceptor."¹⁷⁹

Warning that a mistake has been made may be given by any evidence that under the circumstances is recognizable by the bidder or contracting agency as an error. In particular, it may be shown by an unusually great disparity of one bid in comparison with others.¹⁸⁰ For example, in a Minnesota case, the contracting officer noted a discrepancy in bids for a moving contract in that the other bids were three to four times the amount of the low bid. The officer contracted the bidder to inquire whether it intended the bid that it submitted, and the bidder confirmed its confidence in its bid.¹⁸¹ The court refused to allow equitable relief for the bid mistake, stating that where the bidder is a professional in its field, it is reasonable for the agency to rely on the bid, particularly after the agency has called the bidder's attention to a possible error and has been reassured that that was the bid intended.¹⁸²

e. Bid Security Forfeiture and Exoneration

Bidding instructions that purport to prohibit or restrict withdrawal of bids have been construed as inapplicable to situations involving an honest unilateral mistake. In the same manner, courts have given similar construction to statements providing for forfeiture of deposits or surety bonds serving as security to assure execution of contracts. Because state laws and regulations require bid security in terms of a percentage of the total amount of the bid, the security deposit may represent a substantial amount of money, which a bidder cannot afford to lose. Much of the litigation over bid mistakes, therefore, is concerned with imposition of forfeiture of defaulted deposits, or attempted return of a security deposit following bid withdrawal.

Where a bid mistake is remediable by withdrawal of the bid, and the contracting agency is promptly notified of the error, equity will order return of the security deposit or cancellation of the bid bond. These results are based partly on the policy that once the contracting agency is aware of a bid error, it is unjust to take advantage of this situation and impose a forfeiture, and partly because after the bid is withdrawn the reason for the security ceases to exist.

Where there is a mistake in a bid such that the bidder will be permitted to withdraw its bid, it must be a mistake that either directly affects the price or that makes the bid materially different from that which was intended by the bidder. In a typical case where the reasoning supports equitable recovery or cancellation of bid security, notice of the mistake is received by the

contracting agency before it accepts the erroneous bid. Frequently the discovery is made and notice given before the bid opening. Failure to give notice to the contracting agency before acceptance of an erroneous bid weakens the case for return of bid security, but forfeiture of security is not always the result in these situations. If a bidder notifies the agency after the agency's acceptance of its offer, but before a contract has been signed, and before there is any change in position in reliance on the erroneous bid, it may be successful in obtaining return of its deposit or cancellation of its bid bond.

State statute, however, may prohibit the court from granting equitable relief in the case of a bid mistake. Oklahoma's statute provides that the bid bond "shall" be forfeited if the apparent low bidder does not execute the contract. Even where the contractor brought the mistake to the agency's attention prior to contract award, the court held that the trial court lacked the equitable power to prevent forfeiture of the bid bond in light of the mandatory statutory language.¹⁸³

Often a decisive factor in determining recovery of bid security is whether the contracting party has acted in reliance on the bidder's mistake. In the great majority of cases where equitable relief was requested, bid security was not recovered if the mistake was not discovered or reported until after the agency had made a contract award. Yet, occasionally there are circumstances in which bid mistakes are not discovered and reported until after contract award, and because no culpable negligence is chargeable to it, the bidder is permitted to recover its bid security. An older Kentucky case, *Board of Regents of Murray State Normal School v. Cole*, illustrates the required combination of circumstances.¹⁸⁴ In that case, the agency had inquired about a possible mistake at the time of bid opening, and the bidder verified its bid as correct. Relying on this assurance, the agency awarded that bidder the contract, only to have the bidder discover its mistake shortly thereafter. The court granted relief to the bidder. However, it did not apply the doctrine that an executory contract can be canceled when it is entered into with a unilateral mistake on a material point and without culpable negligence. Rather, the court chose to treat the matter as a rescission of the contract. The parties were restored to their original positions as nearly as possible by the return of the bidder's deposit, and payment by the bidder of the contracting agency's actual expenses of readvertising the project for new bids.

If the bidder chooses not to exercise its option to rescind its bid and reattain its bid bond, it will not be

¹⁷⁹ A.A. Metcalf Moving & Storage Co. v. North St. Paul Sch. Dist., 587 N.W.2d 311, 318 (Minn. App. 1998) (quoting Speckel by Speckel v. Perkins, 364 N.W.2d 890, 893 (Minn. App. (1985))).

¹⁸⁰ See Powder Horn Constructors, 754 P.2d at 358.

¹⁸¹ A.A. Metcalf, 387 N.W.2d at 314.

¹⁸² *Id.* at 318.

¹⁸³ J.D. Graham Constr., Inc. v. Pryor Public Sch. Indep. Sch. Dist. No. 1, Mayes County, 854 P.2d 917, 920, *cert. denied* (Ok. App. 1993) (statute stated that bid bond "shall" be forfeited if bidder does not execute contract); 61 OKLA. STAT. ANN. § 107(B).

¹⁸⁴ 209 Ky. 761, 273 S.W. 508 (1925).

entitled to reform the contract once it is executed.¹⁸⁵ Absent mutual mistake, the court will not reform the contract.¹⁸⁶

f. Damages for Erroneous Rejection of Bid

Some states' courts have held that a disappointed bidder has no cause of action for damages against the awarding agency, even if the contract was wrongly awarded.¹⁸⁷ These courts have based their conclusions on the fact that the fundamental policy underlying public bidding laws is protection of the public interest, and not protection of contractors. At the same time, other courts have recognized that a bidder may be entitled to its bid preparation costs in the event that it is unfairly denied award of the contract. A smaller number have allowed additional damages for the aggrieved low bidder.

Generally, whether the court will consider the award of either bid preparation costs or lost profits depends on the bidder's diligence in seeking to enjoin the contract award or execution. A Maryland court held that it was not inequitable to find that the bidder has no cause of action for damages where it did not seek an injunction.

A timely challenge is compatible with the public interest since it serves to force compliance with the purpose of the bidding procedure. After the project is completed, however, it is difficult to perceive how the public interest is served by investing the low bidder with a cause of action for damages. The public has already paid for the difference between the lowest bid and the bid which was accepted. The taxpayer should not be further penalized.¹⁸⁸

i. Bid preparation costs.—Recovery of bid preparation costs may be an appropriate remedy when a frustrated bidder proves that it should have been awarded the contract.¹⁸⁹ The Georgia Supreme Court has held that where a governmental entity has frustrated the bid process and awarded the contract to an unqualified bidder, the bidder whose bid was unfairly rejected is entitled to its reasonable bid preparation costs.¹⁹⁰ The court found that lost profits would unduly penalize the taxpayers, while compensating the bidder for effort that it did not make and risks that it did not take.¹⁹¹ Awarding bid preparations costs was also found to be the appropriate remedy in *Bolander & Sons Co. v City of Minneapolis*, in which the work under the contract had already begun by the time the unsuccessful bidder prevailed in its challenge to the award of the contract to another bidder.¹⁹² The bidder in that case was also awarded its attorney fees incurred in bringing the bid protest.¹⁹³ However, the bidder must show that the rejection of its bid was improper and that the agency's conduct was arbitrary and capricious or in bad faith.¹⁹⁴ Federal courts have held that in order to be awarded bid preparation costs, the bidder must show that the agency violated its "implied contract to have the involved bids fairly and honestly considered."¹⁹⁵ The court further quoted:

Proposal preparation expenses are a cost of doing business that normally are "lost" when the effort to obtain the contract does not bear fruit. In an appropriate case, however, a losing competitor may recover the costs of preparing its unsuccessful proposal if it can establish that the Government's consideration of the proposals submitted was arbitrary or capricious. The standards that permit a disappointed competitor to recover proposal preparation expenses are high and the burden of proof is heavy.¹⁹⁶

¹⁸⁵ *Midway Excavators, Inc. v. Chandler*, 128 N.H. 654, 522 A.2d 982, 984 (1986).

¹⁸⁶ *Id.*

¹⁸⁷ *C.N. Robinson Lighting Supply Co. v. Board of Educ. of Howard County*, 90 Md. App. 515, 602 A.2d 195, 200, *cert. denied*, 326 Md. 662, 607 A.2d 7 (1992); *BBG Group, L.L.C. v. City of Monroe*, 96 Wash. App. 517, 521, 982 P.2d 1176 (1999); *Debcon, Inc. v. City of Glasgow*, 28 P.3d 478, 485 (Mont. 2001) (citing cases from numerous jurisdictions that hold that aggrieved bidder cannot recover lost profits or other expectancy damages under negligence theory).

¹⁸⁸ *Robinson, supra* note 187, at 200 (quoting *Gulf Oil Corp. v. Clark Co.*, 94 Nev. 116, 575 P.2d 1332, 1334 (1978)).

¹⁸⁹ *Credle v. East Bay Holding Co.*, 263 Ga. 907, 440 S.E.2d 20, 21 (1994).

¹⁹⁰ *City of Atlanta v. J.A. Jones Constr. Co.*, 260 Ga. 658, 398 S.E.2d 369, 371, *on remand*, 198 Ga. App. 345, 402 S.E.2d 554 (1990), *cert. denied*, 111 S. Ct. 2042 (of two possible remedies, lost profits or bid preparation costs, the award of bid preparation costs is the better alternative).

¹⁹¹ *Id.*

¹⁹² 438 N.W.2d 735, 738, *review granted, affirmed*, 451 N.W.2d 204 (1989).

¹⁹³ *Id.*, 438 N.W.2d at 738. The Federal Equal Access to Justice Act (EAJA), 28 U.S.C. § 2412, may also provide a basis for attorney fees. *Taylor Group, Inc. v. Johnson*, 915 F. Supp. 295, 297–98 (M.D. Ala. 1995) (contractor was "prevailing party" for purposes of EAJA where it obtained relief on the merits of its claims both in the issuance of a temporary restraining order that prohibited award to the bidder's rival and in obtaining a subsequent settlement with the agency).

¹⁹⁴ *E.W. Bliss Co. v. United States*, 77 F.3d 445 (Fed. Cir. 1996).

¹⁹⁵ *Id.* at 447 (citation omitted).

¹⁹⁶ *Id.* (Quoting *Lincoln Servs., Ltd. v. United States*, 678 F.2d 157, 158, 230 Ct. Cl. 416 (1982)).

The court went on to further explain what criteria might be used to determine if the government has acted arbitrarily or capriciously in evaluating bids:

One is that subjective bad faith on the part of the procuring officials, depriving a bidder of the fair and honest consideration of his proposal, normally warrants recovery of bid preparation costs. A second is that proof that there was “no reasonable basis” for the administration decision will also suffice, at least in many situations. The third is that the degree of proof of error necessary for recovery is ordinarily related to the amount of discretion entrusted to the procurement officials by applicable statutes and regulations. The fourth is that proven violation of pertinent statutes or regulations can, but need not necessarily be a ground for recovery.¹⁹⁷

Alabama’s public works statutes specifically authorize the award of bid preparation costs when an aggrieved bidder successfully challenges the award of a contract as being contrary to public bidding laws and obtains an injunction, so long as the action is brought within 45 days of award.¹⁹⁸

ii. Lost Profits.—Ordinarily, even if a disappointed bidder’s challenge to the agency’s award is successful, it may not recover money damages.¹⁹⁹ The Washington Supreme Court has held that awarding damages to a disappointed low bidder inherently conflicts with the primary purpose of competitive bidding, which is protecting public funds.²⁰⁰ The court also held that the rejected low bidder’s opportunity to obtain an injunction allows the bidder some recourse while still being within the bounds of protecting both the bidder’s and the public’s mutual interests in the competitive bidding process.²⁰¹ In addition, in the Peerless Food Case the Washington court held that because there is no contract between the aggrieved bidder and the agency, the bidder is not entitled to damages.²⁰² Similarly, Arkansas’s courts have held that a bidder’s remedy is limited to enjoining award of the contract or termination of a wrongfully awarded contract.²⁰³

However, the New Hampshire Supreme Court has held that where a disappointed low bidder has complied with all of the requirements of the invitation for bids, but was denied award of the contract through conduct

of the awarding agency that amounts to bad faith, then it may be entitled to recover its lost profits.²⁰⁴ Similarly, Mississippi’s Supreme Court has held that compensatory damages under the law of contracts are the proper measure of damages for an aggrieved bidder that was entitled to the contract award.²⁰⁵ Montana has also recognized that in the event of bad faith or negligence on the part of the agency, a wronged bidder may be entitled to relief beyond invalidation of the contract.²⁰⁶ However, in a later case, the Montana court held that an aggrieved bidder may not recover lost profits or other expectancy damages under a negligence theory.²⁰⁷

Where courts have awarded lost profits as the measure of damages for wrongful bid rejection, they have done so after a finding of bad faith on the part of the contracting agency. In *Peabody Construction Company v. City of Boston*, the court found that the bidder had complied with all of the requirements in the invitation for bids, and that its bid was rejected through agency conduct that amounted to bad faith.²⁰⁸ The appropriate measure of damages was held to be the profit that the bidder would have earned on that job.

iii. Section 1983 Damages.—Failing to recover anticipated profits when their bids are wrongfully rejected, some contractors have attempted to recover damages under the Civil Rights Act, 42 U.S.C. § 1983. Where a state statute requires that a bid be awarded to the lowest responsible bidder, some courts have found that the lowest responsible bidder has a constitutionally protected interest in obtaining an award of the contract.²⁰⁹ Based on this, the aggrieved bidder may seek damages against the contracting agency for the violation of its constitutional right to obtain the award. However, federal courts have set a similar standard for obtaining damages in the public contract setting as for other types of violations. In order to be eligible to pursue damages under Section 1983, a contractor must show not only a deprivation of rights, but also an inability to obtain a remedy in state court. Where state law provides for some review of the state agency’s action, a

¹⁹⁷ *Id.* (Quoting *Keco Industries v. United States*, 492 F.2d 1200, 1204 (1974) (citations omitted)).

¹⁹⁸ ALA. CODE 39-5-4 (2002).

¹⁹⁹ *Delta Chemical Corp. v. Ocean County Utilities Auth.*, 250 N.J. Super. 395, 594 A.2d 1343, 1346 (1991); *Ralph L. Wadsworth Constr. Co. v. Salt Lake County*, 818 P.2d 600, 602, *cert. denied*, 832 P.2d 476 (1991).

²⁰⁰ *Peerless Food Products, Inc. v. State*, 119 Wash. 2d 584, 835 P.2d 1012 (1992) (bid is offer rather than acceptance of contract; therefore there is no cause of action for damages); *Dick Enterprises v. Metro/King County*, 83 Wa. App. 566, 922 P.2d 184 (1996).

²⁰¹ *Dick Enterprises*, *supra* note 200, at 185.

²⁰² *Peerless*, *supra* note 200, 835 P.2d at 1016.

²⁰³ *Milligan v. Burrow*, 52 Ark. App. 20, 914 S.W.2d 763, 765 (1996) (based on state’s sovereign immunity).

²⁰⁴ *Marbucco Corp. v. City of Manchester*, 137 N.H. 629, 632 A.2d 522, 525 (1993).

²⁰⁵ *City of Durant v. Laws Constr. Co.*, 721 So. 2d 598, 606 (Miss. 1998).

²⁰⁶ *ICS Distributors, Inc. v. Trevor*, 903 P.2d 170 (Mont. 1995).

²⁰⁷ *Debcon, Inc. v. City of Glasgow*, 28 P.3d 478, 485 (Mont. 2001).

²⁰⁸ 28 Mass. App. Ct. 100, 546 N.E.2d 898, 902 (1989).

²⁰⁹ *See Cleveland Constr., Inc. v. Ohio Dep’t of Admin. Services*, 121 Ohio App. 3d 372, 700 N.E.2d 54, 69 (1997). *Pataula Elec. Membership Corp. v. Whitworth*, 951 F.2d 1238, 1241 (11th Cir. 1992), *rehearing denied*, *Georgia Power Co. v. Pataula Elec. Membership Corp.*, 506 U.S. 907, *appeal after remand*, *Flint Elec. Membership Corp. v. Whitworth*, 68 F.3d 1309, *opinion modified*, 77 F.3d 1321 (11th Cir. 1996) (Georgia law requires award to lowest responsible bidder).

bidder is unlikely to be successful in pursuing damages under § 1983.²¹⁰

In order to establish a claim under § 1983, the bidder must show that the agency acted under color of state law to deprive the bidder of a right protected by the United States Constitution.²¹¹ In public contracting, the bidder must establish that it had a legitimate claim of entitlement to the award of the contract by showing that it was actually awarded the contract at any procedural stage, or that the applicable rules limit the discretion of the agency officials as to whom the contract should be awarded.²¹² The right to reject any and all bids usually confers enough discretion on the agency that this standard is difficult to meet. However, even the power to reject all bids does not allow the agency to act arbitrarily.²¹³

In a Sixth Circuit case that illustrates the effect of agency discretion, the bidder was notified that it was the lowest responsible bidder, but that it would be expected to sign the project labor agreement required for the project that it had not yet signed.²¹⁴ The bidder refused to sign the project labor agreement, and its bid was then rejected. The court held that where the county had the ability to award to the “lowest and best bidder,” and the county required a project labor agreement that the bidder refused to sign, the county had acted within its discretion and had not violated the bidder’s constitutional rights.

In addition to alleging a property interest in the award of the contract, a bidder may allege a property interest in its prequalification to bid. In *Systems Contractors Corp. v. Orleans Parish School Board*, the bidder sought Section 1983 damages for its disqualification from bidding on a particular project and its debarment from bidding on future projects.²¹⁵ The bidder had been given written notice of its disqualification and debarment, but not prior to bid opening. The bidder was then given an opportunity to present its case directly to the agency. It then had the option of appealing the agency decision to an arbitrator. The court held that the bidder was not entitled to written notice of the disqualification and debarment prior to bid opening,

and that the opportunity to appeal to the agency and to an arbitrator provided an adequate post-deprivation remedy sufficient to defeat a claim for § 1983 damages.²¹⁶

In other cases, the contractor’s claim under § 1983 has involved the contractor’s contention that its right to free speech was violated by the contracting agency. In *Progressive Transportation Services v. County of Essex*, the court held that there was no First Amendment violation where the speech at issue was based on the contractor’s own personal interest and did not involve issues of public concern.²¹⁷ Thus the contractor was not entitled to damages under § 1983 for its retaliation claim. However, the United States Supreme Court has held that the free speech rights held by individuals under the First Amendment also apply to government contractors. In *O’Hare Truck Service v. Northlake*, the contractor alleged that it was removed from the City’s rotating list of towing contractors for political reasons because it had refused to contribute to the mayor’s reelection campaign, and that it was being denied the opportunity to bid on city contracts.²¹⁸ The Court held that the contractor’s allegations stated a cause of action under § 1983.²¹⁹

iv. Other Remedies.—In Louisiana, a frustrated bidder sued the successful bidder, alleging that the successful bidder had assisted in or encouraged a wrongful act in violation of a state statute that created liability for such actions.²²⁰ The court upheld the validity of the award, and held that the same statute would apply to the consulting engineer retained by the agency, who allegedly conspired with the agency and the successful bidder who wrongfully obtained the contract.²²¹ The Federal False Claim Act may provide a similar remedy where the unsuccessful bidder alleges that the successful bidder has obtained the contract through false statements in its bid.²²²

The Eighth Circuit ruled that a contractor could be entitled to damages from its subcontractor for the subcontractor’s bid errors that were used by the prime con-

²¹⁰ *State ex rel. Educ. Assessments Systems, Inc. v. Cooperative Educ. Services of N.M., Inc.*, 115 N.M. 196, 848 P.2d 1123, 1130 (1993) (although procurement code does not provide for damages it does provide adequate legal remedy by providing for protest and for appealable determination of protest); *Church & Tower, Inc. v. Miami-Dade County, Florida*, 11 F. Supp. 2d 1376, 1379 (S.D. Fla. 1998) (neither debarment nor city’s refusal to consider bidder’s bid pending investigation violated due process where there was an adequate procedure for disappointed bidders to challenge debarment procedure and each bid refusal by appeal to state court).

²¹¹ *Enertech Elec., Inc. v. Mahoning County Comm’rs*, 85 F.3d 257, 259, 260 (6th Cir. 1996).

²¹² *Cleveland Constr., Inc.*, *supra* note 209, at 69.

²¹³ *Pataula*, *supra* note 209, at 1243.

²¹⁴ *Enertech Elec., Inc.*, *supra* note 211, at 259.

²¹⁵ 148 F.3d 571 (5th Cir. 1998).

²¹⁶ *Id.* at 575. Although state law provided for additional procedural steps such as written notification prior to award and retention of records of the disqualification hearing, these were not required by the United States Constitution. *Id.*

²¹⁷ 999 F. Supp. 701 (N.D. N.Y. 1998).

²¹⁸ 518 U.S. 712, 116 S. Ct. 2353, 135 L. Ed. 2d 874 (1996).

²¹⁹ *Id.*, 518 U.S. at 720. The Court also pointed out that had the mayor solicited contributions as a *quid pro quo* for not terminating the contractor or for keeping the contractor on the City’s list, the mayor may have violated state bribery statutes. *Id.* at 721.

²²⁰ *Enerland Recovery Services, Inc. v. Parish of Lafourche*, 619 So. 2d 129, 134 (La. App. 1 Cir. 1993).

²²¹ *Id.* at 134.

²²² *United States ex rel. Alexander v. Dyncorp, Inc.*, 924 F. Supp. 292, 298 (D.D.C. 1996).

tractor in preparing its bid, based on a state law theory of implied warranty.²²³

Even where the bidder was awarded a contract under specifications later determined in a bid protest to have been illegal, it was not entitled to damages in a New Jersey case.²²⁴ The court ordered that because of the illegal specifications, the contract had to be readvertised. The bidder submitted another bid, but was not the low bidder in the second round of bids. However, this was not a basis for damages. Similarly, in *Percy J. Matherne Contractor v. Grinnell Fire Protection Systems Company*, the prime contractor was allowed to recover from the subcontractor for the increased cost of substituting another subcontractor, where it relied to its detriment on the subcontractor's bid in submitting its bid.²²⁵

²²³ C.L. Maddox, Inc. v. Benham Group, Inc., 88 F.3d 592, 600 (8th Cir. 1996).

²²⁴ Morie Energy Management, Inc. v. Badame, 575 A.2d 885, 888, 241 N.J. Super. 572 (N.J. Super. A.D. 1990).

²²⁵ 915 F. Supp. 818, 825–26 (E.D. La. 1995).

SECTION 4

DISADVANTAGED BUSINESS AND LABOR REQUIREMENTS

A. MINORITY AND DISADVANTAGED BUSINESS ENTERPRISE REQUIREMENTS

1. Executive Order 11246 and its Progeny

Requirements for “nondiscrimination” in public contracts present few constitutional issues.¹ Instead, they reinforce the requirements of the Fifth and Fourteenth Amendments as well as the statutes designed to implement those constitutional provisions.² Eventually, however, nondiscrimination requirements gave way to affirmative action requirements. Affirmative action plans were designed to redress the lingering effects of past discrimination and gave rise to significant constitutional questions.³

a. The Equal Employment Opportunity Program

Equal Employment Opportunity (EEO), affirmative action, and the Minority Business Enterprise (MBE) and Disadvantaged Business Enterprise (DBE) programs all have a common origin in Executive Order 11246. As early as 1941, President Roosevelt under the War Manpower Act ordered that provisions of nondiscrimination be included in all federal defense contracts. The rationale was that nondiscrimination would ensure a large work force in the wartime effort. This order was continued by all succeeding presidents and led to the issuance of Executive Order 11246 on September 24, 1965, by President Johnson. This order expanded the 1941 order to apply to all federally-assisted construction contracts, and mandated that contractors and subcontractors take affirmative action to ensure that no applicant for employment was discriminated against by reason of race, color, religion, sex, or national origin. The Department of Labor was made responsible for the administration of the EEO program and was authorized by the President to adopt regulations to implement the order. This new obligation of affirmative action was more than a prohibition against discrimination. It called for establishment of goals and monitoring of achievement.

Each bidder on a federally-assisted contract was required to submit an affirmative action plan (AAP) with a schedule of goals to be achieved in employing minority workers for several trades involved in the construction. Each AAP had to receive Department of Labor approval before the low bidder could be awarded the contract. However, an alternative developed whereby the bidder or the specifications could incorporate any of

the several “hometown plans” approved by the Department of Labor for the community involved.⁴ Hometown plans were tripartite plans involving the contractors, the unions, and the minority community. The success of the plans therefore depended on the ability of the community leaders to work with unions and local contractors’ associations to obtain mutual concurrence in a plan acceptable to the Department of Labor.

One of the first legal challenges to the program involved a hometown plan known as the “Philadelphia Plan” in *Contractors Association of Eastern Pennsylvania v. Secretary of Labor*.⁵ The challenge was that the Philadelphia Plan was social legislation of local application enacted by the federal executive without congressional or constitutional authority. The court’s decision rested on the power of the President, rather than Congress, to impose fair employment conditions incident to the power to contract.

The opinion relied upon Justice Jackson’s opinion in *Youngstown Sheet & Tube Company v. Sawyer*, in which the Court held that an executive order seizing steel mills was not within the constitutional power of the President.⁶ In that opinion, Justice Jackson divided presidential authority into three categories: (1) presidential acts responding to an express or implied authorization of Congress; (2) measures inconsistent or incompatible with the expressed or implied will of Congress; and (3) actions taken in the absence of either congressional grant or denial of authority, express or implied. The third category took into account three interrelated features: the possibility of concurrent authority, congressional acquiescence in conferring executive authority, and the fact that the test of authority may depend more on events than on theories of law.

The Third Circuit then traced the development of Executive Order (EO) 11246 from the original 1941 EO requiring nondiscrimination covenants in all defense contracts. Based on a historical analysis of EO 11246, the court concluded that the executive action was a valid exercise of contract authority within Justice Jackson’s third category. This conclusion was fortified by acquiescence of Congress, since it had for many years continued to appropriate funds for both federal and federal-aid projects with knowledge of the preexisting EOs.

EO 11246 and its implementing regulations at 41 C.F.R. Part 60 are enforced by the U.S. Department of Labor, Office of Federal Contract Compliance, rather

¹ Portions of this section are derived from *Minority and Disadvantaged Business Enterprise Requirements in Public Contracting* by Orrin F. Finch, published by Transportation Research Board in SELECTED STUDIES IN HIGHWAY LAW, vol. 3, at 1582-N1.

² See, 49 C.F.R. pt. 21 (2001).

³ See Note, *Executive Order No. 11246: Anti-Discrimination Obligations in Government Contracts*, 44 N.Y.U. L. REV. 590 (1969).

⁴ For a history of the development of the home town plan theories see Comment, *The Philadelphia Plan: A Study in the Dynamics of Executive Power*, 39 U. CHI. L. REV. 723 (1972); Leiken, *Preferential Treatment in the Skilled Building Trades: An Analysis of the Philadelphia Plan*, 56 CORNELL L. REV. 84 (1970); and Jones, *The Bugaboo of Employment Quotas*, 1970 WIS. L. REV. 341 (1970).

⁵ 442 F.2d 159 (3d Cir. 1971), cert. denied, 404 U.S. 854, 92 S. Ct. 98.

⁶ 343 U.S. 579, 72 S. Ct. 863 (1952).

than by FHWA, USDOT, or state transportation departments.⁷

b. The Minority Business Enterprise Program

The EEO program was designed to promote affirmative action in the employment of construction workers. Affirmative action for minority- and women-owned businesses in construction developed more slowly than EEO, but had more impact on the industry and on state and local governments.⁸

Section 8(a) of the Small Business Act of 1953 authorized the federal Small Business Administration (SBA) to contract directly with small businesses on behalf of various federal procurement agencies.⁹ Through its regulatory authority, the SBA developed a set-aside program for socially and economically disadvantaged small businesses. The absence of congressional authority for this preferential program was challenged in a number of equal protection cases, but these challenges were largely unsuccessful for lack of standing based on the plaintiffs' inability to show that they would otherwise qualify for certification and participation under the Small Business Act.¹⁰

However, Congress supplied legislative authority in 1978, requiring eligibility for 8(a) status to include both social *and* economic disadvantage. Socially disadvantaged persons were defined as those "...who have been subjected to racial or ethnic prejudice or cultural bias because of their identity as a member of a group without regard to their individual qualities."¹¹ Economic disadvantage also had to be proved. It was defined as: "those socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others in the same business area who are not socially disadvantaged...."¹²

This involved an examination of the individual's total net worth. While the individual had to qualify socially and economically, it was the business entity, whether sole proprietorship, partnership, or corporation, that received the certification. But to qualify for certification, the business entity had to also be at least 51 percent owned and controlled by socially and economically

disadvantaged individuals and qualify as a "small" business.

In 1980, USDOT instituted the MBE/WBE program for all recipients of federal transportation funds. The program was not initiated in response to specific congressional direction, but was based on Title VI of the Civil Rights Act and on several transportation statutes containing general provisions directing federal agencies to prevent discrimination.¹³

The MBE/WBE program was unique in several respects. First, each transportation agency or "recipient" was directed to prepare overall annual goals for federal approval and to establish specific goals for minorities and women businesses for each construction contract. Second, traditional award to the lowest responsible bidder was modified to require a two-step bidding process in which (1) bids were opened to determine prices, and then (2) those bidders desiring to remain in competition were to submit their MBE/WBE participation documentation by a stated date and time. Award was then to be made to the lowest responsible bidder with a "reasonable price" meeting the specific MBE/WBE goals. If none met the goal, award was to be made to the bidder with the highest MBE/WBE participation and a "reasonable price." A "reasonable price" was the highest price at which the agency would award the contract if there were a single bidder.¹⁴

The regulation also permitted "set-asides" where authorized by state law and found necessary for the state to meet its annual goal. A further condition for use of set-asides provided that there must be at least three capable MBEs identified as available to bid on the contract in order to provide adequate competition for the contract.¹⁵

Numerous lawsuits were filed challenging the regulations, including *Central Alabama Paving v. James*.¹⁶ In that case, the court concluded that USDOT was acting beyond the bounds of congressional authority in promulgating the MBE/WBE regulations and had not determined prior to issuing the regulations whether prior discrimination had occurred against the minority groups and women favored by the program.

c. Good Faith Efforts and the DBE Program

In the early 1980s, USDOT issued new interim regulations eliminating the two-step bidding process, and replacing it with a good faith effort standard for contract award. This permitted the states to award to the low bidder even if the MBE or WBE goal was not met, provided that the bidder could demonstrate that it made good faith efforts to secure minority or women subcontractors but was unable to achieve the goal. The new regulations also eliminated the conclusive presumption of social and economic disadvantage being

⁷ FHWA Order 4710.8, "Clarification Of Federal Highway Administration (FHWA) And State Responsibilities Under Executive Order 11246 And Department Of Labor (DOL) Regulations in 41 CFR Chapter 60," Feb. 1, 1999.

⁸ See Levinson, *A Study of Preferential Treatment: The Evolution of Minority Business Enterprise Assistance Programs*, 49 GEO. WASH. L. REV. 61 (1980).

⁹ 15 U.S.C. § 637(a)(1)(B).

¹⁰ See, e.g., *Fortec Constructors v. Kleppe*, 350 F. Supp. 171, 173 (D.D.C. 1972) (SBA had authority to designate projects for SBA subcontract awards and plaintiff could not challenge the award without alleging denial of a right and opportunity to compete under the 8(a) certification program, i.e., that it was entitled to and was denied 8(a) status).

¹¹ 15 U.S.C. § 637(a)(5) (2002).

¹² 15 U.S.C. § 637(a)(6)(A) (2002).

¹³ 64 Fed. Reg. 5096 (Feb. 2, 1999).

¹⁴ 45 Fed. Reg. 21184 (Mar. 31, 1980).

¹⁵ *Id.*

¹⁶ 499 F. Supp. 629 (M.D. Ala. 1980).

applied to the listed minorities and replaced it with a rebuttable presumption.¹⁷ Congress then passed the Surface Transportation Assistance Act (STAA) of 1982, which included a one-sentence provision in Section 105(f):

Except to extent the Secretary [of Transportation] determines otherwise, not less than ten percentum of the amounts authorized to be appropriated under this Act shall be expended with small business concerns owned and controlled by socially and economically disadvantaged individuals as defined by section 8(d) of the Small Business Act (15 U.S.C. 637(d)) and relevant subcontracting regulations promulgated pursuant thereto.¹⁸

USDOT's next regulations were issued on July 21, 1983.¹⁹ Those regulations followed the lead of the SBA regulations and provided a rebuttable presumption that the members of designated minority groups are socially and economically disadvantaged. For example, a wealthy minority or woman business owner would be ineligible because he or she was not economically disadvantaged. The DBE program was restricted to those identified with a minority group and those with SBA Section 8(a) certifications, and the regulations mandated that the state recipients honor all SBA Section 8(a) certifications.²⁰

Section 105(f) of STAA was replaced by Section 106(c) of the Surface Transportation and Uniform Relocation Assistance Act of 1987 (STURAA):

Except to the extent that the Secretary [of Transportation] determines otherwise, not less than 10 percent of the amounts authorized to be appropriated under titles I, II, and III of this Act or obligated under titles I, II, and III (other than section 203) of the Surface Transportation Assistance Act of 1982 after the date of the enactment of this Act shall be expended with small business concerns owned and controlled by socially and economically disadvantaged individuals.²¹

One major change was that WBEs were presumptively included within the class of socially and economically disadvantaged individuals: "The term 'socially and economically disadvantaged individuals' has the meaning such term has under section 8(d) of the Small Business Act (15 U.S.C. 637(d)) and relevant subcontracting regulations promulgated pursuant thereto; *except that women shall be presumed to be socially and economically disadvantaged individuals for purposes of this subsection.*"²²

Congress then passed the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA), which continued the requirement that not less than 10 percent of the federal highway funds be spent on contracts or sub-

contracts with DBEs.²³ Section 1003 of ISTEA defined a "small business" as one with average annual gross receipts of less than \$15,370,000 for the preceding 3 years, with the amount to be adjusted upward for inflation in subsequent years.²⁴ Section 1003 also incorporated the Section 8(d) definition of disadvantaged businesses. The Transportation Equity Act for the 21st Century (TEA-21), passed in 1998, also continued the federal DBE program.²⁵

2. Review of Affirmative Action Programs

The U. S. Supreme Court has reviewed a number of affirmative action cases that have ultimately required significant changes in the DBE program. These decisions show the development of the strict scrutiny standard of review that now applies to these programs.

In one case, the Court struck down an AAP in an admissions policy for university medical students.²⁶ The Court also addressed whether programs served a compelling state interest and whether "societal discrimination" was an adequate basis for AAP requirements.²⁷ *Fullilove* upheld the constitutionality of an MBE program established by Congress for public construction for economically depressed communities.²⁸ *Croson* applied a strict scrutiny standard for local public works projects, and *Adarand* applied the same standard to federal projects.²⁹ *Adarand* required major changes to the DBE program, resulting in issuance of a new rule by USDOT on February 2, 1999.³⁰

a. *Fullilove v. Klutznick*

The *Fullilove* case involved an AAP created by Congress rather than by EO or administrative action.³¹ This case later served as the basis for adding Section 105(f) of the STAA of 1982 establishing the DBE program for federal-aid highway appropriations.

²³ Pub. L. No. 102-240, 105 Stat. 1914.

²⁴ *Id.*, § 1003(b)(2)(A).

²⁵ Pub. L. No. 105-178 (June 9, 1998).

²⁶ *Regents of the Univ. of Cal. v. Bakke*, 438 U.S. 265, 98 S. Ct. 2733 57 L. Ed. 2d 750 (1978) ("strict scrutiny" test applied to protect minorities against discrimination would apply equally to protect any and all members of society, including nonminorities from discrimination).

²⁷ *Wygant v. Jackson Board of Educ.*, 476 U.S. 267, 106 S. Ct. 1842 90 L. Ed. 2d 260 (1986) (more tenured white teachers were laid off in preference to retaining probationary minority teachers in order to maintain affirmative actions gains in minority hirings; providing minority role models was not a compelling state interest and reliance on societal discrimination failed to provide the needed evidence of prior acts of discrimination; means chosen were not narrowly tailored to accomplish purpose).

²⁸ *See infra* note 31 and accompanying text.

²⁹ *See infra* note 42 and note 57, and accompanying text.

³⁰ *Id.*; 49 C.F.R. pt. 26 (2000).

³¹ *Fullilove v. Klutznick*, 448 U.S. 448, 100 S. Ct. 2758 65 L. Ed. 2d 902 (1980).

¹⁷ *See FINCH, supra* note 1.

¹⁸ Pub. L. No. 97-424.

¹⁹ 48 Fed. Reg. 33432 (July 21, 1983).

²⁰ 48 Fed. Reg. 33432 (July 21, 1983); *see* 13 C.F.R. § 124.104(c)(2).

²¹ Pub. L. No. 100-17 (Apr. 2, 1987), § 106(c)(1).

²² Pub. L. No. 100-17 (Apr. 2, 1987), § 106(c)(2)(B) (emphasis added).

In May 1977 Congress enacted the Public Works Employment Act (PWEA), appropriating \$4 billion for federal grants to state and local governments for local public works projects.³² The main objective was to alleviate widespread unemployment. It included an MBE provision requiring that "...no grant shall be made under this Chapter for any local public works project unless the applicant gives satisfactory assurance...that at least 10 per centum of the amount of each grant shall be expended for minority business enterprises" with provision for administrative waiver by the Secretary of Commerce.³³ Regulations issued by the Secretary required competitive bidding and award by local entities to prime contractors responsive to the MBE requirements. The 10 percent MBE goal could be waived if the bidder could demonstrate that MBE subcontractors were not available at a reasonable price. Otherwise, the contract would be awarded to another bidder.³⁴

The Supreme Court held that the objectives of the MBE provisions of the Act were within the proper exercise of the powers of Congress and passed constitutional muster. The MBE provision fell within Congress's broad constitutional authority, and the means selected, using racial and ethnic criteria as described in the legislation and implemented by the regulations, did not violate constitutional guarantees of nonminorities.

The most significant basis of the holding was that the AAP was enacted by Congress:

A program that employs racial or ethnic criteria, even in a remedial context, calls for close examination; yet we are bound to approach our task with appropriate deference to the Congress, a co-equal branch charged by the Constitution with the power to "provide for the...general Welfare..." and "to enforce, by appropriate legislation" the equal protection guarantees of the Fourteenth Amendment....³⁵

Also, Congress was not required to make findings or create a record. The Court found that the legislative history of the PWEA was sufficient to support a congressional conclusion that minorities had been denied effective participation in public contracts.³⁶

The Court favored the "nonmandatory" nature of the AAP, referencing the waiver provisions implemented by the regulations.³⁷ The AAP thus was able to avoid the "quota" stigma and possible disqualification. The Court also noted the competitive bidding requirement, which created incentives to prime contractors to meet their MBE obligations to qualify as responsive bidders and to seek out the most competitive, qualified, and bona fide minority subcontractors.³⁸ Finally, the Court noted the Act's narrow focus, short duration, and minimal impact

on nonminorities innocent of past discriminatory practices.³⁹

b. Croson v. City of Richmond

The City of Richmond advertised for competitive bids to refurbish the plumbing fixtures in its city jail. By ordinance, the City had established a minority preference program that required nonminority-owned prime contractors to subcontract at least 30 percent of the total contract to MBEs. J.A. Croson submitted the only bid and provided no minority participation, although it had contacted several minority suppliers without success. Croson requested a waiver of the MBE requirement, which the City denied. A major portion of the contract involved the purchase of plumbing fixtures, so Croson next arranged for a minority supplier, but at a price higher than the original supplier relied upon in the bid. The City also rejected the higher contract price to accommodate the MBE supplier.

The federal district court upheld the City's minority plan. The Fourth Circuit Court of Appeals initially affirmed,⁴⁰ but on remand following a Supreme Court order directing reconsideration in light of an intervening decision, the Fourth Circuit reversed the judgment on the basis that the ordinance violated the federal Equal Protection Clause.⁴¹ The Supreme Court affirmed the Fourth Circuit ruling.⁴²

For the first time, a majority agreed that racially based preference programs would be subject to the constitutional strict scrutiny test. This case also reinforced the Court's earlier plurality ruling in *Wygant v. Jackson Board of Education* that reliance on "societal discrimination" will not suffice.⁴³ The effect of these two principles of strict scrutiny and inability to rely on societal discrimination meant that classifications based on race would be presumed invalid. Justice O'Connor's opinion, which was divided into six distinct parts, represented the majority views of the Court on all but Part II, which dealt with whether *Fullilove* provided authority for local legislative bodies to adopt an AAP without independent findings of past discrimination.⁴⁴

Part I affirmed the court of appeals based on the earlier *Wygant* ruling against reliance on "societal discrimination:" "As the court read this requirement, '[f]indings of societal discrimination will not suffice; the findings must concern "prior discrimination by the government unit involved."'"⁴⁵

³⁹ *Id.* at 484.

⁴⁰ *J.A. Croson v. City of Richmond*, 779 F.2d 181 (4th Cir. 1985).

⁴¹ 822 F.2d 1355 (4th Cir. 1987).

⁴² *Richmond v. J.A. Croson Co.*, 488 U.S. 469, 109 S. Ct. 706, 102 L. Ed. 2d 854 (1989).

⁴³ 488 U.S. at 486 (citing *Wygant v. Jackson Board of Educ.*, 476 U.S. 267 106 S. Ct. 1842, 90 L. Ed. 2d 260 (1986)).

⁴⁴ See *Contractors Ass'n of Eastern Pa. v. City of Phila.*, 735 F. Supp. 1274, 1288-92 (E.D. Pa. 1990) for an extensive discussion of Justice O'Connor's opinion by Chief Judge Bechtel.

⁴⁵ 488 U.S. at 485 (emphasis in original).

³² 91 Stat. 116.

³³ 91 Stat. 116; 42 U.S.C. § 6705(f)(2).

³⁴ *Id.*

³⁵ 448 U.S. at 472, 100 S. Ct. 2772.

³⁶ 448 U.S. at 478.

³⁷ *Id.* at 488-90.

³⁸ *Id.* at 481.

The Court found that the city council had not made findings of prior discrimination.⁴⁶ The Court affirmed the Fourth Circuit's ruling that the 30 percent set-aside was chosen arbitrarily and was not narrowly tailored.⁴⁷

The City relied heavily on *Fullilove v. Klutznick*, arguing that *Fullilove* was controlling and provided the City with "sweeping legislative power to define and attack the effects of prior discrimination in its local construction industry."⁴⁸ In distinguishing *Fullilove*, Justice O'Connor viewed Sections 1 and 5 of the Fourteenth Amendment as limitations on the powers of the states and an enlargement of the power of Congress to identify and redress the effects of societal discrimination.⁴⁹

In Part III-A, for the first time in a majority holding, the Supreme Court ruled that all classifications based on race will be subject to strict scrutiny, whether they benefit or burden minorities or nonminorities. Thus, all such classifications by states and local governments would be presumed invalid: "We thus reaffirm the view expressed by the plurality in *Wygant* that the standard of review under the Equal Protection Clause is not dependent on the race of those burdened or benefited by a particular classification...."⁵⁰

In Part III-B of the majority opinion, the Court set out the requirement that the "factual predicate" underlying the AAP be supported by adequate findings of past discrimination without reliance on generalized assertions of past discrimination:

We think it clear that the factual predicate offered in support of the Richmond Plan suffers from the same two defects identified as fatal in *Wygant*...Like the "role model" theory employed in *Wygant*, a generalized assertion that there has been past discrimination in an entire industry provides no guidance for a legislative body to determine the precise scope of the injury it seeks to remedy....⁵¹

The Richmond City Council had attempted to establish a factual predicate by relying on the exclusion of blacks from skilled construction trade unions and training programs, and on statements made by proponents of the plan that there had been past discrimination in the industry and that minority business had received less than 1 percent of the prime contracts from the City, while minorities represented 50 percent of the city's population. But the majority disagreed that this was adequate: "None of these 'findings,' singly or together, provide the city of Richmond with a 'strong basis in evidence for its conclusion that remedial action was necessary.' There is nothing approaching a prima

facie case of a constitutional or statutory violation by anyone in the Richmond construction industry."⁵²

The Court concluded that the City was applying its preferential program as a strict quota rather than attempting to use its provisions as a goal. For example, Croson was a sole bidder who demonstrated what could be described as good faith efforts to secure a minority supplier both before and after the bidding, yet the City rejected its bid.

While there is no doubt that the sorry history of both private and public discrimination in this country has contributed to a lack of opportunities for black entrepreneurs, this observation, standing alone, cannot justify a rigid racial quota in the awarding of public contracts in Richmond, Virginia. Like the claim that discrimination in primary and secondary schooling justifies a rigid racial preference in medical school admission, an amorphous claim that there has been past discrimination in a particular industry cannot justify the use of an unyielding racial quota.⁵³

The Court concluded that, "none of the evidence presented by the City points to any identified discrimination in the Richmond construction industry," and ruled that as a consequence, "the city has failed to demonstrate a compelling interest in apportioning public contracting opportunities on the basis of race."⁵⁴

In Part IV, the Court observed that without the specificity needed to identify the past discrimination, it could not assess whether the Richmond Plan was narrowly tailored. But the majority did not view the 30 percent quota as being narrowly tailored to any legitimate goal. Justice O'Connor noted the City's failure to consider any alternatives to the race-based quota system, its rigid adherence to the 30 percent quota, and its refusal to grant a waiver. "Under Richmond's scheme, a successful black, Hispanic, or Oriental entrepreneur from anywhere in the country enjoys an absolute preference over other citizens based solely on their race. We think it obvious that such a program is not narrowly tailored to remedy the effects of prior discrimination."⁵⁵

Part V concerns the failure of the City to explore possible "race-neutral devices" to increase contracting opportunities for small contractors of all races:

Simplification of bidding procedures, relaxation of bonding requirements, and training and financial aid for disadvantaged entrepreneurs of all races would open the public contracting market to all those who have suffered the effects of past societal discrimination or neglect. Many of the formal barriers to new entrants may be the product of bureaucratic inertia more than actual necessity, and may have a disproportionate effect on the opportunities open to new minority firms....⁵⁶

The majority emphasized that "[n]othing we say today precludes a state or local entity from taking action

⁴⁶ *Id.*

⁴⁷ *Id.* at 486.

⁴⁸ *Id.*

⁴⁹ *Id.* at 491.

⁵⁰ *Id.* at 494.

⁵¹ *Id.* at 498 (citations omitted; emphasis in original).

⁵² *Id.* at 500.

⁵³ *Id.* at 499.

⁵⁴ *Id.* at 505.

⁵⁵ *Id.* at 508.

⁵⁶ *Id.* at 509–10.

to rectify the effects of identified discrimination within its jurisdiction.⁵⁷ At the same time the Court noted the importance of adequate findings:

Proper findings in this regard are necessary to define both the scope of the injury and the extent of the remedy necessary to cure its effects. Such findings also serve to assure all citizens that the deviation from the norm of equal treatment of all racial and ethnic groups is a temporary matter, a measure taken in the service of the goal of equality itself. Absent such findings, there is a danger that a racial classification is merely the product of unthinking stereotypes or a form of racial politics....⁵⁸

c. *Adarand Constructors v. Pena*

Adarand Constructors, Inc. v. Pena answered the question as to whether strict scrutiny would apply to federal contracting.⁵⁹ *Adarand Constructors* was a Colorado construction company that specialized in guardrail work. As such, it regularly competed for subcontracts on highway construction projects. In 1989, the Central Federal Lands Highway Division of FHWA awarded a prime contract to Mountain Gravel & Construction Company. The terms of the direct federal construction contract provided that Mountain Gravel would receive additional compensation if it gave subcontracts to “socially and economically disadvantaged individuals.”⁶⁰ *Adarand* was not certified as a DBE. The subcontract that *Adarand* competed for was awarded to a DBE, despite the fact that *Adarand* was the low bidder. The prime admitted that but for the additional payment the prime would receive for hiring the DBE, it would have hired *Adarand*.⁶¹

Federal law required that the construction contract state that “the contractor shall presume that socially and economically disadvantaged individuals include Black Americans, Hispanic Americans, Native Americans, Asian Pacific Americans, and other minorities or any other individual found to be disadvantaged by the [Small Business] Administration pursuant to section 8(a) of the Small Business Act.”⁶² *Adarand* claimed that the provision discriminated on the basis of race in violation of the Fifth Amendment obligation not to deny anyone equal protection of the law. The district court

⁵⁷ *Id.* at 509.

⁵⁸ *Id.* at 510.

⁵⁹ 515 U.S. 200, 115 S. Ct. 2097, 132 L. Ed. 2d 158 (1995).

⁶⁰ 515 U.S. at 205, 209. The subcontracting compensation clause at issue provided:

Monetary compensation is offered for awarding subcontracts to small business concerns owned and controlled by socially and economically disadvantaged individuals...

The Contractor will be paid an amount computed as follows:

1. If a subcontract is awarded to one DBE, 10 percent of the final amount of the approved DBE subcontract, not to exceed 1.5 percent of the original contract amount....

⁶¹ *Id.* at 205.

⁶² *Id.* (citations omitted).

had granted the government’s summary judgment motion.⁶³ The Tenth Circuit affirmed, based on its understanding that *Fullilove* set out an intermediate scrutiny standard for race-based federal action.⁶⁴ The Supreme Court vacated the court of appeals ruling and remanded the case to the trial court.⁶⁵

The Court reviewed the development of its views regarding rights protected by the Fifth Amendment, beginning with the 1940s cases that upheld the internment of Japanese Americans.⁶⁶ Those cases resulted in the Court’s holding that there is a difference between the rights protected by the Fourteenth Amendment and those protected by the Fifth Amendment, and that the Fifth Amendment “provides no guaranty against discriminatory legislation by Congress.”⁶⁷ However, the Court noted that even in so holding, the earlier Court had stated in the *Hirabayashi* decision that “distinctions between citizens solely because of their ancestry are by their very nature odious.”⁶⁸

The Court noted that despite the uncertainty in their details, the cases through *Croson* established three general propositions with respect to governmental race classifications: (1) skepticism, or a requirement that a racial preference receive “a most searching examination”; (2) consistency, or a requirement that the same standard apply whether a particular class is burdened or benefited; and (3) congruence, or the application of the same standard under either the Fifth Amendment or the Fourteenth Amendment.⁶⁹ Applying these principles, Justice O’Connor concluded as follows:

Taken together, these three propositions lead to the conclusion that any person, of whatever race, has the right to demand that any governmental actor subject to the Constitution justify any racial classification subjecting that person to unequal treatment under the strictest judicial scrutiny....

....

Accordingly, we hold today that all racial classifications, imposed by whatever federal, state, or local governmental actor, must be analyzed by a reviewing court under strict scrutiny. In other words, such classifications are constitutional only if they are narrowly tailored measures that further compelling governmental interests.⁷⁰

Finally, Justice O’Connor set out the requirement that remedies be narrowly tailored:

⁶³ *Adarand Constructors, Inc. v. Skinner*, 790 F. Supp. 240 (D. Colo. 1992).

⁶⁴ *Adarand Constructors, Inc. v. Pena*, 16 F.3d 1537 (10th Cir. 1994).

⁶⁵ *Adarand Constructors, Inc. v. Pena*, 515 U.S. 200, 204–05, 115 S. Ct. 2097, 132 L. Ed. 2d 158 (1995).

⁶⁶ *Id.* at 213–14 (citing *Hirabayashi v. United States*, 320 U.S. 81, 63 S. Ct. 137, 87 L. Ed. 1774 (1943)).

⁶⁷ *Id.* at 213 (citations omitted).

⁶⁸ *Id.* at 215 (quoting *Hirabayashi*, 320 U.S. at 100).

⁶⁹ *Id.* at 223–24.

⁷⁰ *Id.* at 224, 227.

The unhappy persistence of both the practice and the lingering effects of racial discrimination against minority groups in this country is an unfortunate reality, and government is not disqualified from acting in response to it...When race-based action is necessary to further a compelling interest, such action is within constitutional constraints if it satisfies the “narrow tailoring” test this Court has set out in previous cases.⁷¹

The Court remanded *Adarand* to the district court for a determination of whether any of the ways that the government was using the subcontractor compensation clauses could survive strict scrutiny.⁷²

The result of the *Adarand* decision was the adoption of new regulations by the USDOT that are intended to be consistent with the requirements of strict scrutiny, and that provide a remedy for demonstrated discrimination, but that do not rely on the “societal discrimination” that had been a basis for racial preference programs in the past.

3. Challenges to AAPs After *Croson* and *Adarand*

a. State and Local Programs

Croson and *Adarand* led to challenges being filed against state and local DBE programs, based on contentions that those programs would not survive strict scrutiny.⁷³

Phillips & Jordan, Inc. v. Watts involved a challenge to a Florida Department of Transportation (FDOT) DBE program.⁷⁴ FDOT was authorized under state law to implement a program to remedy disparities based on race, national origin, and gender, based on a showing of past and/or continuing discrimination in the award of state-funded highway contracts.⁷⁵ The program required annual goals for minority participation, and allowed FDOT to set aside contracts for DBEs. The goals and set-asides were supposed to be based on a finding of “significant disparity” in a disparity study.

FDOT set aside certain maintenance contracts for black or Hispanic-owned businesses, despite the fact that there was no evidence that the agency had ever discriminated against these groups in the award of maintenance contracts. Rather, FDOT claimed it was a “passive participant” in discrimination practiced in the private sector.⁷⁶ In reviewing the program, the court applied the strict scrutiny analysis mandated by *Croson*.⁷⁷ The “strong basis in evidence” that *Croson*

required as proof of past discrimination could not be based on “societal discrimination” or on an unsupported assumption regarding past discrimination in a particular industry. Rather, it must be based on a showing of the agency’s own active or passive participation in past or present discrimination, possibly by prime contractors, bonding companies, or financial institutions.⁷⁸

Defending its program, FDOT argued that it must have been a passive participant in discrimination based on its disparity study, which compared the number of contracts awarded by FDOT with the number of available DBEs. The court rejected this argument, noting that any such discrimination must be demonstrated with particularity.⁷⁹ While statistical evidence may serve this purpose, it does not do so where the “identity of the wrongdoers is unknown.”⁸⁰ The court found that FDOT officials had merely speculated that FDOT had been a possible participant in discrimination by primes, bonding companies, and financial institutions, with no evidence to establish who may have engaged in any discriminatory practices.⁸¹ The court held that an AAP must be focused on “those who discriminate.”⁸² A disparity study that relied on “ill-defined wrongs” committed by “unidentified wrongdoers” was insufficient under *Croson*.⁸³

In *Louisiana Associated General Contractors v. State*, the Louisiana Supreme Court held that its own state constitution precludes any AAP, even one that passes strict scrutiny under *Croson*. The court held that the Louisiana Bid Preference Act violated the equal protection requirements of the state constitution.⁸⁴ The Louisiana Health Care Authority had set aside a clinic renovation project as a DBE-only project in its advertisement for bids.⁸⁵ The program created a bid preference for minority contractors, in that all contractors could bid, but a certified MBE would receive the bid if its bid was within 5 percent of the lowest responsive and responsible bid, provided that the MBE agreed to contract for the amount of the lowest bid.⁸⁶ AGC challenged the specification on the grounds that it violated equal protection. The court enjoined the receipt and acceptance of bids, and also enjoined the agency from continuing to advertise the project as a set-aside. The agency readvertised the project without the set-aside provision; however, the court did not consider the issue moot as the agency intended to bid future contracts as set-asides.⁸⁷

⁷¹ *Id.* at 237 (citation omitted).

⁷² *Id.* at 238–39.

⁷³ For a summary of court decisions on state and local DBE/M/WBE programs following *Croson*, see D. Rudley and D. Hubbard, *What a Difference A Decade Makes: Judicial Response To State And Local Minority Business Set-Asides Ten Years After*, City of Richmond v. J.A. Croson, 25 S. ILL. U. L.J. 39–93 (2000).

⁷⁴ 13 F. Supp. 2d 1308 (N.D. Fla. 1998).

⁷⁵ FLA. STAT. § 339.0805(1)(b).

⁷⁶ 13 F. Supp. 2d at 1312, 1314.

⁷⁷ *Id.*

⁷⁸ *Id.* at 1313.

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ *Id.* at 1314.

⁸² *Id.*

⁸³ *Id.*

⁸⁴ 669 So. 2d 1185 (La. 1996).

⁸⁵ La. R.S. 39:1951 *et seq.*

⁸⁶ 669 So. 2d at 1201.

⁸⁷ 669 So. 2d at 1189.

The court relied on *Croson* and *Adarand* for the principle that the same standard applies regardless of what race is burdened or benefited.⁸⁸ The court found even less tolerance for the program in the state constitution than in the U.S. Constitution, however, holding that the state constitution allows *no* scrutiny to be applied to the program. Rather, the court held that when a law discriminates against a person by classifying him or her on the basis of race, “it shall be repudiated completely, regardless of the justification behind the racial discrimination.”⁸⁹

The state agency utilized the program in part to qualify for federal funds. The court refused to allow this as a basis for what it considered a prohibited discriminatory program, and found that the “absolute and mandatory language used in the prohibition against laws which discriminate on the basis of race found in the constitution does not change simply because the state may stand to lose federal funds....”⁹⁰

California’s MBE/WBE program was declared to be unconstitutional as violating the equal protection clause in *Monterey Mechanical Co. v. Wilson*.⁹¹ Despite the fact that the program allowed contractors to either comply with the contract goals or show good faith efforts to do so, the court found that the program was not supported by evidence of past or present discrimination against the protected groups. The state did not present any evidence of past or present discrimination, relying only on general findings stated in the legislation. Finding that the program also was not narrowly-tailored, the court noted that the program included a number of minority groups who were highly unlikely to be found in California.

A city ordinance allowing set-aside contracts was challenged by a contractor association in *Contractor’s Association of Eastern Pennsylvania v. City of Philadelphia*.⁹² The ordinance allowed the use of set-asides for black contractors; if there were insufficient black contractors available for competitive bidding, then the goal could be met through subcontracting.⁹³ The City utilized the subcontracting portion of the ordinance exclusively, and did not create set-asides. Meeting the subcontracting goal was considered an element of responsiveness. Good faith efforts were to be considered, however, if at least one bidder met the goal; then all others were presumed not to have used good faith efforts. If no bidder met the goals, the one who had the highest minority participation was granted a waiver and awarded the contract.⁹⁴

The district court found that the ordinance created a protected segment of city construction work for which non-DBEs could not compete.⁹⁵ Relying on *Croson*, the court applied strict scrutiny, noting that a program can withstand strict scrutiny only if it is “narrowly tailored to serve a compelling state interest.” The court then set out the test as follows:

The party challenging the race-based preferences can succeed by showing either (1) that the subjective intent of the legislative body was not to remedy race discrimination in which the municipality played a role or (2) that there is no “strong basis in evidence” for the conclusions that race-based discrimination existed and that the remedy chosen was necessary. (citation omitted).⁹⁶

The court ultimately rejected the program on the basis that it was not narrowly tailored.⁹⁷ Where the only identified discrimination was by the City in its award of prime contracts, a program that focused exclusively on subcontracting did not provide a narrowly tailored remedy. The court thus declared the subcontracting portion of the ordinance unconstitutional under *Croson*.⁹⁸ Regarding the set-aside provision, the City did not have evidence to show that a 15 percent set-aside was necessary to remedy the discrimination, where that figure was much higher than the percentage of minority firms qualified to do City construction work.⁹⁹

The court also addressed the ordinance’s failure to include race-neutral measures, such as relaxed bonding or prequalification requirements for newer businesses. In addition, the City could have used training and financial assistance programs to assist disadvantaged contractors of all races. Because these measures were available to the City, the court found that to the extent the program did not utilize race-neutral measures, it was not narrowly tailored and was thus unconstitutional.¹⁰⁰

An example of a program that was upheld after *Croson* is found in *Domar Electric v. City of Los Angeles*.¹⁰¹ A bidder challenged a contractor “outreach” program that was required by a city ordinance as being inconsistent with the city charter and with competitive bidding rules. The program required only that contractors make a good faith effort to include DBEs as subcontractors; it did not require bid preferences or quotas, nor did it allow the City to set aside contracts for DBEs. The ordinance stated that a contractor’s good faith efforts would be evaluated by considering its efforts in (1) identifying and selecting specific work items for subcontracting to DBEs, (2) advertising that work to DBEs, (3) providing information to the DBE contractor commu-

⁸⁸ *Id.* at 1198.

⁸⁹ *Id.*

⁹⁰ *Id.* at 1200.

⁹¹ 125 F.3d 702 (9th Cir. 1998), *rehearing denied*, 138 F.3d 1270.

⁹² 91 F.3d 586 (3d Cir. 1996).

⁹³ *Id.* at 592–93.

⁹⁴ *Id.* at 593.

⁹⁵ *Contractors Ass’n of Easton Pa. v. City of Pa.*, 893 F. Supp. 419, 426 (E.D. Pa. 1995).

⁹⁶ *Id.* 91 F.3d at 597.

⁹⁷ *Id.* at 605.

⁹⁸ *Id.* at 606.

⁹⁹ *Id.* at 607.

¹⁰⁰ *Id.* at 609.

¹⁰¹ 9 Cal. 4th 161, 885 P.2d 934, 36 Cal. Rptr. 521 (1994).

nity, and (4) negotiating in good faith with DBE subcontractors that were interested in subcontracting. The program set goals, but a bidder's failure to meet the goal in its bid did not disqualify the bidder or render its bid nonresponsive. There was no advantage gained from meeting the goal, nor was there a disadvantage from not meeting the goal.¹⁰²

Domar was the low bidder, but failed to provide documentation of its good faith efforts by the deadline. The contract was then awarded to the next low bidder, and Domar appealed. The superior court denied its appeal, but the court of appeals reversed, finding the outreach program unconstitutional under *Croson*.¹⁰³ The California Supreme Court reversed, holding that the outreach program was constitutional. The program did not conflict with the city charter, even though it was not specifically authorized by the charter. It was also consistent with the goals of competitive bidding, such as excluding favoritism and corruption. The court reasoned that competitive bidding requirements necessarily imply that there be equal opportunities provided to all who may be interested in bidding. The outreach program only required that minority and women businesses be contacted and equal opportunities provided to them to bid on subcontracts.¹⁰⁴

b. Federal Programs

A federal court examined the constitutionality of USDOT's DBE program in light of the *Adarand* decision in *In re Sherbrooke Sodding Company*.¹⁰⁵ This case was both a facial and an as-applied challenge to the DBE program authorized by ISTEA in 1991 as well as the Minnesota Department of Transportation's (MnDOT) DBE program.¹⁰⁶ The court also considered a 1996 memorandum in which FHWA directed the states to "count the participation of DBE primes as 100 percent both towards meeting overall recipient goals and...toward meeting contract-specific goals."¹⁰⁷ The result of this change in policy was that DBE prime contractors were exempt from DBE subcontract requirements, which would continue to apply to non-DBE primes.

The court noted that under *Adarand*, the government bears the burden of showing that the DBE program is constitutional by proving that its race and gender classifications are narrowly tailored to serve a compelling governmental interest.¹⁰⁸ MnDOT claimed that it was

simply implementing a federal government program, and was therefore relieved from any duty to show that the program was narrowly tailored to serve a compelling state interest.¹⁰⁹ The court assumed that MnDOT was properly implementing the program, and turned to USDOT for proof that the program should survive strict scrutiny.

USDOT claimed (1) that Congress had made an adequate finding of past discrimination to support a compelling governmental interest, and (2) that Congress was not required to make such findings on a state or local basis, but rather could do so nationally. The court agreed with this argument, relying in part on the decision on remand in *Adarand* in which the district court in Colorado found that Congress had a "strong basis in evidence" to support a race-conscious program.¹¹⁰

The court then focused its analysis on whether the DBE program was narrowly tailored. The court found no evidence that Congress considered race-neutral alternatives to the DBE program. Noting that the Supreme Court had suggested several potential race-neutral measures in *Croson*, none of which were evident in the USDOT program, the court found a lack of such alternatives to "strongly suggest the DBE program is Constitutionally flawed."¹¹¹

The court further found that the DBE program was not limited in duration, where *Adarand* required that such a program "will not last longer than the discriminatory effects it is designed to eliminate."¹¹² However, due to ISTEA's sunset provision, the court did not consider this factor significant. More significant were the problems that the program placed an undue burden on innocent parties, was not sufficiently flexible, and tended to haphazardly include as DBE's virtually all non-white people.¹¹³ The court held regarding the lack of flexibility: "Whatever the terminology or palliative applied, whether the program be called an 'aspirational goal' or ameliorated by a 'flexible waiver,' the bottom line is that there is still a quota that is imposed by the government. This quota penalizes some and advantages other, each without Constitutional justification."¹¹⁴

The court thus held that the USDOT DBE program failed to pass strict scrutiny as required by *Adarand*.

4. Narrowly Tailoring the DBE Requirements

In response to the *Adarand* and *Sherbrooke Sodding* decisions, USDOT undertook a substantial revision of the DBE program in order to develop a program that would withstand strict scrutiny. First, the agency con-

for the purposes of the motions before it, the court did apply strict scrutiny to the gender classifications. *Id.*

¹⁰⁹ *Id.* at 1033-34.

¹¹⁰ *Id.* at 1034-35 (citing *Adarand Constructors, Inc. v. Pena*, 965 F. Supp. 1556, 1576-77 (D. Colo. 1997).

¹¹¹ *Id.* at 1035.

¹¹² *Id.* (quoting *Adarand*, 515 U.S. at 238).

¹¹³ *Id.* at 1036-37.

¹¹⁴ *Id.* at 1037.

¹⁰² 9 Cal. 4th at 167.

¹⁰³ *Id.* at 168-69.

¹⁰⁴ *Id.* at 172-73.

¹⁰⁵ 17 F. Supp. 2d 1026 (D. Minn. 1998).

¹⁰⁶ Pub. L. No. 102-240, 105 Stat. 1914 (1991); 49 C.F.R. (1996).

¹⁰⁷ 17 F. Supp. 2d. at 1029.

¹⁰⁸ *Id.* at 1033. Although the Supreme Court has not indicated that it would apply strict scrutiny to gender-based classifications, this court was invited by the parties to do so, and

cluded that the Congressional debate surrounding the adoption of TEA-21 provided sufficient findings of a compelling governmental interest in remedying any discrimination in federally-assisted transportation contracting.¹¹⁵ The remainder of the rule adoption process was directed at creating a program that was narrowly tailored to address that discrimination. USDOT addressed each element of the narrow-tailoring test set out in *Adarand*: (1) determining the necessity of relief; (2) considering the efficacy of alternative (race-neutral) remedies; (3) providing for flexibility of relief, through use of waivers and good faith efforts standards; (4) limiting duration of relief to the time needed to effect the remedy; (5) setting goals in relation to the relevant market; (6) considering the impact on the rights of third parties; and (7) inclusion of appropriate beneficiaries.¹¹⁶

The language in TEA-21 largely retained the 10 percent goal contained in previous legislation, which had always been applied by USDOT as requiring that each contract have a 10 percent DBE goal. However, USDOT's new rules recharacterized the meaning of the statutory goal language, interpreting it as a national overall goal:

Section 26.41 makes clear that the 10 percent statutory goal contained in ISTEA and TEA-21 is an aspirational goal at the national level. It does not set any funds aside for any person or group. It does not require any recipient or contractor to have 10 percent (or any other percentage) DBE goals or participation. Unlike former part 23, it does not require recipients to take any special administrative steps (e.g. providing a special justification to DOT) if their annual overall goal is less than 10 percent. Recipients must set goals consistent with their own circumstances. (§ 26.45) There is no direct link between the national 10 percent aspirational goal and the way a recipient operates its program....¹¹⁷

a. Race-Neutral Alternatives

One of the reasons that the court found the USDOT program to not be narrowly tailored was its lack of race-neutral alternatives. As part of its revision, USDOT required recipients to first rely on race-neutral measures to meet the "maximum feasible portion" of their overall DBE goals.¹¹⁸ Race-neutral alternatives include measures such as outreach, technical assistance, procurement process modifications, and other means of increasing opportunities for all small businesses, not just DBEs.¹¹⁹ It may also include relaxing bonding requirements and prequalification standards for new or small businesses. Prompt payment requirements for all subcontractors are also race-neutral and have the effect of assisting DBEs that cannot tolerate delay in payment.¹²⁰ Also, when a DBE firm is awarded

a prime contract on the sole basis that it is the lowest responsible bidder, then that is considered to be a race-neutral alternative.¹²¹ Recipients are expected to estimate how much of the overall goal they can meet through the use of race-neutral alternatives. Only then are they to set contract DBE goals.

b. Flexibility Through Contract Goals and Good Faith Efforts Standards

Under the 1999 regulations, the contract is to be awarded to the lowest responsible bidder meeting the specified DBE goals or demonstrating good faith efforts in its attempt to meet the goals.¹²² One of the significant points made by the 1999 regulations is that in setting contract goals, they do not intend that a recipient be required to accept a higher bid from a DBE prime contractor when a non-DBE has submitted a lower bid. Thus the rule does not interfere with state and local requirements to award to the lowest responsible bidder. The comment to the rule notes that selection of subcontractors by bidders is not subject to any low-bid rule; a bidder may select any subcontractor that it wants, and generally does so based on its familiarity and experience with a subcontractor, the quality of the subcontractor's work, and the subcontractor's reputation in the community.¹²³ These factors can be as significant as price.¹²⁴ This was the basis for the requirement of good faith efforts. "Contractors cannot simply refuse to consider qualified, competitive DBE subcontractors."¹²⁵

The 1999 rules made major changes to the use of contract goals, in the interest of addressing the "flexibility" issue identified in *Adarand*. As noted earlier, the 10 percent goal in TEA-21 was interpreted by USDOT to be an overall national "aspirational" goal, and not a goal for any given contract.

Recipients have broad discretion to choose whether or not to use a goal on any given contract, and if they do choose to use a contract goal, they are free to set it at any level they believe is appropriate for the type and location of the specific work involved....¹²⁶

In addition to providing flexibility to recipients in implementing DBE programs, flexibility is provided for each individual contract in that if a bidder fails to meet any goals established for that contract, it may satisfy the regulatory requirement by showing that it made good faith efforts to do so. Examples of what might constitute good faith efforts are listed in Appendix A to the 1999 rule. These include (1) soliciting the interest of DBEs through all "reasonable and available means," such as attendance at pre-bid conferences and advertising; (2) selecting portions of the work that may be subcontracted to DBEs, breaking out contract items

¹¹⁵ 64 Fed. Reg. at 5100-01 (1999).

¹¹⁶ 64 Fed. Reg. at 5102-03.

¹¹⁷ 64 Fed. Reg. at 5097.

¹¹⁸ 64 Fed. Reg. at 5102.

¹¹⁹ 64 Fed. Reg. at 5112.

¹²⁰ 49 C.F.R. § 26.29 (2000).

¹²¹ 64 Fed. Reg. at 5112.

¹²² 49 C.F.R. § 26.53(b) (2000).

¹²³ 64 Fed. Reg. at 5099-5100.

¹²⁴ *Id.*

¹²⁵ *Id.* at 5100.

¹²⁶ 64 Fed. Reg. at 5102.

into “economically feasible units”; (3) providing interested DBEs with adequate information; (4) negotiating in good faith with interested DBEs; (5) not rejecting DBEs as unqualified without a thorough investigation of their capabilities; (6) making efforts to assist DBEs in obtaining bonds, lines of credit, or insurance; (7) assisting DBEs in obtaining necessary equipment and supplies; and (8) utilizing minority and women’s organizations for recruitment of DBEs.¹²⁷

Any analysis of good faith efforts must be made against this standard, although other factors, positive or negative, can legitimately be considered when included in the bidding specifications. For example, a bidder is not obligated to accept a minority whose price is “unreasonable.”¹²⁸ This means that it is not sufficient that all the lowest subcontract prices were accepted and none were minorities. It must be demonstrated by the bidder that good faith negotiations were conducted with minorities and that their prices were unreasonable.

However, a system that required bidders to subcontract with DBEs regardless of price would likely violate the standards of *Croson* and *Adarand*. In *Monterey Mechanical Co. v. Sacramento Regional Sanitary District*, the California court of appeals found that a local requirement that M/WBE subcontracts could be rejected only for “significant price difference” violated the state statutory standard for evaluating good faith efforts.¹²⁹ By requiring the bidder to accept a much higher priced M/WBE, the local agency effectively required that a bidder preference be accorded M/WBE subcontractors. In addition, the court found that the “negotiation in good faith” requirement only applies where there are interested M/WBEs with whom to negotiate on price. It did not require the bidder to “encourage” or “persuade” M/WBEs to submit subcontractor bids.¹³⁰

Objective standards for judging good faith efforts are difficult to discern from case law. The task imposed on state highway agencies is to analyze all the relevant facts and apply their best judgment. The natural course of action for an agency is to attempt to save a low bid where possible. The agency’s exercise of its discretion will generally be upheld unless a clear abuse of discretion can be proved. The best course of action is to set out all of the standards in the bid specifications and then apply them as uniformly as possible. The *Monterey Mechanical* court did, however, find that it was reasonable to use a comparative approach in evaluating good faith efforts. Although “comparative compliance” is not the standard, it is more reasonable for an agency to more closely scrutinize the efforts of a bidder who comes nowhere near the goal, as opposed to one who closely approaches it.¹³¹

¹²⁷ 64 Fed. Reg. at 5145–56; 49 C.F.R. pt. 26, app. A (2001).

¹²⁸ 48 Fed. Reg. 33441-2, July 21, 1983, preamble commentary.

¹²⁹ 44 Cal. App. 4th 1391, 52 Cal. Rptr. 2d 395 (1996).

¹³⁰ *Id.*, 52 Cal. Rptr. 2d at 406–07.

¹³¹ 52 Cal. Rptr. 2d at 407.

c. Setting Overall Goals

The comments to the final 1999 rule include extensive discussion of how overall goals should be set. USDOT set out a two step process that includes determining a base figure for the overall goal, and then making adjustments to that figure to account for conditions affecting the availability of DBEs in a given area.¹³²

5. Compliance with DBE Requirement as Element of Responsiveness or Responsibility

Whether a contractor has met DBE goals is usually treated as a bid responsiveness issue rather than as a lack of bidder responsibility. A failure to include a DBE plan with the bid is a material deviation and renders the bid nonresponsive.¹³³ The Minnesota court held that this was not an omission that could be corrected by the bidder after bid opening. “Whether or not other bidders would be prejudiced by subsequential insertion, the government’s broad policy objective [of minority participation] may be prejudiced by the omission.”¹³⁴

The 1999 revision to the FHWA DBE rules allows recipients to consider compliance with DBE requirements as a matter of either responsibility or responsiveness. Although there were arguments to be made for one or the other, USDOT took the position that recipients should be allowed to exercise their discretion in how to treat this issue.¹³⁵

a. Substitutions

Where the state chooses to treat compliance as a matter of responsiveness, bidders occasionally have problems if they include a subcontractor DBE who turns out not to have been certified in time for bid submission. Several cases have considered whether such bidders may substitute a certified DBE after bid opening but prior to award. Although these cases address AAPs decided prior to *Adarand* and the 1999 USDOT rules, the analysis regarding responsiveness is still valid.

In *Regional Scaffolding & Hoisting Co. v. City of Philadelphia*, the low bidder was not permitted to substitute for an uncertifiable MBE.¹³⁶ The specifications required that the listed MBE be certified before the time of award to be counted toward the goal. It also provided that failure to submit a completed schedule of MBE/WBE participation or request for waiver with the proposal would result in rejection of the bid as nonresponsive. In addition, the listing of a minority or female

¹³² 64 Fed. Reg. at 5109–5111.

¹³³ *Bolander & Sons Co. v. City of Minneapolis*, 438 N.W.2d 735, 738 (Minn. App. 1989) *review granted, aff’d*, 451 N.W.2d 204 (1990).

¹³⁴ *Id.* at 738 (quoting *Northeast Constr. Co. v. Romney*, 485 F.2d 752, 759 (D.C. Cir. 1973)).

¹³⁵ 64 Fed. Reg. at 5115, 5134 (1999); 49 C.F.R. § 26.53(b)(3) (2000).

¹³⁶ 593 F. Supp. 529 (E.D. Pa. 1984).

constituted a representation that the listed subcontractor was available and capable of completing the work with its own forces.

Two of the low bidder's subcontractors, listed as an MBE and as a WBE, were not certified at the time of bidding and failed to obtain certification in time for the award. The regulations applicable to the program permitted substitutions after award where the subcontractor withdrew from the project. The low bidder here requested the right to substitute before award. This request was denied by the City. The court concluded that the City's consistent "no substitution" policy was not arbitrary or capricious.¹³⁷

However, where compliance was treated as a matter of responsibility, the court allowed substitution even after award. In *Holman Erection Co. v. Orville E. Madson & Sons, Inc.*, the Supreme Court of Minnesota held that the prime contractor's listing of a nonminority subcontractor in its winning bid did not result in a binding subcontract, and that the contractor was free to use a different subcontractor to fulfill its MBE obligations.¹³⁸

b. Submission of Supplemental AAP Information After Bid Opening

Where the state considers compliance to be an element of responsiveness, failure to submit the required MBE information as specified will result in a nonresponsive bid, provided that the requirement in the bid specifications is unambiguous and valid. In *James Luterbach Const. Co. v. Adamkus*, the specifications directed bidders to supply certain information regarding their efforts to comply with a 10 percent MBE goal, and warned that failure to submit that information "may" cause rejection of the bid as nonresponsive.¹³⁹ The low bid was rejected as being nonresponsive because it had set out "0" minority participation, even though the bidder had offered supplemental information saying that the "0" was inadvertent and that the 10 percent goal would be met. The bidder appealed the Village's determination to the EPA regional administrator, who concluded that the Village had acted improperly in rejecting the low bid. The court upheld EPA's ruling, finding that the use of "may" in the specifications failed to make MBE compliance an element of responsiveness.¹⁴⁰

In *Noel J. Brunell & Son, Inc. v. Town of Champlain*, the low bidder failed to complete its bid documents by filling in its MBE participation to achieve the 10 percent goal.¹⁴¹ The Town refused to award on the basis that it was an incomplete, nonresponsive bid. The con-

tractor contended the information was not required because the specifications stated that within 5 days the low bidder would be notified to supply detailed information regarding each MBE to be employed on the project. The court held in favor of the bidder, as the specifications were considered to treat MBE participation as an element of responsibility rather than responsiveness.

There are concerns about considering efforts made after bid opening to secure the award, as opposed to good faith efforts expended before bid opening in preparation of the bid. One of these is that if a bidder is not required to secure minority commitments in advance of bid preparation, the low bidder is provided with the option of "bid shopping" for DBE subcontractors to meet the goal or be disqualified for the award as it chooses. Another is that this practice tends to lead to negotiations between the low bidder and the agency over what further efforts and participation will be accepted as a condition for award.

Another concern of public agencies is that subsequent submittals of information can provide the low bidder with an option for the award. By withholding the documentation the bid becomes nonresponsive, or the bidder not responsible, providing an escape from the proposal should the bidder so choose, and giving that bidder an advantage over other bidders. WSDOT has made such an action subject to a bond forfeiture:

Failure to return the insurance certification and bond with the signed contract as required in Section 1-03.3, or failure to provide Disadvantaged, Minority or Women's Business Enterprise information if required in the contract, or failure or refusal to sign the contract shall result in forfeiture of the proposal bond or deposit of this bidder. If this should occur, the Contracting Agency may then award the contract to the second lowest responsible bidder or reject all remaining bids. If the second lowest responsible bidder fails to return the required documents as stated above within the time provided after award, the contract may then be awarded successively in a like manner to the remaining lowest responsible bidders until the above requirements are met or the remaining proposals are rejected.¹⁴²

In a Washington State case, *Land Const. Co. v. Snohomish County*, the court held that the bidder could not substitute a certified WBE after bid opening where it would provide the bidder with a substantial advantage over other bidders.¹⁴³ The specifications required each bidder to list only certified MBE and WBE subcontractors. The low bid was rejected because the WBE listed was not on the WSDOT list of certified WBEs and no substitution was permitted.

The court recognized that the awarding authority could waive an irregularity if it was not material. "The test of whether a variance is material is whether it

¹³⁷ *Id.* at 536. It was probably significant that the city rejected all bids rather than award to the next bidder, whose price was considered unreasonable.

¹³⁸ 330 N.W.2d 693 (Minn. 1983).

¹³⁹ 577 F. Supp. 869 (E.D. Wis. 1984).

¹⁴⁰ *Id.* at 871.

¹⁴¹ 95 Misc. 2d 320, 407 N.Y.S.2d 396 (App. 1979), *aff'd*, 64 A.D. 2d 757, 408 N.Y.S.2d 447 (1978).

¹⁴² Washington State Department of Transportation, Standard Specifications for Road, Highway, and Bridge Construction, § 1-03.5 (2002) (available on WSDOT's Web site, www.wsdot.wa.gov).

¹⁴³ 40 Wash. App. 480, 698 P.2d 1120 (1985).

gives a bidder a substantial advantage or benefit not enjoyed by other bidders.”¹⁴⁴ The conclusion was that allowing substitution would be a material variation in bidding and that the bid was not responsive:

Land Construction would enjoy a “substantial advantage” over other bidders if permitted to submit the low bid with a non-certified WBE and then substitute a certified WBE after the bids are opened in that it could refuse to make such a substitution if it discovered that its bid was too low. Because it is the acceptance, not the tender, of a bid for public work which constitutes a contract Land Construction would have no obligation to perform under a bid containing a non-certified WBE. Before its bid is accepted, Land Construction could not be compelled to substitute a certified WBE. Snohomish County could not accept this low bid until it contained a certified WBE. If Land was permitted to make this substitution after the bids are opened, control over the award of public work contracts would pass from the municipality involved to the low bidder.¹⁴⁵

Although commenters on the proposed rule advocated that the rule should state whether compliance was a responsibility or responsiveness matter, USDOT concluded that agencies should retain this discretion. This was also in keeping with the fact that agencies deal with responsibility differently—some have extensive prequalification requirements, under which only prequalified bidders are allowed to bid. Others, particularly smaller agencies, deal with responsibility through postqualification measures, in which only the low bidder must submit evidence of responsibility.¹⁴⁶ For these agencies, addressing DBE compliance as part of a responsibility determination is more cost effective. Commenters pointed out that requiring that DBE compliance be an element of responsiveness serves to deter bid-shopping.¹⁴⁷ However, agencies retain the ability to require that even though documentation might be submitted only after the low bidder has been identified, it must have been prepared and commitments obtained prior to bid opening.

The importance of the distinction goes mainly to questions of due process and necessity for a hearing before rejecting a bid or bidder. Generally, if a low responsive bidder is determined not to be responsible, it is entitled to a hearing before the agency. However, a bid may be rejected as nonresponsive without providing a hearing to the bidder. This too is addressed in the 1999 regulations. If a bidder’s good faith efforts are questioned, an opportunity for administrative reconsideration must be provided, regardless of whether the agency has treated the issue as an element of responsibility or of responsiveness.¹⁴⁸ The bidder must be af-

forded the opportunity to provide written documentation and meet with an agency representative on whether it either met the DBE goal or made good faith efforts. The agency must assign a different individual to evaluate the bidder’s request than whoever made the initial determination.¹⁴⁹ The agency’s subsequent determination is final and not appealable to USDOT.¹⁵⁰

6. Certifications and Appeals

In 1987, Congress required the Secretary of Transportation to establish minimum uniform criteria for DBE certifications:

The Secretary shall establish minimum uniform criteria for State governments to use in certifying whether a concern qualifies for purposes of this subsection. Such minimum uniform criteria shall include but not be limited to on-site visits, personal interviews, licenses, analysis of stock ownership, listing of equipment, analysis of bonding capacity, listing of work completed, resumes of principal owners, financial capacity, and type of work preferred.¹⁵¹

Amendments to the DOT regulations were filed to implement the changes.¹⁵² USDOT determined that it was already administering uniform standards for certification and added only a requirement that recipients compile and update their DBE/WBE directories annually.¹⁵³

a. The Certification Process

Certification of DBEs and WBEs is a state function subject to review by USDOT on appeals taken by applicants who are denied certification or by third parties challenging a certification. The state must certify that the applicant is (1) a small business entity, (2) owned, and (3) controlled by, (4) an economically, and (5) socially disadvantaged person.¹⁵⁴

Each word in this definition is critical. First, the applicant is a “concern” or “entity,” which may be a corporation, partnership, or sole proprietorship. This entity, as opposed to the qualifying individual or individuals, must be a “small business concern” as defined in Section 3 of the Small Business Act and as implemented in the SBA regulations.¹⁵⁵ Currently this means that the business concern or entity seeking certification has gross receipts of not more than \$16.6 million as an average for the prior 3 years, but the Secretary has

¹⁴⁴ 698 P.2d at 1122 (quoting *Duffy v. Village of Princeton*, 240 Minn. 9, 60 N.W.2d 27, 29 (1953)).

¹⁴⁵ *Id.* (citation omitted).

¹⁴⁶ See Section Two for a discussion of prequalification and postqualification.

¹⁴⁷ 64 Fed. Reg. at 5115.

¹⁴⁸ 49 C.F.R. § 26.53(d) (2000).

¹⁴⁹ 49 C.F.R. § 26.53(d)(2) (2000).

¹⁵⁰ 49 C.F.R. § 26.53(d)(5) (2000).

¹⁵¹ Pub. L. No. 100-17 § 106(c)(4). This same language was included in TEA-21. Pub. L. No. 105-178, tit. I, subtit. A. § 1101(b)(4).

¹⁵² 52 Fed. Reg. 39225-39231 (Oct. 21, 1987).

¹⁵³ 49 C.F.R. pt. 26, subpt. C, § 26.45 (f)(1) (Oct. 21, 1987).

¹⁵⁴ 49 C.F.R. pt. 26, subpt. D (2000); 49 C.F.R. § 26.67(a)(2)(i)(iii) (personal net worth criteria for qualification of individual).

¹⁵⁵ See 5 U.S.C. § 632(a)(2001).

authority to adjust this amount for inflation.¹⁵⁶ Different figures and formulas apply as to certain specialty firms and manufacturers.¹⁵⁷

Next, the entity must be owned and controlled by a qualifying disadvantaged individual or individuals.¹⁵⁸ Ownership means that 51 percent or more of the business must be owned by eligible individuals, and control means that the eligible business owners themselves control and direct the firm's management and daily business operations.¹⁵⁹ These appear as straightforward propositions, but in closely held or family-owned business arrangements it may be difficult to distinguish between actual conditions and appearances.

i. Ownership.—In order to meet the requirement for ownership, the minority's or woman's interest must encompass the risks and benefits that normally accompany ownership of a business. If the interest does not include those risks and benefits, then it may be inadequate to establish minority or woman ownership.

In *American Combustion, Inc. v. Minority Business Opportunity Commission*, ACI had been certified as an MBE under the District of Columbia's Minority Contracting Act.¹⁶⁰ ACI submitted the lowest bid on a mechanical construction contract, bidding in joint venture with a nonminority firm. However, ACI's certification had expired and it was given an opportunity to reapply. Another bidder protested ACI's minority status. Following a hearing by the Commission, the reapplication was denied. Stock in ACI was supposedly owned by two minorities and three whites, with controlling ownership held by the minorities. The hearing revealed that the stock ownership of the black owners was actually in the form of "options," because the stock was purchased with little or nothing down and the balance was to be paid from bonuses and profits with no risk of financial loss to the minorities. Thus, it was concluded that no bona fide transfer of ownership had taken place, and the court refused to enjoin award of the contract to the second bidder or to reinstate ACI's certification.¹⁶¹

In another case, *Agricultural Land Services v. State*, the female co-owner's personal loans to the company, which constituted 60 percent of its assets, were not considered capital investments under the 1987 rule.¹⁶² The disadvantaged owner's contribution must be an actual investment of capital and not a loan.

¹⁵⁶ 49 C.F.R. § 26.65(b) (2000).

¹⁵⁷ See 13 C.F.R. pt. 121 regarding determinations of business size.

¹⁵⁸ See *Lane Constr. Corp. v. Hennessy*, 98 Misc. 2d 500, 414 N.Y.S.2d 268 (App. 1979) (firm with a majority of its stock owned by women sought to compel the state transportation commission to place its name on the MBE/WBE registry; in denying the application the court held that majority ownership alone was not sufficient).

¹⁵⁹ 49 C.F.R. §§ 26.69, 26.71 (2000).

¹⁶⁰ 441 A.2d 660 (D.C. App. 1982).

¹⁶¹ *Id.* at 668.

¹⁶² 715 So. 2d 297 (Fla. App. 1998).

USDOT rules address this issue in stating that capital contributions of the minority owner must be "real and substantial."¹⁶³ Examples of insufficient contributions include "a promise to contribute capital, [or] an unsecured note payable to the firm or an owner who is not a disadvantaged individual..."¹⁶⁴

ii. Control of Business.—State law will determine the legality of particular business arrangements. For example, if a qualifying minority owns controlling interest in a close corporation, but control is in a four-person board of directors, a majority of three is required for corporate action. Therefore, the minority is not in control. However, if state law permits a by-law amendment delegating total control to the minority owner with controlling interest, the requirement would be satisfied if that individual actually is in control.

Agricultural Land Services also addressed the issue of when a business is family-owned and is owned and operated by both disadvantaged and nondisadvantaged individuals. Such a business cannot be presumed to be controlled or owned by the disadvantaged individual, even if the members jointly handle business responsibilities and decision-making.¹⁶⁵ The firm must describe how the disadvantaged owner exercises majority control.

The USDOT rules specifically address situations when a woman business owner has acquired the business due to the death of her husband or in a divorce settlement. In these cases, the assets are considered to be "unquestionably hers."¹⁶⁶ However, if a woman owner acquires the business as a gift, then the business is presumed not to be held by a socially and economically disadvantaged individual.¹⁶⁷ To overcome this presumption, the owner must prove by clear and convincing evidence that the transfer was not made for the purpose of obtaining DBE certification and that the disadvantaged individual actually controls the "management, policy, and operations of the firm."¹⁶⁸

A District of Columbia case, *Jack Wood Constr. Co. v. United States Dept. of Transp.*, prompted USDOT to more clearly explain what is meant by "control" of the firm.¹⁶⁹ In that case, the court had overturned a USDOT decision denying DBE certification based on the woman owner's lack of control of the business. Mr. and Mrs. Wood were joint owners of the company. The business had been certified as a DBE after the owner transferred some of his shares to his daughter, making it more than 51 percent female owned. Mrs. Wood had always been involved in the company's bidding and decision-making, but Mr. Wood provided the technical expertise. After

¹⁶³ 49 C.F.R. § 26.69(e) (2000).

¹⁶⁴ *Id.*

¹⁶⁵ 715 So. 2d at 298.

¹⁶⁶ 64 Fed. Reg. at 5118 (comment to 49 C.F.R. § 26.69(g)(2)).

¹⁶⁷ 49 C.F.R. § 26.69(h) (2000).

¹⁶⁸ *Id.*

¹⁶⁹ 12 F. Supp. 2d 25 (D.D.C. 1998).

Mr. Wood's death, Mrs. Wood inherited his shares in the company, with the remaining shares still being owned by their daughter. Mrs. Wood then relied on another male employee for technical expertise in bid preparation, but retained the decision-making authority on what jobs to bid and the amount of the company's bid.

After certifying the company as a DBE for 14 years, the Arkansas Highway and Transportation Department determined that the company did not qualify as a DBE because Mrs. Wood, even though she was president of the company, did not meet the federal standard for control of the firm.¹⁷⁰ Rather, the agency found that a male employee "controlled" the company as he had the technical expertise and that Mrs. Wood lacked the background and ability "to independently control the operations of [the] business" under the federal regulation.¹⁷¹

The district court held this to be an abuse of discretion.¹⁷² The agency had relied on a regulation that applies to "owners" of firms, and because the male employee relied on by Mrs. Wood was not an owner, that rule did not apply. The court also held that technical expertise alone was not enough to determine who has control.¹⁷³ USDOT had always had a policy of requiring that a DBE owner "must have an overall understanding of, and managerial or technical competence and experience directly related to the type of business in which the business is engaged."¹⁷⁴ The court interpreted this policy as requiring that the owner have technical *or* managerial competence, but not both. Mrs. Wood clearly had managerial competence, having been involved in all corporate decision-making for 30 years, including what jobs to bid and at what price, and equipment acquisition. Her reliance on an employee to handle technical aspects of bid preparation was no different than what was done in other companies.

USDOT clarified its rule in 1999 to address this issue. The most significant change with regard to the *Wood* case is the change from "technical *or* managerial competence" to "technical *and* managerial competence."¹⁷⁵ At the same time, the rule acknowledges that technical tasks may be delegated, or that others may be relied on for some technical expertise:

The socially and economically disadvantaged owners are not required to have experience or expertise in every critical area of the firm's operations, or to have greater experience or expertise in a given field than managers or key employees. The socially and economically disadvantaged owners must have the ability to intelligently and critically evaluate information presented by other participants in the firm's activities and to use this information to make independent decisions concerning the firm's daily operations, management, and policymaking. Gen-

erally, expertise limited to office management, administration, or bookkeeping functions unrelated to the principal business activities of the firm is insufficient to demonstrate control.¹⁷⁶

Whether Mrs. Wood would have qualified as a DBE under this regulation is unclear from the opinion. However, clearly there was a difference of opinion between USDOT and the court as to whether she did even under the previous rule. The new rule was intended to prevent a woman from claiming that she controls a business where her role in running the business has been limited to managerial and accounting functions, rather than actual construction-related work.

iii. *Uniform Certification Program.*—No Interstate reciprocity requirement exists that obligates one state to honor certifications of another state. USDOT has had a concern that a reciprocity requirement would lead to "forum shopping" by ineligible businesses.¹⁷⁷ However, the 1999 rule requires that states set up a Unified Certification Program (UCP) within each state by March 2002, with the goal being a system of "one-stop shopping" for certification with all recipients within a given state.¹⁷⁸ The rule also allows two or more states to form regional UCPs, and allows UCPs to enter into written reciprocity agreements with other states or other UCPs.¹⁷⁹

b. *Determining Social and Economic Disadvantage*

The individual or individuals qualifying the business as a DBE must be both socially and economically disadvantaged. Certain defined minorities are rebuttably presumed to be socially and economically disadvantaged, including African Americans, Hispanic Americans, Native Americans, Asian-Pacific Americans, and Asian-Indian Americans.¹⁸⁰ In addition, other minorities or individuals found to be disadvantaged by the SBA under Section 8(a) of the Small Business Act are included. The states must accept and cannot challenge an 8(a) certification except through SBA.¹⁸¹

Apart from 8(a) certifications, the specified minorities are not presumed to be economically and socially disadvantaged. For example, a wealthy minority would not be economically disadvantaged, as he or she would not meet the requirements for limits on personal net worth.¹⁸² Likewise, the qualifying individual must actually be a member of one of the defined minority groups to establish social disadvantage. The rules set out a

¹⁷⁶ *Id.*

¹⁷⁷ 64 Fed. Reg. at 5122.

¹⁷⁸ 49 C.F.R. pt. 26, subpt. E § 26.81 *et. seq.* (2000); *see also* CalTrans Web site for a description of its Uniform Certification program and application, www.dot.ca.gov (Doing Business with CalTrans, Civil Rights Program).

¹⁷⁹ 49 C.F.R. § 26.81(e) (2000).

¹⁸⁰ 49 C.F.R. § 26.5 (2001).

¹⁸¹ 49 C.F.R. § 26.67 (2000).

¹⁸² 49 C.F.R. § 26.67 sets this limit at \$750,000, excluding the assets of the firm being certified.

¹⁷⁰ *Id.* at 27 (citing 49 C.F.R. § 23.53(a)(3)–(4) (1987)).

¹⁷¹ *Id.* at 28 (quoting 49 C.F.R. § 23.53(a)(2)–(3) (1987)).

¹⁷² *Id.* at 28.

¹⁷³ *Id.* at 29.

¹⁷⁴ *Id.*

¹⁷⁵ 49 C.F.R. § 26.71(g) (2000).

standard for evaluating whether one is actually part of a minority group, including “whether the person has held himself out to be a member of the group over a long period of time” and “whether the person is regarded as a member of the group by the relevant community.”¹⁸³

As to eligible minorities who are presumptively disadvantaged, the states are not burdened with the obligation of inquiring into the actual social and economic situation to make determinations for every firm seeking certification. Disadvantaged status is presumed. However, if a third party challenges this status the state must follow the challenge procedures and make a determination from the facts presented by all sides.¹⁸⁴

The states are authorized to make individual determinations of social and economic disadvantage regarding individuals who are not part of a presumptive group. Appendix E to 49 C.F.R. Part 26 provides guidance and standards for making social and economic disadvantage determinations. Three elements must be shown to support a finding of social disadvantage: (1) social disadvantage arising from color, national origin, gender, physical handicap, or long-term isolation from mainstream American society; (2) demonstration that the individual personally suffered substantial and chronic disadvantage in American society and not in other countries; and (3) demonstration that the disadvantage must have negatively affected the individual’s entry into or advancement in the business community. Evidence of social disadvantage to establish these points can include denial of equal access to employment opportunities, credit or capital, or educational opportunities, including entry into business or professional schools.

Economically disadvantaged individuals are usually socially disadvantaged as well because of their limited capital and credit opportunities. Therefore, the guidelines direct that a determination first be made as to social disadvantage based on factors other than economic considerations. If social disadvantage is found in accordance with the described elements, an economic determination is made.¹⁸⁵

c. Certification Denials, Challenges, and Appeals

The regulations provide that a denial of certification must be in writing.¹⁸⁶ The recipient is expected to establish a time period of no more than 12 months that the firm must wait to reapply.¹⁸⁷

The applicant may appeal a denial of certification to USDOT.¹⁸⁸ Only USDOT has jurisdiction to consider

such a denial of certification by a recipient agency.¹⁸⁹ Any firm that believes that it was wrongfully denied certification must file its appeal with USDOT within 90 days after denial of certification unless the time period is extended by USDOT for good cause.¹⁹⁰ USDOT is required to make its decision based on the recipient’s administrative record; it does not conduct a de novo review and does not hold a hearing. USDOT will affirm the recipient’s decision unless it is not supported by substantial evidence in view of the entire administrative record, or unless it is inconsistent with the regulations regarding certification.¹⁹¹

If a recipient is considering removing a firm’s DBE status, it must hold an informal hearing and give the firm an opportunity to respond to the agency’s reasons for removing its eligibility.¹⁹² The agency must maintain a complete record of the hearing; this facilitates USDOT’s review on the administrative record. The agency’s decision to remove a firm’s eligibility must be made by separate agency personnel from those who originally sought to remove the firm’s certification.¹⁹³

7. Counting DBE Participation

The comment to the rules notes:

In a narrowly tailored program, it is important that DBE credit be awarded only for work actually being performed by DBEs themselves. The necessary implication of this principle is that when a DBE prime contractor or subcontractor subcontracts work to another firm, the work counts toward DBE goals only if the other firm is itself a DBE....¹⁹⁴

Under the former regulations, if the prime contractor was a DBE, then the entire contract counted as 100 percent DBE participation. Under the 1999 rules, the DBE prime contract counts only to the extent that the DBE does the work itself or subcontracts with DBE subcontractors. Along the same lines, the rule requires that DBE bidders meet the same contract goals or good faith efforts required of non-DBE bidders.¹⁹⁵ Section 26.55 addresses in detail what types of work, equipment rental, and purchase of materials count toward the DBE goal.¹⁹⁶

If a DBE joint ventures with a non-DBE, only the portion of the work that the DBE joint venturer per-

¹⁸⁹ *Mabin Constr. Co. v. Missouri Highway and Transp. Comm’n*, 974 S.W.2d 561 (Mo. App. 1998) (state court lacked subject matter jurisdiction to consider state agency’s denial of DBE certification, because regulations required that appeal be made to USDOT, whose decision was reviewable only by the federal courts).

¹⁹⁰ 49 C.F.R. § 26.89(c) (2000).

¹⁹¹ 49 C.F.R. § 26.89(e) (2001).

¹⁹² 49 C.F.R. § 26.87(d) (2000).

¹⁹³ 49 C.F.R. § 26.89(e) (2000).

¹⁹⁴ 64 Fed. Reg. at 5115.

¹⁹⁵ 64 Fed. Reg. at 5115.

¹⁹⁶ 49 C.F.R. § 26.55 (2000).

¹⁸³ 49 C.F.R. § 26.63 (2000).

¹⁸⁴ 49 C.F.R. § 26.87 (2000).

¹⁸⁵ 49 C.F.R. pt. 26, app. E.

¹⁸⁶ 49 C.F.R. § 26.85(a) (2000).

¹⁸⁷ 49 C.F.R. § 26.85(b) (2000).

¹⁸⁸ 49 C.F.R. §§ 26.85(c), 26.87 (2000).

forms with its own forces may be counted toward the DBE goal.¹⁹⁷

a. The Captive DBE and the Mentor-Protege Program

One of the most difficult areas of enforcement for state highway agencies has been the “captive” DBE. A prime contractor may aid, assist, or encourage a female or minority member of the contracting firm to establish another contracting business in order to take on subcontracting work for the prime contractor. Usually the individual has gained competence and experience in the prime contractor’s business and is assured of future continuing business from the mentor. Characteristically these new firms become closely identified with the prime contractor. Equipment, workers, and even working capital may be supplied by the prime contractor, and the prime may own a financial interest in the fledgling firm.

FHWA has recognized that these arrangements can be beneficial to the program to bring new minorities and women into the mainstream of construction contracting. This assumes that they are not used as fronts but are permitted to grow in independence as they gain business experience to supplement their technical competence. FHWA included guidelines for the mentor-protege program in the 1999 rules. It permits established firms to assist fledgling firms in providing specialized assistance to satisfy a mutually beneficial special need.¹⁹⁸

Only firms that have already been certified as DBEs are eligible to participate in a mentor-protege program. This is intended to prevent the use of “captive” proteges that are set up by contractors to help them in meeting DBE goals.¹⁹⁹ The mentor and the protege must enter into a written development plan to be approved by the state highway agency. The protege firm must remain responsible for management of the new firm, and the two firms must remain separate and independent business entities. The development plan must be of limited duration and contain developmental benchmarks that the protege should achieve at successive stages of the plan. This is to permit proper monitoring of the development of the DBE firm to be certain that progress is being achieved toward a goal of independence.

The mentor-protege program is not intended to be a substitute for the DBE program. The 1999 rule requires that a mentor may count only one-half of the work done by a protege firm toward its DBE goal.²⁰⁰

b. “Commercially Useful Function”

A particular concern regarding counting DBE participation involves the application of the requirement that each DBE subcontractor perform a “commercially use-

ful function.”²⁰¹ The rules define the performance of a commercially useful function as follows:

A DBE performs a commercially useful function when it is responsible for execution of the work of the contract and is carrying out its responsibilities by actually performing, managing, and supervising the work involved...To determine whether a DBE is performing a commercially useful function, you must evaluate the amount of work subcontracted, industry practices, whether the amount the firm is to be paid under the contract is commensurate with the work it is actually performing and the DBE credit claimed for its performance of the work and other relevant factors.²⁰²

In addition, FHWA has suggested additional elements that a state agency may use to determine whether the DBE subcontractor is performing a commercially useful function. These include (1) the DBE’s management of the work; (2) whether the DBE is using its own work force; (3) whether it rents or leases equipment, or owns its own equipment; and (4) whether it is using its own materials.²⁰³

c. Monitoring Contract Compliance

Contract compliance involves monitoring each project to be certain that the contractor continues with its good faith efforts to achieve the contract goals. The monitoring and enforcement requirements of the 1999 rules are intended to verify that the work committed to DBEs at contract award is actually performed by them.²⁰⁴

As part of the recipient’s DBE program, the recipient must require that the prime contractor not terminate a DBE subcontractor for convenience and then perform the work with its own forces.²⁰⁵ Further, when a DBE subcontractor is terminated for default or fails to complete its work for any reason, the prime contractor is required to make good faith efforts to find another DBE to substitute for the terminated DBE.²⁰⁶ The same actions cited as good faith efforts in preparing a bid should also be required for substitution. Substitution is required for at least the same amount of work on the contract, but it need not be for exactly the same item of work.

The rules do not provide for specific enforcement mechanisms, stating only that recipients must implement appropriate mechanisms to ensure compliance with the program requirements, “applying legal and contract remedies available under Federal, state and local law.”²⁰⁷ Some organizations and states have advo-

¹⁹⁷ 49 C.F.R. § 26.55(b) (2000).

¹⁹⁸ 49 C.F.R. § 26.35 and pt. 26, app. D (2000).

¹⁹⁹ 64 Fed. Reg. at 5107.

²⁰⁰ 49 C.F.R. § 26.35 (b)(2)(i) (2000).

²⁰¹ 49 C.F.R. § 26.55(c) (2000).

²⁰² 49 C.F.R. § 26.55(c)(1) (2000).

²⁰³ See FHWA Web page entitled “Contract Administration Core Curriculum, Participant’s Manual and Reference Guide 2001, Chapter II B,” found at http://www.fhwa.dot.gov/programadmin/contracts/cor_IIB.htm.

²⁰⁴ 49 C.F.R. § 26.37 (2000).

²⁰⁵ 49 C.F.R. § 26.53(f)(1) (2000).

²⁰⁶ 49 C.F.R. § 26.53(f)(2) (2000).

²⁰⁷ 49 C.F.R. § 26.37(a) (2000).

cated the use of liquidated damage provisions as an enforcement device to ensure goal achievement. This appears to be a convenient and effective means to ensure results, but actually poses problems.²⁰⁸ Liquidated damages have worked well for owners and contractors in controlling timely completion of the work. However, they have not worked well in other areas to compel performance. They may be challenged as unenforceable penalties, except where actual out-of-pocket damages are quantified. Also, a stipulated damage provision in the contract for failure to achieve the goal could be used by a contractor as an invitation to incur the penalty as a cost of doing business, and include its cost in the bid price rather than employ the good faith efforts that were promised.

8. Review of New Regulations Under *Adarand* Standard

The U.S. Supreme Court remanded the *Adarand* case to the district court for a determination of whether the USDOT regulations met the new standard of review that it set out in that case. The federal district court subsequently held that the Subcontractor Compensation Clause (SCC) was unconstitutional as not being narrowly tailored.²⁰⁹ The Tenth Circuit found on review that because the Colorado Department of Transportation had certified *Adarand* as a DBE, its case was moot.²¹⁰ The U.S. Supreme Court vacated that decision and remanded the case to the Tenth Circuit for consideration on the merits.²¹¹

The Tenth Circuit held that while the SCC failed to pass strict scrutiny, the new USDOT regulations were narrowly tailored and were constitutional.²¹² The court noted the standard set out by the Supreme Court, which required that the government prove a compelling interest with evidence of past and present discrimination in federally-funded highway construction.²¹³ The court found adequate evidence in the many studies considered by Congress in its enactment of amendments to the Federal Highway Act.²¹⁴ The government's evidence demonstrated two particular barriers to minority participation in subcontracting: those that created a barrier to the formation of minority-and women-owned

firms, and those that acted as a barrier to participation by DBEs.²¹⁵ The most significant obstacles identified were lack of access to capital and inability to get surety bonds.²¹⁶ The government also presented evidence that "when minority firms are permitted to bid on subcontracts, prime contractors often resist working with them."²¹⁷ The court concluded that the government's evidence established "the kinds of obstacles minority subcontracting businesses face," and that these obstacles are different from those faced by other new businesses.²¹⁸ The court also found evidence of discrimination in disparity studies, and studies of minority business participation after affirmative action programs were discontinued.²¹⁹ The court therefore concluded that there was evidence to support the contention that there was a compelling interest to be served by the DBE requirements.

The court further found that the new USDOT regulations were narrowly tailored to address the compelling interest. The court based this conclusion on the fact that (1) the program relies in large part on race-neutral means of achieving its goals;²²⁰ (2) there are time limits on the duration of the DBE certification program;²²¹ (3) the program is flexible, and includes waiver provisions;²²² (4) the program is numerically proportional to the numbers of available firms, and allows good faith efforts to meet requirements;²²³ (5) there is an acceptable burden on third parties;²²⁴ and (6) the DBE program is neither over- nor under-inclusive in that minority firms above a certain gross income level are ineligible for it.²²⁵

9. Bidder Preferences

Bidder preference statutes were adopted in many states during the Great Depression to preserve job opportunities for state residents. Decades later, many states still give statutory preferences to resident contractors and require hiring of local workers, citing to the same need to provide employment opportunities to state residents. Even where these statutes have stood for years, they may still be challenged on constitutional grounds where they have been more recently amended. In other cases, challengers may argue that economic conditions no longer justify the preference. Challenges have alleged violations of the Commerce Clause, the Privileges and Immunities Clause, and the Equal Protection Clause.

²⁰⁸ See *DiMambro-Northend Assoc. v. Blanck-Alvarez, Ind.*, 251 Ga. 704, 309 S.E.2d 364 (1983).

²⁰⁹ *Adarand Constructors, Inc. v. Pena*, 965 F. Supp. 1556 (D. Colo. 1997).

²¹⁰ *Adarand Constructors, Inc. v. Slater*, 169 F.3d 1292 (10th Cir. 1999).

²¹¹ *Adarand Constructors, Inc. v. Slater*, 528 U.S. 216, 120 S. Ct. 722, 145 L. Ed. 2d 650 (2000).

²¹² *Adarand Constructors, Inc. v. Slater*, 228 F.3d 1147 (10th Cir. 2000). The court noted that by the time of this decision, the SCCs were no longer used by FHWA in its direct federal contracts. *Id.* at 1159 n.4.

²¹³ *Id.* at 1164.

²¹⁴ *Id.* at 1167 (citing "The Compelling Interest for Affirmative Action in Federal Procurement," 61 Fed. Reg. 26,050, 26,051-52 & nn.12-21 (1996)).

²¹⁵ *Id.* at 1167-68.

²¹⁶ *Id.* at 1169.

²¹⁷ *Id.* at 1170 (citing 61 Fed. Reg. at 26, 058-59).

²¹⁸ *Id.* at 1172.

²¹⁹ *Id.* at 1172-75.

²²⁰ *Id.* at 1178-79.

²²¹ *Id.* at 1179.

²²² *Id.* at 1180-81.

²²³ *Id.* at 1181-83.

²²⁴ *Id.* at 1183.

²²⁵ *Id.* at 1183-86.

a. The Commerce Clause

The Commerce Clause prohibits the states from unduly burdening Interstate commerce in their regulatory activity.²²⁶ Generally, a preference statute will not be found to have violated the Commerce Clause if it applies only to actions in which the agency is acting as a market participant rather than as a regulator.

The U.S. Supreme Court upheld a City of Boston preference in *White v. Massachusetts Council of Construction Employers*.²²⁷ The Court stated in that case:

If the city is a market participant, then the Commerce Clause establishes no barrier to conditions such as these which the city demands for its participation. Impact on out-of-state residents figures in the equation only after it is decided that the city is regulating the market rather than participating in it, for only in the former case need it be determined whether any burden on interstate commerce is permitted by the Commerce Clause.²²⁸

In a later case, the Court of Appeals of Wisconsin upheld the Department of Transportation's bid requirement that contractors supplying road salt stockpile the salt at locations within the state, finding that it did not violate the Commerce Clause.²²⁹ Relying on *White*, the court found that the department was not acting as a regulator:

The department is not attempting to control any transactions other than the one in which it is involved: the purchase of road salt for state and municipal use. It is not employing its regulatory powers to dictate who may, or may not, buy or sell road salt in Wisconsin; nor is it requiring that Glacier, or any other businesses, do anything other than have the purchased salt in specified locations at a specified time—hardly an unusual or oppressive provision in a purchase contract. And, as we have said, Glacier is free to contract with other municipalities and counties on its own terms. The department is simply a party to a contract for the purchase of road salt and, when acting as a proprietor, a government shares the same freedom from the Commerce Clause that private parties enjoy.²³⁰

b. The Privileges and Immunities Clause

The Privileges and Immunities Clause prohibits discrimination by a state against citizens of other states, unless noncitizens are a “peculiar source of evil” at which the statute is directed and the remedy is narrowly tailored.²³¹

In *Hicklin v. Orbeck*, the United State Supreme Court struck down a state statute known as the “Alaska

Hire” statute, which contained a residential hiring preference for all employment arising out of oil and gas leases.²³² The Court held that it violated the Privileges and Immunities Clause, because it required private employers to discriminate against nonresidents, and there was no showing that out-of-state hiring was the cause of unemployment in the state. First, the State did not show that the influx of out-of-state workers was the cause of unemployment; rather, lack of adequate education and training and the remoteness of some Alaska residents was more likely the cause.²³³ Second, the remedy was not narrowly tailored in that it gave a preference to all Alaska residents, regardless of their qualifications.²³⁴ Lastly, the discriminatory effect went beyond the area in which the State had a proprietary interest, and applied to private employers as well. The only basis for application of the statute was the state ownership of oil and gas resources.²³⁵

In *United Building and Construction Trades Council v. The Mayor and Council of the City of Camden*, the U.S. Supreme Court held that Camden's AAP discriminated against residents of other states, and thus violated the Privileges and Immunities Clause.²³⁶ The Court stated that a law preferring local workers for public construction projects burdens a fundamental right and is covered by the Privileges and Immunities Clause. However, the Court noted that the clause is not absolute:

[The Privileges and Immunities Clause] does not preclude discrimination against citizens of other States where there is a “substantial reason” for the difference in treatment. “[The] injury in each case must be concerned with whether such reasons do exist and whether the degree of discrimination bears a close relation to them.”...As part of any justification offered for the discriminatory law, nonresidents must somehow be shown to “constitute a peculiar source of the evil at which the statute is aimed.”²³⁷

In *People ex rel. Bernardi v. Leary Construction Co.*, the Illinois Supreme Court used this to create a two-part test to determine when state actions violated rights protected by the Privileges and Immunities Clause.²³⁸ First, the state must identify nonresidents as being a “peculiar source of evil” at which the statute is directed. Second, the discrimination must bear a substantial relationship to the evil that nonresidents present. In a municipal painting contract, the court found that nothing in the record established a relationship between nonresident employment on public works projects and resident unemployment. Accordingly, nonresident laborers could not be considered a “peculiar

²²⁶ U.S. CONST. ART. I § 8, cl. 3; *Huron Portland Cement Co. v. City of Detroit*, 362 U.S. 440, 80 S. Ct. 813, 4 L. Ed. 2d 852 (1960).

²²⁷ 460 U.S. 204, 103 S. Ct. 1042, 75 L. Ed. 2d 201 (1983).

²²⁸ *Id.* at 210.

²²⁹ *Glacier State Distribution Services, Inc. v. Wis. Dep't of Transp.*, 221 Wis. 2d 359, 585 N.W.2d 652, 658 (1998).

²³⁰ *Id.*, 585 N.W.2d at 658–59 (citations omitted).

²³¹ CONST. ART. IV § 2, cl. 1; *Toomer v. Witsell*, 334 U.S. 385 68 S. Ct. 1156, 92 L. Ed. 1460 (1948).

²³² 437 U.S. 518, 98 S. Ct. 2482, 57 L. Ed. 2d 397 (1978).

²³³ *Id.* at 526–27.

²³⁴ *Id.* at 527.

²³⁵ *Id.* at 530–31.

²³⁶ 465 U.S. 208, 104 S. Ct. 1020, 79 L. Ed. 2d 249 (1984).

²³⁷ 465 U.S. at 222 (citations omitted).

²³⁸ 80 Ill. Dec. 36, 102 Ill. 2d 295, 464 N.E.2d 1019 (1984).

source” of the evil of unemployment, and so there was not a sufficient reason to interfere with the right of a citizen to cross state lines to work.²³⁹

Applying this standard, the Wyoming Supreme Court in *State v. Antonich* ruled that the State’s Preference for State Laborers Act did not violate the Privileges and Immunities Clause of the United States Constitution.²⁴⁰ This statute required contractors to employ available Wyoming laborers for public works projects in preference to nonresident workers, with provision for certification by the State employment office if local resident employees possessing the necessary skills are not available. Analyzing the *City of Camden* and the “Alaska Hire” case, the court concluded that the preference did in fact discriminate against nonresidents regarding a fundamental right. At the same time it viewed the statute as narrowly tailored to address a valid state goal of ensuring employment of its citizens, stating that it “precisely fits the particular evil identified by the State.”²⁴¹ First, the statute’s applicability was limited only to qualified state residents. Contractors were required to contact local employment offices for qualified workers, and if none were available could hire from out of state. Second, it applied in the State’s proprietary role in carrying out government-funded projects. Third, it specifically addressed unemployment in the construction industry.²⁴²

c. The Equal Protection Clause

When challenged under the Equal Protection Clause of the Fourteenth Amendment, a bidder preference statute must pass only minimal scrutiny as economic legislation. While the right of an individual to employment is considered a fundamental right, the right of a company to bid on public works is not.²⁴³

A bidding preference statute was upheld against an equal protection challenge in *Equitable Shipyards v. Washington State Department of Transportation*.²⁴⁴ In considering bids for new state ferries, the WSDOT was authorized by statute to add a 6 percent “penalty” to the bids of out-of-state shipbuilding companies when determining the lowest responsible bidder. When this action was challenged by the otherwise low bidder as being arbitrary and capricious, and thus unconstitutional, the court found that a reasonable basis existed for the preference that was sufficient to withstand constitutional attack. The court’s inquiry involved a three-part test: “(1) Does the classification apply alike to all members of the designated class? (2) Does some basis

²³⁹ *Id.* at 1022.

²⁴⁰ 694 P.2d 60 (Wyo. 1985).

²⁴¹ *Id.* at 63.

²⁴² *Id.*

²⁴³ Note that the Privileges and Immunities Clause applies to “citizens,” while the Equal Protection Clause applies to “persons.” Thus while a corporation may allege a violation of Equal Protection as a “person,” it is not a “citizen” with rights under the Privileges and Immunities Clause.

²⁴⁴ 93 Wash. 2d 465, 611 P.2d 396 (1980).

in reality exist for reasonably distinguishing between those within and without the designated class? (3) Does the classification have a rational relation to the purpose of the challenged statute?”²⁴⁵

The court noted that ferry construction was exempt from the state sales tax and that lost revenues from the tax exemption would be partially offset if the shipbuilding occurred in Washington, because the work would generate secondary economic activity. The court also pointed out that construction out-of-state would increase the state’s administrative costs for inspecting the work, and that there was a greater potential for delay.²⁴⁶ The court concluded: “We are convinced that a rational relation exists between the purposes of RCW 47.60.670 and its classifications of in-state and out-of-state shipbuilding firms.”²⁴⁷

The Alaska Supreme Court found a regional preference law that benefited residents of economically distressed zones to be unconstitutional under the state constitution’s equal protection clause.²⁴⁸ Acknowledging that the Alaska Constitution’s equal protection clause provides greater protection than its federal equivalent, the court determined that “the right to engage in an economic endeavor within a particular industry is an ‘important’ right for state equal protection purposes.”²⁴⁹ It applied this standard to the regional preference statute, holding that the statute would be scrutinized “closely.”²⁵⁰ The court concluded that the statute essentially benefited one class of workers over another. “We conclude that the disparate treatment of unemployed workers in one region in order to confer an economic benefit on similarly-situated workers in another region is not a legitimate legislative goal.”²⁵¹

d. Payment of State and Local Taxes as Basis for Preference

The Arizona Supreme Court found unconstitutional a bid preference statute that granted a preference to contractors who had paid state taxes for 2 consecutive years.²⁵² The court found that the statute did not further any constitutionally permissible state interest in preventing unemployment, or in benefiting contractors who contributed to the state’s public funds or the state’s economy. The statute did not even require that the contractor have an office or any presence within the state, only that it have paid state taxes for the previous 2 years.²⁵³ It did not require or even encourage contrac-

²⁴⁵ *Id.*

²⁴⁶ 611 P.2d at 404 (citations omitted).

²⁴⁷ *Id.* (citations omitted).

²⁴⁸ *State, by and Through Dep’ts of Transp. and Labor v. Enserch Alaska Constr., Inc.*, 787 P.2d 624 (Alaska 1989).

²⁴⁹ *Id.* at 632.

²⁵⁰ *Id.* at 633.

²⁵¹ *Id.* at 634.

²⁵² *Big D Constr. Corp. v. Court of Appeals for State of Ariz.*, Division One, 163 Ariz. 560, 789 P.2d 1061 (1990).

²⁵³ *Id.* at 1069.

tors to hire state residents. Thus, the court found that the statute created a burden and not a benefit.²⁵⁴ The court noted the statute's Depression origins, but found that it had been altered to no longer suit its original purpose. One of the original purposes of the statute had been to benefit "resident" contractors, and that requirement had been removed by amendment.²⁵⁵

In contrast, the Nevada Supreme Court found a very similar statute constitutional.²⁵⁶ In that case, the preference statute required that bidders have paid state taxes for 60 successive months counting back from submission of their bids. The court found that the statute created a preference for contractors who had a "permanent and continuing presence" in the state, which benefited residents and the state economy and fostered warranty work.²⁵⁷ The goal of the statute was in fact to have the contractor establish a presence in the state, and not just to have contributed to the state's tax revenues. The statute had recently been amended to extend the time period from 2 to 5 years, in order to "demonstrate a presence here even more convincingly."²⁵⁸

e. Federally Funded Projects

State laws providing for preferential treatment of local contractors in bidding or preferential hiring of local labor or suppliers in performance of a public construction contract may not be used in federally-funded work. Under statutory authority to approve methods of bidding used in federally-funded contracts,²⁵⁹ the Secretary of Transportation and Federal Highway Administrator have promulgated regulations requiring the bidding procedure to be nondiscriminatory.²⁶⁰ They have further required that the selection of labor to be employed by a contractor shall be of its own choosing.²⁶¹ Prohibition of discriminatory hiring practices is provided in the Required Contract Provisions for Federal-Aid Contracts.²⁶²

f. Contract Requirements

Even where there is an adequate justification for the use of a bidder preference, the standards under which the preference will be applied must be established prior to bidding and must be set out in the bid documents. The Ohio Supreme Court addressed this problem in *City of Dayton, ex rel. Scandrick v. McGee*, a case in

which the agency was found to have abused its discretion in the use of bidder preferences:

The evil here is not necessarily that "resident" bidders are preferred but that there are absolutely no guidelines or established standards for deciding by how "many percentages" a bid may exceed the lowest bid and yet still qualify as the "lowest and best bid." Absent such standards, the bidding process becomes an uncharted desert, without landmarks or guideposts, and subject to a city official's shifting definition of what constitutes "many percentages...."²⁶³

B. LABOR STANDARDS

The Secretary of Transportation and the Federal Highway Administrator are responsible for requiring that the states' contracting officers require compliance with federal labor standards in federal-aid highway construction contracts and subcontracts.²⁶⁴ Failure of a contractor or subcontractor to comply with federal labor standards may constitute a violation of federal law directly by the contractor, and also a violation by the state highway agency of the federal statutes or regulations prescribing the terms on which federal funds are used.

In addition to a violation of federal law, the failure to enforce these labor standards also may place the contractor-employer in an unfair competitive advantage with regard to the unsuccessful bidders, and denies to the employees the benefits of federal labor standards. Similarly, enforcement of the standards beyond their proper scope may infringe on the contractor's rights both under the law and the contract.

1. Minimum Wage Standards

Federal regulations governing minimum wages that are applicable to federally-funded highway projects include the Davis-Bacon Act, which mandates payment of prevailing wages, and the Contract Work Hours and Safety Standards Act, which requires payment of minimum wages and adherence to a 40-hour work week.

a. Application of the Davis-Bacon Act to Federal-Aid Highway Projects

The basic federal legislation dealing with wage standards for public construction contracts is the Davis-Bacon Act, enacted in 1931.²⁶⁵ It requires that federal public works contracts provide for minimum wage rates and payment of laborers and mechanics according to the prevailing rates in the area where the work is per-

²⁵⁴ *Id.*

²⁵⁵ *Id.* at 1070 (although a rational basis for the privileges granted by the statute may have existed at the time it was enacted in 1933, it has ceased to exist).

²⁵⁶ *City of Las Vegas v. Kitchell Contractors, Inc.*, 768 F. Supp. 742 (D. Nev. 1991).

²⁵⁷ *Id.* at 745.

²⁵⁸ *Id.* at 746.

²⁵⁹ 23 U.S.C. § 112(a).

²⁶⁰ 23 C.F.R. § 635.107(e).

²⁶¹ 23 C.F.R. § 635.124(b), Claim Awards & Settlements; FHWA LABOR COMPLIANCE MANUAL, §§ 208-2, 508-3, app. C-9.

²⁶² 23 C.F.R. § 633.207.

²⁶³ 67 Ohio St. 2d 356, 423 N.E.2d 1095, 1097 (1981).

²⁶⁴ Portions of this article are derived from *Labor Standards in Federal-Aid Highway Construction Contracts*, by Ross D. Netherton, published by Transportation Research Board and included in SELECTED STUDIES IN HIGHWAY LAW, vol. 3, p. 1295.

²⁶⁵ 40 U.S.C. §§ 276a-276a-7 now codified at 40 U.S.C. §§ 3141-3144 (2003).

formed.²⁶⁶ The dual purposes of the Davis-Bacon Act are to give local laborers and contractors a fair opportunity to participate in building programs when federal money is involved, and to protect local wage standards by preventing contractors from basing bids on wages lower than those prevailing in the area.²⁶⁷

The Act also deals with related matters, including payment of fringe benefits,²⁶⁸ withholding of contract funds from the contractor to assure compliance with the wage standards,²⁶⁹ and termination of contracts because of failure to pay wages according to predetermined rates.²⁷⁰ Additional incentives for compliance are supplied by provisions for direct payment of restitution wages to employees by the Comptroller General of the United States from retained funds under the contract, and disqualification of violators of the law from bidding on future federal contracts.²⁷¹

The Davis Bacon Act applies to all federal-aid construction contracts that exceed \$2,000 and to all related subcontracts on federal-aid highways; it does not apply to projects on roadways classified as local roads or rural minor collectors.²⁷² Application of Davis-Bacon to the federal-aid highway program is set out in 23 U.S.C. § 113 (a):

The Secretary shall take such action as may be necessary to insure that all laborers and mechanics employed by contractors or subcontractors on the construction work performed on highway projects on the Federal-aid highways authorized under the highway laws providing for the expenditure of Federal funds upon the Federal-aid systems, shall be paid wages at rates not less than those prevailing on the same type of work on similar construction in the immediate locality as determined by the Secretary of Labor in accordance with the Act of March 3, 1931, known as the Davis-Bacon Act (40 U.S.C. 276a).²⁷³

²⁶⁶ 40 U.S.C. § 3142(b) (2003).

²⁶⁷ *L.P. Cavett Co. v. United States Dep't of Labor*, 101 F.3d 1111, 1113 (6th Cir. 1996).

²⁶⁸ 40 U.S.C. § 3141(2)(B) (2002).

²⁶⁹ 40 U.S.C. § 3142(c)(3) (2003).

²⁷⁰ 40 U.S.C. § 3143 (2003).

²⁷¹ 40 U.S.C. § 3144 (2003).

²⁷² See FHWA CONTRACT ADMINISTRATION CORE CURRICULUM MANUAL (hereinafter CACC Manual), § II.A.4, Payment of Predetermined Minimum Wage (2001) (available on FHWA Web site, www.fhwa.dot.gov, Contract Administration Group page).

²⁷³ 23 U.S.C. § 113 (2002). For legislative history of the application of Davis Bacon to highway projects, see Appalachian Regional Act of 1965, as amended, 40 U.S.C. App. § 402, for inclusion of federal labor standards in construction contracts for projects on the Appalachian Development Highway System and local access roads; 102 CONG. REC. 9156-9171 (Senate debate in which excerpts from letters from 29 state highway departments were introduced as evidence of how the Davis-Bacon Act would affect highway construction); HOUSE COMM. ON PUBLIC WORKS, FEDERAL HIGHWAY AND HIGHWAY REVENUE ACTS OF 1956, H.R. REP. NO. 2022, 84th Cong., 2d Sess., 12-13, 25-32 (1956); 41 Op. Att'y Gen. 488 (1960).

Because the state highway agency, or local unit of government working in cooperation with the state highway agency, is the contracting agency for federal-aid highway construction, it has the primary responsibility for assuring contractor notification of and compliance with the predetermined prevailing wage rates. In the performance of these responsibilities, several specific steps must be taken by the contracting agency, which include assuring that (1) requests for determination of prevailing wage rates are submitted when required; (2) applicable wage rates and labor standards clauses are incorporated into all contract specifications, and in all contracts and subcontracts; (3) wage rate determinations are posted conspicuously at the jobsite; (4) laborers and mechanics are paid weekly at rates not less than those prescribed for the classes of work that they actually perform; (5) jobs are correctly classified in accordance with standards and procedures of the Department of Labor; and (6) failures on the part of contractors or subcontractors to comply with requirements of either the contract or the law are corrected or adjudicated.²⁷⁴

b. Determination of Prevailing Wage Rates

The “prevailing wage” for a specific classification is the wage paid to the majority of those employed in that classification in the area where the proposed work is to be done.²⁷⁵ If a single rate cannot be identified for the majority of those in the classification, the Secretary is directed to use an average of the wages paid, weighted by the total employed in the classification.²⁷⁶

The authority to predetermine wage rates is given by statute to the Secretary of Labor, but it actually is exercised by the Administrator, Wage and Hour Division, Employment Standards Administration.²⁷⁷ The Administrator carries on a continuing program to compile data and to encourage voluntary submission of wage rate data by contractors, contractor associations, labor organizations, public officials, and other interested parties.²⁷⁸ In determining a prevailing wage rate, however, the regulations require that the Administrator insure accuracy by giving preference to data that reflect actual conditions in the labor market. Thus the regulations prescribe that wage rates will be determined by reference to (1) statements showing wage rates on specific projects, identifying contractors, locations, costs, dates, types of work, and the like; (2) signed collective bargaining agreements; (3) wage rate determinations for public construction by state and local officials pursuant to state prevailing wage laws; and (4) information fur-

²⁷⁴ 29 C.F.R. § 5.5(a); 29 C.F.R. § 5.5(a)(7), 5.5(b)(2) (2001); see also CACC Manual, § II.4, *supra* note 272.

²⁷⁵ 29 C.F.R. § 1.2(a)(1) (2001).

²⁷⁶ 29 C.F.R. § 1.2(a)(1) (2001).

²⁷⁷ 29 C.F.R. § 1.1(a) (2001).

²⁷⁸ 29 C.F.R. § 1.3 (2001).

nished by state transportation agencies in consultation with the Administrator.²⁷⁹

All agencies using wage determination must furnish the Wage and Hour Division annual outlines of their proposed construction programs, indicating estimated number of projects for which determinations will be needed.²⁸⁰

The prevailing wage as paid in the “locality” requires that the wage be calculated based on the average rate paid to workers in the county in which the work is performed, not at a particular plant.²⁸¹ Where the employees perform more unusual work, the rate must be based on that paid to other workers for the same or similar work, even if they are considered to be in different classifications. For example, where the rate was being determined for shipyard boilermakers, it was not adequate to look only at what shipyard boilermakers were being paid. Where their work was of the same type and similar in nature to that of pipefitters in the construction industry, the wages paid to pipefitters had to be considered in determining the prevailing wage.²⁸²

The Davis Bacon Act requires the Secretary of Labor to set wage rates for the various classifications of work.²⁸³ With respect to job classifications for highway work, § 113 of Title 23 U.S.C. sets out further requirements:

In carrying out the duties of subsection (a) of this section, the Secretary of Labor shall consult with the highway department of the State in which a project on any of the Federal-aid systems is to be performed. After giving due regard to the information thus obtained, he shall make a predetermination of the minimum wages to be paid laborers and mechanics in accordance with the provisions of subsection (a) of this section which shall be set out in each project advertisement for bids and in each bid proposal form and shall be made a part of the contract covering the project.²⁸⁴

Because of the nature of the federal-aid highway program and other programs providing federal funds administered by state or local agencies, it is possible for transportation construction contracts to provide that wage rates must comply with both the federal standards in the Davis-Bacon Act and with state standards. The two sets of standards may differ in their language or interpretations such that employers are obligated to pay higher rates under one than under the other. In these instances, courts have taken the position that these minimum wage rates are to be treated as a floor, but not as a ceiling.²⁸⁵ FHWA will approve state rates

that are higher than the federal rates, recognizing the states’ abilities to establish their own rates under state law.²⁸⁶

i. Requests for Wage Rate Determinations.—There are two processes for obtaining wage determinations from the Department of Labor. Both are initiated with a request from the federal agency that is required to comply with the Davis Bacon Act.

A federal agency may request that the Secretary make a general wage determination for particular types of construction work in particular areas, when wages are well-settled and there is likely to be a significant amount of construction in that area.²⁸⁷ Notices of wage rate determinations are published in the Federal Register. Davis Bacon wage rates are now available on the Department of Labor’s Web site at www.access.gpo.gov/davisbacon.²⁸⁸

For determinations on one or more classifications for which there is not a general wage determination, the federal agency may submit a request form to the Department of Labor requesting a determination. The agency must provide a detailed description of the work, indicating the type of construction involved, and must provide any pertinent wage information.²⁸⁹

ii. Legal Effects of Wage Rate Determinations and Changes to Determinations.—After prevailing wage rates for job classifications in the area of a construction project are determined, the contracting agency is responsible for seeing that they are inserted in the project advertisement and in the construction contract.²⁹⁰

Once the Secretary of Labor has made a wage rate determination, its correctness is not subject to judicial review.²⁹¹ It may, however, be challenged in administrative review proceedings. First, an interested party may ask the Administrator for reconsideration, in which case it must provide the Administrator with argument or data to support its position.²⁹² If the Administrator denies reconsideration, the interested party may appeal the determination to the Administrative Review Board.²⁹³ An “interested person” includes a contractor, subcontractor, or contractor association who is likely to seek work under a contract with the wage determination; a laborer, mechanic, or labor union likely to seek employment under such a contract; or a federal, state, or local agency concerned with administration of such a contract.²⁹⁴

and holding that the higher of either the federal or state would prevail).

²⁷⁹ 29 C.F.R. § 1.3(b) (2001).

²⁸⁰ 29 C.F.R. § 1.4 (2001).

²⁸¹ *Lockheed Shipbuilding Co. v. Department of Labor and Indus.*, 56 Wash. App. 421, 783 P.2d 1119 (Wash. App. 1989), *review denied*, 791 P.2d 535, 114 Wash. 2d 1018 (1989).

²⁸² *Id.*, 783 P.2d at 1124.

²⁸³ 40 U.S.C. § 3142(b) (2003).

²⁸⁴ 23 U.S.C. § 113(b) (2001).

²⁸⁵ *See Ritchie Paving, Inc. v. Kansas Dep’t of Transp.*, 232 Kan. 346, 654 P.2d 440 (1982) (applying KAN. STAT. § 44-201,

²⁸⁶ *See CACC Manual, supra note 272*, at section II.A.4.

²⁸⁷ 29 C.F.R. § 1.5(b) (2001).

²⁸⁸ CACC Manual, *supra note 272*.

²⁸⁹ 29 C.F.R. § 1.5(a) (2001).

²⁹⁰ 29 C.F.R. § 1.6(b) (2001).

²⁹¹ *Nello L. Teer Co. v. United States*, 348 F.2d 533, 539–40, 172 Ct. Cl. 255 (Ct. Cl. 1965).

²⁹² 29 C.F.R. § 1.8 (2001).

²⁹³ 29 C.F.R. § 1.9; 29 C.F.R. pt. 7 (2001).

²⁹⁴ 29 C.F.R. § 7.2 (b) (2001).

A request for review will not interfere with the contract advertisement or award schedule. The Board will “under no circumstances” request postponement of contract action because of the filing of a petition.²⁹⁵

The transportation agency is required to incorporate the published applicable wage determinations in federal aid contracts.²⁹⁶ An addendum must be circulated if notice of an amendment of a general wage determination is published in the Federal Register 10 days or more prior to bid opening.²⁹⁷

c. Fringe Benefit Provisions of the Davis-Bacon Act

The Davis-Bacon Act requires that the prevailing wage rate determined for federal and federally-assisted construction include not only the basic hourly rate of pay, but also all amounts contributed by the contractor or subcontractor for certain fringe benefits.²⁹⁸ The statute is specific regarding the items included in this component of the wage rate.

[F]or medical or hospital care, pensions on retirement or death, compensation for injuries or illness resulting from occupational activity, or insurance to provide any of the foregoing, for unemployment benefits, life insurance, disability and sickness insurance, or accident insurance, for vacation and holiday pay, for defraying costs of apprenticeship or other similar programs, or for other bona fide fringe benefits, but only where the contractor or subcontractor is not required by other federal, state, or local law to provide any of those benefits, the amount of —

(A) the rate of contribution irrevocably made by a contractor or subcontractor to a trustee or to a third person under a fund, plan or program; and

(B) the rate of costs to the contractor or subcontractor that may be reasonably anticipated in providing benefits to laborers and mechanics pursuant to an enforceable commitment to carry out a financially responsible plan or program which was communicated in writing to the laborers and mechanics affected.²⁹⁹

The Davis-Bacon Act is open-ended in its coverage of these benefits. By providing for determinations regarding “other bona fide fringe benefits,” it contemplates that the Secretary may recognize new fringe benefits as they come into general use and prevalence in an area.

Whether such benefits are provided through conventional insurance programs or trusts, they must be based on voluntary commitments to the employee-beneficiaries rather than an obligation imposed by federal, state, or local law. Accordingly, funds to pay for health benefits, pensions, vacations, and apprenticeship programs are distinguishable from payments made by an employer for workmen’s compensation insurance under compulsory or elective state laws.³⁰⁰

²⁹⁵ 29 C.F.R. § 7.4(b) (2001).

²⁹⁶ CACC Manual, *supra* note 272.

²⁹⁷ *Id.*; 29 C.F.R. § 1.6(c)(2)(i)(A) (2001).

²⁹⁸ 40 U.S.C. § 3141 (2003).

²⁹⁹ 40 U.S.C. § 3141(2)(B) (2003).

³⁰⁰ *Id.*

Under this section, the Secretary is required to make separate findings as to the rates of contribution or costs of fringe benefits to which employees may be entitled.³⁰¹ Ordinarily this is an hourly rate; however, it may be expressed as a formula or a method of payment that can be converted into an hourly rate.³⁰² Whatever form is used to describe an employer’s contribution, it must show that the contribution is made irrevocably to a trustee or third party not affiliated with the employer.³⁰³ The trust or fund into which the contribution is made must be set up in such a way that the contractor-employer can in no way recapture any of the funds for itself, or have the funds diverted to its benefit.³⁰⁴

Determination of contribution rates is facilitated when a regularly established fund, plan, or program is involved.³⁰⁵ However, a contractor or subcontractor may, through an enforceable commitment, undertake to carry out a financially responsible plan or program for the benefit of its employees.³⁰⁶ Since this plan or program is financed from general assets of the employer, it is called an “unfunded plan,” and the determination is directed to the cost reasonably to be anticipated in providing the benefits. In addition to showing its actuarial soundness, an unfunded plan must meet four basic criteria, namely: (1) it must be reasonably expected to provide the benefits described in the Davis-Bacon Act; (2) it must represent a legally enforceable commitment; (3) it must be carried out under a financially responsible program; and, (4) it must have been communicated in writing to the employees affected.³⁰⁷ In addition to these criteria, and as a further safeguard against the possible use of “unfunded plans” to avoid compliance with the law, the Secretary is authorized to direct a contractor-employer to set aside in a separate account sufficient funds to meet future obligations under the plan.³⁰⁸

The District of Columbia Circuit considered the adequacy of a fringe benefit plan under the Davis-Bacon Act in *Tom Mistick & Sons, Inc. v. Reich*.³⁰⁹ The contractor had made contributions to an employee benefit plan in an amount that constituted the difference between the prevailing wages paid in the locality and the actual cash wages paid to each employee. This was challenged as not being a “bona fide fringe benefit plan” under Davis-Bacon.³¹⁰

The court noted that under Davis-Bacon, the employer’s obligation may be met either solely by payment

³⁰¹ 29 C.F.R. § 5.25 (2001).

³⁰² 29 C.F.R. § 5.25(b) (2001).

³⁰³ 29 C.F.R. § 5.26 (2001).

³⁰⁴ *Id.*

³⁰⁵ 29 C.F.R. § 5.27 (2001).

³⁰⁶ 29 C.F.R. § 5.28 (2001).

³⁰⁷ 40 U.S.C. § 3141(2)(B)(ii) (2003); 29 C.F.R. § 5.28(b) (2001).

³⁰⁸ 29 C.F.R. § 5.28(c) (2001).

³⁰⁹ 312 U.S. App. D.C. 67, 54 F.3d 900 (D.C. Cir. 1995).

³¹⁰ *Id.*, 54 F.3d at 902; 40 U.S.C. § 3141(2)(B)(ii) (2003).

of cash wages in the prevailing amount, or by a combination of cash wages and irrevocable contributions to an employee fringe benefit plan or program.³¹¹ In *Mistick*, contributions to a fringe benefit plan were made for the contractor's employees for all work covered by Davis-Bacon, and were irrevocable. The funds were placed in individual employee interest-bearing trust accounts managed by a neutral trustee. The cost of administering the accounts was not deducted from the accounts. Only the trustee, at the request of the employee, could make withdrawals from the accounts. Upon termination of their employment, the employees received the balance in the accounts.³¹²

The Labor Department requires that "the amount contributed by an employer must bear a reasonable relationship to the actual rate of costs or contributions required to provide benefits for the employee in question."³¹³ The Administrator of the Wage and Hour Division of the Department of Labor determined that the plan was not bona fide because (1) contributions were greater than and not reasonably related to the costs of benefits, and (2) disbursements had been made for expenses not recognized as fringe benefits under Davis-Bacon. The court then found that the plan did in fact pass the "reasonable relationship" test.³¹⁴ The Labor Department had taken the position that it was insufficient that the employee would eventually receive the proceeds of the benefit fund, but rather argued that the employee was entitled to receive the prevailing wage at the time the work was performed. However, Davis-Bacon specifically allows use of the fringe benefit plan in conjunction with the cash wage, which necessarily implies that the employee will not get all payment due at the time of the work. *Mistick's* plan was essentially a pension plan with added benefits such as medical and disability insurance and vacation and sick leave, and was thus more generous than most employee fringe benefit plans.³¹⁵ The court thus found that even though contributions were greater than those required only for the insurance benefits, the plan actually benefited the employees.

i. Whether Plans Are Preempted by ERISA.—The Ninth Circuit found that California's prevailing wage law was not preempted by the Employee Retirement Income Security Act of 1974 (ERISA), even though it "referred to" ERISA plans.³¹⁶ The state statute measured the "prevailing wage" as the prevailing cash wage plus the prevailing benefits contribution by employers in a given locality. The statute referred to the benefits plans, which are ERISA plans, but the court found that the statute did not "refer to" them in enough detail to warrant ERISA preemption. Fringe benefit costs were calculated without regard to whether they were contributions to ERISA plans, and the employers' obligations to pay prevailing wages did not depend on the existence of an ERISA plan. The law did not impose any additional burden on an ERISA plan, nor did it require an employer to take any action regarding those plans.

d. Classification of Laborers and Mechanics

Proper classification of laborers and mechanics is considered a key factor in successful accomplishment of the goals of the Davis-Bacon Act.³¹⁷ This involves categorizing laborers and mechanics according to the work they actually perform, in terms of the comprehensive classification nomenclature adopted by the Secretary of Labor. Construction contract specifications are prepared with this in mind, and the states' standard specifications for highway construction furnish detailed descriptions of the work from which job descriptions can be developed. Traditionally, construction work has been performed by recognized craft classifications—carpenters, surveyors, truck drivers, electricians, heavy equipment operators—for which the regular duties are standardized. Where this situation exists, and the practices of the construction industry and labor organizations agree on correlation of duties and classifications, the craft classifications provide a reliable initial index for classifying work on highway projects. Another well-regarded test for job classification is the employee's use of the "tools of a trade."³¹⁸

No single system of classification has succeeded in listing and assigning distinctive definitions to all construction job classifications. Therefore, differences may arise between the duties actually performed by a worker, his or her payroll designation, and the classification for which the contracting officer has requested a wage rate determination. Incomplete or improper classification may result in over- or under-payment of wages, wage disputes, and possible violation of contract terms. Accordingly, doubtful classifications should be clarified to the greatest possible extent, and contracting officers should minimize the chances for disputes by seeking agreement of all parties concerned with wage

³¹¹ *Id.*, 54 F.3d at 902.

³¹² *Id.*

³¹³ *Id.* at 903.

³¹⁴ *Id.* at 902.

³¹⁵ *Id.* at 904.

³¹⁶ *WSB Elec., Inc. v. Curry*, 88 F.3d 788 (9th Cir. 1996), cert. denied, 519 U.S. 1109, 117 S. Ct. 945 (1997).

³¹⁷ CACC Manual, *supra* note 272.

³¹⁸ *See*, 29 C.F.R. § 5.2(m) (2001).

rate determinations before they are incorporated into project announcements or contracts.

e. "Site of the Work"

Another issue that has been considered is whether workers whose jobs are mainly located away from the construction site should be covered. The statutory provision refers to "mechanics and laborers employed directly on the site of the work."³¹⁹

The regulations define "site of the work" as "[T]he physical place or places where the building or work called for in the contract will remain; and any other site where a significant portion of the building or work is constructed, *provided* that such site is established specifically for the performance of the contract or project;..."³²⁰

The definition may include such facilities as batch plants or borrow pits, provided that they are dedicated exclusively, or nearly exclusively, to the project or contract, and also provided that they are adjacent or virtually adjacent to the site of the work defined in § 5.2(l).³²¹ The "site of the work" does not include home offices, fabrication plants, or other facilities whose location and operation are not determined by the particular contract or project.³²²

The District of Columbia Circuit interpreted that language as not including workers employed at borrow pits and batch plants located about 2 miles away from the project, and overruled a contrary interpretation by the Secretary of Labor.³²³ The Sixth Circuit later relied on this decision in *L.P. Cavett Co. v. United States Department of Labor*, where it concluded that truck drivers who drove over 3 miles from a batch plant at a quarry to the job site were not considered "mechanics and laborers employed directly on the site of the work."³²⁴ The court found that the quoted language was not ambiguous, and that it means "only employees working directly on the physical site of the public work under construction."³²⁵ The court also noted that expanding the geographic proximity in the manner being advocated by the Labor Department would create a problem with determining which off-site workers are closely enough "related" to the project to be covered by the statute.

Further, the Sixth Circuit held that the Davis-Bacon language was not modified by the Federal-Aid Highway Act, which does not contain the "site of the work" language, but which refers specifically to the Davis-Bacon

³¹⁹ 40 U.S.C. § 3142(c)(1) (2003).

³²⁰ 29 C.F.R. § 5.2(l)(1) (2001).

³²¹ 29 C.F.R. § 5.2(l)(2) (2001).

³²² 29 C.F.R. § 5.2(l)(3) (2001); *see also* CACC Manual, *supra* note 272.

³²³ *Ball, Ball, & Brosamer, Inc. v. Reich*, 24 F.3d 1447 (D.C. Cir. 1994).

³²⁴ 101 F.3d 1111, 1115 (6th Cir. 1996).

³²⁵ *Id.*

Act.³²⁶ The current rules defining "site of the work" were adopted in response to this decision.

f. Use of Apprenticeship Programs

Apprentices and trainees are included within the definition of "laborers and mechanics" in the regulations.³²⁷ However, amendments to the Davis-Bacon Act allow apprentices and trainees to be paid a lower wage provided that they are enrolled in approved programs.

Apprenticeship programs are considered necessary to the effective administration of a prevailing wage program. It is essential to any apprenticeship program that an employer be allowed to pay apprentices a lower wage than what it pays fully trained and qualified journeyman employees.³²⁸ The Davis-Bacon Act and state equivalent statutes allow payment of reduced wages to apprentices so long as the employer uses an apprenticeship program that meets the standard issued under the National Apprenticeship Act, known as the Fitzgerald Act.³²⁹ The Department of Labor determines the adequacy of apprenticeship programs through its Bureau of Apprenticeship and Training.³³⁰ States may apply similar standards to their own apprenticeship programs.³³¹ Although public works contractors are not required to use apprentices, they are allowed to, and if they do they may pay the reduced apprentice wage only to those apprentices in approved programs.³³²

In addition, there is an exemption for those apprentices and trainees employed in equal opportunity employment programs: "The provisions of the section shall not be applicable to employment pursuant to apprenticeship and skill training programs which have been certified by the Secretary of Transportation as promoting equal employment opportunity in connection with Federal-aid highway construction programs."³³³

³²⁶ *Id.* at 1116; 23 U.S.C. § 113(a).

³²⁷ 29 C.F.R. § 5.2(m) (2001).

³²⁸ *Minnesota Chapter of Associated Builders and Contractors, Inc. v. Minnesota Dep't of Labor and Indus.*, 47 F.3d 975, 981 (8th Cir. 1995), *reh'g denied*.

³²⁹ 29 U.S.C. § 50 (1999) authorizes the Secretary of Labor to:

Formulate and promote the furtherance of labor standards necessary to safeguard the welfare of apprentices, to extend the application of such standards by encouraging the inclusion thereof in contracts of apprenticeship to bring together employers and labor for the formulation of programs of apprenticeship, to cooperate with State agencies engaged in the formulation and promotion of standards of apprenticeship....

³³⁰ *See generally* 29 C.F.R. pt. 29 (1999) for standards and procedures regarding federal approval of apprenticeship programs.

³³¹ *See California Division of Labor Standards Enforcement v. Dillingham Constr., N.A., Inc.*, 519 U.S. 316, 117 S. Ct. 832, 835, 136 L. Ed. 2d 791 (1997).

³³² *Id.*

³³³ 23 U.S.C. § 113(c) (2001).

The implications of this exception were considered in *Siuslaw Concrete Construction Company v. State of Washington, Department of Transportation*.³³⁴ The contractor argued that the state department of transportation could not require the contractor to pay wages higher than those required by federal regulations. However, the court found that there was insufficient evidence of congressional intent to occupy the field of minimum wages in order to support a finding of preemption.

i. Relationship of Apprenticeship Programs to ERISA.—Since the enactment of ERISA, these programs have been challenged in a number of states as being preempted by ERISA. The purpose of ERISA is to promote the interests of employees and their beneficiaries in employee benefit plans.³³⁵ It also serves to protect employers by eliminating the threat of conflicting or inconsistent state and local regulation of employee benefit plans.³³⁶ To this end, ERISA includes a preemption clause.³³⁷ However, it is not intended to preempt areas of traditional state regulation.³³⁸

Issues arose among courts as to whether the states' requirements for apprenticeship programs were preempted by ERISA.³³⁹ An apprenticeship program that is a joint effort of management and labor, or a "joint apprenticeship committee," is an "employee welfare benefit plan" as defined in ERISA. The problem has been to determine what the state may regulate with respect to apprenticeship programs without encountering the ERISA preemption. Unlike other issues that have been raised with respect to ERISA, such as use of project labor agreements by contracting agencies, the apprenticeship program is considered part of the state's regulatory role rather than its role as a construction project owner.

In *Dillingham Construction, N.A. v. County of Sonoma*, the Ninth Circuit held that a program that required state approval of apprenticeship programs before contractors could pay reduced wages conflicted with ERISA and was therefore preempted by it.³⁴⁰ The court found that the program, which required state approval of what the court considered an employee benefit

plan under ERISA, "related to" an employee benefit plan and was therefore preempted. Following that decision, the Ninth Circuit came to the same conclusion regarding the State of Washington's apprenticeship program.³⁴¹

In a similar case, the Eighth Circuit held that Minnesota's apprenticeship program was not preempted by ERISA.³⁴² The only difference in that state program appeared to be that the State of Minnesota program allowed approval of the apprenticeship program by either the state or the federal government. However, the court stated more broadly that the purpose of ERISA in protecting employee benefit plans was not hindered by the state's regulation of wages and labor in state-funded construction. Rather, this was within the scope of the state's traditional police power, which Congress did not intend to preempt with ERISA.³⁴³

The United States Supreme Court took the opportunity to resolve this issue in its review of the Ninth Circuit's decision in *Dillingham Construction*.³⁴⁴ Reversing the Ninth Circuit, the Court held that California's prevailing wage law, specifically its apprenticeship program requirements, did not "relate to" employee benefit plans, and thus was not preempted by ERISA.

The Court stated that a state law "relates to" a covered employee benefit plan if it "has a connection with" or if it "references" such a plan.³⁴⁵ Because the range of apprenticeship programs that were eligible for state approval was broader than just those that arguably qualified as ERISA plans (joint apprenticeship committee plans), the law did not make "reference to" an ERISA plan.³⁴⁶

The Court then considered whether the apprenticeship program "had a connection to" ERISA plans. Given that both the federal government and the states regulated apprenticeship programs prior to ERISA, the Court concluded that Congress expected those programs to continue after ERISA's enactment. The Court noted that: "The wages to be paid on public works projects and the substantive standards to be applied to apprenticeship training programs are, however, quite remote from the areas with which ERISA is expressly

³³⁴ 784 F.2d 952 (9th Cir. 1986).

³³⁵ *WSB Elec., Inc. v. Curry*, 88 F.3d 788, 791 (9th Cir. 1996) *cert. denied*, 117 S. Ct. 945 (1997) (quoting *Shaw v. Delta Air Lines, Inc.*, 463 U.S. 85, 90, 103 S. Ct. 2890, 77 L. Ed. 2d 490 (1983)).

³³⁶ *Id.* at 791 (quoting *Shaw*, 463 U.S. at 99).

³³⁷ ERISA, § 514(a); 29 U.S.C. § 1144(a).

³³⁸ *WSB*, 88 F.3d at 791 (citing *Metropolitan Life Ins. Co. v. Mass.*, 471 U.S. 724, 740, 105 S. Ct. 2380, 85 L. Ed. 2d 728 (1985)).

³³⁹ See *Inland Empire Chapter of Associated General Contractors v. Dear*, 77 F.3d 296 (9th Cir. 1996) (Washington apprenticeship program preempted by ERISA); *Minnesota Chapter of Associated Builders and Contractors, Inc. v. Minn. Dep't of Labor and Indus.*, 47 F.3d 975 (8th Cir. 1995), *reh'g denied* (Minn. apprenticeship program not preempted by ERISA).

³⁴⁰ 57 F.3d 712 (9th Cir. 1995).

³⁴¹ *Inland Empire Chapter of Associated General Contractors v. Dear*, 77 F.3d 296 (9th Cir. 1996).

³⁴² *Minn. Chapter of Associated Builders and Contractors, Inc. v. Minn. Dep't of Labor and Indus.*, 47 F.3d 975 (8th Cir. 1995), *reh'g denied*.

³⁴³ *Id.* at 979.

³⁴⁴ *Dillingham*, *supra* note 331.

³⁴⁵ *Id.*, 117 S. Ct. at 837.

³⁴⁶ *Id.* at 838. In contrast, the Court had found that a prevailing wage statute was preempted where it expressly referred to an ERISA-covered plan, in which the obligation imposed on the employer was measured by reference to the level of benefit provided by that employer under an ERISA plan. *District of Columbia v. Greater Washington Board of Trade*, 506 U.S. 125, 128, 132, 113 S. Ct. 580, 121 L. Ed. 2d 513 (1992).

concerned—reporting, disclosure, fiduciary responsibility, and the like.”³⁴⁷

Thus the Court refused to find that ERISA preempted the prevailing wage law and apprenticeship standards, which it found to be part of an “area of traditional state regulation.”³⁴⁸

ii. Consistency with Competitive Bidding.—Other apprenticeship programs have been challenged as being inconsistent with the requirements of competitive bidding. In *Associated Builders and Contractors v. City of Rochester*, the court struck down an apprenticeship program “precondition,” in which the successful bidder had to agree to participate in the state program.³⁴⁹ The requirement in effect created a bidder preference for those bidders whose employees participated in a state-approved apprenticeship program. The court found that this precondition was not linked to the interests embodied in the competitive bidding statutes. An applicable state statute required that the City utilize competitive bidding.³⁵⁰ The municipal ordinance that established the apprenticeship program preference was found to be inconsistent with competitive bidding statute, and there was not specific statutory authorization for it. The court pointed out that the main purpose of the competitive bidding law was the protection of the public fisc. The requirement for apprenticeship training, while a desirable goal, was not intended to affect the qualification of an otherwise responsible low bidder.

2. Hours and Conditions of Work

Federal legislation prescribing standards for hours of work and conditions of the work environment is contained in the Fair Labor Standards Act of 1938 (FLSA)³⁵¹ and the Contract Work Hours and Safety Standards Act of 1962.³⁵² Both prescribe a standard workweek of 40 hours. Compensation for work in excess of these levels is specified as not less than one and one-half times the basic rate of pay.³⁵³ The Contract Work Hours and Safety Standards Act also provides that employers shall not require their employees to work in surroundings or work conditions that are unsanitary, hazardous, or dangerous to their health or safety, as determined by regulations of the Secretary of Labor.³⁵⁴

The language of the FLSA is directed to “persons engaged in commerce, or in the production of goods for commerce.”³⁵⁵ The Contract Work Hours and Safety Standards Act applies to construction projects to which

the United States is a party, or which are done on behalf of the United States, or which are wholly or partially financed by grants or loans given or guaranteed by the United States.³⁵⁶ In the case of federal-aid highway construction projects, the application of the federal law’s wage and hour standards is achieved by reading 40 U.S.C. §§ 328 and 329 together. Section 328(b) provides that the 40-hour workweek “shall be a condition of every contract of the character specified in section 329...and of any obligation of the United States...in connection therewith.” Section 329, in turn, extends the standards to contracts “financed in whole or in part by loans or grants from...the United States or any agency or instrumentality thereof under any statute of the United States providing wage standards for such work....”

Requirements for adherence to the 40-hour workweek have been incorporated into the Required Contract Provisions for Federal-Aid Construction Contracts:

No contractor or subcontractor contracting for any part of the contract work which may require or involve the employment of laborers, mechanics, watchmen, or guards (including apprentices, trainees, and helpers described in paragraphs 4 and 5 above) shall require or permit any laborer, mechanic, watchman, or guard in any workweek in which he/she is employed on such work, to work in excess of 40 hours in such workweek unless such laborer, mechanic, watchman, or guard receives compensation at a rate not less than one-and-one-half times his/her basic rate of pay for all hours worked in excess of 40 hours in such workweek.³⁵⁷

3. Compliance with Wage and Hour Requirements

Contractors are required to submit weekly payroll statements documenting the wages paid to laborers and mechanics in the previous weekly payroll.³⁵⁸ These statements are submitted to the contracting agency.³⁵⁹ The contracting agency should review these statements for completeness, checking periodically items such as classification, hourly rates, fringe benefits, and overtime.³⁶⁰

The Required Contract Provisions for Federal-Aid Construction Contracts include a provision for withholding liquidated damages for days on which the contractor did not pay overtime.³⁶¹ These liquidated damages of \$10 per day per employee are forwarded to the Department of Labor to support their enforcement activities.

The Comptroller General has the ability under the Davis-Bacon Act to withhold funds from payments due the contractor for payment of prevailing wages, and to

³⁴⁷ *Id.* at 840 (quoting *N.Y. State Conference of Blue Cross and Blue Shield Plans v. Travelers Ins. Co.*, 514 U.S. 645, 115 S. Ct. 1671, 1680, 131 L. Ed. 2d 695 (1995)).

³⁴⁸ *Id.* at 842.

³⁴⁹ 501 N.Y.S.2d 653, 492 N.E.2d 781, 67 N.Y.2d 854 (1986).

³⁵⁰ N.Y. GEN. MUN. LAW § 103.

³⁵¹ 29 U.S.C. §§ 201–19 (2001).

³⁵² 40 U.S.C. §§ 327–34 (2001).

³⁵³ 29 U.S.C. § 207 *et. seq.* (2001); 40 U.S.C. § 328(a) (2001).

³⁵⁴ 40 U.S.C. § 333 (2001).

³⁵⁵ 29 U.S.C. §§ 202(a).

³⁵⁶ 40 U.S.C. §§ 328–29.

³⁵⁷ Required Contract Provisions for Federal-Aid Construction Contracts, § IV.7

³⁵⁸ 29 C.F.R. § 3.3(b) (2001).

³⁵⁹ 29 C.F.R. § 3.4(a) (2001).

³⁶⁰ CACC Manual, *supra* note 272.

³⁶¹ Required Contract Provisions, *supra* note 357, § IV.8; 29 C.F.R. § 5.8 (2001).

pay those funds directly to laborers and mechanics who have not been paid the wages due to them.³⁶² Contractors who have failed to meet their obligations under the Davis-Bacon Act are also subject to debarment for a period of 3 years.³⁶³

4. Project Labor Agreements

The National Labor Relations Act (NLRA) allows the formation of project labor agreements on public works projects.³⁶⁴ Project labor agreements are collective bargaining agreements entered into by the public agency and a representative union. They provide generally for recognition of that union as the representative of all employees on the project, compulsory union dues, and mandatory use of union hiring halls. Where a project specification calls for a project labor agreement, or PLA, the successful bidder must agree to be bound by the terms of the PLA as a condition of award. Although several issues of consistency with state and federal law have been raised with respect to PLAs, they have usually been found to be valid when challenged.

a. Consistency with Federal Law

i. Consistency with NLRA.—In *Building and Construction Trades Council v. Associated Builders and Contractors*, the United States Supreme Court considered whether PLAs are consistent with the requirements of the NLRA.³⁶⁵ The Massachusetts Water Resources Authority (MWRA) had been ordered to clean up Boston Harbor in part by adding treatment facilities for sewer discharges that entered the harbor. The project manager negotiated a PLA with the Building and Construction Trades Council (BCTC), which was designed to assure labor stability over the length of the project. MWRA then included a specification in its bid package that each successful bidder must agree to abide by the terms of the PLA.

Associated Builders first filed a complaint with the National Labor Relations Board (NLRB). The NLRB found that the PLA was valid under Section 8(e) of the NLRA, which contains the exception allowing PLAs. Associated Builders then sought to enjoin the use of the specification on the grounds that it violated the NLRA. The district court denied the injunction, but the First Circuit reversed, finding that the specification was preempted under NLRA. The appeals court found that the PLA was barred by the preemption doctrine set out in *San Diego Building Trades Council v. Garmon*, in which the Court held that the NLRA preempted state or local regulation that constituted a pervasive intrusion into the bargaining process, but not “peripheral regulation.”³⁶⁶ The First Circuit also considered the PLA

to be preempted under *International Ass'n of Machinists v. Wisconsin Employment Relations Comm'n*, which held that the State could not regulate activities that Congress intended to be unrestricted by government.³⁶⁷ The Supreme Court reversed the First Circuit, holding that the NLRA does not preempt the enforcement by a state agency, acting as an owner of a construction project, of an otherwise lawful pre-hire collective bargaining agreement, such as the PLA in this case.³⁶⁸

The Court held that the preemption doctrines of *Garmon* and *Machinists* apply only to state labor regulation. The State may act without the effect of preemption when it is acting as a proprietary, not as a regulator or policy-maker.³⁶⁹ As support for its conclusion, the Court cited to the 1959 amendments to the NLRA. Sections 8(e) and 8(f) had previously prohibited this type of agreement by prohibiting agreements that require an employer to refrain from doing business with anyone who does not agree to be bound by a pre-hire agreement. However, the amendments specifically allowed pre-hire collective bargaining agreements in construction contracts. These amendments were intended to accommodate conditions specific to the construction industry, both public and private.³⁷⁰ These conditions include the short term nature of employment in the construction industry, which makes post-hire collective bargaining difficult, and the contractor’s need for a steady supply of labor and predictable costs. Further, pre-hire agreements had been a long-standing custom in the construction industry.³⁷¹

In this particular use of a PLA, the Court noted that the agency had been ordered pursuant to the Clean Water Act to undertake the harbor cleanup.³⁷² Compliance with this court order required construction to proceed without interruption, and made no allowance for delays caused by labor strikes. The project manager had been hired by MWRA to advise the agency on labor relations, and suggested the use of a PLA. The project manager then negotiated the PLA, which included terms such as (1) recognition of the BCTC as exclusive bargaining agent for all craft employees on the project; (2) use of specified methods of resolving all labor-related disputes; (3) a requirement that all employees be required to become union members within 7 days of employment; (4) primary use of BCTC’s hiring halls to supply the project’s craft labor force; (5) a 10-year no-strike commitment on the part of the union; and (6)

³⁶⁷ *Id.* (citing 427 U.S. 132, 96 S. Ct. 2548, 49 L. Ed. 2d 396 (1976)).

³⁶⁸ *Id.* at 1198.

³⁶⁹ *Id.* at 1197.

³⁷⁰ *Id.*

³⁷¹ *Id.* at 1198.

³⁷² *United States v. Metropolitan District Comm'n*, 757 F. Supp. 121, 123 (D. Mass. 1991), *rev'd* *Associated Builders and Contractors, Inc. v. Mass. Water Resources Auth.*, 935 F.2d 345 (1st Cir. 1991).

³⁶² 40 U.S.C. § 3144 (2003).

³⁶³ *Id.*

³⁶⁴ 29 U.S.C. §§ 158(e), (f).

³⁶⁵ 507 U.S. 218, 113 S. Ct. 1190, 122 L. Ed. 2d 565 (1993).

³⁶⁶ 113 S. Ct. at 1194 (citing 359 U.S. 236, 79 S. Ct. 773, 3 L. Ed. 2d 775 (1959)).

requirements that all contractors and subcontractors agree to be bound by the PLA.³⁷³

The Court noted that NLRA does not contain a specific preemption. A statute or state activity is not preempted by federal law unless it actually conflicts with federal law, or would frustrate a federal scheme, or unless the Court discerns that “Congress sought to occupy the field to the exclusion of the States.”³⁷⁴ *Garmon* holds that the NLRA preempts state regulation, even of activities that NLRA only arguably prohibits or protects.³⁷⁵ A state cannot establish standards that are inconsistent with NLRA, or provide regulatory or judicial remedies. For example a state could not debar a contractor based on NLRA violations.³⁷⁶ However, this doctrine applies only to the state’s role as a regulator, and not to its activities as a construction project owner.³⁷⁷

Thus, under the amendments to Sections 8(e) and (f) of the NLRA, the Court found that the use of a project labor agreement to prohibit an employer from hiring contractors unless they agree to abide by the PLA was valid. However, the Court noted that Sections 8(e) and (f) are not specifically applicable to the states, as “state” is excluded from the definition of “employer.”³⁷⁸ Still, the Court considered the general goals of Sections 8(e) and (f) to be relevant in determining the intent of Congress with respect to the states.³⁷⁹

In *Minnesota Chapter of Associated Builders and Contractors v. County of St. Louis*, the court held that a PLA was not a “state law” that was preempted by ERISA.³⁸⁰ Because it applied to only one project and not to all of the agency’s projects generally, it was not a “state law” of general application, even though it specified particular benefits that must be paid by contractors to employees.

ii. *Executive Order 13202*.—In June 1997, President Clinton issued a Presidential Memorandum entitled “Use of Project Labor Agreements for Federal Construction Projects.” This memorandum prohibited the requirement of PLAs in direct federal contracts.³⁸¹ However, it did not prohibit their inclusion in contracts for federally-assisted projects. President George W. Bush issued EO 13202 in February 2001, which rescinded the memorandum and extended the PLA prohibition to federally-assisted projects.

EO 13202 requires that “neither the awarding Government authority nor any construction manager acting on behalf of Government shall, bid specifications, project agreements, nor other controlling documents for construction contracts” that are awarded by recipients of federal funds may

(a) Require or prohibit bidders, offerors, contractors, or subcontractors to enter into or adhere to agreements with one or more labor organizations, on the same or other related construction projects(s); or

(b) Otherwise discriminate against bidders, offerors, contractors, or subcontractors for becoming or refusing to become or remain signatories or otherwise to adhere to agreements with one or more labor organizations, on the same or other related construction project(s).³⁸²

EO 13202 allows an exemption for “special circumstances...in order to avert an imminent threat to public health or safety or to serve the national security.”³⁸³ However, it also provides that the possibility of a labor dispute is not such a “special circumstance.”³⁸⁴

The EO does not prohibit voluntary agreements between contractors or subcontractors and labor unions.³⁸⁵ FHWA does not consider such an agreement to be a PLA where it is not required by the owner-agency in the construction contract.³⁸⁶

Executive Order 13202 was challenged by labor unions in *Building and Construction Trades Department, AFL-CIO v. Allbaugh*.³⁸⁷ The plaintiffs challenged the president’s authority to issue the EO, and contended that it was preempted by the NLRA. The district court granted the plaintiffs’ request for a preliminary injunction. The D.C. Circuit reversed, holding that the President has constitutional authority to issue EOs, and that the NLRA did not preempt the EO where it applied only to federal government contracts, and was not regulatory in nature.³⁸⁸

³⁸¹ See FHWA Contract Administration Core Curriculum Participant’s Manual and Reference Guide 2001, available on FHWA’s Web site at http://www.fhwa.dot.gov/programadmin/contracts/cor_V.htm for a summary of the applicability of the memorandum and executive order to FHWA and federally-assisted contracts.

³⁸² E.O. 13202.

³⁸³ E.O. 13202 § 5.

³⁸⁴ *Id.*

³⁸⁵ *Id.*; see also CACC Manual, *supra* note 381.

³⁸⁶ *Id.*

³⁸⁷ 295 F.3d 28 (D.C. Cir. 2002).

³⁸⁸ *Id.*

³⁷³ 113 S. Ct. at 1193.

³⁷⁴ *Id.* at 1194 (quoting *Metropolitan Life Ins. Co. v. Mass.*, 471 U.S. 724, 747–48, 105 S. Ct. 2380, 85 L. Ed. 2d 728 (1985)).

³⁷⁵ *Id.* at 1195 (citing *San Diego Building Trades Council v. Gorman*, 359 U.S. 236, 79 S. Ct. 773, 3 L. Ed. 2d 775) (1959).

³⁷⁶ *Id.*

³⁷⁷ *Id.* at 1196.

³⁷⁸ 29 U.S.C. § 152(2).

³⁷⁹ 113 S. Ct. at 1198.

³⁸⁰ 825 F. Supp. 238 (D. Minn. 1993); *Employee Retirement Income Security Act of 1974*, 29 U.S.C. § 1144.

b. Consistency with State Law

i. Consistency with Competitive Bidding.—The most significant question regarding the use of PLAs under state law is whether the use of a PLA is consistent with the statutes, regulations, and policies of competitive bidding. Contractors have also raised constitutional questions, such as whether the requirement of abiding by a PLA violates the contractor’s right to equal protection.

The New Jersey Supreme Court considered whether the use of a PLA violated the state constitution’s guarantee of equal protection in *George Harms Construction Company v. New Jersey Turnpike Authority*.³⁸⁹ The contractor had alleged that the state had improperly coerced construction workers in their choice of bargaining representatives by favoring one group of unions over others. Although identifying the petitioner’s constitutional claims, the court did not resolve them.

Rather, the court decided the case on the issue of whether the requirement for a PLA violated the state’s statutes requiring competitive bidding of public works projects. The court compared the PLA requirement to a “sole source” specification, and questioned whether the agency could choose a sole source for labor, citing to a New Jersey statute that prohibits the use of sole sources.³⁹⁰ The court found that the specification requiring the PLA had the effect of lessening competition, and was thus contrary to public bidding requirements. The specification was not “drafted in a manner to encourage free, open and competitive bidding” as required by New Jersey law.³⁹¹ The court thus concluded that the agency needed specific statutory authority to use a PLA, in order to overcome the conflict with competitive bidding requirements.

Other states’ courts have examined the *Harms* decision in light of their own public bidding statutes and the general policies underlying competitive bidding, and have concluded that PLAs are consistent with both. In *New York State Chapter, Inc., Associated General Contractors v. New York State Thruway Authority*, the contractors had sought a declaratory ruling that the use of a PLA on a bridge refurbishment contract was illegal, and asked for an order to halt the bidding process.³⁹² Following the *Harms* decision, the New York Supreme Court ruled in the contractors’ favor, concluding that the “policy of using PLA’s contravenes two of the purposes of [the competitive bidding statutes] in discouraging competition by deterring non-union bidders, and postering favoritism by dispensing advantages to unions and union contractors.”³⁹³ In reversing the trial court, the Appellate Division assumed that the use of a PLA discourages competition in the bidding process.³⁹⁴

³⁸⁹ 137 N.J. 8, 644 A.2d 76 (1994).

³⁹⁰ 644 A.2d at 94; N.J.S.A. 40A:11-13.

³⁹¹ *Id.* at 95; N.J.S.A. 40A:11-13.

³⁹² 88 N.Y.2d 56, 643 N.Y.S.2d 480, 486, 666 N.E.2d 185 (1996).

³⁹³ *Id.*

³⁹⁴ 207 A.D. 2d 26, 620 N.Y.S.2d 855, 857 (1994).

The court concluded, however, that this does not necessarily mean that it is inconsistent with competitive bidding. The purpose of public bidding statutes is not to have “unfettered competition,” but to get the best work at the lowest price and to guard against favoritism, extravagance, fraud, and corruption. Specifications are not necessarily illegal because they might tend to favor one contractor or manufacturer over another. Rather, they may be found to be illegal when they are drawn for the benefit of one contractor or manufacturer, and not in the public interest.³⁹⁵ A specification that has the impact of reducing competition must be based on a public interest, and not for the benefit of a particular contractor.

The court concluded that the agency’s decision to use a PLA was rationally based on reasons that were well-grounded in the public interest. These included the need to accommodate conditions unique to the construction industry, noted by the Supreme Court in *Building and Construction Trades Council* as the short-term nature of employment in the construction industry, which makes post-hire collective bargaining difficult, and the contractor’s need for a steady supply of labor and predictable costs.³⁹⁶ Further, the court determined that the use of a PLA advanced the goal of obtaining the best product at the lowest price. The court concluded that the PLA was also consistent with the policy of avoiding favoritism and corruption in that it applied to union and non-union contractors alike, and prohibited discrimination against union members or non-union members in hiring.³⁹⁷ The court stated that the decision should not be considered a blanket approval of all PLAs, only a holding that the state’s competitive bidding statutes do not prohibit PLAs.³⁹⁸

ii. Standard of Review and Necessity of Agency Record.—In a decision affirming the Appellate Division in this case, the New York Court of Appeals further stated that PLAs are neither absolutely prohibited nor absolutely permitted by competitive bidding laws.³⁹⁹ Rather, the court held that the use of a PLA is by its nature anti-competitive, but will be sustained for a particular project where the record supports the agency’s determination that a PLA is justified by interests that are consistent with the policies underlying competitive bidding.⁴⁰⁰

The Court of Appeals noted that the PLA included the typical requirements that all bidders (1) hire workers through union hiring halls; (2) follow specified dispute resolution procedures; (3) comply with union wage, benefit, seniority, and apprenticeship requirements;

³⁹⁵ *Id.*, 620 N.Y.S.2d at 857.

³⁹⁶ Citing *Building and Construction Trades Council*, 113 S. Ct. at 1198.

³⁹⁷ *Id.* at 858.

³⁹⁸ *Id.*

³⁹⁹ *N.Y. State Chapter, Associated General Contractors v. N.Y. State Thruway Auth.*, 88 N.Y.2d 56, 643 N.Y.S.2d 480, 482 666 N.E.2d 185 (1996).

⁴⁰⁰ *Id.*, 643 N.Y.S.2d at 482–83.

and (4) contribute to union benefit funds, together with the union's promise of "labor peace" throughout the life of the contract. The court then concluded that by requiring bidders to conform to a variety of union practices and limiting each bidder's autonomy in negotiating its own employment terms with a labor pool that includes non-union workers, PLAs do have an anticompetitive impact on the bidding process. As such, they are unlike the usual bid specification. However, PLAs also provide efficiencies to be gained by the public project.⁴⁰¹

In examining the anticompetitive nature of the PLA specification, the court looked at *Gerzof v. Sweeney*, a New York case that examined the use of narrowly-drawn specifications that limit who might bid on a project. In that case, the bid specification required experience constructing three generators of a specific type, and had the effect of eliminating all but one manufacturer.⁴⁰² While such a specification is not illegal per se, there must be a clear showing that its use is in the public interest. Based on the ruling in *Gerzof*, the court concluded that New York Competitive Bidding statutes "do not compel unfettered competition, but do demand that specifications that exclude a class of would-be bidders be both rational and essential to the public interest."⁴⁰³

The two central purposes of New York's competitive bidding statutes were pointed out as (1) protection of the public fisc by obtaining the best work at the lowest possible price, and (2) prevention of favoritism, improvidence, fraud, and corruption. If an agency uses a specification that impedes competition to bid on its work, then the use must be rationally related to these two purposes. If not, it may be found invalid.⁴⁰⁴

Although the practical effect of the test by the court is that a rational basis must be established by the record, the court noted that "more than a rational basis" must be shown because of the broad scope of PLAs. The court placed the burden on the agency of showing that the decision to use a PLA "had as its purpose and likely effect the advancement of the interests embodied in the competitive bidding statutes."⁴⁰⁵ The court refused to allow agencies to approve PLAs in a "pro forma" manner.

In this particular case, the court considered the following information from the agency's record. The PLA was being used for a toll bridge refurbishment project that would take 4 years to complete, including deck replacement under traffic. The agency determined that efficiency in completing the project was important to protect a major revenue-producing facility, maximize

public safety, and minimize the inconvenience to the traveling public.⁴⁰⁶

The agency further considered that in the history of work on this particular bridge, union contractors had performed over 90 percent of the work. Based on the size and complexity of the project, it would subject to the jurisdiction of 19 local unions, all of whom would have separate labor contracts setting out different standard hours of work and different benefits requirements. The last time that the Thruway Authority had awarded a contract to a nonunion contractor, a labor dispute had erupted that required police assistance, and the bridge was picketed.⁴⁰⁷ The court found that the Thruway Authority had assessed the specific project needs and demonstrated on the record that a PLA was directly tied to competitive bidding goals. The PLA could not be said to promote favoritism because it applied whether a contractor was union or nonunion. The fact that nonunion contractors may be disinclined to submit bids did not amount to preclusion of competition like that identified in *Gerzof* as violative of competitive bidding laws. The agency's detailed record documented the likely cost savings, the fact that toll revenues would not be interrupted, the size and complexity of the project, and a history of labor unrest. This record was sufficient to support the court's determination that the PLA was adopted in conformity with public bidding laws.⁴⁰⁸

While there is a need that a record be created by an agency contemporaneously with its decision to use a PLA, that record need not be formal or extensive. In *Albany Specialties, Inc. v. County of Orange*, the construction manager had analyzed the potential advantages of a PLA in a letter to the agency, including the prior high use of union labor, the fact that other jobs in the area had had significant delays due to labor disruptions, and that avoiding these delays would also avoid their associated costs.⁴⁰⁹ The court found that this met the requirements for an adequate record set out in the *New York State Ch., AGC v. Thruway Authority* case.

The Alaska Supreme Court came to a very similar conclusion on the use of PLAs in *Laborers Local # 942 v. Lampkin*.⁴¹⁰ The Borough of Fairbanks had required a PLA for a school renovation project, and approved a resolution to support the mayor's use of a PLA in the project. The resolution set out the rationale for the PLA, including general justifications based on other agencies' experience, benefit to the school renovation

⁴⁰¹ *Id.* at 483.

⁴⁰² *Id.* at 484 (citing 16 N.Y.2d 206, 264 N.Y.S.2d 376, 211 N.E.2d 826 (1965)).

⁴⁰³ *Id.*

⁴⁰⁴ *Id.* at 485.

⁴⁰⁵ *Id.*

⁴⁰⁶ *Id.*

⁴⁰⁷ *Id.*

⁴⁰⁸ *Id.* at 486. On the contrary, the court found in a companion case involving the Dormitory Authority of the State of New York that there was no contemporaneous record to support the use of a PLA. There was no documentation of potential cost savings, nor any documented history of labor unrest. Post hoc rationalization cannot substitute for the agency's consideration of the goals of competitive bidding prior to signing the PLA. *Id.*, 643 N.Y.S.2d at 487-89

⁴⁰⁹ 240 A.D. 2d 739, 662 N.Y.S.2d 773 (1997).

⁴¹⁰ 956 P.2d 422 (Alaska 1998).

project, and economic and financial interests.⁴¹¹ The school renovation project was the largest and most complex project in the borough's history, involving work on a school of over 1400 students. There was a significant interest in assuring that it was completed on time and within its budget. Failure to complete it on time would be harmful to all residents, particularly students. The court found this record sufficient to support the use of the PLA. The court adopted the rationale of the New York cases in finding that the PLA did not violate the applicable procurement code.⁴¹²

c. Constitutional Issues

Constitutional issues have been raised with respect to PLAs based on both federal and state constitutional provisions guaranteeing equal protection. The main argument is that the requirement violates equal protection by favoring union contractors and union employees. However, courts have rejected that argument on the grounds that the PLAs considered applied equally to all, union and nonunion contractors alike. Further, they have prohibited any discrimination against union or nonunion employees on that basis or their union status.⁴¹³

A federal district court in Missouri considered whether the PLA violated the associational rights of contractors.⁴¹⁴ In upholding the use of the PLA, the court found that the agency had a rational basis in its desire to have an efficient, productive, and harmonious workforce without work stoppages or delays. Applying the rational basis test, the court found that the PLA requirement did not "directly and substantially interfere" with the contractor's associational rights.⁴¹⁵

The contractor in *Enertech Electrical v. Mahoning County Commissioners* argued that it was entitled to damages under § 1983 for the agency's refusal to award it a contract after the contractor refused to sign the PLA.⁴¹⁶ Enertech, the low bidder, alleged that it was deprived of its right to the award of the contract without due process. It also alleged abuse of discretion by the county and demanded its lost profits.

To support a claim for damages under § 1983, a bidder must demonstrate that it had a constitutionally protected property interest in a publicly bid contract.⁴¹⁷ This can be accomplished by showing either that the

contract was awarded and then withdrawn, or that the agency abused its discretion in the award. Enertech argued that the county did not have discretion to condition the award of the contract on the bidder's willingness to sign the PLA. However, the court noted that the Ohio Supreme Court has held that under the language of Ohio's public bidding statute, which requires award to the "lowest and best bidder," that agencies are not limited to acceptance of the lowest dollar bid.⁴¹⁸ The agency therefore has the discretion to make a qualitative determination as to the lowest and best bid.

The court then concluded that the county did not abuse its discretion by determining that the "best" bidder would be one who was willing to ratify the PLA. The contract terms requiring the PLA had been included in the contract in order to secure labor harmony, and were not inconsistent with the competitive bidding statute's policy to provide for open and honest competition in bidding and protect the public from favoritism and fraud.⁴¹⁹ Because Enertech was never the lowest and best bidder, it could not show that it was deprived of a right to the contract without due process; it had no constitutionally protected interest in the contract.

d. Standing to Challenge a PLA

The Ohio court considered the issue of standing to challenge a PLA, and concluded that an individual contractor must have submitted a bid on that project in order to have standing. Further, it held that a contractor's association must have a member who submitted a bid in order for the association to have standing.⁴²⁰

⁴¹¹ *Id.* at 427 n.2.

⁴¹² *Id.* at 432-33.

⁴¹³ See, e.g., *State ex rel. Associated Builders and Contractors, Central Ohio Chapter v. Jefferson County Board of Comm'rs*, 106 Ohio App. 3d 176, 665 N.E.2d 723, 725-26 (1995), *review denied*, 74 Ohio St. 3d 1499, 659 N.E.2d 314 (1996); *Laborers Local # 942 v. Lampkin*, 956 P.2d 422, 436 (Alaska (1998)).

⁴¹⁴ *Hanten v. School District of Riverview Gardens*, 13 F. Supp. 2d 971 (E.D. Mo. 1998).

⁴¹⁵ *Id.* at 976.

⁴¹⁶ 85 F.3d 257 (6th Cir. 1996).

⁴¹⁷ *Id.* at 260.

⁴¹⁸ *Id.* at 260 (citing *Cedar Bay Constr., Inc. v. City of Fremont*, 50 Ohio St. 3d 19, 552 N.E.2d 202, 205 (1990)).

⁴¹⁹ *Id.* (citing *Cedar Bay Constr.*, 552 N.E.2d at 204).

⁴²⁰ *State ex rel. Associated Builders and Contractors, Central Ohio Chapter v. Jefferson County Board of Comm'rs*, *supra* note 409.

SECTION 5



**CONTRACT MODIFICATIONS
AND DELAY**

A. THE CHANGES CLAUSE

1. Introduction

Virtually all construction contracts contain a “Changes” clause that allows the owner to modify the scope of the work, or the time of performance, without the contractor’s consent, when the owner and the contractor cannot agree on the terms of the change. Under the common law, an attempt by one party to modify the contract without the consent of the other party was a breach of contract.¹ Thus, without a Changes clause, an owner could not modify the contract unless the contractor agreed to the change.

By empowering the owner to change the contract unilaterally, the clause gives an owner the flexibility it needs to administer the contract. Changes may be necessary for various reasons. A change order may be necessary to correct a design error, or deal with unanticipated site conditions that materially affect the cost of performance, or alter the time allowed for completion of the contract.

While the clause provides operating flexibility for the owner, it may also produce controversies that lead to disputes.² The clause is probably the most frequently litigated provision in construction contracts. The legal problems raised by the clause vary depending upon how the clause is worded and the nature of the change. The problems may vary from the enforceability of an oral directive to perform extra work, to the effect of an unprotested bilateral change as an accord and satisfaction, barring a later claim for additional compensation for changed work.

These and other related issues are discussed in this subsection. Part 2 begins this discussion with an overview of some standard clauses used by the Federal Government and some state transportation agencies. Part 3 reviews the law relating to unauthorized change orders. Part 4 discusses the requirement found in most “changes clauses” that changes must be ordered in writing to be enforceable and exceptions to this requirement based on waiver and estoppel. Part 4 also discusses constructive changes. Parts 5 and 6, respec-

¹ *Tondevoid v. Blaine School Dist.*, 91 Wash. 2d 632, 590 P.2d 1268, 1270–71 (Wash. 1979). The common law rule requiring mutual assent to make contractual changes applies to government contracts with private parties. *Hensler v. City of L.A.*, 124 Cal. App. 2d 71, 268 P.2d 12, 18 (Cal. App. 1954); *Clark County Constr. Co. v. State Highway Comm’n*, 248 Ky. 158, 58 S.W.2d 388, 2390-91 (1933).

² Typically, the dispute provisions of the contract require the contractor to keep working, with the resolution of the dispute deferred until later. *WALLEY & VANCE, Legal Problems Arising From Changes, Changed Conditions and Disputes Clauses in Highway Construction Contracts*, SELECTED STUDIES IN HIGHWAY LAW, vol. 3, pp. 1441–42. This allows the owner to keep the project on schedule, or at least moving forward, instead of coming to a standstill if the contractor stopped working. *Id.*

tively, focus on “cardinal changes” and notice requirements. The remaining parts of this subsection deal with bilateral changes, as an accord and satisfaction, barring claims for additional compensation beyond the amount agreed to in the change order, and exceptions to the rule of an accord and satisfaction based on economic duress, mistake, and the cardinal change doctrine. Variations in estimated quantities in unit price contracts complete this subsection.

2. Standard Clauses

The clause has been used in Federal Government construction contracting for over 100 years.³ While its use spans over a century, the wording of the clause has not remained static. The clause has been revised, from time to time, to reflect both the experiences gained in the administration of contracts and the views expressed by federal courts in numerous decisions. Similar revisions have taken place in standard clauses used by state transportation agencies in their construction contracts.⁴

No attempt is made, however, to trace the various changes that have taken place, over the years, in federal and state clauses. Instead, it is the intent of this subsection to compare the current federal clause⁵ with representative clauses used by various state transportation agencies,⁶ including the AASHTO Guide Specification for Highway Construction.⁷

The standard changes clauses used by the Federal Government and state agencies have certain basic elements in common beyond empowering the owner to make unilateral changes to the contract. An analysis of the clauses shows that all of them identify the person who is authorized to issue change orders for the owner. Most clauses require change orders to be in writing to be binding on the owner, but some allow oral change orders and a few allow constructive change orders. All of the clauses specify, either generally or with particularity, the extent of changes that are permitted and impose limitations on the power to order changes by requiring that they must be within the general scope of

³ *General Dynamics v. United States*, 585 F.2d 457 (Ct. Cl. 1978).

⁴ *WALLEY & VANCE, supra* note 2.

⁵ 48 C.F.R. ch. 1, pt. 52.243-4, Changes (1987).

⁶ AASHTO Guide Specifications 104.03 (1998); Alaska Department of Transportation and Public Facilities Standard Specification 104.1.02 (1998); Arizona Standard Specification 104.02 (2000); California Department of Transportation Standard Specification 4-1.03 (1995); Florida Department of Transportation Standard Specification 4.3.2.1 (1996); Iowa Department of Transportation Standard Specification 1109.16C.1; Michigan Department of Transportation Standard Specification 103.02.B (1996); New Jersey Department of Transportation, Standard Specification 104.02 (1996); New York Department of Transportation Standard Specification 109-05 (1995); Texas Department of Transportation Standard Specification 4.2 (1995); Washington State Department of Transportation Standard Specification 1-04.4 (1996).

⁷ AASHTO Guide Specification 104.03 (1998).

the original contract work. All allow changes to be made without the consent of the performance and payment bond surety or sureties. All clauses require the owner to compensate the contractor for its additional costs in performing changed work and to grant time extensions when appropriate. The federal clause allows impact costs for the effect of the change upon unchanged work. Most states allow compensation when the changed work affects other work, causing such work to become significantly different in character. Parenthetically, the DSC clauses used by the states and the federally-mandated clause,⁸ for use in federally-aided Interstate highway construction contracts, do not allow a price adjustment for the effects of a DSC on unchanged work.⁹ All clauses require the contractor to give notice of claims. Most provide for increases and decreases in quantities, where the contract quantities are based on unit prices. The key elements of the standard clauses are discussed in this subsection.

3. Authority To Order Changes

A change order must be issued by someone with actual authority to change the contract. In federal construction contracting, that person is the contracting officer. The Standard Changes Clause provides in part that, “the Contracting Officer may...make change in the work within the general scope of the contract....”¹⁰ This is further emphasized by a federal regulation that “[o]nly Contracting Officers acting within the scope of their authority are empowered to execute modifications on behalf of the Government.”¹¹

In many state highway construction contracts, the person empowered to execute change orders on behalf of the agency is the “Engineer.”¹² For example, the Texas Department of Transportation Standard Specification states in part that, “the Engineer reserves the right to make...such changes in quantities and such alterations in the work as are necessary to satisfactorily complete the project.”¹³ The Guide Specifications issued by AASHTO state in part that “[d]uring the course of the Contract, the Engineer can make written changes in quantities or make other alterations as necessary to complete the work.”¹⁴ Some other state specifications are couched in similar language.¹⁵

The identity of the person authorized to modify the contract is important because a government agency is not bound by the unauthorized acts of its agents. This

rule is strictly enforced in public contracting.¹⁶ It protects the government from the potential liability of employees who, without authorization, purport to alter the terms of the written contract.¹⁷ Thus, government agencies are not bound by changes ordered by a project inspector,¹⁸ or by a consulting engineer.¹⁹

The Doctrine of Apparent Authority—which allows private owners to be bound by the unauthorized acts of their representatives, who are clothed with apparent authority to act the way they did—cannot be invoked against government agencies.²⁰ The contractor’s good faith belief concerning the authority of government agencies to make changes to the contract is irrelevant. Contractors who perform changed work that is unauthorized do so at their peril.²¹

4. Requirement That Change Orders Be in Writing

a. Waiver and Estoppel

Public construction contracts usually require that changes to the contract must be authorized in writing. A typical clause, used by state transportation agencies, authorizes the “Engineer” to make changes, “in writing” ... “as are necessary to satisfactorily complete the project.”²² Some specifications may be even more explicit. For example, California’s Standard Clause provides that,

Those changes will be set forth in a contract change order which will specify, in addition to the work to be done in connection with the change made, adjustment of contract time, if any, and the basis of compensation for that work. A contract change order will not become effective until approved by the Engineer.²³

Generally, provisions of this kind are judicially enforced unless the owner is found to have waived the requirement that changes must be ordered in writing.²⁴

¹⁶ *ECC Int’l Corp. v. United States*, 43 Fed. Cl. 359, 367–68 (1999); *United States v. Christensen*, 50 F. Supp. 30, 32–33 (E.D. Ill. 1943); *Noel v. Cole*, 98 Wash. 2d 375, 655 P.2d 245, 249–50 (Wash. 1982); 10 MCQUILLIAN, MUNICIPAL CORPORATIONS, § 29.04 (3d ed.).

¹⁷ *County of Brevard v. Miorelli Eng’g, Inc.*, 703 So. 2d 1049, 1051 (Fla. 1997).

¹⁸ *Elastomeric Roofing Assocs. v. United States*, 26 Fed. Cl. 1106 (1992).

¹⁹ *Dillingham Constr. N.A., Inc. v. United States*, 33 Fed. Cl. 495, 503 (1995), *aff’d*, 91 F.3d 167 (1996).

²⁰ *Johnson Drake & Piper, Inc.*, ASBCA 9824 and 10199, 65-2 BCA 4868 180 (1965).

²¹ *ECC Inter Corp v. United States*, *supra* note 16.

²² Iowa DOT Standard Specification 1109.16 C1 (2001); Texas DOT Standard Specification 4.2 (1993).

²³ California DOT Standard Specification 4-1.03 (1995).

²⁴ *See generally* 64 AM. JUR. 2D *Public Works and Contracts*, § 189–198 (2d ed. 1972), Annotation, *Effect of Stipulation, in Public Building or Construction Contract, That Alterations or Extras Must Be Ordered In Writing*, 1 A.L.R. 3d 1273, 1281–1282 (1965). *See also*, *Sentinel Indus. Cont. v. Kimmins Indus. Service Corp.* 74 So. 2d 934, 964 (Miss. 1999).

⁸ This topic is discussed in Subsection B, Differing Site Conditions.

⁹ 48 C.F.R. ch. 1 pt. 52.243-4(a).

¹⁰ 48 C.F.R. 52.243-4(a).

¹¹ 48 C.F.R. pt. 43, § 43.102(a).

¹² The “Engineer” is usually defined in the Contract.

¹³ Texas DOT Standard Specification 4.2 (1995).

¹⁴ AASHTO Guide Specification for Highway Construction 104.03 (1998).

¹⁵ For some examples, see the specifications listed in note 6.

In *Foster Wheeler Enviresponse v. Franklin County Convention Facilities Auth.*,²⁵ the Ohio Supreme Court said:

It is universally recognized that where a building or construction contract, public or private, stipulates that additional, altered, or extra work must be ordered in writing, the stipulation is valid and binding upon the parties, and no recovery can be had for such work without a written directive therefor in compliance with the terms of the contract, unless waived by the owner or employer...(citations omitted).

This rule is based on the notion that a person who has authority to change the contract may waive its provisions.²⁶ Acts or conduct that may constitute waiver include: (1) the owner's knowledge of the change and its acquiescence in allowing the extra work to proceed,²⁷ and (2) a course of dealing between the owner and the contractor disregarding the requirement that changes be in writing.²⁸ This waiver principle is applicable to construction contracts.²⁹ The Parol Evidence Rule does not bar this kind of extrinsic evidence. The rule does not apply to evidence regarding a subsequent modification of a written contract, or to the waiver of contractual terms by language or conduct.³⁰

A number of jurisdictions require clear and convincing evidence to prove that the owner waived the written change order provision.³¹ In *Powers v. Miller*, the court gave several reasons why an oral modification to a written contract requiring that changes be in writing must be proven by clear and convincing evidence:

²⁵ 78 Ohio St. 3d, 353, 678 N.E.2d 519, 525 (Ohio 1997).

²⁶ *Clark County Constr. Co. v. State Highway Comm'n*, 248 Ky. 158, 58 S.W.2d 388, 390-91 (Ky. 1933); *Hempel v. Bragg*, 856 S.W.2d 393, 297 (Ark. 1993); 13 AM. JUR. 2D; *Building and Construction Contracts*, § 24 *et seq.* (1964); *Gilmartin Bros. v. Kern*, 916 S.W.2d 324, 329 (Mo. App. 1995); *Weaver v. Acampora*, 229 A.D. 2d 727, 642 N.Y.S.2d 339, 341 (N.Y. A.D. 1996); *Bonacorso Constr. Corp. v. Commonwealth*, 41 Mass. App. Ct. 8, 668 N.E.2d 366, 368 (Mass. App. 1996); *Austin v. Barber*, 227 A.D. 2d 826, 642 N.Y.S.2d 972, 974 (N.Y. A.D. 1996); *Todd Shipyards Corp. v. Cunard Line Ltd.*, 943 F.2d 1056, 1061 (9th Cir. 1991); *D.K. Meyer Corp. v. Bevco, Inc.*, 206, Neb. 318, 292 N.W.2d 773, 775 (1980); *Morango v. Phillips*, 33 Wash. 2d 351, 205 P.2d 892, 894 (1949); Annotation, 2 A.L.R. 3d 620.

²⁷ *State v. Eastwind, Inc.*, 851 P.2d 1348, 1351 (Alaska 1993).

²⁸ *Gilmartin Bros. v. Kern*, 916 S.W.2d 324, 329 (Mo. App. 1995); *Menard & Co. Masonary Bldg. Contractors v. Marshall Bldg. Systems, Inc.*, 539 A.2d 523, 526-27 (R.I. 1988).

²⁹ See 13 AM. JUR. 2D *Building and Construction Contracts* § 24 (2d ed. 2000).

³⁰ 29 AM. JUR. 2D *Evidence* § 1133 (2d ed. 1994).

³¹ *City Nat'l Bank of Fort Smith v. First Nat'l Bank and Trust*, 22 Ark. App. 5, 732 S.W.2d 489, 492 (1987); *Kline v. Clinton*, 103 Idaho 116, 645 P.2d 350, 355 (1982); *Duncan v. Cannon*, 204 Ill. App. 3d 160, 561 N.E.2d 1147, 1149, 149 Ill. Dec. 451 (1990); *Glass v. Bryant*, 302, Ky. 236, 194 S.W.2d 390, 393 (1946); *Jenson v. Olson*, 144 Mont. 224, 395 P.2d 465, 469 (1964); *Nicolella v. Palmer*, 248 A.2d 20, 23 (Pa. 1968).

[W]e believe that the higher standard of proof is appropriate in order to avoid the type of ambiguous situation that occurred in this case, in which one party thought the contract had been modified and the other did not think a modification had occurred. We further believe that requiring proof by clear and convincing evidence is an appropriate balancing of the principles of freedom of contract against the sanctity of written contracts. That standard reduces the risk that the parties' intent as set forth in the contract will not prevail.³²

Estoppel is another theory that is used to avoid the preclusive effect of a written change order requirement. When the owner's words or conduct constitute a waiver of the written change order requirement, the owner may be estopped from asserting that requirement as a defense to a claim for extra work.³³ The court is likely to apply estoppel as another reason why the written change order requirement does not bar an oral change order, when the owner has acted unfairly.³⁴ Estoppel, like waiver, must be proved with clear and convincing evidence.³⁵

Some courts, for policy reasons, have refused to enforce an oral modification to a public works construction contract when the contract provides that modifications must be made in writing. In *County of Brevard v. Miorelli Engineering*, the court held, as a matter of law, that waiver and estoppel cannot be applied to the government in any dispute arising out of a contractual relationship.³⁶ The court said:

MEI asserts that the County waived the written change order requirement by directing work changes without following its own formalities. We decline to hold that the doctrines of waiver and estoppel can be used to defeat the express terms of the contract. Otherwise, the requirement of *Pan Am* that there first be an express written contract before there can be a waiver of sovereign immunity would be an empty one. An unscrupulous or careless government employee could alter or waive the terms of the written agreement, thereby leaving the sovereign with potentially unlimited liability.³⁷

In a similar view, the court in *State Highway Commission v. Green-Boots Construction Co.*³⁸ said:

The stipulation in construction contracts that compensation for extra work should be agreed upon prior to the performance of the work is not an unusual provision in this class of contracts. The reason therefore, no doubt, arises because of the frequent claims made by contractors for this so-called extra work. 'Municipal Corpora-

³² 127 N.M. 496, 984 P.2d 177, 180 (1999) (citation omitted).

³³ *Harrington v. McCarthy*, 91 Idaho 307, 420 P.2d 790, 793 (1966); *Northern Improvement Co. v. S.D. State Hwy Comm'n*, 267 N.W.2d 208, 213 (S.D. 1978).

³⁴ *W.H. Armstrong & Co. v. United States*, 98 Ct. Cl. 519, 528-29 (1941); *Griffith v. United States*, 77 Ct. Cl. 542, 556-57 (1933); *Bignold v. King County*, 65 Wash. 2d 817, 54 Wash. 2d 817, 399 P.2d 611, 616 (Wash. 1965).

³⁵ 28 AM. JUR. 2D *Estoppel and Waiver* § 148 (2d ed. 2000).

³⁶ 703 So. 2d 1049 (Fla. 1997).

³⁷ *Id.* at 1051.

³⁸ 199 Okla. 477, 187 P.2d 209 (Okla. 1947).

tions have so frequently been defrauded by exorbitant claims for extra work under contracts for public improvements that it has become usual to insert in contracts a provision that the contractor shall not be entitled to compensation for extra work unless it has been ordered in a particular manner.' Mr. Justice Clarke, in the *Wells Brothers Case*, said: 'Men who take \$1,000,000 contracts for government buildings are neither unsophisticated nor careless.' We think that statement applies to this present situation. Contractors engaged in the nature of the work here performed are neither 'unsophisticated nor careless.' It would have been a simple matter for the plaintiff to have agreed in writing with the commission for this extra work prior to the performance thereof. This provision of the contract is not an unreasonable provision, and we know of no reason why it should not be given effect....³⁹

The rule requiring written authorization for changes as a condition precedent to recovery by a contractor for the cost of performing the change is designed to protect owners. This was explained by the Ohio Supreme Court in *Foster Wheeler Enviresponse, Inc. v. Franklin County Convention Facilities Auth.*:

The primary purpose of requiring written authorization for alterations in a building or construction contract is to protect owners against unjust and exorbitant claims for compensation for extra work. It is generally regarded as one of the most effective methods of protection because such clauses limit the source and means of introducing additional work into the project at hand. It allows the owner to investigate the validity of a claim when evidence is still available and to consider early on alternative methods of construction that may prove to be more economically viable. It protects against runaway projects and is, in the final analysis, a necessary adjunct to fiscal planning.⁴⁰

While denying recovery to the contractor, the court noted that, "under proper circumstances, the refusal of a public entity to give a contractor a written order for alterations, in accordance with a contract stipulation therefor, may constitute a breach of the contract or amount to a waiver of written orders." Moreover, "proof of waiver, however must either be in writing, or by such clear and convincing evidence as to leave no reasonable doubt about it."⁴¹

b. Constructive Changes

A "constructive change" occurs when the clause provides that the contract may be modified by an oral order, or determination by the owner, which causes the contractor to perform work beyond contract requirements.⁴² The standard clause used by the Federal Gov-

ernment incorporates the constructive change concept.⁴³ The clause provides in part that, "(b) any other written or oral order (which, as used in this paragraph (b), shall include direction, instruction, interpretation or determination) from the Contracting Officer that causes a change shall be treated as a change order under the clause...." This language, which was adopted in 1968,⁴⁴ has been an express provision of the clause for more than 30 years, and has allowed contracting officers to deal administratively with disputes involving extra work under the changes clause where no formal change order had been issued.⁴⁵ This has allowed claims to be dealt with more expeditiously than resolving them through litigation.⁴⁶

To establish a constructive change for extra work, "the contractor must show the performance of work in addition to or different from that required under the contract (the change component) either by express or implied direction of the Government or by Government fault (the order/fault component)...."⁴⁷ The "change component" includes defective contract specifications and misinterpretation of the specifications by the Government, requiring the contractor to perform extra work.⁴⁸

A state court has held that a constructive change occurred where the contract contained language identical to that used in part (B) of the federal clause.⁴⁹ But the constructive change theory has been rejected where the contract provides only for written change orders.⁵⁰ Massachusetts reached a similar result, holding that the constructive change theory is inconsistent with an express contract requirement that changes must be ordered in writing.⁵¹ Under this view, the written change order requirement will be enforced unless the changes clause expressly allows constructive changes or the

App. 1997); *Youngdale & Sons Constr. Co. v. United States*, 27 Fed. Cl. 516 (1993).

⁴³ 48 C.F.R. § 52.243-4.

⁴⁴ 32 Fed. Reg. 16269 (Nov. 29, 1967).

⁴⁵ Incorporation of the constructive change concept into the clause allows the Contracting Officer to deal with claims under the terms of the contract rather than for breach of contract.

⁴⁶ *United States v. Utah Constr. & Mining Co.*, 384 U.S. 394, 405 (1966).

⁴⁷ *Miller Elevator Co. v. United States*, 30 Fed. Cl. 662, 679 (1994).

⁴⁸ *Id.* at 678.

⁴⁹ *Roger J. Au & Sons, Inc. v. Northeast Ohio Regional Sewer Dist.*, 29 Ohio App. 3d 284, 504 N.E. 1209 (Ohio App. 1986). See also *Julian Speer Co. v. Ohio State Univ.*, 83 Ohio Misc. 2d 88, 680 N.E.2d 254, 257 (Ohio Ct. Cl. 1997) (oral instruction to change specifications created a constructive change order), and *R.J. Wildner Contracting Co. v. Ohio Turnpike Comm'n*, 913 F. Supp. 1031 (N.D. Ohio 1996) (unjust enrichment claim based on superior knowledge).

⁵⁰ *Sentinel Indus. Contracting Corp. v. Kimmins Indus. Service*, 743 So. 2d 954 (Miss. 1999).

⁵¹ *Bonacorso Constr. Corp v. Commonwealth*, 41 Mass. App. Ct. 8, 668 N.E.2d 366, 368 (Mass. App. Ct. 1996).

³⁹ *Id.* at 220 (citations omitted).

⁴⁰ 78 Ohio St. 3d 353, 678 N.E.2d 519, 527-28 (Ohio 1997) (citations omitted).

⁴¹ *Id.*, 678 N.E.2d at 528.

⁴² *District of Columbia v. Organization for Env'tl. Growth*, 700 A.2d 185, 203 (D.C. App. 1997); *Miller Elevator Co. v. United States*, 30 Fed. Cl. 662, 677 (1994); *Global Constr. v. Mo. Highway and Trans. Comm'n*, 963 S.W.2d 340, 343 (Mo.

owner, by its acts or declarations, has waived the requirement. The contractor has a greater burden of proof in establishing waiver or estoppel than in proving a constructive change.⁵²

5. Changes Within the General Scope of the Contract—Cardinal Changes

The power to order changes, under a changes clause, is not unlimited. In general, a contractor is not contractually obligated, under the disputes clause, to perform a unilateral change order when the changed work results in a contract that is substantially different from the one the contractor agreed to perform when it signed the contract.⁵³

Most clauses contain language limiting the power to order changes. Some clauses limit changes to those that are “within the general scope of the contract.”⁵⁴ Some clauses allow changes that are “necessary to satisfactorily complete the contract,”⁵⁵ or “to satisfactorily complete the project.”⁵⁶ The clause may permit the engineer to make changes “required for the proper completion or construction of the whole work contemplated.”⁵⁷ Most clauses allow the owner to increase or decrease the quantity of an item in the contract or delete any item or portion of the work.⁵⁸ Some clauses specify the types of changes that the clause covers. For example, the Federal Changes clause covers changes within the general scope of the contract, including changes: “(1) in the specifications (including drawings and designs); (2) in the method or manner of performance of the work; (3) in the government-furnished facilities, equipment, materials, services or site; or (4) directing acceleration in the performance of the work.”⁵⁹

Drafting the clause too narrowly may limit the owner’s authority to make changes. For example, in *General Contracting & Construction Co. v. United*

States, the deletion of a building from a hospital construction contract was held to be beyond the scope of the contract, even though the value of the building that was deleted was about 10 percent of the contract price.⁶⁰ The standard changes clause that was used by the Federal Government prior to 1968 was limited to changes “in the drawings and specifications.”⁶¹ The 1968 revision to the clause⁶² expanded the authority to modify the contract.⁶³ The criterion for determining whether the change is authorized is whether it is within the “general scope of the contract.”⁶⁴ That determination is governed by the magnitude of the change and whether the change is of the type that would be within the contemplation of the parties when the contract was let.⁶⁵

A contractor who believes that a change ordered by the Government is beyond the scope of the contract has a choice. It may perform the change and sue later for damages, or it may refuse to perform the change and sue for breach of contract.⁶⁶ The contractor cannot hedge by seeking a declaratory judgment as to whether the change is beyond the scope of the contract.⁶⁷ Faced with these choices, and the consequences if the change is later determined not to be cardinal, most contractors will elect to perform the change and sue later for damages.

The doctrine that contractors cannot be contractually compelled to perform changes beyond the scope of the contract developed as part of federal procurement law. The rule had two purposes. First, it was designed to

⁶⁰ 84 Ct. Cl. 570 (1937).

⁶¹ Article 3 of the contract provided that, “The Contracting Officer may at any time, by written order...make changes in the drawings and (or) specifications of this contract and within the general scope thereof...” *Id.* at p. 579.

⁶² See note 44.

⁶³ 48 C.F.R. 52.243-4.

⁶⁴ *Id.*

⁶⁵ *Dittmore-Freimuth Corp. v. United States*, 182 Ct. Cl. 507 (1968), 290 Fed 664; *ThermoCor, Inc. v. United States*, 35 Fed. Cl. 480, 492 (1996); *Albert Elia Building Co. v. New York State Urban Dev. Corp.*, 338 N.Y.S.2d 462 (App. Div. 1976); *Freund v. United States*, 260 U.S. 60, 68–69 (1922). Work can be deleted as a partial termination under a termination for convenience clause. Whether work is deleted under the changes clause or as a partial termination under a termination for convenience clause does not matter if the amount of the equitable adjustment would be the same in either case. *J.D. Hedin Constr. Co. v. United States*, 171 Ct. Cl. 70, 347 F.2d 235 (Ct. Cl. 1965). If the deletion would result in a cardinal change, the owner should delete the work as a partial termination under the termination for convenience clause. *Krygoski Constr. Co. v. United States*, 94 F.3d 1537, 1543 (Fed. Cir. 1996).

⁶⁶ *L.K. Comstock & Co. v. Becon Constr. Co.*, 932 F. Supp. 906, 945 (E.D. Ky. 1992); *Hensel Phelps Constr. Co. v. King County*, 59 Wash. App 170, 787 P.2d 58, 65 (1990); *United States v. Spearin*, 248 U.S. 132, 138, 39 S. Ct. 59, 63 L. Ed. 166 (1918).

⁶⁷ *Valley View Enters., Inc. v. United States*, 35 Fed. Cl. 378, 383–84 (1996).

⁵² *Summerset Community Hosp. v. Allen B. Michell & Assocs.*, 454 Pa. Super. Ct. 188, 685 A.2d 141, 146 (Pa. Supp. 1996) (written contract for architectural services to renovate hospital modified orally, even though contract required modifications to be in writing, where clear and convincing evidence showed the hospital’s intent to waive the requirement that modifications be made in writing).

⁵³ See *L. K. Comstock & Co. v. Becon Constr. Co.*, 932 F. Supp. 906 (E.D. Ky. 1993) (extensive discussion of the “Cardinal Change” doctrine).

⁵⁴ 48 C.F.R. ch. 1, 52.243-4(a); Alaska DOT Specification 104.02.

⁵⁵ AASHTO Guide Specification 104.03; Florida DOT Specification 4.3.1.

⁵⁶ Arizona DOT Specification 104.02. (D)(1); Michigan DOT Specification 103.02; New Jersey DOT Specification 104.02; New York DOT Specification 109-05(A).

⁵⁷ California DOT Specification 4-1.03.

⁵⁸ *Id.* Most clauses allow the owner to make “such changes in quantities and such alterations in the work as are necessary to satisfactorily complete the project.” See, e.g., Texas DOT Specification 4.2.

⁵⁹ 48 C.F.R. ch 1, 52.243-4 (a)(1), (2), (3), (4).

protect contractors from being compelled to perform work substantially different from the work the contractor agreed to perform when it signed the contract.⁶⁸ Second, the rule prevented government agencies “from circumventing the competitive procurement process by adopting drastic modifications beyond the original scope of a contract.”⁶⁹ The doctrine developed at the state level for similar reasons,⁷⁰ and has been referred to in various ways: “fundamental changes,”⁷¹ radical changes,⁷² and “abandonment.”⁷³ The Cardinal Change doctrine, however, has not been universally accepted.⁷⁴

The Cardinal Change doctrine is fact dependent.⁷⁵ “No rule of thumb exists to measure what constitutes a cardinal change.”⁷⁶ Each case must be analyzed on its facts, considering the magnitude or quantity of the change and its affect upon the project as a whole.⁷⁷ At the end of the day, the basic question is whether the contractor has been ordered to perform changes that are substantially different from what the contractor

agreed to do when it accepted the contract.⁷⁸ For example, adding a tunnel by change order to connect a building that the contractor was constructing to an adjacent site owned by the developer was a cardinal change, because the change was not the same type of work the contractor agreed to perform when the contract was awarded.⁷⁹

A change that causes a substantial increase in the cost of the work by making it more difficult to perform may constitute a cardinal change.⁸⁰ However, a substantial increase in the cost of the contract, standing alone, does not constitute a cardinal change where the change “entails the same nature of work as contemplated under the original contract (albeit of a different scope).”⁸¹ Similar reasoning applies to the number of changes made by the owner. A changes clause does not limit the number of changes that the owner can order. Changes only become cardinal when they exceed the reasonable number of changes that should be expected for the type of work specified in the contract. This can be proven through expert testimony. For example, an expert can testify as to the usual and customary number of changes as a percentage of the contract price.⁸²

⁶⁸ General Dynamics Corp. v. United States, 585 F.2d 457 (Ct. Cl. 1978); ThermoCor Inc. v. United States, 35 Fed. Cl. 480 (1996); Wunderlich Contracting Co. v. United States, 173 Ct. Cl. 80, 351 F.2d 956 (1965); L.K. Comstock & Co. v. Becon Constr. Co., 932 F. Supp. 906 (E.D. Ky. 1993).

⁶⁹ Cray Research, Inc. v. Department of Navy, 556 F. Supp. 201, 203 (D.D.C. 1982), *quoted with approval in* Miller Elevator Co. v. United States, 30 Fed. Cl. 662, 677 (1994).

⁷⁰ Albert Elia Building Co. v. N.Y. State Urban Dev. Corp., 388 N.Y.S.2d 462, 468 (App. Div. 1976); C. Norman Peterson Co. v. Container Corp. of America, 172 Cal. App. 3d 628, 218 Cal. Rptr. 592 (Cal. App. 1985); Blum v. City of Hillsboro, 183 N.W.2d 47, 50 (Wis. 1971); State Highway Comm’n v. J.H. Beckman Constr. Co., 84 S.D. 337, 171 N.W.2d 504, 506 (S.D. 1969). *See* Annotation, *Statute Requiring Competitive Bidding for Public Contract as Affecting Validity of Agreement Subsequent to Award of Contract to Allow the Contractor Additional Compensation for Extras or Additional Labor and Material Not Included in the Written Contract*. 135 A.L.R. 1265. The Alaska DOT Standard Specification (104-1.02) provides that, “Changes that are determined to be outside the general scope of the original Contract will be authorized only by Supplemental Agreement.”

⁷¹ Hensel Phelps Constr. Co. v. King County, 57 Wash. App. 170, 787 P.2d 58 (1990).

⁷² McHugh v. Tacoma, 76 Wash. 127, 135 Pac. 1011, 1015 (1913).

⁷³ C. Norman Peterson Co. v. Container Corp. of America, 172 Cal. App. 3d 628, 218 Cal. Rptr. 592, 598 (Cal. App. 1985) (changes so numerous that they constituted an abandonment of the contract).

⁷⁴ Claude DuBois Excavation v. Town of Kittery, 634 A.2d 1299, 1301–02 (Me. 1993); Jackson v. Sam Finley, Inc., 366 F.2d 148, 155 (5th Cir. 1966).

⁷⁵ Air-A-Plane Corp v. United States, 187 Ct. Cl. 269, 408 F.2d 1030, 1033 (Ct. Cl. 1969).

⁷⁶ Miller Elevator Co. v. United States, 30 Fed. Cl. 662, 677 (1994).

⁷⁷ L.K. Comstock & Co. v. Becon Constr. Co., 932 F. Supp. 906, 909 (E.D. Ky. 1992).

⁷⁸ Alliant Techsystems, Inc. v. United States, 178 F.3d 1260, 1276 (Fed. Cir. 1999).

⁷⁹ Albert Elia Building Co. v. N.Y. State Urban Dev. Corp., 54 A.D. 2d 337, 388 N.Y.S.2d 462, 467 (App. Div. 1976).

⁸⁰ Merrill Eng’g Co. v. United States, 47 F.2d 932, 933–34 (S.D. Miss. 1931) (change in design of a brick pavement on a bridge reduced bricklaying production from 1000 square yards per day to 200 square yards per day and increased the amount of asphalt needed by 66 percent); Luria Bros. & Co. v. United States., 177 Ct. Cl. 676, 369 F.2d 701, 707–08 (Ct. Cl. 1966) (change lowered depth of footings for columns from 9 feet to 19 feet).

⁸¹ Miller Elevator Co. v. United States, 30 Fed. Cl. 662, 677 (1994) (an adjustment of \$75,615.21 contract to \$212,900.00 contract not a cardinal change); General Dynamics Corp. v. United States, 218 Ct. Cl. 40, 585 F.2d 457 (Ct. Cl. 1978) (An increase of \$100 million in a \$60 million contract not a cardinal change); Peter Kiewit Sons Co. v. Summit Constr. Co., 422 F.2d 242, 255 (8th Cir. 1969) (a treble rise in the cost of the contract was beyond the scope of the contract).

⁸² In a case involving a building construction contract for the State of Washington, the architect testified that it was normal to expect changes of about 5 percent of the contract price for that type of construction. The contractor’s claim for quantum meruit was based on what it considered to be an excessive number of changes. The trial court disregarded the number of changes and looked to the dollar value of the changes. The court found that the dollar value of the changes was not excessive and not a cardinal change and dismissed the quantum meruit claim. However, where there are numerous changes due to poor design, the changes may be cardinal. *See, e.g.,* Slattery Contracting Co. v. New York, 288 N.Y.S.2d 126, 129 (N.Y. Ct. Cl. 1968); Housing Auth. of Texarkana v. E.W. Johnson Constr. Co., 264 Ark 523, 573 S.W.2d 316 (Ark. 1978); General Contracting and Constr. Co. v. United States, 84 Ct. Cl. 570, 580 (1937).

A change outside the scope of the contract is not governed by the changes clause.⁸³ Whether the change is an “in-scope” change that the contractor is contractually obligated to perform or an “out-of-scope” breach depends upon whether the change is reasonable and necessary to complete the work specified in the original contract. While it may be difficult, at times, to define the boundaries of an allowable change—since each case depends upon its own set of facts—there are, however, some guidelines. Is the work, as changed, essentially the same work called for in the original contract? Are the total number of changes reasonable for the type of work specified in the contract? And finally, are the changes normally associated with the type of work called for in the contract?

If the change is reasonable, and necessary to complete the contract, and does not have an unreasonable impact on the contractor, the change should be within the general scope of the contract. If the change does not meet this test, it is a breach of contract, giving the contractor a choice: perform the change and sue later for damages, or stop work and sue for damages. Most cases involve the former situation rather than the latter because of the consequences that the contractor may face if the change is found by a court to be an allowable change under the change clause.⁸⁴

6. Notice Requirements

“A typical clause requires the contractor to give the owner written notice when it believes that it is performing extra work. The clause specifies that notice must be given within a specified number of days from the event that gave rise to the claim.”

The federal Changes clause⁸⁵ requires written notice of any oral order, as defined in the clause, which the contractor regards as a change order.

If any change under this clause causes an increase or decrease in the Contractor’s cost of, or the time required for, the performance of any part of the work under this contract, whether or not changed by any such order, the Contracting Officer shall make an equitable adjustment and modify the contract in writing. However, except for an adjustment based on defective specifications, no adjustment for any change under paragraph (b) of this clause shall be made for any costs incurred more than 20 days before the Contractor gives written notice as required. In the case of defective specifications for which the Government is responsible, the equitable adjustment shall include any increased cost reasonably incurred by

the Contractor in attempting to comply with the defective specifications.⁸⁶

The Contractor must assert its right to an adjustment under this clause within 30 days after (1) receipt of a written change order under paragraph (a) of this clause or (2) the furnishing of a written notice under paragraph (b) of this clause, by submitting to the Contracting Officer a written statement describing the general nature and amount of proposal, unless this period is extended by the Government. The statement of proposal for adjustment may be included in the notice under paragraph (b) above.⁸⁷

Some Changes clauses require the contractor to give notice, before it begins work, that it regards it as a change.⁸⁸ Other clauses require notice, within a specified time, after the contractor believes that any work ordered by the owner is extra work and not original contract work. An example is a specification used by the New Jersey Department of Transportation, which requires that “the contractor shall promptly notify the Engineer in writing, on forms provided by the Department, within five days from the date that the Contractor identifies any actions or state conduct including, inactions, and written or oral communications, which the Contractor regards as a change to the Contract terms and conditions.”⁸⁹

Some contractors have stamps that they use to protest unilateral change orders. The stamp is worded to allow the contractor to reserve its increased costs for performing unchanged work, as well as any additional time needed for performing the changed work. Reservation of the right to assert a claim is usually based on the contention that the contractor is unable to determine, in advance of performing the work, the extra costs and time that may result from the change. When faced with a reservation or notice of a claim, an owner may wish to determine whether the change is really necessary in order to perform the original contract work. In some instances, the owner could withdraw the change order, avoid a dispute, and add the work to a future contract or perform the work with its own employees after the contract is completed.

The notice requirement serves several purposes. Notice enables the owner to investigate the claim while the facts are still fresh to determine its validity. Notice allows the owner to keep records of the costs of an operation that the contractor asserts is extra work. Notice allows the owner to take remedial action to mitigate damages, or take other steps that are in the owner’s best interests. Notice also protects the owner from claims for changes that the owner never ordered.⁹⁰ The

⁸³ *Miller Elevator Co. v. United States*, 30 Fed. Cl. 662, 677 (Ct. Cl. 1994).

⁸⁴ Under the “dispute” provisions of the contract, a contractor is contractually obligated to perform a unilateral change order that is within the scope of the contract. Refusal to perform such a change is a material breach of contract by the contractor, establishing grounds for a default termination. *Discount Co. v. United States*, 213 Ct. Cl. 567, 554 F.2d 435, 440 (Ct. Cl. 1977).

⁸⁵ *See, e.g.*, 48 C.F.R. § 52.243-4 (1987).

⁸⁶ *Id.*, at § 52.243-4(d).

⁸⁷ *Id.*, at § 52.243-4(e).

⁸⁸ *See, e.g.*, Connecticut DOT Standard Specification § 1.04-04(3) (2000); Oregon DOT Standard Specification § 00140.40 (2002).

⁸⁹ New Jersey Standard Specifications 104.09 (1996).

⁹⁰ 3 JOHN C. VANCE, *Enforceability of the Requirement of Notice in Highway Construction Contracts*, SELECTED STUDIES

public policy considerations that underlie notice requirements in public works contracts were recently articulated by the New York Court of Appeals.⁹¹

Strong public policy considerations favor scrutiny of claims of bad faith when offered by contractors to excuse noncompliance with notice and reporting requirements in public contracts. These provisions, common in public works projects, provide public agencies with timely notice of deviations from budgeted expenditures or of any supposed malfeasance, and allow them to take early steps to avoid extra or unnecessary expense, make any necessary adjustments, mitigate damages and avoid the waste of public funds. Such provisions are important both to the public fisc and to the integrity of the bidding process. Respondent's accumulation of \$1,000,000 in undocumented damages—a full 20% over the combined contract price—is precisely the situation that the cited provisions are intended to prevent.⁹²

Generally, notice requirements are strictly enforced.⁹³ However, as with most general rules, there are exceptions. Written notice may be waived if the owner had actual knowledge that extra work was being performed.⁹⁴ Also a consideration of the claim, on its merits, may waive lack of timely notice as a defense.⁹⁵ And some courts follow the rule that strict compliance with notice requirements will not bar a claim if the court finds that the owner is not prejudiced by lack of notice. Under federal case law, lack of notice will not bar the claim unless the government can show that it was prejudiced, or put at a disadvantage due to the contractor's failure to provide notice.⁹⁶ In other jurisdictions,

lack of prejudice will not prevent notice requirements from being enforced.⁹⁷

The question of notice often turns on whether the information provided is sufficient to inform the owner that the contractor has a problem for which it intends to hold the owner responsible.⁹⁸ The form of the notice is not important if the notice alerts the owner to the problem and gives the owner an opportunity to investigate and take steps to protect itself.⁹⁹ The case law dealing with notice requirements has established the following propositions: First, contract provisions that require written notice of intention to make a claim for extra work before starting work are enforceable, absent circumstances constituting waiver, and in a few jurisdictions, lack of prejudice to the owner. Second, in those jurisdictions where waiver has been applied to avoid the defense of lack of notice, certain facts have been identified as being significant. These facts include: extra work orally ordered by the owner,¹⁰⁰ or a course of conduct and dealing between the parties establishing a continuing disregard for the provision relating to notice,¹⁰¹ or remaining silent, knowing that the contractor is performing extra work.¹⁰²

In general, most courts are disinclined to allow an owner to avoid payment for extra work because the contractor failed to provide written notice when the owner had actual knowledge that extra work was being performed and did nothing to stop it. Some jurisdictions, however, require strict compliance with notice provisions when public contracts are involved.¹⁰³

For example, in *Perini Corp. v. City of New York*, the City's construction contract was funded by the EPA and contained the Federal Changes clause required by EPA regulations.¹⁰⁴ The contractor's claim for extra work was denied by the City because of the contractor's failure to give written notice that it was performing what it considered to be extra work. The contract required such notice before the contractor could begin work.

IN HIGHWAY LAW 1542-N2, *et seq.*; Clark-Fitzpatrick, Inc./Franki Foundation Co. v. Gill, 652 A.2d 440, 447 (R.I. 1994); Plumley v. United States, 226 U.S. 545, 548, 33 S. Ct. 139, 57 L. Ed. 342 (1913).

⁹¹ A.H.A. General Constr., Inc. v. N.Y. Housing Auth., 92 N.Y.2d 20, 699 N.E.2d 368, 677 N.Y.S.2d 9 (N.Y. 1998).

⁹² *Id.* at 376.

⁹³ *Supra* note 91; Risser & McMurry Co. v. Sheridan Area Water Supply Joint Powers Bd., 929 P.2d 1228, 1232–33 (Wyo. 1996); Sime Constr. Co. v. Wash. Pub. Power Supply Systems, 28 Wash. App. 10, 621 P.2d 1299, 1302–03 (1980); Allen-Howe Specialties Corp. v. United States Constr., Inc., 611 P.2d 705, 707–08 (Utah 1980).

⁹⁴ Harrington v. McCarthy, 91 Idaho 307, 420 P.2d 790 (1966); Frederick Snare Corp. v. Maine-New Hampshire Interstate Bridge Auth., 41 F. Supp. 638, 645 (D. N.H. 1941) (failure to give written notice did not bar claim—owner was reasonably conversant with all the facts that written notice would have provided); Hoel-Steffen Constr. Co. v. United States, 456 F.2d 760, 766 (Ct. Cl. 1972) (actual notice of claim satisfies notice requirement).

⁹⁵ Dittmore-Freimuth Corp. v. United States, 390 F.2d 664, 667 (Ct. Cl. 1968) (owner should obtain agreement from the contractor that consideration of the claim in settlement negotiations will not waive the defense of lack of timely notice in litigation if the claim is not settled).

⁹⁶ Fru-Con Constr. Corp. v. United States, 43 Fed. Cl. 306, 328–29 (Fed. Cl. 1999); Eggers & Higgins & Edwin A. Keeble Assocs., Inc. v. United States, 185 Ct. Cl. 765, 403 F.2d 225, 233 (Ct. Cl. 1968) (prejudiced established—claim barred).

⁹⁷ *Supra* note 91, at 368, 374. 677 N.Y.S.2d. 9 (N.Y. 1998); Absher Constr. Co. v. Kent School Dist., 77 Wash. App. 137, 890 P.2d 1071, 1096 (Wash. App. 1995).

⁹⁸ State Highway Dep't v. Hall Paving Co., 127 Ga. App. 625, 194 S.E.2d 493, 496 (1972); Department of Transp. v. Fru-Con Constr. Corp., 206 Ga. App. 821, 426 S.E.2d 905, 908 (Ga. App. 1992) (knowledge that grading work was behind schedule did not waive the agency's right to notice that the contractor would seek a time extension).

⁹⁹ Gilmarten Bros. v. Kern, 916 S.W.2d 324, 329 (Mo. App. 1995).

¹⁰⁰ Reif v. Smith, 319 N.W.2d 815, 817 (S.D. 1982).

¹⁰¹ *Supra* note 99; DeNiro v. Gasvoda, 1999 Mont. 129, 982 P.2d 1002, 1004 (1999).

¹⁰² Zook Bros. Constr. Co. v. State, 171 Mont. 64, 556 P.2d 911, 915 (Mont. 1976).

¹⁰³ D. Federico Co. v. Commonwealth, 11 Mass. 248, 252, 415 N.E.2d 855, 857–58 (1981) *See, e.g.*, cases cited in note 97.

¹⁰⁴ 18 F. Supp. 2d 287 (S.D. N.Y. 1998), *aff'd without published opinion*, 182 F.3d 901 (2d Cir. 1999), *cert. denied*, 120 S. Ct. 615 (1999).

The question before the court was whether state law or federal law applied in determining what type of notice was sufficient. Under federal law construing notice provisions, lack of notice will bar the claim only if the Government can show prejudice. Under state law, strict compliance with notice requirements was a condition precedent to payment for extra work. The court held that New York law applied, and that the contractor's failure to provide notice as required by the contract barred its claim.¹⁰⁵

A typical "changes" clause does not require the owner to obtain the consent of the payment and performance bond surety. Without language of this kind, the owner may discharge the surety's obligations under its bonds for changes made without the surety's approval.¹⁰⁶

Most clauses do not require the owner to give the surety notice of the change. For example, the clause may provide that, "Such changes in quantities and alterations do not invalidate the contract nor release the contract surety...."¹⁰⁷ However, a clause may require the contractor to obtain surety consent for substantial changes.¹⁰⁸ The standard form performance bond used by some agencies incorporates by reference all of the provisions of the construction contract. The surety, by signing the bond, agrees to the waiver provisions in the Changes clause or the limitations on notice as provided in the construction contract.

7. Effect of Changes on Other Work

The Federal Changes clause allows the contractor to recover, as part of an equitable adjustment, the contractor's increased costs of performing unchanged work.¹⁰⁹ This was not necessarily so prior to 1968 because of the so-called *Rice* doctrine.¹¹⁰ Under this doctrine, the contractor could recover for performing the change, but not for the effect that the change had on unchanged work. The increased cost of performing unchanged work caused by the change was held to be "consequential."¹¹¹ In 1968, the *Rice* doctrine was eliminated from federal construction law when the Changes clause was revised.¹¹² Today, at the federal level,

¹⁰⁵ 18 F. Supp. 2d at 295.

¹⁰⁶ *Gritz Harvestore, Inc. v. A.O. Smith Harvestore Products, Inc.*, 769 F.2d 1225, 1230 (7th Cir. 1985) (material alteration without consent of guarantor discharges guarantor); *National Sur. Corp. v. United States*, 118 F.3d 1542, 1546 (Fed. Cir. 1997).

¹⁰⁷ AASHTO Guide Specifications § 104.03, Texas DOT Specification 4.2. The Alaska DOT Changes Clause (104-1.02) allows changes to be made, "without notice to the sureties and within the general scope of the contract."

¹⁰⁸ Surety consent required for changes that increase the total cost of the project by more than 25 percent. WSDOT Standard Specification, 1-04.4.

¹⁰⁹ 48 C.F.R. ch. 1 § 52.243-2(b).

¹¹⁰ *United States v. Rice*, 317 U.S. 61 (1942).

¹¹¹ *Id.*

¹¹² The elimination of the *Rice* doctrine was accomplished by adding the phrases "any part of the work" and "whether or

changes that affect unchanged work are compensable. This has been true for over 30 years.

In general, the same is true at the state level. The clause used by the New York State Department of Transportation provides in part that, "if the alterations or changes in quantities significantly change the character under the contract whether such alterations or changes are in themselves significant changes to character of the work, or by affecting other work, cause such other work to become significantly different in character, an adjustment excluding anticipated profit, will be made to the contract."¹¹³ The Florida¹¹⁴ and Texas¹¹⁵ specifications provide that, "if the alterations or changes in quantities significantly change the character of the work under the contract, whether or not changed by any such different quantities or alterations, an adjustment, excluding loss of anticipated profits, will be made to the contract." The standard specifications used by Arizona,¹¹⁶ Michigan,¹¹⁷ and Iowa¹¹⁸ have similar language. They provide that, "If the alterations or changes in quantities significantly change the character of the work under the contract, whether such alterations or changes are in themselves significant changes to the character of the work, or by affecting other work, cause such other work to become significantly different in character, an adjustment excluding anticipated profit, will be made to the contract." The Changes clause mandated by 23 U.S.C. § 112 contains similar provisions.¹¹⁹

8. Variations in Estimated Quantities

Highway construction contracts based on fixed unit prices for estimated quantities typically contain a variation in estimated quantities (VEQ) clause. The VEQ clause used in federal contracts is based upon variations in estimated quantities that exceed 115 percent, or are less than 85 percent of the estimated plan quantities.¹²⁰ The VEQ clauses typically used in state transportation contracts provide for a price adjustment from the contract unit price when the actual quantity used exceeds or is less than 25 percent of the estimated

not changed" to the clause. Appendix to 32 Fed. Reg. 16269 (Nov. 29, 1967).

¹¹³ Standard Specification 109-16A(3)(ii).

¹¹⁴ Standard Specification 4.3.2.1.

¹¹⁵ Standard Specification 4.2.

¹¹⁶ Standard Specification 104.02(D)(2).

¹¹⁷ Standard Specification 103.02 B.

¹¹⁸ Standard Specification 1109.16 C2.

¹¹⁹ 23 C.F.R. § 635.109(a)(3)(ii), "Significant Changes in the Character of the Work" provides:

If the alterations or changes in quantities significantly change the character of the work under the contract, whether such alterations or changes are in themselves significant changes to the character or work or affecting other work cause such work to become significant different in character an adjustment, excluding loss of anticipated profits, will be made to the contract.

¹²⁰ 48 C.F.R. § 52.211-18.

contract quantity.¹²¹ The federally-mandated Changes clause also uses 25 percent.¹²²

The VEQ clause has several purposes: First, it affords protection to the contractor by providing a remedy for excessive overruns or underruns from estimated contract quantities.¹²³ Second, it affords protection to the owner from claims when the quantities vary from estimated contract quantities within a specified percentage.¹²⁴ The clause may also entitle the owner to a downward adjustment in the unit contract price when the contractor's actual cost is reduced by an overrun in excess of the specified percentage.¹²⁵ An overrun of less than 125 percent or an underrun of less than 75 percent in the case of the state clauses is a risk that the contractor assumes. Agencies, however, are required to use reasonable care in preparing estimated quantities. Where information is available to quantify the estimate with more precision and the owner neglects to use that information, the 25 percent variance may not limit recovery.¹²⁶

The adjustment in the unit contract price for overruns or underruns that exceed or differ from the estimated contract quantities is determined by the language of the VEQ clause and the contractor's costs for performing that item of work. In the case of overruns, the adjustment is based on the actual unit cost for performance of the item minus the unit contract price for 115 percent (Federal VEQ) or 125 percent (state VEQ) of the estimated plan quantity. Where the variation is less than 85 percent (Federal VEQ) or 75 percent (state VEQ) of the original bid quantity, the adjustment is

¹²¹ Arizona DOT Standard Specification (104.2(D)(4)). California DOT Standard Specifications 4-1.03B(1) (1995), (Increases); 4-1.03 B(2) (1995), (Decreases). Michigan DOT Standard Specification 103.02B2 (1996), Florida DOT Standard Specification 4.3.2.1 (B). Texas DOT Standard Specification 4.2 (b).

¹²² 23 C.F.R. § 635.109(a)(3)(iv)(B). A "significant change" includes:

When a major item of work, as defined elsewhere in the contract, is increased in excess of 125 percent or decreased below 75 percent of the original contract quantity. Any allowance for an increase in quantity shall apply only to that portion in excess of 125 percent of original contract item quantity, or in case of a decrease below 75 percent, to the actual amount of work performed.

This clause and the other clauses mandated by 23 C.F.R. 635, *et. seq.*, do not apply to federally-aided state transportation projects if a state has a similar clause, or if state law prohibits their use. 23 U.S.C. § 112.

¹²³ "The object is to retain a fair price for the contract as a whole in the face of unexpectedly large variations from the estimated quantities on which bids are based." *Bean Dredging Corp.*, 89-3 ENGBCA 22,034 (1989) ¶ 110, 816 at 110,824 (concurring opinion).

¹²⁴ *Burnett Constr. Co. v. United States*, 26 Ct. Cl. 296, 302 (1992); *Farub Found. Corp. v. City of N.Y.*, 183 Misc. 636, 49 N.Y.S.2d 922, 923 (N.Y. Sup. Ct. 1944).

¹²⁵ *Foley Co. v. United States*, 11 F.3d 1032 (Fed. Cir. 1993).

¹²⁶ *Travis T. Womack, Jr. v. United States*, 182 Ct. Cl. 399, 389 F.2d 793 (Ct. Cl. 1968).

based on any increase in costs due solely to the variation.¹²⁷

The VEQ clause applies only to errors in estimated quantities. In this sense, it supplements the Changes clause by allowing the overrun or underrun to differ from the original quantity estimate up to or less than the specified percentage, without any adjustment in the contract price, when the overrun or underrun is due to an estimating error, and not a change ordered by the owner or some other cause.¹²⁸ When the variation in quantity is due to a change ordered by the owner, the Changes clause applies and any increase in the cost of performance resulting from the change is governed by that clause.¹²⁹

9. Accord and Satisfaction

An accord and satisfaction is a means of discharging an existing right.¹³⁰ In a change order setting, an accord occurs when the owner and the contractor agree upon the terms of a contract modification and express those terms in a bilateral change order. The satisfaction occurs when the contractor performs the change and is paid for it by the owner.¹³¹ A typical change order provision provides that a change order that is not protested by the contractor is full payment and final settlement of all claims for time, and for costs of any kind, including delays related to any work either covered or affected by the change, and constitutes a waiver of any future claims arising out of the change order.¹³²

An accord and satisfaction will bar any claim arising within the scope of the accord.¹³³ There are, however, exceptions to this rule. One frequently litigated exception is whether the contractor and the owner reached an accord. In *Safeco Credit v. United States*, the court said: "As in many contract cases where accord and satisfaction is the government's asserted defense, this case requires the court to rule on whether there was a meeting of the plaintiff's and the Government's minds. Without agreement the parties did not reach an accord..."¹³⁴ (citations omitted).

This determination is a question of law that requires the court to determine whether the parties intended the change order to be an accord.¹³⁵ In making this deter-

¹²⁷ *Burnett Constr. Co. v. United States*, 26 Ct. Cl. 296, 302 *et. seq.* (1992); *Foley v. United States*, *supra* note 125.

¹²⁸ *Reliance Ins. Co. v. United States*, 931 F.2d 863, 866 (Fed. Cir. 1991).

¹²⁹ *ThermoCur v. United States*, 35 Fed. Cl. 480, 486 (1996).

¹³⁰ 6 CORBIN, CORBIN ON CONTRACTS, § 1276 (rev. ed. 1993).

¹³¹ *Brock & Blevins Co. v. United States*, 170 Ct. Cl. 52, 343 F.2d 951, 955 (Ct. Cl. 1965); *C. & H. Commercial Contractors, Inc. v. United States*, 35 Fed. Cl. 246, 252 (1996).

¹³² *See Safeco Credit v. United States*, 44 Fed. Cl. 406, 419-20 (Fed. Cl. 1999), for examples of this type of clause.

¹³³ *Transpower Contractors v. Grand River Dam Auth.*, 905 F.2d 1413, 1419 (10th Cir. 1990).

¹³⁴ *Safeco Credit v. United States*, *supra* note 132, at 419.

¹³⁵ *McLain Plumbing & Elec. Serv., Inc. v. United States*, 30 Fed. Cl. 70, 78 (Fed. Cl. 1993).

mination, the court will not consider parol evidence of prior negotiations to create a genuine issue of material fact when such evidence would vary or contradict the plain and unambiguous language of the change order.¹³⁶

Another theory that a contractor may advance to avoid the preclusive effect of a bilateral change order is economic duress. To establish economic duress, the contractor must prove that the contractor's assent was induced by an improper threat that left the contractor with no reasonable alternative, other than to sign the change order without protest.¹³⁷ Economic pressure, and even the threat of considerable financial loss, do not constitute duress. The act must be coercive and violate notions of fair dealing.¹³⁸ For instance, when the owner induces the contractor to sign because of an improper threat, the change order is voidable.¹³⁹

Because a change order induced by duress is voidable and not void, the contractor must act promptly to repudiate the change order or be deemed as having waived the right to do so.¹⁴⁰ A contractor may also be deemed as having ratified a change order executed under duress when the contractor accepts payment for the change, and then remains silent for a period of time after the contractor has had an opportunity to repudiate the change order.¹⁴¹

Another theory for avoiding the preclusive effect of an unprotested change order is the Cardinal Change doctrine. This exception is based on the premise that a contractor should not be bound by a change order as an accord and satisfaction when the contractor was unable to assess the cumulative effect of the change order on the overall performance of the contract,¹⁴² or determine how the changes would ultimately impact the work.¹⁴³ The Cardinal Change doctrine will not apply, however, where the contractor clearly waives future claims. For example, in *In re Boston Shipyard Corp.*,¹⁴⁴ the contractor signed a change order settling all of its claims for delay and disruption. The contractor later attempted to avoid the change order by claiming that the changes were so extensive that they amounted to a cardinal

change. The court found that the change order barred the contractor's claim for quantum meruit. The court observed that the change order clearly served as a release of claims, and once the contractor accepted payment, the parties had reached an accord and satisfaction on all possible claims, including those for delay and disruption. The court also noted that the contractor's assertion that it did not intend to waive its claim when it signed the change order was insufficient to raise a genuine issue of material fact so as to preclude summary judgment for the Government.

A claim cannot be reserved on the basis of the contractor's subjective intent.¹⁴⁵ To avoid the preclusive effect of a bilateral change order, the contractor must show that the mistake was mutual, not unilateral, and that the change order did not reflect what the contractor and the owner intended.¹⁴⁶ The Parol Evidence rule prevents the contractor from creating a contractual ambiguity based on its intentions.¹⁴⁷

10. Observations

The Changes clause is a powerful and necessary tool in the administration of construction contracts. Yet, the clause should be used sparingly insofar as practicable. Changes to the contract increase the cost of the work and the potential for delay. In addition, they often lead to disputes and ultimately to litigation. Thus, the goal of every owner should be to reduce change orders. Owners may wish to consider better subsurface site investigations when the contract contains a DSC clause. Also, when the work is novel or extremely complex, the owner may wish to employ constructibility reviews to assure that the design is reasonably constructible within accepted industry standards.

A balance should be struck by weighing the cost of such investigations and reviews against the potential cost and delay that can result when design errors and inadequate investigations have to be corrected through the change order process.

¹³⁶ *Safeco Credit v. United States*, *supra* note 132, at 420-21.

¹³⁷ *Systems Technology Assocs. v. United States*, 699 F.2d 1383, 1386-87 (Fed Cir. 1983); *David Nassif Assocs. v. United States*, 644 F.2d 4, 12 (Ct. Cl. 1981).

¹³⁸ *David Nassif Assocs. v. United States*, *supra* note 137.

¹³⁹ *Willms Trucking Co. v. JW Constr. Co.*, 314 S.C. 170, 442 S.E.2d 197 (S.C. App. 1994) (citing the RESTATEMENT OF CONTRACTS, § 175(1)) (2d 1981) (contractor needed payment provided by change order to pay subcontractors and suppliers and avoid litigation).

¹⁴⁰ *In re Boston Shipyard Corp.*, 886 F.2d 451, 455 (1st Cir. 1989).

¹⁴¹ *Id.* at 455.

¹⁴² *Atlantic Dry Dock Corp. v. United States*, 773 F. Supp. 335, 399 (M.D. Fla. 1991).

¹⁴³ *Saddler v. United States*, 152 Ct. Cl. 557, 287 F.2d 411, 413 (Ct. Cl. 1961).

¹⁴⁴ *In re Boston Shipyard Corp.*, *supra* note 140.

¹⁴⁵ *Id.*

¹⁴⁶ *H. L. C. & Assocs. Constr. Co. v. United States*, 367 F.2d 586, 591 (Ct. Cl. 1966).

¹⁴⁷ *Denver D. Darling v. Controlled Env'ts Constr., Inc.*, 89 Cal. App 4th 1221, 1235, 108 Cal. Rptr. 2d 213 (2001).

B. DIFFERING SITE CONDITIONS

1. Introduction

Under common law, a contractor who agreed to build some improvement assumed the risks ordinarily associated with performing that kind of work.¹⁴⁸ The fact that the work was actually more difficult and costly than the contractor anticipated did not entitle the contractor to additional compensation or excuse its performance. This principle of construction law was succinctly stated in *United States v. Spearin*:¹⁴⁹ “Where one agrees to do, for a fixed sum, a thing possible to be performed, he will not be excused or become entitled to additional compensation, because unforeseen difficulties are encountered.”

This principle applies to unknown subsurface or latent physical conditions at the work site. These are risks that the contractor assumes, unless the contract shifts those risks to the project owner.¹⁵⁰ It was generally understood that contractors, faced with the risk of adverse, unknown site conditions, would include some amount in their bids as a contingency against encountering such conditions.¹⁵¹ Some project owners, particularly large institutional owners such as the Federal Government, realized that if they assumed the risk of adverse site conditions, bids would be lower and the overall cost of their construction projects would be reduced. This realization was based on three assumptions: First, by shifting the risk of adverse conditions to the owners, the contractor would not have to include a contingency in its bid to guard against the risk of unforeseen site conditions. Second, on fixed-price contracts that are competitively bid, contractors must be competitive to obtain work. Third, it was cheaper to pay

the occasional DSC claim than to pay the contingency as part of the price of each contract. Thus, the competitive process would force contractors to exclude those contingencies from their bids if they wished to be competitive and obtain contracts.

The desire of owners to reduce construction costs led to the development of the Federal “Changed Conditions” clause, and in 1968, its successor, the “Differing Site Conditions” (DSC) clause. This clause, which is now codified in the Federal Acquisition Regulations (FAR),¹⁵² is required in direct, fixed-price construction contracts. Its purpose is to take some of the gamble out of bidding with regard to subsurface conditions. That purpose was stated by the Court of Claims in *Foster Construction C.A. and Williams Brothers v. United States*:

The starting point of the policy expressed in the changed conditions clause is the great risk, for bidders on construction projects, of adverse subsurface conditions...Whenever dependable information on the subsurface is unavailable, bidders will make their own borings or, more likely, include in their bids a contingency element to cover the risk. Either alternative inflates the costs to the Government. The Government, therefore, often makes such borings and provides them for the use of the bidders, as part of a contract containing the standard changed conditions clause.¹⁵³

Bidders are thereby given information on which they can rely in making their bids, and are at the same time promised an equitable adjustment under the changed conditions clause if subsurface conditions turn out to be materially different than those indicated in the logs. The purpose of the changed conditions clause is thus to take at least some of the gamble on subsurface conditions out of bidding. Bidders need not weigh the cost and ease of making their own borings against the risk of encountering an adverse subsurface, and they need not consider how large a contingency should be added to their bid to cover the risk.

Some state transportation agencies have developed their own DSC clauses. Those clauses differ from the standard clause used by the Federal Government in its construction contracts. Some states have adopted the Changed Conditions clause contained in the AASHTO Guide Specifications for Highway Construction.¹⁵⁴ This subsection discusses those differences and the legal problems ordinarily associated with this type of clause.

¹⁴⁸ *Ashton Co. v. State*, 9 Ariz. App. 564, 454 P.2d 1004, 1008 (Ariz. App. 1969); 3 A. CORBIN, CORBIN ON CONTRACTS § 598; 6 A. CORBIN, CORBIN ON CONTRACTS § 1333 (1962).

¹⁴⁹ 248 U.S. 132, 136, 39 S. Ct. 59, 63 L. Ed. 166 (1918).

¹⁵⁰ “[N]o one can ever know with certainty what will be found during subsurface operations.” *Kaiser Indus. Corp. v. United States*, 169 Ct. Cl. 310, 340 F.2d 322, 329 (Ct. Cl. 1965). “If he [the contractor] wishes to protect himself against the hazards of the soil...he must do so by his contract.” *White v. Mitchell*, 123 Wash. 630, 213 Pac. 10, 12 (Wash. 1923). There can be no claim for “Changed Conditions” when the contract does not contain a “Changed Conditions” clause. *Frenz Enters. v. Port of Everglades*, 746 So. 2d 498, 503 (Fla. App. 1999) (“[T]he parties’ contract contained no ‘changed conditions’ clause, thus no breach of contract actions would lie for changed conditions.”); *Dravo Corp. v. Metro Seattle*, 79 Wash. 2d 214, 484 P.2d 399, 402 (1971).

¹⁵¹ *Foster Constr. and Williams Bros. Co. v. United States*, 193 Ct. Cl. 587, 435 F.2d 873, 887 (Ct. Cl. 1970); *Hardwick Bros. Co., II v. United States*, 36 Fed. Cl. 347, 405 (1996); *H.B. Mac, Inc. v. United States*, 36 Fed. Cl. 793, 819 (1996); *Department of General Services v. Harmans Assoc.*, 987 Md. App. 535, 633 A.2d 939, 947 (Md. App. 1993); *Sornsin Constr. Co. v. State*, 190 Mont. 248, 590 P.2d 125, 130 (1978), P.T.L. Constr. v. Department of Transp., 531 A.2d 1330 (N.J. 1987).

¹⁵² 48 C.F.R. ch. 1 § 52.236-2. In 1968, the title of the clause was changed from “Changed Conditions” to “Differing Site Conditions.” 32 Fed. Reg. 16269 (Nov. 29, 1967).

¹⁵³ *Foster Constr.*, *supra* note 151, at 887. See also Annotation, *Construction and Effect of “Changed Conditions” Clause in Public Works or Construction Contract With State or its Subdivision*, 56 A.L.R. 4th 1042 (1987).

¹⁵⁴ 3 D. W. HARP, *Preventing and Defending Against Highway Construction Claims: The Use of Changes or Differing Site Conditions Clause, Etc.*, SELECTED STUDIES IN HIGHWAY LAW, National Cooperative Highway Research Program Legal Research Digest No. 28.

In the absence of a DSC clause, the contractor assumes the risk of subsurface conditions unless the contractor can shift that risk to the owner under one of several common law theories. One such theory is misrepresentation. This theory imposes liability on an owner for adverse site conditions when the contractor can prove that it was misled by erroneous information in the contract documents that caused the contractor to submit a bid lower than it would have otherwise made. Liability is based on the theory that furnishing misleading plans and specifications constitutes a breach of an implied warranty of their correctness.

Alternatively, a contractor may claim that the owner failed to disclose information about site conditions that was vital in preparing the bid. Liability for nondisclosure may be imposed where the contractor could not reasonably obtain such information without resort to the owner.

This subsection also discusses impossibility of performance as an excuse for nonperformance where unforeseen, adverse site conditions make performance physically impossible or commercially impracticable. Subcontractor pass-through claims are also discussed briefly, since subsurface work is often sublet by the general contractor and a DSC clause may be incorporated in the subcontract, either expressly or by implication through a flow-down clause. The subsection concludes with some observations about change orders as admissions when an owner wishes to change the design and keep the project moving, rather than let it languish because of a dispute over whether a DSC has occurred.

2. Contract Clauses—Type I And Type II Conditions

The FAR require inclusion of the standard DSC clause in all fixed-price construction contracts.¹⁵⁵ Some states have similar laws.¹⁵⁶ Other state agencies include DSC clauses under their general authority to develop plans and specifications for their construction projects.¹⁵⁷

The federal clause differs from most state clauses in how it treats the effect of a DSC on unchanged work. The 1968 revisions to the federal clause not only changed the name of the clause from “Changed Conditions” to “Differing Site Conditions,” it also broadened the equitable adjustment provisions of the clause to cover the effect of changed conditions upon the cost of performing unchanged work. Prior to 1968, a contractor was only entitled to the additional cost it incurred in performing the changed work. If the changed condition

affected other work by delaying or resequencing that work, the contractor was not entitled to additional compensation. The financial impact that the condition had on other work was considered “consequential” and as such was not compensable.¹⁵⁸ To obviate that result, the 1968 revision added this language: “...that such conditions do materially so differ and cause an increase or decrease in the contractor’s cost of, or the time required for, performance of any part of any work under this contract, *whether or not changed as a result of such conditions*” (emphasis added). This language eliminated the *Rice* doctrine.¹⁵⁹

The standard DSC clauses used by most states contain language disallowing impact costs on unchanged work.¹⁶⁰ The FHWA DSC clause mandated in 23 C.F.R. 109(A)(1) for federally-aided highway projects also disallows impact costs. Subsection (IV) of that clause provides that, “no contract adjustment will be allowed under this clause for any effects caused on unchanged work.”

Both the federal and state clauses recognize two types of DSCs: (1) subsurface or latent physical conditions at the site that differ materially from those indicated in the contract (generally referred to as a Type I condition); and (2) physical conditions that are so unusual for the type of work performed that the conditions could not have been reasonably anticipated by an experienced and prudent contractor (generally referred to as a Type II condition). For example, the DSC clause contained in federal construction contracts provides in pertinent part as follows:

The Contractor shall promptly, and before the conditions are disturbed, give a written notice to the Contracting Officer of (1) subsurface or latent physical conditions at the site which differ materially from those indicated in this contract, or (2) unknown physical conditions at the site, of an unusual nature, which differ materially from those ordinarily encountered and generally recognized as inhering in work of the character provided for in the contract.¹⁶¹

The AASHTO Guide Specification defines differing site conditions similarly as:

- Surface or latent physical conditions at the site that:
- A. Differ materially from those indicated in the Contract.
 - B. Differ materially from conditions normally encountered or from those conditions generally recognized as inherent in the nature of the work required.

¹⁵⁵ 48 C.F.R. ch. 1 § 52.236-2.

¹⁵⁶ See *Sutton Corp. v. Metropolitan Dist. Comm’n*, 423 Mass. 200, 667 N.E.2d 838, 842 (Mass. 1996); *Metro Sewerage Comm’n of the County of Milwaukee v. R.W. Constr., Inc.*, 72 Wis. 2d 365, 241 N.W.2d 371, 376 (Wis. 1976); *Department of Gen. Services v. Harman Assocs.*, 98 Md. App. 535, 633 A.2d 939, 948 (Md. App. 1993).

¹⁵⁷ For example, WASH. REV. CODE § 47.28.050 authorizes the WSDOT to include in its highway construction contracts those specifications which in its judgment it deems necessary.

¹⁵⁸ *United States v. Rice*, 317 U.S. 61, 63 S. Ct. 120 (1942).

¹⁵⁹ 32 Fed. Reg. 16269 (Nov. 29, 1967).

¹⁶⁰ Arizona Standard Specification 104.02(B)(4); California Standard Specification 5-1.116 (1995) (“no contract adjustment allowed...for any effects caused on unchanged works.”); Iowa Standard Specification 1109.16 A.4.; New York Standard Specification 109-16A(1)(iv); Texas Standard Specification 9.7. Florida’s DSC clause, however, allows for an increase or decrease in the cost required for the performance of any work under the contract. Florida Standard Specification 4-3.4.

¹⁶¹ 48 C.F.R. pt. 1 § 52.243.2(A).

C. Present unknown or unusual physical conditions.¹⁶²

a. Type I DSC

To prevail on a Type I DSC claim, a contractor must prove that the conditions indicated in the contract differed materially from those it encountered during contract performance.¹⁶³ The meaning of the term “indicated” is generally regarded as a question of law since it requires an interpretation of the contract.¹⁶⁴ The indications in the contract need not be explicit, but may be proved by inferences and implications in the contract documents that would lead a reasonable contractor to expect certain site conditions in performing the work.¹⁶⁵

The basic question is whether the conditions actually encountered differ from what a reasonably prudent, knowledgeable, and experienced contractor would expect when bidding the contract.¹⁶⁶ For example, in *Foster Construction Co.*,¹⁶⁷ the contractor claimed that it had encountered a Type I DSC in constructing bridge pier footings at three of the six bridge pier locations. The court found that the contract led the contractor to believe, when it prepared its bid, that dry soil could be expected at all six pier conditions. The actual soil conditions at three of the piers were highly permeable, causing the cofferdams to fill with water and requiring the use of seals and tremie concrete¹⁶⁸ to pour the footings. The court held that a Type I changed condition had occurred at those three piers.

The fact situations that constitute Type I conditions vary. Rock obtained from a quarry designated in the contract as an approved source was a Type I condition when the rock could not be used. The court held that by designating the quarry in the contract as an approved source, the government indicated that the quarry would produce suitable material.¹⁶⁹ A Type I condition was

established when the contractor encountered numerous boulders while driving sheet pile. The contract indicated that sheet pile could be driven without extraordinary efforts.¹⁷⁰ Wet soil conditions have produced their share of Type I claims. Type I conditions were established where the moisture content was far greater than indicated in the contract,¹⁷¹ where the site contained dense, nondraining soil, rather than free-draining sands and gravel,¹⁷² and where the site contained perched water instead of dry soil as indicated in the contract documents.¹⁷³ The possibility that actual conditions may vary from those indicated in the contract is almost unlimited. “[N]o one can ever know with certainty what will be found during subsurface operations.”¹⁷⁴

There are six elements which the contractor must prove, by a preponderance of the evidence, to establish a Type I DSC claim. These six elements are:

- (1) the contract documents must have affirmatively indicated or represented the subsurface or latent physical conditions which form the basis of plaintiff's claim; (2) the contractor must have acted as a reasonably prudent contractor in interpreting the contract documents; (3) the contractor must have reasonably relied on the indications of subsurface or latent physical conditions in the contract; (4) the subsurface or latent physical conditions actually encountered within the contract area must have differed materially from the conditions indicated in the same contract area; (5) the actual subsurface conditions or latent physical conditions encountered must have been reasonably unforeseeable; and (6) the contractor's claimed excess costs must be shown to be solely attributable to the materially different subsurface or latent physical conditions within the contract site. To prove these six elements, the contractor is only required to use a simple logical process in evaluating the information in the contract documents to determine the expected subsurface or latent physical conditions....¹⁷⁵ (citations omitted).

The term contract documents, as used in a typical Type I DSC clause, includes not only the documents furnished to bidders, but also materials referenced in those documents. There cannot be, however, a Type I condition when there is nothing in the documents indi-

¹⁶² AASHTO Guide Specifications for Highway Construction § 101.03 (1998). Some of the states using the AASHTO Guide Specifications are Arizona, California, Florida, Iowa, Michigan, New York, and Texas. The WSDOT clause is patterned after the federal clause.

¹⁶³ *H.B. Mac, Inc. v. United States*, 36 Fed. Cl. 793, 819 (1996). “In the absence of controlling state authority, state courts naturally look for guidance in public contract law to the federal court of claims and federal boards of contract appeals.” *New Pueblo Constructors, Inc. v. State*, 144 Ariz. 95, 696 P.2d 185, 191 (Ariz. 1985).

¹⁶⁴ *P.J. Maffi Bldg. Wrecking Corp. v. United States*, 732 F.2d 913, 916 (Fed. Cir. 1984).

¹⁶⁵ *H.B. Mac, Inc. v. United States*, *supra* note 163, at 819. If the contract is silent as to a condition, there cannot be a Type I condition. *Olympus Corp. v. United States*, 98 F.3d 1314, 1318 (Fed. Cir. 1996).

¹⁶⁶ *H.B. Mac, Inc. v. United States*, *supra* note 166, at 819.

¹⁶⁷ 435 F.2d 873, *supra* note 151.

¹⁶⁸ Tremie is a means of placing concrete under water by using a pipe or “elephant trunk.”

¹⁶⁹ *Kaiser Indus. Corp. v. United States*, 169 Ct. Cl. 310, 340 F.2d 322 (Ct. Cl. 1965).

¹⁷⁰ *Kit-San-Azusa v. United States*, 32 Fed. Cl. 647, 658 (1995); *Thomas M. Durkin & Sons, Inc. v. Department of Transp.*, 742 A.2d 233, 238 (Pa. Commw. 1999) (encountering unanticipated rock in constructing highway ramps).

¹⁷¹ *Ray D. Bolander Co. v. United States*, 186 Ct. Cl. 398, 408 (1968).

¹⁷² *H.B. Mac, Inc. v. United States*, *supra* note 163; *Ragonese v. United States*, 128 Ct. Cl. 156, 120 F. Supp. 768 (Ct. Cl. 1954) (subterranean water where boring showed no water).

¹⁷³ *Appeal of R.D. Brown Contractors*, ABSCA No. 43973, 93-1 BCA ¶ 25, 368 (1992).

¹⁷⁴ *Kaiser Indus. Corp. v. United States*, 340 F.2d 322, 329 (Ct. Cl. 1965), *supra* note 169.

¹⁷⁵ *H.B. Mac, Inc. v. United States*, 36 Fed. Cl. 793, 820 (1996); (citing *Youngdale & Sons Constr. Co. v. United States*, 27 Fed. Cl. 516 (1993)).

cating what the contractor could expect to encounter in the way of site conditions.¹⁷⁶ For example, a Type I condition was denied where there was nothing in the contract about the density or type of soil that the contractor could expect to encounter in driving sheet pile.¹⁷⁷ A similar result was reached where there was no indication in the contract as to the size of boulders where large boulders were encountered.¹⁷⁸ Even where there are indications in the contract, the contractor must show that its reliance upon those indications was reasonable. If the inference that the contractor draws from the documents is not reasonable, there is no Type I condition. This principle was applied in *Stuyvesant Dredging Co. v. United States*, where the contractor claimed it encountered a Type I condition when it dredged materials that were denser than indicated in the technical provisions of the contract.¹⁷⁹ The court denied the claim because the contract stated that the density readings were the average value of all the readings. The contractor was not entitled to rely on the average density since it should have known that the average density represented densities both greater and less than the average. A contractor's claim for a Type I condition for encountering hardpan¹⁸⁰ was denied where the hardpan amounted to 11 percent of the material excavated, and the contract warned the contractor that some hardpan could be expected.¹⁸¹ A similar result was reached where the contract contained indications that the subsurface soil would be wet.¹⁸² This principle was applied by a Washington DOT disputes review board in denying a claim for a Type I condition. The contractor claimed that it encountered a DSC when it was unable to drive piling at a bridge pier using the same driving methods that were successfully used at other piers. The board denied the claim, finding that the contract warned the contractor that it might be necessary to use certain predriving techniques to loosen the soil and make driving easier.¹⁸³

A Type I condition must be physical in nature. This is so because both the federal clause and the clauses used by some states refer to subsurface or latent physical

conditions at the site.¹⁸⁴ The DSC must exist before the contract is awarded. This is so because the DSC clause requires that the conditions differ materially from those indicated in the contract. This was explained by the New Jersey Supreme Court in *P. T. & L Construction v. State, Department of Transportation*, when it said:

Bidders are thereby given information on which they may rely in making their bids, and are at the same time promised an equitable adjustment under the changed conditions clause, if subsurface conditions turn out to be materially different than those indicated in the logs. The two elements work together; the presence of the changed conditions clause works to reassure bidders that they may confidently rely on the logs and need not include a contingency element in their bids. Reliance is affirmatively desired by the Government, for if bidders feel they cannot rely, they will revert to the practice of increasing their bids.¹⁸⁵

A Type I DSC (as well as a Type II DSC, which is discussed next) must be material. Both the federal and state clauses refer to conditions at the site that differ *materially* from those indicated in the contract. To be material, the condition must affect the contractor's costs and/or the time for performance. And the extra costs and/or delays claimed by the contractor must be solely attributable to the DSC.¹⁸⁶ Whether the condition is material is a question of fact. "We think that whether the changed conditions are 'conditions...differing materially from those in the contract' under § 104.03 is a question of fact regardless of whether the claimed changes result in quantitative or qualitative changes to the work to performed."¹⁸⁷

b. Type II DSC

The Federal DSC clause defines a Type II condition as: "(2) unknown physical conditions at the site, of an unusual nature, which differ materially from those ordinarily encountered and generally recognized as inhering in work of the contractor provided for in the contract."¹⁸⁸

Most DSC clauses used by state transportation agencies follow the AASHTO Guide Specifications in providing for a Type II condition.¹⁸⁹ The Guide Specification defines DSCs in part as those that:

¹⁸⁴ The same requirement applies to Type II conditions, as discussed in Part B *infra*.

¹⁸⁵ 108 N.J. 539, 531 A.2d 1330, 1334–35 (N.J. 1987) (quoting *Foster Constr. Co. v. C.A. Williams Bros. Co. v. United States*, 435 F.2d 873, 887, 193 Ct. Cl. 587 (1970)).

¹⁸⁶ *Fruin-Colnon Corp. v. Niagara Frontier*, 180 A.D. 2d 222, 585 N.Y.S.2d 248, 251 (N.Y. A.D. 1992) (citing federal cases).

¹⁸⁷ *Asphalt Roads & Materials Co. v. Commw., DOT*, 257 Va. 452, 512 S.E.2d 804, 807 (Va. 1999).

¹⁸⁸ 48 C.F.R. pt. 1 § 52.243.2(A).

¹⁸⁹ AASHTO Guide Specification for Highway Construction § 101.03 (1998).

¹⁷⁶ *Fru-Con Constr. Corp. v. United States*, 43 Fed. Cl. 306, 318 (Fed. Cl. 1999) (defining contract documents); *Olympus Corp. v. United States*, 98 F.3d 1314 (1996) (no Type I condition when contract is silent about the condition).

¹⁷⁷ *Appeal of PK Contractors, Inc.*, ENGBCA 92-1 BCA, ¶ 24, 583.

¹⁷⁸ *T.F. Scholes, Inc. v. United States*, 357 F.2d 963 (Ct. Cl. 1966).

¹⁷⁹ 834 F.2d 1576 (Fed. Cir. 1987).

¹⁸⁰ A very dense, cemented material, often clay, which is difficult to excavate.

¹⁸¹ *R.C. Huffman Constr. Co. v. United States*, 100 Ct. Cl. 80 (1943).

¹⁸² *Leal v. United States*, 149 Ct. Cl. 451, 276 F.2d 378 (Ct. Cl. 1960).

¹⁸³ I-90 Bridge Approach Spans, Third Lake Washington Floating Bridge Project.

B. Differs materially from conditions normally encountered or from those conditions generally recognized as inherent in the nature of the work required.

C. Present unknown or unusual physical conditions.

A Type II DSC exists when the conditions at the work site differ materially from those normally encountered in performing the work specified in the contract. To prevail on a claim for a Type II condition, the contractor must show: (1) that it did not know about the condition; (2) that it could not have reasonably anticipated the condition after a review of the contract documents, a site inspection, and the contractor's general experience in that area; and (3) that the condition was unusual because it varied from the norm in similar construction work.¹⁹⁰

The condition does not have to be a "geological freak" to qualify as unusual.¹⁹¹ Nevertheless, the contractor's burden in establishing a Type II site condition is heavy.¹⁹² The key is whether the site condition is physical, preexisting, unknown, and unusual. If these elements are satisfied the condition may qualify as a Type II DSC.¹⁹³ But conditions that do not satisfy these criteria are not covered by the clause.¹⁹⁴ A Type II condition

¹⁹⁰ Fru-Con Constr. Corp. v. United States, 44 Fed. Cl. 298, 311 (Fed. Cl. 1999); Lathan Co. v. United States, 20 Cl. Ct. 122, 127 (1990). Information in boring logs available to the contractor that provided notice of the condition precluded recovery for a Type II claim. Youndale & Sons Constr. Co. v. United States, 27 Fed. Cl. 516, 537 (1993).

¹⁹¹ Western Well Drilling Co. v. United States, 96 F. Supp. 377, 379 (N.D. Cal. 1951).

¹⁹² Charles T. Parker Constr. Co. v. United States, 433 F.2d 771, 778 (Ct. Cl. 1970); Youndale & Sons, *supra* note 190, at 537-39 (discussing contractor's burden of proof).

¹⁹³ Type II conditions established when contractor encountered: James Julian, Inc. v. Comm'rs of Town of Elkton, 341 F.2d 205 (4th Cir. 1965) (buried wharf during construction of a sewer); Reliance Ins. Co. v. County of Monroe, 198 A.D. 2d 871, 604 N.Y.S.2d 439, 440 (N.Y. 1993) (hazardous waste); Appeal of Panhandle Constr. Co., DOTCAB 79-1 BCA ¶ 13576 (1979) (buried animal bones); Kit-San Azusa v. United States, 32 Fed. Cl. 647 (1995) (encountering boulders that impeded driving sheet pile).

¹⁹⁴ Type II conditions were not established in the following cases. Condition visible from site inspection: Walsh Bros. v. United States, 107, Ct. Cl. 627, 69 F. Supp. 125 (Ct. Cl. 1947) (foundations from old buildings visible); Appeal of Basic Construction Co., ASBCA 77-2 BCA 2738 (1977) (roadway cuts revealed rock outcroppings); Sergeant Mech. Sys., Inc. v. United States, 34 Fed. Cl. 505, 527 (1995) (encountering heavy rains preventing compaction not a Type II condition at air-force base project). Not preexisting: Olympus Corp. v. United States, 98 F.3d 1314, 1317 (Fed. Cir. 1996) (damage to work caused by another contractor after contract award). Weather: Donald B. Murphy Contractors, Inc. v. State, 40 Wash. App. 98, 696 P.2d 1270 (Wash. App. 1985); Annotation, *Construction and Effect of a "Changed Conditions" Clause in Public Works or Construction Contract with State or its Subdivision*, 56 A.L.R. 4th 1042, 1066 (1987) (heavy rain); contracts, 56 A.L.R. 4th 1042, 1066 (heavy rain); Turnkey

may be proven by expert testimony.¹⁹⁵ Proving a Type II condition is usually more difficult when the condition is natural. Generally, it is more difficult to prove that a natural condition was unexpected because of the variations and kinds of earth materials found in subsurface work.¹⁹⁶

Generally, the DSC clause encompasses only those site conditions that existed prior to the time the contract was awarded.¹⁹⁷ Site conditions that are created after the contract has been awarded are not covered by the clause, although there are some exceptions to this rule.¹⁹⁸ In addition, changes to the work that are non-physical in nature do not qualify as DSCs since the clause refers only to physical conditions at the site.¹⁹⁹

States must use the DSC clause in 23 C.F.R. 635.109(a)(1) for federal-aid highway projects unless the agency has an acceptable²⁰⁰ DSC clause of its own or use of the clause is prohibited by state law.²⁰¹ The federally-mandated clause reads as follows:

(i) During the progress of the work, if subsurface or latent physical conditions are encountered at the site differing materially from those indicated in the contract or if unknown physical conditions of an unusual nature, differing materially from those ordinarily encountered and generally recognized as inherent in the work provided for in the contract, are encountered at the site, the party discovering such conditions shall promptly notify the other party in writing of the specific differing conditions

Enterprises v. United States, 220 Ct. Cl. 199, 597 F.2d 750 (Ct. Cl. 1977) (drought). Difficulty in performing work due to alleged unusual site condition: Fru-Con Constr. Corp. v. United States, 44 Fed. Cl. 298, 311-12 (Fed. Cl. 1999) (concrete removal).

¹⁹⁵ T. Brown Constr., Inc., DOTCAB, 95-2 BCA ¶ 27,870 (1995) (expert testified that it was unusual for clay to adhere to rock); Charles T. Parker Constr. Co. v. United States, 193 Ct. Cl. 320, 433 F.2d 771, 778 (Ct. Cl. 1970) (expert testified to the amount of garnet encountered in excavating rock and its affect on drilling the rock).

¹⁹⁶ Charles T. Parker, *supra* note 79; Hardwick Bros. Co. II. v. United States, 36 Fed. Cl. 347, 409-10 (Ct. Cl. 1996) (ground water conditions not a Type II condition).

¹⁹⁷ Arundel Corp. v. United States, 96 Ct. Cl. 773 (Ct. Cl. 1942); Olympus Corp. v. United States, 98 F.3d 1314, 1317 (Fed. Cir. 1996).

¹⁹⁸ John A. Johnson Contracting Corp. v. United States, 132 F. Supp. 698, 702 (Ct. Cl. 1955) (unusual soil conditions combined with rains and early thaw damaged haul roads); Phillips Constr. Co. v. United States, 184 Ct. Cl. 249, 394 F.2d 834 (1968) (flooding of site due to heavy rainfall exacerbated by defective drainage system); Donald B. Murphy Contractors, Inc. v. State, 40 Wash. App. 98, 696 P.2d 1270, 1273 (Wash. App. 1985) (changed conditions claim based on defective drainage system and heavy rains denied).

¹⁹⁹ Olympus Corp. v. United States, *supra* note 197, at 1318 (labor strike not a DSC); Bateson-Stolte, Inc. v. United States, 145 Ct. Cl. 387, 172 F. Supp. 454 (1959) (change in wage rates during contract performance not a changed condition).

²⁰⁰ The substitute clause is subject to FHWA approval.

²⁰¹ 23 U.S.C. § 112.

before they are disturbed and before the affected work is performed.

(ii) Upon written notification, the engineer will investigate the conditions and if it is determined that the conditions materially differ and cause an increase or decrease in the cost or time required for the performance of any work under the contract, an adjustment, excluding anticipated profits, will be made and the contract modified in writing accordingly. The engineer will notify the contractor of the determination whether or not an adjustment of the contract is warranted.

(iii) No contract adjustment which results in a benefit to the contractor will be allowed unless the contractor has provided the required written notice.

(iv) No contract adjustment will be allowed under this clause for any effects caused on unchanged work. (This provision may be omitted by the SHA's at their option).

3. Site Investigation

Most construction contracts contain site inspection clauses. These clauses require bidders to bid on conditions, as they appear, based upon a reasonable investigation of the physical conditions at the site that could affect the work. The site investigation clause, when coupled with a DSC clause, encourages more accurate bidding as to the true cost of performing the work.²⁰²

The federal "Site Investigation" clause²⁰³ is typical of the type of clause used in construction contracts. That clause provides as follows:

(a) The Contractor acknowledges that it has taken steps reasonably necessary to ascertain the nature and location of the work, and that it has investigated and satisfied itself as to the general and local conditions which can affect the work or its cost, including but not limited to (1) conditions bearing upon transportation, disposal, handling, and storage of materials; (2) the availability of labor, water, electric power, and roads; (3) uncertainties of weather, river stages, tides, or similar physical conditions at the site; (4) the conformation and conditions of the ground; and (5) the character of equipment and facilities needed preliminary to and during work performance. The Contractor also acknowledges that it has satisfied itself as to the character, quality, and quantity of surface and subsurface materials or obstacles to be encountered insofar as this information is reasonably ascertainable from an inspection of the site, including all exploratory work done by the Government, as well as from the drawings and specifications made a part of this contract. Any failure of the Contractor to take the actions described and acknowledged in this paragraph will not relieve the Contractor from responsibility for estimating properly the difficulty and cost of successfully performing the work, or for proceeding to successfully perform the work without additional expense to the Government.

(b) The Government assumes no responsibility for any conclusions or interpretations made by the Contractor based on the information made available by the Govern-

ment. Nor does the Government assume responsibility for any understanding reached or representation made concerning conditions which can affect the work by any of its officers or agents before the execution of this contract, unless that understanding or representation is expressly stated in this contract.

The knowledge that a reasonable site inspection would disclose is imputed to the contractor.²⁰⁴ A contractor who fails to make a reasonable site inspection may not recover for a DSC if the condition would have been observed by a reasonably prudent contractor.²⁰⁵

As a general rule, a contractor is not obligated to verify representations in the contract about subsurface site conditions through independent tests when the contract contains a DSC clause and the accuracy of the information, such as test borings, is not specifically disclaimed. The presence of the DSC clause is intended to assure bidders that they may rely on the soils information and need not incur the expense of their own tests, or include a contingency element in their bids.²⁰⁶

DSC clauses cannot be overridden by general exculpatory clauses.²⁰⁷ In *Asphalt Roads & Materials v. Commw. DOT*,²⁰⁸ the State argued that the exculpatory provisions in the contract relating to site investigation and bid submittal²⁰⁹ precluded the contractor's claim for

²⁰⁴ *Hardwick Bros. v. United States*, 36 Fed. Cl. 347, 406 (Ct. Cl. 1996).

²⁰⁵ *Gene Hock Excavating, Inc. v. Town of Hamburg*, 227 A.D. 2d 911, 643 N.Y.S.2d 268 (App. Div. 1996); *Umpqua Riv. Nav. Co. v. Crescent City Harbor Dist.*, 618 F.2d 588 (9th Cir. 1980); "The conditions actually encountered must have been reasonably unforeseeable based on all the information available to the contractor at the time of bidding." *Fur-Con Constr. Corp. v. United States*, 44 Fed. Cl. 298, 309 (1999) (quoting *A.S. McGaughan Co. v. United States*, 24 Cl. Ct. 659 (1991) *aff'd*, 980 Fed. 2d 744 (Fed. Cir. 1992) and referring also to *CIBINIC & NASH, ADMINISTRATION OF GOVERNMENT CONTRACTS* 508 (3d ed. 1995)). Contractor charged with knowledge that reasonable site inspection would disclose. *Beltrone Constr. v. State*, 256 A.D. 2d 992, 682 N.Y.S.2d 299, 301 N.Y. A.D. 1998).

²⁰⁶ *H.B. Mac, Inc. v. United States*, 36 Fed. Cl. 793, 819 (1996); *Foster Constr. C.A. & Williams Bros. Co. v. United States*, 93 Ct. Cl. 589, 435 F.2d 873, 887 (1970); *Asphalt Roads & Materials Co. v. Commw. DOT*, 257 Va. 452, 512 S.E.2d 804, 807-08 (Va. 1999).

²⁰⁷ *Sutton Corp. of Metro. Dist. Comm'n*, 423 Mass. 200, 667 N.E.2d 838, 843 (Mass. 1996); *Metro Sewerage Comm'n of the County of Milwaukee v. R.W. Constr., Inc.*, 72 Wis. 2d 365, 241 N.W.2d 371, 382 (Wis. 1976); *United Contractors v. United States*, 177 Ct. Cl. 151, 368 F.2d 585, 598 (Ct. Cl. 1966). These cases involve DSC clauses that were required by law to be included in construction contracts. Contracting agencies lack authority to negate DSC clauses through the use of exculpatory provisions. *See, e.g.*, *Department of General Services v. Harmans' Assocs.*, 98 Md. App. 535, 633 A.2d 939, 945 (Md. App. 1993).

²⁰⁸ 257 Va. 452, 512 S.E.2d 804 (Va. 1999).

²⁰⁹ *Id.* at 808. "The submission of a bid will be considered conclusive evidence that the bidder has examined the site...and is satisfied as to the conditions to be encountered in performing the work..." VDOT Specification 102.04.

²⁰² *Foster Constr. Co.*, 435 F.2d at 887.

²⁰³ 48 C.F.R. pt. 1 § 52-236-3.

a DSC. The court, in rejecting this contention, said that giving effect to the exculpatory provisions, "...would render meaningless the language of sections like 104.03 [Differing Site Condition clause] and negate their salutary purposes."²¹⁰

A contractor must conduct the site inspection in a reasonable and prudent manner. A contractor is not required or expected to discover conditions that would only be observed by a geologist or a geotechnical engineer. The standard is what a reasonably prudent and experienced contractor would learn from a reasonable pre-bid site investigation.²¹¹

Occasionally, contractors try to avoid the consequences of not conducting a site investigation by arguing that the time between the advertisement for bids and bid opening was too short to allow for a reasonable inspection. How this argument fares depends upon several considerations. First, was the time really too short to permit a reasonable inspection of the project site? Second, is the clause mandated by a statute or regulation? If the answer to these questions is "yes," the contractor's failure or inability to conduct a reasonable site inspection will not bar a claim for a DSC.²¹² However, the claim may be barred where the information that would be gleaned from a site investigation could be obtained from other sources, available to the contractor when it prepared its bid.²¹³

Where there is no DSC clause in the contract, failure to investigate the site may bar a claim for misrepresentation²¹⁴ of site conditions even though the time allowed for the investigation is insufficient. The risk of unanticipated soil conditions should be considered by the contractor in formulating its bid.²¹⁵

²¹⁰ 515 S.E.2d at 808 (citations omitted).

²¹¹ Foster Constr. Bros., 435 F.2d at 886, *supra* note 151; Western Contracting Corp., ENGBCA No. 4066, 82-1 BCA ¶ 15,486 (1982); Gulf Constr. Group, Inc., *supra* ENGBCA 93-3 BCA ¶ 26,040, CCH 25,229 (1993).

²¹² Where the DSC clause is required by statute or regulation, an agency cannot frustrate those laws by imposing unreasonable requirements. Department of General Services v. Harmon, 633 A.2d 739 (Md. App. 1993). See also Grow Constr. Co. v. State, 56 A.D. 2d 95391 N.Y.S.2d 726, 728 (N.Y. A.D. 1977) (evidence indicated that it would have taken far more time to investigate the site than allowed).

²¹³ "[T]he conditions actually encountered must have been reasonably unforeseeable based on all the information available to the contractor at the time of bidding." Fru-Con Constr. Corp. v. United States, 44 Fed. Cl. 298, 309 (Fed. Cl. 1999); Fortec Constructors, ENGBCA No. 4352, 80-2 BCA ¶ 14,623 (1980).

²¹⁴ Misrepresentation, as a theory of recovery of recovery for adverse site conditions encountered during contract performance, is discussed in Part Five of this subsection.

²¹⁵ J.E. Brenneman Co. v. Commw., Dep't of Transp., 56 Pa. Commw. 210, 424 A.2d 592, 595 (Pa. Commw. 1981); Central Penn Indus., Inc. v. Commw., Dep't of Transp., 358 A.2d 445, 448 (Pa. Commw. 1976) (insufficient time for site investigation will not support a claim for unanticipated conditions).

4. Notice Requirements

All DSC clauses require the contractor to provide prompt written notice to the owner when it encounters what it considers to be a DSC. Notice must be given before the condition is disturbed.²¹⁶ Prompt notice allows the owner to investigate the condition while the facts are fresh and determine whether a DSC occurred. If the owner determines that a DSC has occurred, it can consider design changes or other alternatives to reduce costs and keep the project on schedule. This is particularly important to public agencies that operate under tight budgetary restrictions.²¹⁷ Notice also allows the owner the opportunity to document costs caused by the condition as they are incurred by the contractor.²¹⁸

Generally cases involving notice issues range from strict enforcement²¹⁹ to no enforcement, unless the owner can show that it was prejudiced by lack of notice.²²⁰ Jurisdictions that require strict compliance with notice requirements regard them as substantive rights that the owner is entitled to enforce as a condition precedent to any recovery, by the contractor, for a DSC. Failure to satisfy notice requirements will bar a claim for DSC,²²¹ unless the owner has waived notice or the owner is estopped from asserting lack of notice as a defense.²²² Once notice is given, it is not necessary to continue to give notice when the condition recurs.²²³

²¹⁶ "Notify the Agency...when encountering different site conditions on the project. Unless directed otherwise, leave the site undisturbed and suspend work." AASHTO Guide Specification § 104.02 (1998). "The Contractor shall promptly, and before the conditions are disturbed, give a written notice to the Contracting Officer...." 48 C.F.R. pt. 1 § 52.236.2. See "Enforceability of the Requirements of Notice in Highway Construction Contracts," 3 JOHN C. VANCE, SELECTED STUDIES IN HIGHWAY LAW 154 N-1.

²¹⁷ Justin Sweet, *Owner Architect Contractor: Another Eternal Triangle*, 47 CAL. L. REV. 645 (1959).

²¹⁸ Sutton Corp. v. Metro Dist. Comm'n, 423 Mass. 200, 667 N.E.2d 838, 843 (Mass. 1996); Blankenship Constr. Co. v. N.C. State Highway Comm'n, 28 N.C. 593, 222 S.E.2d 452, 459-60 (N.C. 1976).

²¹⁹ A.H.A. General Constr., Inc. v. Housing Auth., 241 A.D. 2d 428, 661 N.Y.S.2d 213, 215 (A.D. 1997); Blankenship Constr. Co. v. State Highway Comm'n, *supra* note 218 (strict compliance with notice requirements required).

²²⁰ Hoel-Steffen Constr. Co. v. United States, 197 Ct. Cl. 561, 456 F.2d 760, 767-8 (Ct. Cl. 1972); Fru-Con Constr. Corp. v. United States, 44 Fed. Cl. 298, 313 (Fed. Cl. 1999); T. Brown Contractors, Inc., DOTCAB 95-2 BCA ¶ 27870 (1995); New Pueblo Constructors, Inc. v. State, 144 Ariz. 95, 696 P.2d 185, 191 (Ariz. 1985). Contra: Absher Constr. Co. v. Kent Sch. Dist., 77 Wash. App. 137, 890 P.2d 1071, 1073 (Wash. App. 1995) (showing of prejudice not required to enforce notice provision).

²²¹ A.H.A. General Constr., Inc. v. N.Y. City Housing Auth., 92 N.Y.2d 20, 699 N.E.2d 368, 374, 677 N.Y.S.2d 9, 15 (N.Y. 1998).

²²² Reif v. Smith, 319 N.W.2d 815, 817 (S.D. 1982) (waiver); Thorn Constr. Co. v. Utah Dep't of Transp., 598 P.2d 365, 370 (Utah 1979) (estoppel; work ordered by project engineer); Northern Improvement Co. v. State Highway Comm'n, 267

Courts that do not require strict compliance with notice requirements view notice from the standpoint of why notice is required. Under this approach, written notice is excused if the owner knew about the condition early enough to take steps to protect its interests.²²⁴ This “substantial compliance” approach to notice often leads to arguments over who told what to whom, requiring a trial or hearing to resolve those kinds of factual disputes. The contractor must prove that the alleged oral notice of a DSC was “sufficiently forceful to anyone to replace the contractual requirement of clear written notice.” Failure to make that showing will bar a claim for DSCs.²²⁵

Under federal contract law, lack of notice by the contractor that it encountered a DSC will not bar the contractor’s claim for the condition, unless the Government can show that it was prejudiced by lack of notice.²²⁶

5. Misrepresentation of Soil Conditions

Construction contracts may contain language that purports to relieve owners from any responsibility for the accuracy or completeness of soils information and other site data furnished to bidders. Owners who choose not to include DSC clauses in their contracts are reluctant to guarantee this type of information. This is not only understandable, it is prudent. Information of this kind is obtained for design purposes and is furnished to prospective bidders with the caveat that the information is not part of the contract, is not necessarily accurate, was obtained for design purposes, and should not be relied upon by the bidders in making their bids. Bidders are cautioned to make their own site investigation to verify the data and obtain additional information. Often the time allowed for the site investigation is short, and on occasion insufficient. It may be

N.W.2d 208, 214 (S.D. 1978) (estoppel). There is authority, however, that lack of notice may be waived as a defense when the claim is considered on the merits. *Blount Bros. Corp. v. United States*, 191 Ct. Cl. 784, 424 F.2d 1074, 1076 (Ct. Cl. 1970); *T. Brown Contractors, Inc., DOTCAB 95-2 BCA ¶ 27,870* (1995).

²²³ *Fru-Con Constr. Corp. v. United States*, 43 Fed. Cl. 306, 328 (Fed. Cl. 1999).

²²⁴ *Neal & Co. v. City of Dillingham*, 923 P.2d 89, 92 (Alaska 1993); *New Pueblo Constructors, Inc. v. State*, 144 Ariz. 93, 696 P.2d 185, 191 (Ariz. 1985); *Zook Bros. Constr. Co. v. State*, 177 Mont. 64 556 P.2d 911, 914–15 (Mont. 1976); *Lindbrook Constr. Co. v. Mukilteo Sch. Dist.*, 76 Wash. 2d 539, 458 P.2d 1 (Wash. 1969).

²²⁵ *Neal & Co. v. City of Dillingham*, *supra* note 227, at 92–93.

²²⁶ *Fru-Con Constr. Corp.*; 43 Fed. Cl., *supra* note 226, at 324–25. But where prejudice is shown the claim will be barred. *Schnip Building Co. v. United States*, 227 Ct. Cl. 148, 645 F.2d 950, 958–59 (Ct. Cl. 1981) (lack of notice prevented Government from determining whether problems with rock were due to a DSC or the contractor’s blasting methods); *Eggers & Higgins v. United States*, 185 Ct. Cl. 765, 403 F.2d 225, 293 (Ct. Cl. 1968) (late notice prejudiced Government’s ability to evaluate DSC claim).

difficult for bidders to discover, in a limited time, information that the owner was unable to discover during its own site investigation—an investigation that may have taken months, even years.²²⁷ The bidders are given the site data that the owner obtained for design purposes, but told not to rely on the data. Faced with this dilemma, bidders can choose not to bid, or to bid and include an amount in their bids to cover site investigations of their own (if they so choose) and a contingency for unforeseen site conditions. The DSC clause, as discussed earlier, is designed to obviate this dilemma.

As a general rule, a broad exculpatory clause will not override the DSC clause; otherwise the purpose of the DSC clause would be negated.²²⁸ When a DSC clause is required to be in the contract by a statute or regulation, an agency cannot avoid the clause by omitting it from the contract. A DSC clause that is physically omitted will be read into the contract and enforced as if it were part of the contract.²²⁹ Where the DSC clause in the contract is not mandated by statute or regulation, a disclaimer concerning site conditions must be specific, clear, and unambiguous, otherwise it will not be enforced.²³⁰ But what are the rules when there is no DSC clause in the contract, and the agency is not legally obligated to include one as part of its procurement policy?

In the absence of a DSC clause in the contract, the contractor assumes the risk of unforeseen site conditions.²³¹ The contractor may attempt to shift this risk to the owner under several legal theories. The contractor may claim that the owner failed to disclose information about the site that would have been important to the contractor in preparing its bid. This theory is advanced when the contract documents are silent about the condition that was encountered.²³² A more common situation is where the contract contains information about the site but the information was inaccurate. When this occurs, the claim for adverse site conditions is based on misrepresentation.²³³

²²⁷ 3 WALLEY & VANCE, *Legal Problems Arising From Changes, Changed Conditions, and Disputes Clauses in Highway Construction Contracts*, SELECTED STUDIES IN HIGHWAY LAW 1441.

²²⁸ *Asphalt Roads & Materials v. Com. DOT*, 757 Va. 452, 512 S.E.2d 804, 808 (Va. 1997).

²²⁹ *District of Columbia v. Organization for Env’tl. Growth, Inc.*, 700 A.2d 185, 198–99 (D.C. App. 1999); *Department of General Services v. Harman Assocs.*, 98 Md. App. 535, 633 A.2d 939, 947 (Md. App. 1993).

²³⁰ *United Contractors v. United States*, 177 Ct. Cl. 151, 368 F.2d 585, 598 (Ct. Cl. 1966); *Bignold v. King County*, 65 Wash. 2d 817, 399 P.2d 611, 614 (1965).

²³¹ See note 150 *supra*.

²³² This theory is discussed next in the part dealing with nondisclosure.

²³³ 3 VANCE & JONES, *Legal Effect of Representations as to Subsurface Conditions*, SELECTED STUDIES IN HIGHWAY LAW 1471–77.

Misrepresentation has its roots in actions for damages based on fraud and deceit.²³⁴ The theory has evolved in construction law, so that today a contractor may recover for adverse conditions if it can prove that the owner misrepresented the conditions at the site. The general rule is that when statements of fact made by an owner in the contract documents cause a contractor to make a lower bid than it otherwise would have made, the owner is liable for the increased costs caused by those conditions.²³⁵ This rule has been expressed in various ways:

[W]here plans or specifications lead a public contractor reasonably to believe that conditions represented therein do exist and may be relied upon in bidding, he (contractor) is entitled to compensation for extra expense incurred as a result of the inaccuracy of those representations....²³⁶

A contractor...who, acting reasonably, is misled by incorrect plans and specifications issued by public authorities as the basis for bids and who, as a result, submits a bid which is lower than he would have otherwise made may recover in a contract action for extra work or expenses necessitated by the conditions being other than as represented. This rule is mainly based on the theory that furnishing of misleading plans and specifications by the public body constitutes a breach of an implied warranty of their correctness...(citations omitted).²³⁷

The rule articulated in these cases is a fundamental principle of construction law,²³⁸ and is based on reliance. This was observed by Professor Williston when he said,

The real issue which should be discussed is this constantly obscured by the terminology of the subject. The real issue is no less than this: When a defendant has induced another to act by representations false in fact although not dishonestly made, and damage has directly

resulted from the action taken, who should bear the loss?²³⁹

The answer is the owner when the following elements are proven:²⁴⁰

- Positive representations about physical conditions at the project site. The representations must be material, i.e., basic to the work called for in the contract.
- The contractor must rely on the representations in making its bid. Its reliance must be reasonable.
- The actual conditions that the contractor encounters must differ materially from those represented in the contract.
- The difference between the actual conditions encountered and those represented in the contract must result in damages suffered by the contractor.

An application of these elements is illustrated in the following case. In *Christie v. United States*, there was a representation as to the type of materials that the contractor would excavate in constructing a dam.²⁴¹ The representation was material because the excavation was necessary in building the dam. The contractor relied on the representation in figuring its bid. The reliance was justified because there was insufficient time to verify the information by personal investigation. The material encountered was substantially different from that described in the contract and more costly to excavate than the material the contractor expected to encounter. Since these elements were proved, the contractor was able to recover its additional costs.

Recovery, however, has been denied where the court found that there was no factual misrepresentation. For example in *L-J Inc. v. South Carolina State Highway Department*, the court said that each soil boring "was a true revelation of the content of the earth at the 33 sites. The Contractor's problem arises because the borings were misinterpreted. It was assumed that rock lay on a level plane and this assumption was simply erroneous."²⁴²

A similar result was reached in *Codell Construction v. Commonwealth of Kentucky*, which involved a contract for the construction of 8 miles of Interstate 71.²⁴³ Among the documents provided by the state to prospective bidders was a profile showing the line where rock would be encountered. Printed on the plans and contained in other contract documents were specific disclaimers stating that the information about the rock was solely for the information of the state, and was not to be taken as an indication of classified excavation or the quality of rock that would be encountered. The contractor brought suit claiming an overrun of rock and alleging misrepresentation by the state as to subsurface conditions. In denying recovery, the court said:

²³⁴ L. PROSSER & KEETON, HANDBOOK ON THE LAW OF TORTS, ch. 18, at 525, *et seq.* (5th ed. 1984).

²³⁵ *United States v. Spearin*, 248 U.S. 132, 135-36, 395 S. Ct. 59, 63 L. Ed. 166 (1918); *E.H. Morrill Co. v. State*, 65 Cal. 2d 787, 791, 423 P.2d 551, 56 Cal. Rptr. 479 (1967). *Morris Inc. v. State ex rel DOT*, 1999 S.D. 95, 598 N.W.2d 525, 523 (S.D. 1999); *Changed Conditions as Misrepresentation in Government Construction Contracts*, 35 GEO. WASH. L. REV. (1967).

²³⁶ *Nelson Constr. Co. of Ferndale, Inc. v. Port of Bremerton*, 20 Wash. App. 321, 582 P.2d 511, 515 (Wash. App. 1978).

²³⁷ *Souza & McCue Constr. Co. v. Superior Court*, 57 Cal. 2d 508, 370 P.2d 338, 339-40, 20 Cal Rptr. 634 (Cal. 1962); *Fairbanks North Star Borough v. Kandik Constr. & Assoc.*, 795 P.2d 793, 797 (Alaska 1990); *Vinnell Corp. v. State Highway Comm'n*, 85 N.M. 311 512 P.2d 71, 77 (N.M. 1973); *Jack B. Parson Constr. Co. v. State*, 725 P.2d 614, 616 (Utah 1986); *Ideker, Inc. v. Mo. State Highway Comm'n*, 654 S.W.2d 617 (Mo. App. 1982); *P.T. & L. Constr. Co. v. Department of Transp.*, 108 N.J. 539, 531 A.2d 1330, 1335 (N.J. 1987).

²³⁸ *Nelson Constr.*, *supra* note 236. Annotation, *Right of Public Contractor to Allowance of Extra Expenses Over What Would Have Been Necessary if Conditions Had Been as Represented by the Plans and Specifications*, 76 A.L.R. 268 (1932).

²³⁹ WILLISTON ON CONTRACTS § 1510, at 462 (3d ed. 1970).

²⁴⁰ *Supra* note 233.

²⁴¹ 237 U.S. 234, 35 S. Ct. 565, 59 Ed. 733 (Ct. Cl. 1915).

²⁴² 270 S.C. 413, 242 S.E.2d 656, 665 (S.C. 1978).

²⁴³ 566 S.W.2d 161 (Ky. App. 1977).

The record does not disclose any misrepresentations of facts or withholding of material information in connection with the drawings, plans, specifications or other data furnished by the Department. The Highway Department, for its own purposes, made tests of the soil conditions and published the results with an express and unqualified disclaimer as to any guarantee of their accuracy. Clearly, this put any bidder on notice as to its obligation to make its own private investigation to determine the classification and quantities of the materials to be excavated....

The express and unqualified disclaimer...clearly put the bidders on notice of their obligation to make a private investigation. In a situation where the information and representations are intended to be suggestive of construction conditions, or the contract provides that they are to be taken as estimates only, then the governmental agency is not to be held accountable for variances which may be encountered on the job when there is no deliberate misrepresentation or fraud involved. (citations omitted).²⁴⁴

The element paramount to recovery is reliance. The contractor must show that it was misled by the representations. If a reasonably prudent contractor would not have relied on the information in preparing its bid, there can be no recovery for misrepresentation. The question is this: Were the disclaimers about the accuracy of the data sufficiently specific to warn a reasonable contractor not to rely on them in formulating its bid?²⁴⁵ This question is discussed further in Part Seven (Exculpatory Provisions) of this subsection.

6. Nondisclosure

Generally, the law holds an owner liable for failing to impart its knowledge about the difficulties a contractor may encounter in performing the work.²⁴⁶ The rule requiring disclosure has been described in various ways. For example, in *Warner Construction Corp. v. City of Los Angeles*, the court said:

²⁴⁴ *Id.*, at 164.

²⁴⁵ *J.A. Constr. Corp. v. Department of Transp.*, 591 A.2d 1146 (Pa. Commw. 1991); *Wunderlich v. State*, 65 Cal. 2d 777, 423 P.2d 545, 548–50, 56 Cal. Rptr. 473 (Cal. 1967) (“The crucial question is one of justified reliance.”); *Joseph F. Trionfo & Sons, Inc. v. Board of Educ.*, 41 Md. App. 103, 395 A.2d 1207, 1209 (Md. App. 1979).

²⁴⁶ *GAF Corp. v. United States*, 932 F.2d 947, 949 (Fed. Cir. 1991); *Hercules, Inc. v. United States*, 24 F.3d 188, 196 (Fed. Cir. 1994); *J. A. Jones Constr. Co. v. United States*, 390 F.2d 886 (Ct. Cl. 1968); *Warner Constr. Corp. v. City of L.A.*, 2 Cal. 3d 285, 466 P.2d 996, 1001, 85 Cal. Rptr. 444 (Cal. 1970); *Nelson Constr. Co. of Ferndale, Inc. v. Port of Bremerton*, 20 Wash. App. 32, 582 P.2d 511, 514–15 (Wash. App. 1978); *Hardwick Bros. II v. United States*, 36 Fed. Cl. 347, 386 (Ct. Cl. 1996); *R.J. Wildner Contracting Co. v. Ohio Turnpike Comm’n*, 913 F. Supp. 1031, 1042 (N.D. Ohio 1996); Annotation, *Public Contracts: Duty of Public Authority to Disclose to Contractor Information Allegedly in its Possession, Affecting Cost or Feasibility of Project*, 86 A.L.R. 3d 182 (1978). *McDonnell Douglas Corp. v. United States*, 182, 3d 1319, 1329 (Fed. Cir. 1999).

A fraudulent concealment often composes the basis of an action in tort, but tort actions for misrepresentation against public agencies are barred by Government Code section 818.8. Plaintiff retains, however, a cause of action in contract. “It is the general rule that by failing to impart its knowledge of difficulties to be encountered in a project, the owner will be liable for misrepresentation if the contractor is unable to perform according to the contract provisions. This rule is mainly based on the theory that the furnishing of misleading plans and specifications by the public body constitutes a breach of an implied warranty of their correctness. The fact that a breach is fraudulent does not make the rule inapplicable.”²⁴⁷

In *Hardeman-Monier-Hutcherson v. United States*, the court said: “[W]here the government possesses special knowledge, not shared by the contractor, which is vital to the performance of the contract, the government has a affirmative duty to disclose such knowledge. It cannot remain silent with impunity.”²⁴⁸

Similarly, the Alaska Supreme Court, in referring to decisions by the United States Court of Claims concerning disclosure, said that:

We read these cases as establishing the following test for imposing a duty to disclose upon the state: did the state occupy so uniquely-favored a position with regard to the information at issue that no ordinary bidder in the plaintiff’s position could reasonably acquire that information without resort to the state? Where resort to the state is the only reasonable avenue for acquiring the information, the state must disclose it, and may not claim as a defense either the contractor’s failure to make an independent request or exculpatory language in the contract documents....²⁴⁹

An owner, however, does not have a duty to disclose information that the contractor could reasonably obtain for itself. The contractor “cannot thereafter throw the burden of his negligence (in failing to obtain information) upon the shoulders of the state by asserting that the latter was guilty of fraudulent concealment in not furnishing him with information which he made no effort to secure for himself.”²⁵⁰ In one case, for example, the court held that the State had no duty to disclose information that it obtained from other bidders concerning the feasibility of hydraulic dredging at the project site. The court observed that the contractor could

²⁴⁷ 2 Cal. 3d 285, 466 P.2d 996, 1001 85 Cal. Rptr. 444 (Cal. 1970) (citation omitted).

²⁴⁸ 198 Ct. Cl. 472, 458 F.2d 1364, 1371–2 (Ct. Cl. 1972) (citations omitted).

²⁴⁹ *Morrison-Knudson Co. v. State*, 519 P.2d 834, 841, 86 A.L.R. 3d 164 (Alaska 1974).

²⁵⁰ *Wiechmann Eng’rs v. State*, 31 Cal. App. 3d 741, 753, 107 Cal. Rptr. 529 (1973); see also *Nelson Constr.*, *supra* note 236 (agency not required to provide soils report concerning glacially consolidated soils containing boulders where information about harbor bottom was reasonably available from other sources); *Comprehensive Bldg. Contractors, Inc. v. Pollard Excavating, Inc.*, 251 A.D. 2d 951, 674 N.Y.S.2d 869 (N.Y. A.D. 1998) (depth of sewer available to excavation contractor from subdivision plat).

have performed its own tests at the site like other bidders.²⁵¹

In addition to proving that the information that the agency failed to disclose was not reasonably available, the contractor must also prove that it was prejudiced by the nondisclosure. In other words, the contractor must show that its bid would have been different had it seen the information. Failure to make that showing will bar the claim.²⁵²

Whether there was a failure to disclose vital information, entitling the contractor to recover damages is a jury question.²⁵³ The use of special interrogatories to the jury should be considered. This technique was used successfully by the State in a case where the contractor alleged, among other things, that the State failed to disclose test reports about a pit that the State furnished to the contractor.²⁵⁴

7. Exculpatory Provisions

Unless an agency is required by a statute²⁵⁵ or a regulation²⁵⁶ to include a DSC clause in its contracts, it may choose to let the risk of unforeseen site conditions remain with the contractor.²⁵⁷ In making this choice an agency may decide that it would rather pay a contingency for unforeseen conditions than pay for such conditions through litigation. This policy determination is

²⁵¹ *Morrison-Knudson Co. v. State*, 519 P.2d at 842 (Alaska 1974); *but see* *Howard Contracting, Inc. v. G. A. MacDonald Constr. Co.*, 71 Cal. App. 4th 38, 56, 83 Cal. Rptr. 2d 590 (Cal. App. 1998) (city liable for failure to direct bidder to examine permits issued by regulatory agencies, even though bidder knew that agency would impose restrictions on the project).

²⁵² *A.S. Wikstrom, Inc. v. State*, 52 A.D. 2d 658, 381 N.Y.S.2d 1010, 1012 (App. Div. 1976) (contractor failed to prove that its bid would have been different had it seen the test borings); *Wm. A. Smith Contracting Co. v. United States*, 188 Ct. Cl. 1065, 412 F.2d 1325, 1338 (Ct. Cl. 1969) (contractor not misled by failure to disclose information); *see also* *Hendry Corp. v. Metro Dade County*, 648 So. 2d 140, 142 (Fla. App. 1994).

²⁵³ *Horton Indus., Inc. v. Village of MoweAqua*, 142 Ill. App. 3d 730, 492 N.E.2d 220, 226, 97 Ill. Dec. 17 (Ill. App. 1986).

²⁵⁴ *Ledcor Indus., et al. v. State of Wash. Dep't of Transp., Thurston County Superior Court No. 92-200085-4*.

²⁵⁵ *See* *Department of Gen. Services v. Harmans*, 98 Md. App. 535, 633 A.2d 939, 947 (1993) (DSC clause required by statute); 23 U.S.C. § 112 (requiring use of a DSC clause in certain federally-funded state highway construction contracts).

²⁵⁶ 48 C.F.R. ch. 1, pt. 52.236-2.

²⁵⁷ Most state agency DSC clauses provide that, "No contract adjustments will be allowed under this clause for any effects caused by unchanged work." *See, e.g.*, Iowa Standard Specifications 1109.16A.4. When procurement laws require that a particular clause be included in a contract, the contract is read as though it contained that clause irrespective of whether the clause was actually written in the contract. *G.L. Christian & Assocs. v. United States*, 160 Ct. Cal. 1, 312 F.2d 418, 424 (Ct. Cl. 1963); *S.J. Amoroso Constr. Co. v. United States*, 26 Cl. Ct. 759, 764 (1992); *Department of Gen. Services v. Harmans*, 98 Md. App. 535, 633 A.2d 939, 949 (1993).

driven by considerations such as budget predictions, the number and size of its projects, and the availability of potential bidders who are willing to assume the risk of unforeseen conditions and factor that risk into their bids. At times, there may be situations where the agency does not know what will be encountered and prefers that the contractor assume those risks and price them competitively as part of its bid. "But once a policy determination is made, it should be enforced by the courts."²⁵⁸

When a DSC clause is included in the contract, an agency cannot undermine the clause by also including broad exculpatory provisions that purport to shift the risk of unanticipated conditions to the contractor. Generally, broad exculpatory provisions will simply not be enforced.²⁵⁹ Most courts view broad exculpatory language, disclaiming liability for DSCs, as contradictory. General statements, which are inconsistent with the intention of the parties as expressed in the DSC clause, will not be enforced.²⁶⁰ The key to making exculpatory clauses effective is specificity. Specific warnings telling the contractor not to rely on certain information about site conditions should be enforced.

In the absence of a DSC clause, an agency is not liable for unforeseen site conditions unless the contractor was misled by the information provided to prospective bidders,²⁶¹ or the agency failed to disclose information about the site that should have been disclosed.²⁶² To insulate itself from liability for unforeseen site conditions, the agency should: (1) disclose information in its possession about site conditions or tell the prospective bidders where the information can be obtained, and (2) include clear and specific exculpatory clauses in the contract disclaiming responsibility for unforeseen conditions. This latter point is supported by case law, particularly the leading case of *Wunderlich v. State*.²⁶³

²⁵⁸ *P.T. & L. Constr. v. Department of Transp.*, 108 N.J. 539, 531 A.2d 1330, 1331 (N.J. 1987); *S&M Contractors, Inc. v. City of Columbus*, 70 Ohio St. 2d 69, 434 N.E.2d 1349, 1351 (Ohio 1982) (argument that enforcing disclaimer is bad public policy rejected); HARP, *supra* note 154. Mr. Harp notes that a "no claims specification" had mixed reviews by the TRB Task Force on Innovative Contracting. The Task Force expressed concern that "no claims" specifications generate additional litigation and greater conflict between the contractor and the agency, and result in an adverse working relationship that could affect the quality and progress of the work. These observations could be urged as additional reasons, besides eliminating contingency bidding, for having a DSC clause in contracts.

²⁵⁹ *Sornsin Constr. Co. v. State*, 180 Mont. 248, 590 P.2d 125, 129 (1978); *Morris, Inc. v. State ex rel DOT*, 1999 S. D. 95, 598 N.W.2d 520, 523 (S.D. 1999); *Mass. Bay Trans. Auth. v. United States*, 129 F.3d 1226, 1231 (Fed. Cir. 1997).

²⁶⁰ *Morrison-Knudson Co. v. United States*, 184 Ct. Cl. 661, 686, 397 F.2d 826 (Ct. Cl. 1968); *Haggart Constr. Co. v. Highway Comm'n*, 149 Mont. 422, 427 P.2d 686, 689 (Mont. 1967).

²⁶¹ *Id.*

²⁶² 86 A.L.R. 3d 182 (1978).

²⁶³ 65 Cal. 2d 777, 423 P.2d 545, 548 (Cal. 1967).

Wunderlich was a breach of warranty claim by a highway contractor when a state-furnished pit did not provide sufficient material for the project. The contract indicated that there would be certain base material “of satisfactory quality” available for the contractor’s use from a private pit that the state had obtained. The specifications disclaimed responsibility for the quantity of suitable material that could be produced from the pit. The contractor claimed that the material was too sandy, requiring the contractor to bring in more equipment and finally to import material from other pits. The contractor claimed the State had misrepresented the actual conditions encountered in the pit and was liable for the extra costs incurred in processing material at the pit and in hauling material from more distant sources. The State claimed that what was represented in the contract was accurate based on the tests it had performed. The trial court’s decision in favor of the contractor was reversed by the California Supreme Court which, said:

The crucial question is thus one of justified reliance. If the agency makes a “positive and material representation as to a condition presumably within the knowledge of the government, and upon which...the plaintiffs had a right to rely” the agency is deemed to have warranted such facts despite a general provision requiring an onsite inspection by the contractor. (Citation omitted.) But if statements “honestly made” may be considered as “suggestive only,” expenses caused by unforeseen conditions will be placed on the contractor, especially if the contract so stipulates...(citations omitted).

The court concluded that the boring data from the test holes were only indicative of the general area of the pit. There were no positive representations about the quantity of material that could be obtained from the pit. The court emphasized the importance of specific exculpatory language disclaiming any state responsibility for the quantity of acceptable material and requiring the contractor to determine whether there was enough material in the pit for the project.

Briefly stated, the court held that the contractor could not justifiably rely on the information about the sufficiency of suitable material in view of the specific nature of the statements about the quantity of material, the specificity of the exculpatory provisions, and the absence of any misrepresentations about factual matters. Thus, where the statements are not positive representations and the contractor is warned to determine conditions for itself, there is no warranty.

Other states have followed the *Wunderlich* rule, focusing on the lack of positive representations and the specificity of the disclaimer.²⁶⁴ For example, in *Ell-Dorer*

²⁶⁴ Nelson Constr. Co. v. Port of Bremerton, 20 Wash. App. 321, 582 P.2d 511, 515 (Wash. App. 1978); Bilotta Constr. Corp. v. Village of Mamaroneck, 199 A.D. 2d 230, 604 N.Y.S.2d 966 (N.Y. App. Div. 1993); Air Cooling & Energy, Inc. v. Midwestern Constr. Co. of Missouri, Inc., 602 S.W.2d 926, 930 (Mo. App. 1980); L-J, Inc. v. S.C. Highway Dep’t, 280 S.C. 413, 242 S.E.2d 656 (S.C. 1978); Joseph F. Trionfo & Sons v. Board of Ed., 395 A.2d 1207, 1213 (Md. App. 1979); S&M Con-

Contracting Co. v. State, the specifications required the contractor:

[T]o ascertain for himself all the facts concerning conditions to be found at the location of the Project including all physical characteristics above, on, and below the sub-surface of the ground, ...and to make all necessary investigations....

Borings, test excavations and other subsurface investigations, if any, made by the Engineer prior to construction of the project...are made for use as a guide for design. Said borings, test excavations and other subsurface investigations are not warranted to show the actual subsurface conditions. The contractor agrees that he will make no claims against the State if in carrying out the project he finds that the actual conditions encountered do not conform to those indicated by said borings, test excavations and other subsurface investigations.²⁶⁵

The court found that the disclaimers were so specific that the contractor could not justifiably rely on the soils data provided to the bidders. A similar result was reached in *Joseph F. Trionfo & Sons, Inc. v. Board of Education*, where the court enforced an exculpatory clause that provided that the soils information was: (1) not part of the contract, (2) not guaranteed, (3) obtained by the agency for design purposes only, (4) was not to be relied upon by the contractor, and (5) that the contractor should make its own site investigation.²⁶⁶ The clause also provided that the owner was not responsible if the actual conditions differed from what the contractor expected or from what the soils data indicated.

Other examples are *Biolota Construction Corp. v. Village of Mamaroneck*, in which the specifications stated that the grade elevations shown on the plans were approximate, their accuracy not guaranteed, and that the contractor should make its own site investigation,²⁶⁷ and *Air Cooling & Energy, Inc. v. Midwestern Construction Company*, in which no implied warranty was found where the boring logs were not part of the contract and the contractor was required to make its own site investigation and told not to rely on the boring logs.²⁶⁸

It is important that the specifications specifically disclaim responsibility for the accuracy of the soils data provided to bidders. If this is not done, the disclaimer may not be enforced even though the test borings are

tractors, Inc. v. City of Columbus, 434 N.E.2d 1349, 1353 (Ohio 1982); Gene Hock Excavating, Inc. v. Town of Hamburg, 227 A.D. 2d 911, 643 N.Y.S.2d 268 (N.Y. App. Div. 1996); Sasso Contracting Co. v. State, 173 N.J. Super. 486, 414 A.2d 603, 606, cert. denied, 85 N.J. 101, 425 A.2d 265 (N.J. 1980); J.A. Thompson & Sons, Inc. v. State, 51 Haw. 529, 465 P.2d 148, 155 (1970); Frontier Foundns., Inc. v. Layton Constr., 818 P.2d 1040, 1042 (Utah App. 1991).

²⁶⁵ 197 N.J. Super. 175, 484 A.2d 356, 359 (App. Div. N.J. 1984).

²⁶⁶ 41 Md. App. 103, 395 A.2d 1207, 1209 (Md. App. 1979).

²⁶⁷ 199 A.D. 2d 230, 604 N.Y.S.2d 966, 967-68 (N.Y. App. Div. 1993).

²⁶⁸ 602 S.W.2d 926, 930 (Mo. App. 1980).

not part of the contract.²⁶⁹ It is also important for the exculpatory clause to disclaim any intention on the part of the owner that bidders should use the soils information in preparing the bid. Absent a disclaimer specifically disclaiming any such intention, a court may find that “the government performs certain basic tests in order to provide each bidder with some information on which he may make his bid.”²⁷⁰

There are, of course, decisions that decline to enforce exculpatory provisions. The specifications may be viewed as conflicting²⁷¹ or ambiguous²⁷² or unfair because insufficient time was allowed for a reasonable site investigation. With respect to the latter point, there is a split of authority as to the enforceability of exculpatory provisions when insufficient time is allowed for a contractor to conduct its own site investigation. One view is that an agency cannot enforce exculpatory clauses, particularly those requiring a contractor to make its own site investigation, when the time allowed is insufficient.²⁷³ There is authority, however, that insufficient time does not preclude enforceability.²⁷⁴

²⁶⁹ *City of Columbia v. Paul N. Howard Co.*, 707 F.2d 338, 340 (8th Cir. 1983) (court construed contract to mean that contractor could rely upon the data shown in the borings, but not upon interpolations between borings).

²⁷⁰ *Robert E. McKee, Inc. v. City of Atlanta*, 414 Supp. 957, 959 (N.D. Ga. 1976); *Morris, Inc. v. State ex rel. DOT*, 1999 S.D. 95, 598 N.W.2d 520, 523 (S.D. 1999); *Haggart Constr. Co. v. State*, 149 Mont. 422, 427 P.2d 686, 687 (Mont. 1967) (State admitted at trial that one purpose in furnishing soils data to bidders was to obtain lower bids).

²⁷¹ *Young-Fehlhaber v. State*, 265 A.D. 61, 37 N.Y.S.2d 928, 929 (N.Y. A.D. 1942) (conflict between representation in the plans and the disclaimer in the specifications, resolved in favor of the contractor under the rule that plans take precedence over specifications); *Millgard Corp. v. McKee/Mays*, 49 F.3d 1070, 1073 (5th Cir. 1995) (specific disclaimer with respect to underground water took precedence over the more general language in the DSC clause). “[G]eneral disclaimers will not absolve defendant for positive and material representations upon which the contractor had a right to rely.” *Morris, Inc. v. State ex rel. DOT*, 598 N.W.2d 520, 523 (S.D. 1999) (quoting *Western States Mech. Contractors, Inc. v. Sandin Corp.*, 110 N.M. 676, 798 P.2d 1062, 1065 (N.M. App. 1990)).

²⁷² Ambiguous specifications are construed against the drafter. *Metric Constructors, Inc. v. National Aeronautics and Space Admin.*, 169 F.3d 747, 751 (Fed. Cir. 1999); *Van-Go Transport Co. v. N.Y. City Bd. Of Educ.*, 53 F. Supp. 2d 278, 283 (E.D. N.Y. 1999); *Haggart Constr. Co. v. State*, 149 Mont. 422, 427 P.2d 686, 689 (1967) (soils data and general disclaimer conflicted, making the contract ambiguous; contract was construed against the State because the State had drafted it).

²⁷³ *Kiely Constr. Co. v. State*, 154 Mont. 363, 463 P.2d 888, 890 (1970); *Yonkers Contracting Co. v. N.Y. State Thruway Auth.*, 45 Misc. 2d 763, 257 N.Y.S.2d 781, 784 (N.Y. Ct. Cl. 1964); *Peter Salvucci & Sons, Inc. v. State*, 110 N.H. 136, 268 A.2d 899, 906 (1970); *Alpert v. Commonwealth*, 357 Mass. 306, 258 N.E.2d 755, 764 (1970) (adequate site investigation would require 2 ½ to 3 months, but only 21 days allowed).

²⁷⁴ *J.E. Breneman Co. v. Commonwealth, Dep’t of Transp.*, 56 Pa. Commw. 210, 424 A.2d 592, 595 (1981); *Central Penn*

This latter view is premised on the notion that contractors are not compelled to bid. If they believe that the time allowed for an adequate site investigation is not sufficient, they can decline to bid, or they can factor the lack of an adequate site investigation into their bids.²⁷⁵

In preparing contracts that do not contain DSC clauses, care should be taken to avoid the pitfall of nondisclosure. Care should also be taken to avoid presenting information to bidders in a way that can be construed as positive assertions of fact. Data should be qualified by using words like “approximate” or “estimated” or “for design purposes only,” or words of like import. Exculpatory provisions should say in clear and plain language that:

- The soils information is not part of the contract.
- The accuracy or completeness of the soils information is not guaranteed.
- The soils information was obtained only for design purposes.
- The soils information should not be relied upon by bidders in making their bids.
- Bidders should make their own investigations of site conditions. If a bidder believes that the time allowed for the investigation is insufficient, that should be taken into consideration in preparing the bid.
- The owner will not be responsible in any way for additional compensation based on any claim that soils information obtained solely for design purposes and furnished to bidders differed from what the contractor expected to encounter or differed in any way from what the soils information indicated to the contractor concerning subsurface conditions.

Disclaimers that are specific should be enforced.²⁷⁶ Specific contract provisions trump general provisions.²⁷⁷ Thus, where the specific disclaimer conflicts with other general contract provisions, the disclaimer should be enforced. Where the disclaimer is clear, unambiguous,

Indus. v. Commonwealth, 358 A.2d 445, 448 (Pa. Commw. 1976). “Insufficiency of the allowed for investigation by bidders, standing alone, will not support a claim for extra compensation for unanticipated site conditions.”

²⁷⁵ *Codell Constr. Co. v. Commonwealth*, 566 S.W.2d 161, 165 (Ky. App. 1977); *Scherrer v. State Highway Comm’n*, 148 Kan. 357, 80 P.2d 1105, 1110 (Kan. 1938); *McArthur Bros. Co. v. United States*, 258 U.S. 6, 42 S. Ct. 225, 66 L. Ed. 433 (1922).

²⁷⁶ *P.T. & L. Constr. v. State Dep’t of Transp.*, 108 N.J. 539, 531 A.2d 1330, 1334 (N.J. 1987). The court acknowledged that the State, for policy reasons, may require the contractor to assume the risk of unforeseen site conditions.

²⁷⁷ “It is a maxim of interpretation that when two provisions of a contract conflict, the specific trumps the general.” *Millgard Corp. v. McKee/Mays*, 49 F.3d 1070, 1073 (5th Cir. 1995); (specific disclaimer concerning underground water given precedence over more general language in DSC clause). See also *Vaughn v. Gulf Copper*, 54 F. Supp. 2d 688, 690 (E.D. Tex. 1999); *Transitional Learning v. United States*, 220 F.3d 427, 432 (5th Cir. 2000); *Chantilly Constr. Corp. v. Department of Highways*, 6 Va. App. 282, 369 S.E.2d 438, 445 (Va. App. 1988).

and specific, a court may hold that the contractor's reliance on site data was not justified, and that its claim for misrepresentation of site conditions may be dismissed as a matter of law.²⁷⁸

8. Subcontractor Claims

Claims for DSCs often originate with subcontractors. This occurs because earth work, such as excavation, embankment construction, pile driving, and site preparation may be sublet by the general contractor. Typically, claims for DSCs are presented by the subcontractor to the general contractor who, in turn, passes them on to the owner for resolution. This process was described by the California Court of Appeals in *Howard Contracting v. G.A. MacDonald Construction Co.*

As a matter of law, a general contractor can present a subcontractor's claim on a pass-through basis. When a public agency breaches a construction contract with a contractor, damage often ensues to a subcontractor. In such a situation, the subcontractor may not have legal standing to assert a claim directly against the public agency due to a lack of privity of contract, but may assert a claim against the general contractor. In such a case, a general contractor is permitted to present a pass-through claim on behalf of the subcontractor against the public agency...(citations omitted).²⁷⁹

To recover for a DSC (subcontractor versus general contractor), there must be a DSC clause in the subcontract,²⁸⁰ either expressly or by implication.²⁸¹ The *Severin* doctrine, which prevents a general contractor from recovering for its subcontractor against the owner when the prime contractor is not liable to the subcontractor, is discussed in the next section.

9. Impossibility

A contractor is not excused from performing its contract when unforeseen circumstances make performance burdensome.²⁸² To excuse performance, the contractor must prove that performance was impossible. "Impossibility excuses a party's performance only when

the destruction of the subject matter of the contract or the means of performance makes performance objectively impossible. Moreover, the impossibility must be produced by an unanticipated event that could not have been foreseen or guarded against in the contract."²⁸³ (citations omitted).

Impossibility can be either actual or practical. Actual impossibility exists when it is physically impossible for anyone to perform the contract. If another contractor could perform the work, the contractor's own inability to perform is not excused.²⁸⁴ Practical impossibility exists when the cost of performance is so great that it becomes economically senseless.²⁸⁵ Impossibility may be raised as a defense by a contractor in an action brought by an owner for breach of contract for the contractor's nonperformance.²⁸⁶

To prove practical impossibility, the contractor must show that the cost of performance would be so extreme that it would render further performance economically senseless. Because courts are reluctant to excuse performance, this is usually difficult to prove.²⁸⁷ Whether an unanticipated event rendered the contract impossible to perform is a factual question.²⁸⁸

10. Admissions

Occasionally, a dispute over whether a DSC occurred may threaten to delay the work. To expedite construction, the owner may wish to change the design or make some other modification to allow the work to proceed. If this happens, the change order should be carefully worded to prevent the change order from being used by the contractor as an admission by the owner that a DSC had occurred.²⁸⁹

If the contractor will not agree, in a bilateral change order, that the design change is not an admission of a DSC, and if the owner still wishes to make the change, the unilateral change order should be couched in language indicating that the owner denies that a differing

²⁷⁸ *Frontier Found., Inc. v. Layton Constr.*, 818 P.2d 1040, 1041-42 (Utah App. 1991) (where disclaimer is effective as a matter of law, owner is entitled to judgment); *Joseph F. Trionfo*, 395 A.2d 1207 (Md. App. 1979).

²⁷⁹ 71 Cal. App. 4th 38, 60, 83 Cal Rptr. 2d 590 (1998); see also *Buckley & Co. v. State*, 140 N.J. Super., 289, 356 A.2d 56, 73-74 (N.J. Super. 1975) (cases cited from other jurisdictions holding that lack of privity between the subcontractor and the owner does not bar the subcontractor's pass-through claim when the prime contractor is liable to the subcontractor for damages for which the owner ultimately assumes responsibility).

²⁸⁰ *Dravo Corp. v. Metro Seattle*, 79 Wash. 2d 214, 484 P.2d 399 (Wash. 1971).

²⁸¹ A flow-down clause in a subcontract incorporates by implication an express DSC clause in the prime contract.

²⁸² *United States v. Spearin*, 248 U.S. 132, 135-36 39 S. Ct. 59, 63 L. Ed. 166 (1918); *Comprehensive Bldg. Contractors v. Pollard Excavating, Inc.*, 251 A.D. 2d 951, 674 N.Y.S.2d 869, 871 (N.Y. App. 1998).

²⁸³ *Comprehensive Bldg. v. Pollard Excavating*, 674 N.Y.S.2d at 871.

²⁸⁴ *Mineral Park Land Co. v. Howard*, 172 Cal. 289, 156 P. 458, 459 (1916); *Tripp v. Henderson*, 158 Fla. 442, 28 So. 2d 857 (1947).

²⁸⁵ *Blount Bros. Corp. v. United States*, 872 F.2d 1003, 1007 (Fed. Cir. 1989).

²⁸⁶ Annotation, *Modern Status of the Rules Regarding Impossibility of Performance as a Defense in an Action for Breach of Contract*, 84 A.L.R. 2d 12 (1962).

²⁸⁷ Large cost overruns do not necessarily excuse further performance. *Campeau Tool & Die Co.*, ASBCA No. 18,436, 76-1 BCA ¶ 11,653 (1975) (cost overrun of \$600,000 on a \$1.2 million contract did not amount to commercial impossibility).

²⁸⁸ *Silverite Constr. Co. v. Town of North Hempstead*, 259 A.D. 2d 745, 687 N.Y.S.2d 434 (N.Y. A.D. 1999) (Hazardous waste encountered at construction site); *Interstate Markings, Inc. v. Mingus Constructors, Inc.*, 941 F.2d 1010, 1014 (9th Cir. 1991); (jury found that it was not possible to do the work).

²⁸⁹ *Foster Constr. and Williams Bros. C.A. v. United States*, 193 Ct. Cl. 587, 435 F.2d 873 (Ct. Cl. 1970).

site occurred, that it reserves all defenses, waives nothing, and makes the change solely to move the project along rather than have the project delayed because of the dispute. The stronger and more self-serving the language, the less likely the change order will be offered in a lawsuit or arbitration as an admission.

C. DELAY

1. Introduction

Construction work is more susceptible to delay than many other forms of contracting. Variables such as adverse weather conditions, the division of work between the general contractor and its numerous subcontractors, changes to the work ordered by the owner, DSCs, strikes, and other events can delay the original contract completion date.

Most construction contracts contain clauses that deal with delay. The “suspension of work” clause²⁹⁰ and time extension clauses allow the time for contract completion to be extended when the event that caused the delay is excusable.²⁹¹ The “changes” clause and the “differing site conditions” clause (discussed earlier) also provide for time extensions as part of an equitable adjustment.²⁹²

Determining whether a time extension should be granted can be important. If the delay is not excused, the contract completion date will not be extended and the contractor may be assessed liquidated damages. If, however, it is later determined that the delay was excusable, the owner may face a claim for constructive acceleration for costs incurred by the contractor in making up a delay that should have been excused.

This subsection discusses how delay is usually classified in analyzing delay claims made by a contractor. It also discusses the use of time related clauses, such as a “suspension of work” clause, and the use of “no-pay-for-delay” clauses to minimize exposure for delay damages.²⁹³ Acceleration claims and owner’s remedies for delay (liquidated damages and termination for default) complete this subsection.

2. Types of Delay

Some events that may cause delay are usually classified in the contract as excusable, subject to the caveat

²⁹⁰ See, e.g., 48 C.F.R. 52.242-14, Suspension of Work Clause.

²⁹¹ E. M. Freeman v. Department of Highways, 253 La. 105, 217 So. 2d 166 (La. 1968) (delay excusable, contractor entitled to a time extension). “The grant of an extension of time by the contracting officer carries with it an administrative determination (admission) that the delays resulted through no fault of the contractor.” J.D. Hedin Constr. Co. v. United States, 347 F.2d 235, 245 (Ct. Cl. 1965).

²⁹² These clauses require the owner to grant time extensions, when appropriate, for added or changed work.

²⁹³ How delay damages are computed is discussed in Section Six, which deals with construction claims.

that the delay was beyond the control or responsibility of the contractor.²⁹⁴ Acts of God, unavoidable strikes, acts of government, and other *Force Majeure* events are examples.²⁹⁵ If a delay is not classified in the contract, the delay will be determined as excusable or inexcusable by the law of the jurisdiction that governs the contract.²⁹⁶

Contract clauses allocating risk of possible delay between the contractor and the owner provide benefits to owners similar to those provided by a “differing site conditions” clause. Contractors who are promised time extensions, and in some instances monetary relief for specific kinds of delay,²⁹⁷ will be deterred (if contractors wish to be competitive in bidding work) from including contingencies in their bids for delays that may or may not occur during contract performance.²⁹⁸ Whether a time extension is warranted is usually determined by analyzing the critical path method (CPM) schedule furnished by the contractor.²⁹⁹ In general, only delays to work shown on the critical path affect the completion date of the contract,³⁰⁰ although there is authority to the contrary.³⁰¹

²⁹⁴ PYCA Indus., Inc. v. Harrison County Waste Water Management Dist., 177 F.3d 351, 361 (5th Cir. 1999).

²⁹⁵ 3 D.W. HARP, *Liability for Delay in Completion of Highway Construction Contracts*, SELECTED STUDIES IN HIGHWAY LAW, at 1495, 1515-17; J. D. Hedin Constr. Co. v. United States, 408 F.2d 424, 428 (Ct. Cl. 1969).

²⁹⁶ Highland Constr. Co. v. Stevenson, 636 P.2d 1034, 1037 (Utah 1981) (delay caused by utility relocation not excusable; contractor knew that utility relocation would be carried on simultaneously with its own work); Mount Vernon Contracting Corp. v. State, 56 A.D. 2d 952, 392 N.Y.S.2d 726, 727 (N.Y. A.D. 1977) (delay due to work stoppage caused by court order, where contractor, aware of pending litigation when bids were submitted, not changeable to State.); Arrowhead, Inc. v. Safeway Stores, Inc., 179 Mont. 510, 587 P.2d 411, 413-14 (1978) (severe weather that was normal for winter construction was not a basis for further extension of time beyond that already granted); Reichenbach v. Sage, 13 Wash. 364, 43 Pac. 354, 356 (1896) (delay caused by its subcontractor not excusable); Cooke Contracting Co. v. State, 55 Mich. App. 479, 223 N.W.2d 15, 17-18 (1974) (delay to contractor caused by other state contractors not excusable).

²⁹⁷ Delay to unchanged work caused by a DSC is compensable under the federal DSC clause but not under most state clauses. See Subsection B.

²⁹⁸ Foster Constr. C.A. and Williams Bros. Co. v. United States, 193 Ct. Cl. 587, 435 F.2d 873, 887 (Ct. Cl. 1970).

²⁹⁹ The use of CPM schedules in analyzing claims is discussed in Section Six, *infra*.

³⁰⁰ Morrison-Knudsen Corp. v. Fireman’s Fund Ins. Co., 175 F.3d 1221, 1232 (10th Cir. 1999); Haney v. United States, 230 Ct. Cl. 148, 676 F.2d 584, 595 (Ct. Cl. 1982); Neal & Co., Inc. v. United States, 36 Fed. Cl. 600, 645 (1996).

³⁰¹ Howard Contracting, Inc. v. G. A. MacDonald Constr. Co., 71 Cal. App. 4th 38, 83 Cal. Rptr. 2d 590, 597 (Cal. App. 1999) (declining to apply federal rule that only delay to work on the critical path affects the project’s completion date).

a. Excusable But Noncompensable Delay

Simply put, this type of delay allows a time extension but no monetary relief. To be excusable, the contractor must show that (1) the delay was not foreseeable when the contract was let, (2) the delay was not caused by any act or neglect by the contractor, and (3) the contractor could not have reasonably prevented the delay.³⁰² If the contractor can establish these criteria, the contractor is entitled to a time extension. The contractor, however, is not entitled to delay damages unless it can also show that the delay, while excusable, is also compensable.³⁰³

The most common example of excusable but noncompensable delay is unusually severe weather. Weather is considered as unusually severe when the weather was unforeseeable. If it was foreseeable when the contract was let, it is not unusual and therefore not excusable.³⁰⁴ When severe weather is not unusual for the time and place where the work is performed, the contractor is required to anticipate severe weather and account for it in its bid.³⁰⁵ Whether severe weather encountered during construction was normal and to be expected is usually determined by comparing what occurred with weather conditions in prior years.³⁰⁶

Proving unusually severe weather is just the first step in seeking a time extension. The contractor must also show that the weather affected the progress of the work and that the effect of the weather on the work could not have been avoided by taking reasonable care to protect the work.³⁰⁷ In addition, the contractor is usually required to show that the weather affected work on the critical path, causing the contract completion date to be extended.³⁰⁸

³⁰² *Carnegie Steel Co. v. United States*, 240 U.S. 156, 165, 36 S. Ct. 342, 60 L. Ed. 576 (1916); *Morrison-Knudsen Corp. v. Fireman's Fund Insurance Co.*, 175 F.3d 1221-7 (10th Cir. 1999).

³⁰³ *Morrison-Knudsen Corp.*, *supra* note 300, at 1234 n.8 (to establish excusable delay, the contractor need only prove that the delay was not foreseeable, not within its control, or due to its fault; to show that the delay is also compensable, the contractor must prove that the delay was the government's fault).

³⁰⁴ Annotation, *Construction Contract Provision Excusing Delay Caused By "Severe Weather"*, 85 A.L.R. 3d 1085.

³⁰⁵ *Arrowhead, Inc. v. Safeway Stores, Inc.*, 179 Mont. 510, 587 P.2d 411, 414 (1978); *McDevitt & Street Co. v. Marriott Corp.*, 713 F. Supp. 906, 911-12 (E.D. Va. 1989).

³⁰⁶ Experts usually use a 10-year base for comparison purposes, although the base may be longer or even shorter than 10 years. National Oceanic and Atmospheric Administration (NOAA) records may be used. Robert L. Rich, DOTCAB No. 1026, 82-2 BCA ¶ 15,900 (1982). Other records such as airport records may be used if they are not too far from the project site and reliable. University meteorology professors may make excellent expert witnesses on weather issues.

³⁰⁷ *Titan Pacific Constr. Corp.*, ASBCA No. 24,148, 87-1 BCA ¶ 19,626 (1987) (light rain had little effect on steel erection in constructing a bridge, but the same weather could have a serious, adverse effect on painting the bridge).

³⁰⁸ CPM schedules discussed in Section Six, *infra*.

As a general rule, delay caused by third-party actions that were not foreseeable and could not have been reasonably avoided is normally excusable but not compensable unless the owner has assumed responsibility for such actions in the contract. For example, an owner is not liable for delays to its contractor caused by its other contractors unless the contract imposes a duty upon the owner to coordinate and control the work of other contractors.³⁰⁹ Thus, where, under the contract, the engineer completely coordinates construction and controls the work, a court may find that the agency has assumed a contractual duty to coordinate the project.³¹⁰ A similar result may be reached where the contract is ambiguous with respect to the owner's duty to coordinate the work of multi-prime contractors.³¹¹ The rule that an owner is not vicariously liable for its various contractors applies to utility relocation work. Generally, an owner does not owe a duty to its prime contractor to ensure timely relocation of utilities while the prime is performing its contract.³¹² The specifications, however, should clearly provide that any costs resulting from utility relocation, adjustment, or replacement, including delays resulting from such work, shall be at the contractor's expense, and the only remedy for such costs or delay shall be a time extension.³¹³ If the specification is not clear, it will not be enforced.³¹⁴ The rule that the owner is not vicariously liable for third-party actions that delay contract performance applies to labor strikes. Unavoidable strikes are excusable but not compensable.³¹⁵

³⁰⁹ *Department of Transp. v. Fru-Con Constr. Corp.*, 206 Ga. App. 821, 426 S.E.2d 905, 906 (Ga. App. 1992) (DOT was not vicariously liable for delay caused by its various contractors); *Cooke Contracting Co. v. State*, 55 Mich. App. 479, 223 N.W.2d 15 (Mich. App. 1974) (contractor not entitled to recover damages for delays caused by other contractors).

³¹⁰ *Department of Transp. v. APAC-Georgia, Inc.*, 217 Ga. App. 103, 456 S.E.2d 668 (1995). Regarding the duty to coordinate multi-prime construction contractors, see Goldberg, *The Owner's Duty to Coordinate Multi-Prime Construction Contractors, a Condition of Cooperations*, 28 Emory L.J. 377 (1979); *United States v. Blair*, 321 U.S. 730, 737, 64 S. Ct. 820, 88 L. Ed. 1039 (1944).

³¹¹ *E.C. Nolan, Inc. v. State*, 58 Mich. App. 294, 227 N.W.2d 323, 327 (1975); *Liability for Delay in Completion of Contract*, 3 SUPPLEMENTARY MATERIAL, SELECTED STUDIES IN HIGHWAY LAW 1524-S4-S5.

³¹² *White Oak Corp. v. Department of Transp.*, 217 Conn. 281, 585 A.2d 1199, 1204 (1991); *Cooke Contracting Co. v. State*, 223 N.W.2d at 18.

³¹³ *Highland Constr. Co. v. Stevenson*, 636 P.2d 1034, 1037 (Utah 1981).

³¹⁴ *Peter Kiewit & Sons Co. v. State Highway Comm'n*, 184 Kan. 737, 339 P.2d 267, 273-74 (1959); HARP, *supra* note 295.

³¹⁵ *Olympus Corp. v. United States*, 98 F.3d 1314, 1318 (Fed. Cir. 1996). The contract may list "unavoidable strikes" as an excusable delay. *PYCA Indus. v. Harrison County*, 177 F.3d 351, 361 (5th Cir. 1999).

b. Excusable and Compensable Delay

Delay is often equated with money. The adage “Time is Money” may have its origin in construction work. When a project is delayed, although work is unchanged, it may be more costly to perform. For those costs to be compensable, the delay must be caused by the owner, and result from an event that is either covered by a contract clause or by the common law dealing with remedies for breach of contract.³¹⁶

The “suspension of work” clause is one of the more significant clauses dealing with delay. The clause was adopted by the Federal Government in 1960,³¹⁷ and is currently codified in the FAR.³¹⁸ Under this clause, the contractor may be awarded compensation for “government caused delays of an unreasonable duration.”³¹⁹ The clause disallows compensation, however, to the extent that, “other causes” attributable to the contractor “would have simultaneously suspended, delayed, or interrupted contract performance.”³²⁰ The delay, however, need not be a government-ordered work stoppage to be compensable. Any unreasonable delay attributable solely and directly to the government will be considered a constructive suspension of work under the clause.³²¹

The FHWA requires a “suspension of work” clause in state highway construction contracts that receive federal-aid. The federally-mandated clause, like the clause used in direct federal contracts (FAR 52.242-14), allows the agency to suspend work without breaching the contract. The suspension does not entitle the contractor to compensation for the delay unless, “the work is suspended or delayed...for an unreasonable period of time (not originally anticipated, customary or inherent in the construction industry)...”³²² What constitutes an “unreasonable” delay is a question of fact based on the circumstances of each case.³²³ Under the federal clause (FAR 52.242-14) the delay, to be compensable, must be attributable solely and directly to the government.³²⁴ The federally-mandated clause appears to allow compensation for third-party delays, something which the federal clause does not allow. Part (iii) of the federally mandated clause provides for an adjustment (excluding

profit) when the suspension was caused by “conditions beyond the control of and not the fault of the contractor, its suppliers, or subcontractors at any approved tier, and not caused by weather....”

Another notable feature is the language in Part (iv) of the federally-mandated clause. Delay damages that are excluded under another provision of the contract are not recoverable under this clause.³²⁵ For example, delay to unchanged work caused by a DSC is not compensable under the federally-mandated DSC clause. Thus, recovery for such damages would also be excluded under the “suspension of work” clause.

To recover under the federal “suspension of work” clause, the contractor must show that (1) contract performance was delayed, (2) the delay was caused by the government, (3) the delay was for an unreasonable period of time (delay that is not unreasonable in duration is not compensable), and (4) the contractor incurred additional expense because of the delay.³²⁶ The contractor is entitled to an equitable adjustment for both written and constructive (oral) suspended work orders under the federal clause. The concept of a “constructive suspension,” however, has been rejected by one court as inconsistent with a contract requirement that an order delaying or suspending work must be in writing and signed by an authorized representative of the owner.³²⁷

The “changes” clause and the “differing site conditions” clause provide for time extensions in addition to compensation for changes to the work ordered by the owner, or caused by a DSC. Whether delays resulting from such changes are compensable depends upon how the contract is written. The federal clauses provide for an equitable adjustment in the contract price for an increase in the cost of performing unchanged work resulting from the change or the DSC. Most DSC clauses used by the states and the Federally-mandated DSC clause³²⁸ bar delay damages. Those clauses provide that no contract adjustments will be allowed for any effects on unchanged work.

The possible claims that a contractor may have against an owner for delay damages vary. The claim may be based on a specific contract clause entitling the contractor to additional compensation because of owner delay. The “changes” clause is one example. The claim, in the absence of a specific, controlling contract clause,³²⁹ may be based on breach of contract for the owner’s failure to perform some express contract obligation, or for the owner’s actions or inactions that hinder or delay performance. Claims based on the latter theory may result from a myriad of situations.

As a matter of law, there is an implied covenant in every contract that the parties will deal fairly and in

³¹⁶ *Jensen Constr. Co. v. Dallas County*, 920 S.W.2d 761, 770 (Tex. App. 1996); *Morrison-Knudsen Corp. v. Fireman’s Fund Ins. Co.*, 175 F.3d 1221, 1232 (10th Cir. 1999).

³¹⁷ *Hoel-Steffen Constr. Co. v. United States*, 197 Ct. Cl. 561, 456 F.2d 760, 763 n.2 (Ct. Cl. 1972).

³¹⁸ 48 C.F.R. 52.242-14.

³¹⁹ *Beauchamp Constr. Co. v. United States*, 14 Ct. Cl. 430, 436–37 (1988) (emphasis original).

³²⁰ *Id.* at 437.

³²¹ *John A. Johnson & Sons v. United States*, 180 Ct. Cl. 969, 984–85 (Ct. Cl. 1967); *Mega Constr. Co. v. United States*, 29 Fed. Cl. 396, 424 (1993).

³²² *Id.*

³²³ *Commercial Contractors, Inc. v. United States*, 29 Fed. Cl. 654, 662 (1993).

³²⁴ *Beauchamp Constr. Co.*, *supra* note 319, at 437.

³²⁵ See Subsection B of this Section.

³²⁶ *Melka Marine, Inc. v. United States*, 38 Fed. Cl. 545, 546 (Fed. Cl. 1997).

³²⁷ *Bonacorso Constr. Corp. v. Commonwealth*, 41 Mass. App. Ct. 8, 668 N.E.2d 366, 367 (1996).

³²⁸ See Subsection B of this Section.

³²⁹ See Subsection A of this Section.

good faith.³³⁰ Equally basic is the principle that the owner will not hinder or delay the contractor in performing the contract.³³¹ This principal is almost universally accepted as a matter of general contract law.³³² An owner's failure to provide the contractor with the work site, or an owner's interference with the use of the work site, are examples of acts or omission that hinder or delay the contractor, resulting in delay that is excusable and compensable.³³³

c. Inexcusable Delay

Inexcusable delays are delays for which the contractor assumes sole responsibility. Generally, inexcusable delay occurs in one of two ways. The first category involves delays caused by the fault or negligence of the contractor. An example of this type of delay is the contractor's failure to provide sufficient resources to perform the work.³³⁴ Another example is delay caused by the contractor's failure to plan and coordinate the work of its subcontractors.³³⁵ The second category involves delays that result from events for which the contractor assumes responsibility. Adverse weather that is not unusually severe is an example of that kind of delay. The law requires the contractor to consider the effects of normal weather, although severe, when it calculates its bid.³³⁶

A contractor is not entitled to a time extension if the delay is inexcusable.³³⁷ In addition, the contractor may

be liable for damages for breach of contract if the delay caused the contract completion date to be postponed.³³⁸ The contractor must also take reasonable steps to avoid or reduce the delay. A contractor who fails to take such steps may be liable for liquidated damages caused by the delay.

d. Concurrent Delay

Concurrent delay occurs when two or more independent events take place at the same time during contract performance, causing an activity or activities on the critical path to be delayed and resulting in a single, overall delay to project completion.³³⁹ Where both the owner and the contractor contribute to the delay, neither can recover damages from the other, unless there is a clear apportionment of the delay attributable to each party.³⁴⁰

There is some authority that a court should approximate the delay in the nature of a jury verdict. The trial court, however, cannot guess at apportionment—delay must be apportioned in a way that is not too speculative and is supported by some evidence.³⁴¹ The modern trend is to segregate delays using a CPM analysis and allocate the delay to the party responsible for the delay.³⁴² But if the delays are so intertwined that they cannot be apportioned without resorting to speculation, then the general rule proscribing apportionment will apply. "The general rule is that 'where both parties contribute to the delay, neither can recover damages, unless there is in the proof a clear apportionment of the delay and expense attributable to each.'"³⁴³

³³⁰ State v. Transamerica Premier Ins. Co., 856 P.2d 766, 774 (Alaska 1993); Howard Contracting v. McDonald Constr., 71 Cal. App. 4th 38, 83 Cal. Rptr. 2d 590, 596 (Cal. App. 1998) (implied covenant to provide timely access and facilitate performance); United States v. Metric Constructors, Inc., 325 S.C. 129, 480 S.E.2d 447, 450 (S.C. 1997); J&B Steel Contractors, Inc. v. C. Iber & Sons, Inc., 162 Ill. 2d 265, 642 N.E.2d 1215, 1222 (Ill. 1994).

³³¹ Urban Masonary Corp. v. N&N Contractors, Inc., 676 A.2d 26, 36 (D.C. 1996); Neal & Co. v. United States, 36 Fed. Cl. 631 (Ct. Cl. 1996); SIPCO Services & Marine, Inc. v. United States, 41 Fed. Cl. 196, 216 (Fed. Cl. 1998); Lester N. Johnson Co. v. City of Spokane, 22 Wash. App. 265, 588 P.2d 1214, 1217 (1978).

³³² Maine apparently is an exception. See Claude Dubois Excavating, Inc. v. Town of Kittery, 634 A.2d 1299, 1302 (Me. 1993).

³³³ Department of Transp. v. Arapaho Constr., 257 Ga. 299, 357 S.E.2d 593, 595 (1987); Southern Gulf Indus., Inc. v. Boca Ciega San. Dist., 238 So. 2d 458, cert. denied, 240 So. 2d 813 (Fla. 1970) (failure to provide right of way); Grant Constr. Co. v. Burns, 92 Idaho 408, 443 P.2d 1005, 1011 (1968).

³³⁴ John F. Miller Co. v. George Fichera Constr. Corp., 7 Mass. App. Ct. 494, 7 Mass. App. Ct. 494, 388 N.E.2d 1201 (1979).

³³⁵ Reichenbach v. Sage, 13 Wash. 364, 43 Pac. 354, 356 (Wash. 1896); Space Communications Etc., ASBCA No. 9805, 65-1 BCA ¶ 4726 (1965).

³³⁶ See "Excusable But Noncompensable Delay," *supra* note 305.

³³⁷ Morrison Knusen Corp. v. Fireman's Fund Ins. Co., 175 F.3d 1221, 1234 n.8 (10th Cir. 1999) (only delays that are not

foreseeable, not within the contractor's control, or not due to its fault are excusable).

³³⁸ 3 D.W. HARP, *Liability for Delay in Completion of Highway Construction Contracts*, SELECTED STUDIES IN HIGHWAY LAW 1495, 2495, 1508-9. See generally Annotation, *Contractual Provisions for Per Diem Payment for Delay in Performance as One for Liquidated Damages or Penalty*, 12 A.L.R. 4th 891 (1982).

³³⁹ Mega Constr. Co. v. United States, 29 Fed. Cl. 396, 424 (Fed. Cl. 1993).

³⁴⁰ William F. Klingensmith, Inc. v. United States, 731 F.2d 805, 809 (Fed. Cir. 1984); Buckley & Co. v. State, 40 N.J. Super., 289, 356 A.2d 56, 71 (N.J. 1975); L.A. Reynolds Co. v. State Highway Comm'n, 155 S.E.2d 473, 482 (N.C. 1967); Mega Constr. Co. v. United States, 29 Fed. Cl. 396, 424 (1993).

³⁴¹ Grow Constr. Co. v. State, 56 A.D. 2d 95, 391 N.Y.S.2d 726, 729, "Liability of building or construction contractor for liquidated damages for breach of time limit whose work is delayed by contractee or third persons" (App. Div. 1977); Annotation, 152 A.L.R. 1349, 1359-78 (1944).

³⁴² District of Columbia v. Kora & Williams Corp., 743 A. 2d 682, 691-92 (1999).

³⁴³ Mega Constr. Co. v. United States, 29 Fed. Cl. 396, 424 (1993) (quoting William F. Klingensmith, Inc. v. United States, *supra* note 340); Blinderman Constr. Co. v. United States, 695 F.2d 552, 559 (Fed. Cir. 1982); Coath & Gass, Inc. v. United States, 101 Ct. Ct. 702, 714-15 (1944).

3. Early Completion

A contractor may claim damages for delay contending that the owner prevented it from completing the contract earlier than scheduled. As a general rule, an owner has no implied duty to aid the contractor in completing its contract prior to the completion date specified in the contract.³⁴⁴ However, an owner does have a duty not to hinder or prevent the contractor from completing its contract earlier than scheduled.³⁴⁵ In *Metropolitan Paving Co. v. United States*, the court said:

While it is true that there is not an “obligation” or “duty” of defendant to aid a contractor to complete prior to completion date, from this it does not follow that defendant may hinder and prevent a contractor’s early completion without incurring liability. It would seem to make little differences whether or not the parties contemplated an early completion...Where defendant is guilty of “deliberate harassment and dilatory tactics” and a contractor suffers damages as a result of such action, we think that defendant is liable.³⁴⁶

A “no-damage-for-delay” clause should bar an early completion delay claim unless the delay falls within one of the exceptions to enforceability of the clause discussed next in Part 4. For example, New York State has a provision that provides that:

In the event the Contractor completes the work prior to the contract completion date set forth in the proposal, even if he informs the Department of his intention to complete early or submits a schedule depicting early completion, the Contractor hereby agrees to make no claim for extra costs due to delays, interferences or inefficiencies in the performance of the work....³⁴⁷

Most construction contracts require the contractor to submit a schedule showing how the project will be completed on time. Occasionally, contractors submit schedules showing a completion date earlier than required by the contract. There is a desire to accept a schedule showing early completion, since it is usually in the owner’s interest to have the project completed early. This can also be a concern. By accepting a schedule showing early completion, the owner implies that the schedule is realistic. This can come back to haunt an owner when faced with an early completion delay claim. To avoid this dilemma, owners may consider including a “no-damage-for-delay” clause like the one quoted earlier. The owner may also reject schedules that are patently unreasonable.

³⁴⁴ *United States v. Blair*, 321 U.S. 730, 64 S. Ct. 820, 88 L. Ed 559 (1944).

³⁴⁵ *Housing Auth. of City of Texarkana v. E. W. Johnson Constr. Co.*, 1039, 264 Ark. 523, 573 S.W.2d 316, 323 (1978); *Grow Constr. v. State*, 56 A.D. 2d 95, 391 N.Y.S.2d 726, 729 (N.Y. A.D. 1969); *State v. Cherry Hill Sand & Gravel Co.*, 51 Md. App. 29, 443 A.2d 628, 634 (1982).

³⁴⁶ 163 Ct. Cl. 420, 325 F.2d 241 (1963).

³⁴⁷ New York DOT Standard Specifications 102-17, art. 13 (1995).

4. No-Damage-for-Delay Clauses

In an effort to reduce claims, owners will often include “no-damage-for-delay” clauses in their construction contracts. These exculpatory clauses preclude damages for owner-caused delay, limiting the contractor’s sole remedy to a time extension. Generally, such clauses are valid and enforceable.³⁴⁸ A typical clause provides that a contractor’s sole remedy for delay is a time extension, and that the contractor is not entitled to any compensation from the owner for any damages caused by the delay.³⁴⁹ The “no-damage-for-delay” clause may be combined with a clause providing for time extensions.

If delays are caused by acts of God, acts of Government, unavoidable strikes, extra work, or other causes or contingencies clearly beyond the control or responsibility of the Contractor, the Contractor may be entitled to additional time to perform and complete the Work...*The Contractor agrees that he shall not have or assert any [sic.] claim for, nor shall he be entitled to any additional compensation or damages on account of such delays.*³⁵⁰

The law on the validity of “no-pay-for-delay” clauses varies from state to state. All jurisdictions agree that, because such clauses are exculpatory in nature and have harsh results, they will be strictly construed.³⁵¹ Therefore, in drafting this type of clause it is important to make sure that the clause is clear and unambiguous.³⁵² It is also important to make sure that the clause complies with the law of the jurisdiction where the contract will be performed.

The rule that “no-damage-for-delay” clauses are enforceable is subject to the following exceptions: (1) where the delay was not contemplated by the parties to the contract; (2) where the delay was caused by fraud, gross negligence, or active interference; and (3) where the delay is so unreasonable that it is tantamount to an abandonment of the contract.³⁵³

³⁴⁸ Annotation, *Validity and Construction of “No Damage Clause” with Respect to Delay in Building or Construction Contract*, 74 A.L.R. 3d 187 (1976); *Beltrone Constr. Co. v. State*; 256 A.D. 992, 682 N.Y.S.2d 299, 300 (1998).

³⁴⁹ *L & B Constr. Co. v. Ragan Enters., Inc.*, 267 Ga. 809, 482 S.E.2d 279, 282 (1997).

³⁵⁰ *PYCA Indus. v. Harrison County Waste Water Mgmt. Dist.*, 177 F.3d 351, 361 (5th Cir. 1999) (emphasis in original).

³⁵¹ *Little Rock Wastewater Utility v. Larry Moyer Trucking, Inc.*, 321 Ark. 303, 902 S.W.2d 760, 765 (1995); WILLISTON ON CONTRACTS, § 602A (3d ed.). Contract provisions aimed at relieving a party from the consequences of its own faults are strictly construed. Such clauses, however, are valid as long as they comply with the rules governing the validity of contracts. 74 A.L.R. 3d 187, 200 at § 2(a) (1976). Such clauses are risk-shifting provisions in which the contractor assumes the risk of owner caused delay. *Green Int’l, Inc. v. Solis*, 951 S.W.2d 384, 386 (Tex. 1997).

³⁵² See, e.g., *Borden v Phillips*, 752 So. 2d 69, 73 (2000).

³⁵³ *PYCA Indus. v. Harrison County, Id.*, at 364; *Corinno Civetta Constr. Co. v. City of N.Y.*, 67 N.Y.2d 297, 493 N.E.2d 905, 907-08 502 N.Y.S.2d 681 (N.Y. 1986); *United States v. Metric Constructors, Inc., Id.* at 448; *United States ex rel.*

a. Delay Not Contemplated by the Parties

Under this exception, delay is not barred by the clause if the delay was not contemplated by the parties. This exception is based on the premise that if the delay was not contemplated, the contractor could not waive a delay that it had not considered in making its bid.³⁵⁴ “It can hardly be presumed...that the contractor bargained away his right to bring a claim for damages resulting from delays which the parties did not contemplate at the time.”³⁵⁵

Other decisions enforcing the clause have not required that the delay be contemplated.³⁵⁶ Observing that unforeseen delay was the sort of delay that the clause was designed to cover, the court in *City of Houston v. R. W. Ball Const. Co.*, said:

The clause does not limit its application to those delays and hindrances that were foreseen by the parties when they entered into the contract. Instead, it embraces all delays and hindrances which may occur during the course of the work, foreseen and unforeseen. Indeed, it is the unforeseen events which occasion the broad language of the clause since foreseeable ones could be readily provided for by specific language.³⁵⁷ (citations omitted)

b. Delay Caused by Bad Faith, Gross Negligence, or Active Interference

Under this exception, damages for delays are not barred by the clause if the delay is caused by bad faith,³⁵⁸ gross negligence,³⁵⁹ or active interference with

Evergreen Pipeline v. Merritt-Meridan Pipetime Constr. Corp., 890 F. Supp. 1213, 1221 (S.D. N.Y. 1995) (applying New York law).

³⁵⁴ *Corinno Civetta Constr. Co. v. City of N.Y.*, *Id.* at 911; *United States ex rel. Evergreen Pipeline v. Merritt*, 890 F. Supp. 1213 (S.D. N.Y. 1995) (applying New York state law); *J & B Steel Contr. v. C. Iber & Sons*, 246 Ill. App. 3d 523, 617 N.E.2d 405, 411; 187 Ill. Dec. 97 (Ill. App. 1993), *aff'd*, 162 Ill. 2d 265, 642 N.E.2d 1215, 205 Ill. Dec. 98 (1994); *PYCA Indus. v. Harrison County*, *Id.* at 362; *Department of Transp. v. Arapaho Constr., Inc.*, 257 Ga. 269, 357 S.E.2d 593, 594 (1987).

³⁵⁵ *Corinno Civetta Constr. Co. v. City of N.Y.*, 67 N.Y.2d 297, 493 N.E.2d 905, 910 502 N.Y.S.2d 681 (1986).

³⁵⁶ *State Highway Admin. v. Greiner Eng'g Sciences, Inc.*, 83 Md. App. 621, 577 A.2d 363, 367–68 (Md. App. 1990); *John E. Gregory and Son, Inc. v. A. Guenther & Sons Co.*, 148 Wis. 2d 298, 432 N.W.2d 584, 586–89 (1988); *Edward E. Gillen Co. v. City of Lake Forest*, 3 F.3d 192, 194 (7th Cir. 1993); *Western Eng'rs v. State*, 20 Utah 2d 294, 437 P.2d 216, 217–18 (1968). *United States v. Metric Constructors, Inc.*, 325 S.C. 129, 480 S.E.2d 447, 450 (1997).

³⁵⁷ 570 S.W.2d 75, 78 (Tex. Civ. App. 1978).

³⁵⁸ *Halloway Constr. Co. v. Department of Transp.*, 218 Ga. App. 243, 461 S.E.2d 257 (1995); *Owen Constr. Co. v. Iowa State Dep't of Transp.*, 274 N.W.2d 304, 308 (1979); *White Oak Corp. v. Department of Transp.*, 217 Conn. 281, 585 A.2d 1199, 203–04 (1991); *State Highway Admin. v. Greiner Eng'g Sciences, Inc.*, 83 Md. App. 621, 577 A.2d 363 (1990); 74 A.L.R. 3d 187, 215–16 § 7(b). In *Kalisch-Jarcho, Inc. v. City of N.Y.*, 58 N.Y.S.2d 397, 448 N.E.2d 413, 467 N.Y.S.2d 746 (N.Y.

the contractor's efforts to perform the contract.³⁶⁰ This exception is based on the principle that such conduct violates the obligation of good faith and fair dealing implicit in the contract,³⁶¹ and would allow the owner to avoid the consequences of its wrongful acts.³⁶²

c. Abandonment

Some courts recognize an exception to a “no-damage” clause where the delays are so unreasonable in length that they amount to an abandonment of the contract by the owner.³⁶³ Other courts do not recognize this exception and enforce the clause,³⁶⁴ although delays that are unreasonable in duration and prevent the contractor from performing the contract may justify treating the contract as ended.³⁶⁵ In those jurisdictions where this exception is recognized, the question of whether the

1983), the court approved a jury instruction that required the contractor to prove that, “the city acted in bad faith and with deliberate intent delayed the [contractor] in the performance of its obligation.” 448 N.E.2d at 418.

³⁵⁹ *State Highway Admin. v. Greiner Eng'g Sciences, Inc.*, 577 A.2d 363 (Md. App. 1990); *White Oak Corp. v. Department of Transp.*, 585 A.2d 1199, 1203–04 (Conn. 1991); *Gust K. Newberg, Inc. v. Illinois State Toll Highway Auth.*, 153 Ill. App. 3d 918, 506 N.E.2d 658, 665, 106 Ill. Dec. 858 (1987).

³⁶⁰ *Newberry Square Dev. Corp. v. Southern Landmark, Inc.*, 578 So. 2d 750, 752 (Fla. App. 1991); *Owen Constr. Co. v. Iowa State Dep't of Transp.*, 274 N.W.2d 304, 307 (Iowa 1979); *Christiansen Bros. v. State*, 90 Wash. 2d 892, 586 P.2d 840, 844 (1978) (unconscionability defense); *United States v. Metric Constructors, Inc.*, 480 S.E.2d 447, 449 (S.C. 1997) (adopting this exception).

³⁶¹ *Lewis-Nicholson, Inc. v. United States*, 213 Ct. Cl. 192, 550 F.2d 26, 32 (Ct. Cl. 1977).

³⁶² *J & B Steel Contractors, Inc. v. C. Iber and Sons, Inc.*, 162 Ill. 2d 265, 642 N.E.2d 1215, 1222, 205 Ill. Dec. 98 (1994).

³⁶³ *Corinno Civetta Constr. Co. v. City of N.Y.*, 67 N.Y.2d 297, 493 N.E.2d 905, 912, 502 N.Y.S.2d 681 (1986) (“No-Damage” clause did not apply to delay that was so excessive and unreasonable as to be beyond the contemplation of the parties); *United States v. Metric Constructors, Inc.*, 325 S.C. 1, 480 S.E.2d 447, 449–50 (1997); 74 A.L.R. 3d 187, 226–231, 7(i), (1976).

³⁶⁴ *State Highway Admin. v. Greiner Eng'g Sciences, Inc.*, 83 Md. App. 621, 577 A.2d 363, 370 (Md. App. 1990) (clause barred delay of over 4 years); *Dickinson Co. v. Iowa State Dep't of Transp.*, 300 N.W.2d 112, 114–15 (Iowa 1981) (2-year delay).

³⁶⁵ *Gust K. Newberg, Inc. v. Illinois State Toll Auth.*, 153 Ill. App. 3d 918, 506 N.E.2d 658, 665, 106 Ill. Dec. 858 (1987) (“no-damage” clause enforced); *Southern Gulf Utils., Inc. v. Boca Ciega San. Dist.*, 238 So. 2d 458 (Fla. 1970) (“no-damage” clause not enforced); *Merritt-Chapman & Scott Corp. v. United States*, 108 Ct. Cl. 639, 528 F.2d 1392, 1399 (Ct. Cl. 1976) (“no-damage” not enforced); *Buckley & Co. v. State*, 140 N. J. Super. 289, 356 A.2d 56, 61–62 (N.J. Super. 1975) (“no-damage” clause not enforced); *see also United States v. Merritt Meridian Constr. Corp.*, 95 F.3d 153, 167 (2d Cir. 1996).

delay is of sufficient duration to constitute abandonment is factual.³⁶⁶

Contractors, in an effort to avoid the application of a “no-damage” clause, have argued that courts should declare such clauses void and contrary to public policy because they are unfair and inflate bids. Generally, this argument has not been successful. For example, in *Christiansen Bros., Inc. v. State*, the contractor was delayed by design errors and by other contractors performing change orders.³⁶⁷ The trial court determined the amount of damages caused by the delay, but denied judgment to the contractor because of the “no-damages-for-delay” clause in the contract.³⁶⁸ On appeal, the contractor argued that such clauses are contrary to public policy because they inflate bids and are unconscionable. The court held that the clause was valid, and that more forceful considerations of public policy outweighed the argument that the clause was unfair and inflated bids. In this regard, the court said:

In a construction project of the magnitude of the WSU structure, some delays are inevitable. Costs attributable to such delays must be borne by either the owner or the contractor. By allowing the owner to preclude damages at the outset, the contractor may raise the price of his bid so as to take into account delay costs. By this method, the owner is able to know more accurately the total cost of a building at the outset and does not have to worry about “hidden costs” in the form of damages which do not arise until the project is substantially underway. The constituents of a municipality or of the state will also know the costs of a particular project prior to embarking on the construction. The contractor is protected because it knows in advance of bidding that it cannot recover for damages for delay and will bid accordingly....³⁶⁹

Following the court’s decision in *Christiansen Bros.*, the Washington State Legislature enacted a statute prohibiting “no-pay-for-delay” clauses in both public and private contracts.³⁷⁰ In 1990, Missouri enacted legislation prohibiting such clauses in public works contracts.³⁷¹ The prohibition does not apply to contracts between private parties.³⁷² The Missouri statute provides that:

Any clause in a public works contract that purports to waive, release, or extinguish the rights of a contractor to recover costs or damages,...for delays in performing such contract, if such delay is caused in whole, or in part, by acts or omissions within the control of the contracting

public entity or persons acting on behalf thereof, is against public policy and is void and unenforceable.³⁷³

Other states have enacted similar legislation as depicted in the following table.

³⁶⁶ *Hawley v. Orange County Flood Control Dist.*, 211 Cal. App. 2d 708, 716–17, 27 Cal. Rptr. 478 (Cal. App. 1983).

³⁶⁷ 90 Wash. 2d. 872, 586 P.2d 840 (Wash. 1978).

³⁶⁸ The court determined the amount of damages caused by the delay in case its decision on liability was reversed on appeal. *Id.* at 842.

³⁶⁹ *Id.* at 844.

³⁷⁰ WASH. REV. CODE 4.24.360 (1988).

³⁷¹ MO. REV. STAT. 34.058 (2001).

³⁷² *Roy A. Elam Masonary, Inc. v. Fru-Con Constr. Corp.*, 922 S.W.2d 783, 790 (Mo. App. E.D. 1996).

³⁷³ *Supra* note 371.

State	Applies To Public Contracts	Applies To Private Contracts	Reference
California	Yes	No	CAL. PUB. CONT. CODE § 7102 (1985)
Colorado	Yes	No	COLO. REV. STAT. § 24-91-103.5 (1991)
Louisiana	Yes	No	LA. REV. STAT. ANN. § 38.2216(H) (1990)
North Dakota	Yes	No	N.D. CENT. CODE § 9-08-02.1 (1999)
Ohio	Yes	Yes	OHIO CODE ANN. § 4113.62 (C)(1) (1998)
Oregon	Yes	No	OR. REV. STAT. § 279.063 (1985)
Virginia	Yes	No	VA. CODE ANN. § 2.2-4335 (A) (1991)

Despite numerous cases to the contrary, these statutes are based on the premise that “no-pay-for-delay” clauses violate public policy. Those who advocate this view argue that such clauses are unfair. Are such clauses unfair? The language used by the Supreme Court in *Wells Bros. Co. v. United States* is instructive.

Men who take million-dollar contracts for government buildings are neither unsophisticated nor careless. Inexperience and inattention are more likely to be found in other parties to such contracts than the contractors, and the presumption is obvious and strong that the men signing such a contract as we have here protected themselves against such delays as are complained of by the higher price exacted for the work.³⁷⁴

5. Subcontractor Delay

A “no-pay-for-delay” clause may be expressly incorporated in a subcontract, or it may be incorporated by reference through the subcontractor’s “flow-down” clause.³⁷⁵ Whatever its form, the clause is subject to the same rules and exceptions that apply to such clauses in contracts between an owner and a general contractor.³⁷⁶ However, the clause will be enforced between the general contractor and its subcontractor so long as the clause meets the ordinary rules governing contracts and does not fall within one of the exceptions that prevent enforceability. For example, in *L& B Construction Co. v. Ragan Enterprises*, a clause in the subcontract provided that, “[s]hould subcontractor be delayed in the work by contractor then contractor shall owe subcontractor therefor only an extension of time for comple-

tion equal to the delay....”³⁷⁷ The use of the word “only” limited the subcontractor’s remedy to an extension of time. Damages for the delay were not allowed.

Clauses precluding subcontractor claims become important to owners when the prime contractor attempts to pass the claim along to the owner for delays that the owner caused. If the clause bars the subcontractor’s claim against the contractor for delay,³⁷⁸ the claim cannot be passed through to the owner even though the owner caused the delay.³⁷⁹ The clause may also extend to and protect the owner’s architect/engineer as a third-party beneficiary of the owner’s construction contract with the contractor.³⁸⁰ The limitations on pass-through claims and the *Severin* doctrine are discussed in the next section.

6. Notice of Delay

Most construction contracts contain provisions requiring the contractor to notify the owner, in writing, when the contractor claims that it has been delayed and seeks a time extension, or additional compensation for the delay.³⁸¹ Notice serves several purposes. It allows the owner to verify the contractor’s claim and document the contractor’s costs. It also allows the

³⁷⁴ 254 U.S. 83, 84, 41 S. Ct. 34, 65 L. Ed. 148 (1920).

³⁷⁵ *Pete Scalamandre & Sons v. Village Dock*, 187 A.D. 2d 496, 589 N.Y.S.2d 191 (1992).

³⁷⁶ *Port Chester Elec. Constr. Corp. v. HBE Corp.*, 894 F.2d 47, 49 (2nd Cir. 1990).

³⁷⁷ 267 Ga. 809, 482 S.E.2d 279, 280 (1997).

³⁷⁸ *Green Int’l, Inc. v. Solis*, 951 S.W.2d 384, 387 (Tex. 1997).

³⁷⁹ *Frank Briscoe Co. v. County of Clark*, 772 F. Supp. 513, 516–17 (D. Nev. 1991).

³⁸⁰ *Bates & Rogers Constr. Corp. v. Greeley & Hanseon*, 109 Ill. 2d 225, 486 N.E.2d 902, 906, 693 Ill. Dec. 369 (Ill. 1985).

³⁸¹ Under the *Severin* doctrine, the contractor must be liable to the subcontractor in order to pass the subcontractor’s claim through to the owner. *Severin v. United States*, 99 Ct. Cl. 435 (1943).

owner to explore alternatives such as termination for convenience if the delay could be extensive.³⁸²

There is ample authority that failure to provide written notice, as required by the contract, will bar the claim.³⁸³ There is, however, authority to the contrary. These cases hold that written notice is not required when the owner had actual notice of the delay,³⁸⁴ or the government was not prejudiced or disadvantaged by lack of notice.³⁸⁵ These views focus more on the purpose of the clause than on a literal and strict construction of its language.³⁸⁶

Whether oral notice was given, or whether the owner knew about the delay is often disputed. Requiring strict compliance with the notice requirements of the contract eliminates those types of disputes. This is of particular importance when the issue of whether oral notice was given, or the owner knew about the delay, is being litigated years after the project has been completed. These are questions of fact.³⁸⁷ Written notice requirements, like other contract provisions, can be waived.³⁸⁸ This may occur, for example, by granting time extensions that have not been requested by the contractor and by not assessing liquidated damages.³⁸⁹

7. Acceleration

Acceleration in construction parlance means to speed up work through the use of increased labor, additional equipment, or other contractor resources. Acceleration may be used to make up work that is behind schedule or to complete the project earlier than scheduled. There are two types of acceleration: actual and constructive. Both types are based on the changes clause.³⁹⁰

Actual acceleration occurs when the owner issues a formal change order directing the contractor to speed

up the work.³⁹¹ Constructive acceleration, as the name implies, does not involve a formal change order. Generally, it occurs when a contractor encounters an excusable delay,³⁹² and the owner refuses to grant an extension of time for the delay and directs the contractor to meet the original contract completion date.³⁹³

The vast majority of cases recognizing constructive acceleration are federal decisions.³⁹⁴ There are, however, some state court decisions where constructive acceleration has been recognized as a theory of entitlement in public works contracts³⁹⁵ and private contracts.³⁹⁶ In the absence of precedent, state courts may look to federal law for the elements necessary to establish constructive acceleration.³⁹⁷

To prove construction acceleration under federal law, five elements must be established.

First, there must be an excusable delay. Second, the Government must have knowledge of the delay. Third, the Government must act in a manner which reasonably can be construed as an order to accelerate. Fourth, the contractor must give notice to the Government that the "order" amounts to a constructive change. Fifth, the contractor must actually accelerate and thereby incur added costs.³⁹⁸

An order to accelerate, to be effective, need not be couched in terms of a specific command to speed up the

³⁹¹ For example, the Federal Changes Clause in 48 C.F.R. pt. 1, 52.243-4 authorized the contracting officer to make changes, including: "(4) directing acceleration in the performance of the work."

³⁹² *Norair Eng'g Corp. v. United States*, 229 Ct. Cl. 160, 666 F.2d 546, 548 (Ct. Cl. 1981) (The delay may be compensable or noncompensable, but in either case the delay must be excusable).

³⁹³ *Fru-Constr. Corp. v. United States*, 43 Fed. Cl. 306, 328 (Fed. Cl. 1999).

³⁹⁴ *Id.*; *Norair Eng'g Corp. v. United States*, *supra* note 392; *Tombigee Constructors v. United States*, 190 Ct. Cl. 615, 420 F.2d 1037, 1046 (Ct. Cl. 1970); *McNutt Constr. Co.*, 85-3 BCA ¶ 18,397, at 92,279 (1985); *Envirotech Corp. v. Tenn. Valley Auth.*, 715 F. Supp. 190, 192 (W.D. Ky. 1988).

³⁹⁵ *Department of Transp. v. Anjo Constr. Co.*, 666 A.2d 753, 757 (Pa. Commw. 1995); *Siefford v. Housing Auth. of City of Humbolt*, 192 Neb. 643, 223 N.W.2d 816, 820 (1974) ("no-damage" clause barred recovery for acceleration damages); *Global Constr., Inc. v. Mo. Highway and Transp. Comm'n*, 963 S.W.2d 340, 343 (Mo. App. 1997).

³⁹⁶ *S. Leo Harmonay, Inc. v. Binks Mfg. Co.*, 597 F. Supp. 1014, 1026 (S.D. N.Y. 1984) (general contractor liable to subcontractor for acceleration damages—court applied New York law); *Johnson Controls, Inc. v. National Valve & Mfg. Co.*, 569 F. Supp. 758, 761 (E.D. Okla. 1983) (constructive acceleration claim by subcontractor against general contractor denied because of subcontractor's failure to give notice that it considered a directive from the general contractor to stay on schedule an order to accelerate the work).

³⁹⁷ For example, the court in *Department of Transp. v. Anjo Constr. Co.*, 395, *supra*, followed *Norair Eng'g Corp. v. United States*, 229 Ct. Cl. 160, 666 F.2d 546 (Ct. Cl. 1981).

³⁹⁸ *Fru-Constr. Corp. v. United States*, *supra* note 394, at 328.

³⁸² It may be prudent for the owner to terminate the contract for convenience and pay an "equitable adjustment" under the termination for convenience clause rather than pay damages for a prolonged delay.

³⁸³ See *supra* note 219 and accompanying text.

³⁸⁴ *Id.*

³⁸⁵ *Hoel-Steffen Constr. Co. v. United States*, 197 Ct. Cl. 561, 456 F.2d 760, 768 (Ct. Cl. 1972); *APAC-Georgia, Inc. v. Department of Transp.*, 221 Ga. App. 604, 472 S.E.2d 97, 101 (1996) (any recovery limited to design errors); *New Pueblo Constrs. v. State*, 144 Ariz. 95, 696 P.2d 185, 193 (1985).

³⁸⁶ *Fru-Con Constr. Corp. v. United States*, 43 Fed. Cl. 306, 324-25 (Fed. Cl. 1999).

³⁸⁷ *New Pueblo Constrs. v. State*, *supra* note 385; *State v. Eastwind, Inc.*, 851 P.2d 1348, 1351 (Alaska 1993).

³⁸⁸ *Reif v. Smith*, 319 N.W.2d 815, 817 (S.D. 1982).

³⁸⁹ *APAC-Georgia, Inc. v. Department of Transp.*, *supra* note 389, at 99-100.

³⁹⁰ In the absence of a changes clause authorizing the owner to order acceleration, the contractor is not contractually obligated to accelerate. If the contractor agrees to accelerate, the acceleration may be authorized by a supplemental agreement, which is in effect a new contract, not a change to the existing contract. See Subsection A, "Changes," *supra*.

work. In *Department of Transportation v. Anjo Construction Co.*, the court observed that

An order to accelerate need not be expressed as a specific command by the government unit, but may be constructive. A constructive acceleration order may exist, when the government unit merely asks the contractor to accelerate or when the government expresses concern about lagging progress. Whether a constructive acceleration order was given to a contractor is a question of law. (citations omitted)³⁹⁹

To guard against constructive acceleration claims, an owner may wish to include a clause in its construction contracts prohibiting such claims unless the order to accelerate is in writing and signed by the engineer, or another person authorized to sign change orders. An example of this type of clause is the New York State Department of Transportation Standard Provision governing acceleration claims:

The Contractor may not maintain a dispute for costs associated with acceleration of the work unless the Department has given prior express written direction by the Engineer to the Contractor to accelerate its effort. The Contractor shall always have the basic obligation to complete the work in the time frames set forth in the contract. For purposes of this Subsection, lack of express written direction on the part of the Department shall never be construed as assent.⁴⁰⁰

This type of clause, absent a waiver by the owner, should bar constructive acceleration claims in those jurisdictions where written change order requirements are strictly enforced. Also, clauses requiring the contractor to give notice of a constructive acceleration claim may bar the claim if notice is not given.⁴⁰¹ However, as with any contractual provision, notice requirements may be waived by the party attempting to enforce them.⁴⁰² Also, conduct by the owner that amounts to overreaching or bad faith may equitably estop the owner from asserting such clauses as a defense.⁴⁰³

A contractor may recover its acceleration costs even if it does not complete the project on time. All that is required is a reasonable and diligent effort to make up the delay.⁴⁰⁴ There is also authority that a contractor may recover damages when the owner prevents the contractor from completing the contract earlier than scheduled.⁴⁰⁵ Acceleration costs may include added labor

costs, including premium pay for overtime and weekend work, lost labor productivity due to overmanning, impacts on subcontractors, stacking of trades, and additional equipment. These costs are usually proved by expert witnesses using CPM scheduling methods. Costs are discussed in more detail in Section Six.

8. Owner's Remedies for Delay

a. Liquidated Damages

A failure to complete a contract on time is a breach of contract unless the delay extending the contract completion date is excusable. The owner, as the injured party, is entitled to damages for the breach. Damages for late completion are usually addressed by including a liquidated damages clause in the contract. The clause authorizes the owner to assess a specified sum of money for each day that the contract completion date is delayed.⁴⁰⁶

Historically, the law did not favor liquidated damages. Clauses providing for liquidated damages were often suspect, with some courts viewing them as more penal in nature than compensatory.⁴⁰⁷ When viewed in this matter, the clause was regarded as a penalty because it was being used *in terrorem* to compel performance rather than to quantify damages for delay in completing the contract, and it was invalidated.⁴⁰⁸ The modern view favors liquidated damages.⁴⁰⁹ As a general rule, courts will enforce a liquidated damages clause

⁴⁰⁶ Usually the sum is set forth in the special provision of the contract. For example, the California DOT Standard Specification 8-1-07 provides that, "the Contractor will pay to the State of California, the sum set forth in the special provisions for each and every calendar day's delay in finishing the work in excess of the number of working days prescribed..." Instead of a specific sum, the clause may include a formula for calculating liquidated damages. For example, WSDOT Standard Specification 1-08.9 contains the following formula:

LIQUIDATED DAMAGES FORMULA

$$LD = \frac{0.15C}{T}$$

where: LD = liquidated damages per working day
(rounded to the nearest dollar)

C = original contract amount

T = original time for physical completion

⁴⁰⁷ *Contractual Provisions for Per Diem Payments for Delay in Performance as One for Liquidated Damages or Penalty*, 12 A.L.R. 4th 891 (1982); DARRELL W. HARP, 3 *Liability for Delay in Completion of Highway Construction Contract*, SELECTED STUDIES IN HIGHWAY LAW 1495, 1510-11.

⁴⁰⁸ *S. L. Rowland Constr. Co. v Beall Pipe & Tank Co.*, 14 Wash. App. 297, 540 P.2d 912, 921-22 (1975).

⁴⁰⁹ RESTATEMENT OF CONTRACTS 2d, § 356 (1979); 12 A.L.R. 4th 891 (1982).

³⁹⁹ *Anjo Constr.*, *supra* note 397, at 757 (citing *Norair Eng'g Corp. v. United States*, 666 F.2d 546 (Ct. Cl. 1981)).

⁴⁰⁰ New York DOT Standard Specification § 105-148 (1995).

⁴⁰¹ *Johnson Controls, Inc. v. National Valve & Mfg. Co.*, *supra* note 396.

⁴⁰² *APAC-Georgia, Inc. v. Department of Transp.*, *supra* note 389.

⁴⁰³ *Bignold v. King County*, 54 Wash. 2d 817, 399 P.2d 611, 615-16 (1965); *Kohn v. City of Boulder*, 919 P.2d 822, 824-25 (Colo. App. 1995).

⁴⁰⁴ *Appeal of Monterey Mechanical Co.*, ASBCA No. 51450, 2001-1B.C.A. ¶ 31,380 (2001).

⁴⁰⁵ *Grow Constr. Co. v. State*, 56 A.D. 2d 95, 391 N.Y.S.2d 726, 729 (1977).

unless the party challenging the clause can prove that the clause is unenforceable.⁴¹⁰

An attack on a liquidated damages clause may be made on several fronts. The most common line of attack is that the amount specified as liquidated damages is so disproportionate to the anticipated loss that it is, in fact, a penalty.⁴¹¹ The second but less common line of attack is that actual damages can be accurately quantified. This argument is based on the premise that liquidated damages are permissible only when it would be impracticable or extremely difficult to determine actual damages accurately.⁴¹² A third line of attack is that liquidated damages should not be enforced where no actual damages were sustained because of the delay.⁴¹³ Under the Restatement of Contracts rule, liquidated damages cannot be recovered if there is no loss.⁴¹⁴ This, however, is not the majority rule. The view taken by most courts is that liquidated damages will be enforced even though no actual damages were suffered.⁴¹⁵ This view is based upon the premise that the reasonableness of the amount specified as liquidated damages is determined as of the date the contract was made, not the date that the breach occurred. In *Gaines v. Jones*, the court said:

It is not unfair to hold the contractor performing the work to such agreement if by reason of later developments damages prove to be less or non-existent. Each party by entering into such contractual provision took a calculated risk and is bound by reasonable contractual provisions pertaining to liquidated damages.⁴¹⁶

If the liquidated amount is determined to be a penalty, the clause will be stricken and actual damages may be recovered. The court cannot reform the contract by substituting an amount of liquidated damages that the court believes to be reasonable, but it can determine the actual damages incurred as a result of the delay.⁴¹⁷ An owner's recovery for delay is limited to the

⁴¹⁰ APAC-Carolina v. Greensboro-High Point, Airport Auth., 110 N.C. App. 664 431 S.E.2d 508, 516 (N.C. App. 1993); Reliance Ins. Co. v. Utah Dep't of Transp., 858 P.2d 1363 (Utah 1993).

⁴¹¹ RESTATEMENT OF CONTRACTS 2d, § 356 (1979). See also State Highway Dep't v. Milton Constr. Co., 586 So. 2d 872 (Ala. 1991) (disincentive payment of \$5,000.00 for each day the contract overran in addition to liquidated damages held to be an unenforceable penalty).

⁴¹² 12 A.L.R. 4th 891; New Pueblo Constructors v. State, 144 Ariz. 95, 696 P.2d 185 (Ariz. 1985).

⁴¹³ RESTATEMENT OF CONTRACTS 2d, § 339, 356 (1979).

⁴¹⁴ Lind Bldg. Corp. v. Pacific Bellevue Dev., 55 Wash. App. 70, 776 P.2d 977, 983 (Wash. App. 1989).

⁴¹⁵ 34 A.L.R. 1336 (1925) "Right to amount stipulated in contract for breach, where it appears there were no actual damages, or there was no proof of such damage," (1982); see Wallace Real Estate Inv., Inc. v. Groves, 881 P.2d 1010, 1017 (Wash. 1994).

⁴¹⁶ 486 F.2d 39, 45 (8th Cir. 1973) (quoting Southwest Eng'g Co. v. United States, 341 F.2d 998, 1002-03 (8th Cir. 1965)).

⁴¹⁷ Kingston Contractors, Inc. v. Washington Metro. Area Transit Auth., 930 F. Supp. 651, 656 (D.D.C. 1996).

liquidated amount even though its actual damages are greater.⁴¹⁸ However, a liquidated damages clause does not preclude recovery for actual damages that are not covered by the clause,⁴¹⁹ or where the right to recover actual damages is reserved in the contract. In *VanKirk v. Green Construction Co.*, the state was entitled to liquidated damages for the contractor's delay and to indemnification from the contractor for damages that the state paid to another contractor because of the delay.⁴²⁰

Occasionally, construction contracts will contain milestone completion dates.⁴²¹ Failure to meet these dates is a breach of contract. Liquidated damages are assessed unless it is clear that when the contract was made that no damages could possibly result from a breach. If so, the clause serves no compensable purpose; its only function is to compel performance by "an exacting of punishment for a breach which could produce no possible damage...."⁴²²

The fact that the clause induces performance does not invalidate liquidated damages, if it were reasonable to expect that delays in contract completion would result in damages to the owner. A liquidated damage clause is not invalid because it also has the effect of encouraging prompt performance.⁴²³ In *Robinson v. United States*, the court said that a provision in a construction contract "giving liquidated damages for each day's delay is an appropriate means of inducing due performance, or of giving compensation, in case of failure to perform...."⁴²⁴

Where both the contractor and the owner contribute to the delay, and neither can establish the extent to which the other is responsible for the delay, neither can recover delay damages from the other.⁴²⁵ This is simply the rule of apportionment that was discussed earlier. The authorities also differ regarding the enforcement of a liquidated damage provision for delay that accrues after the contractor abandons the contract. The majority rule is that only actual delay damages can be recovered after the contract has been abandoned.⁴²⁶ This in-

⁴¹⁸ *Brower Co. v. Garrison*, 2 Wash. App. 424, 468 P.2d 469 (Wash. App. 1970).

⁴¹⁹ *Meyer v. Hansen*, 373 N.W.2d 392, 395-96 (N.D. 1985).

⁴²⁰ 195 W. Va. 714, 466 S.E.2d 782, 787 (1995).

⁴²¹ Milestone dates refer to dates when certain portions of the project are required to be completed; for example, in opening the highway to traffic. *Department of Transp. v. Anjo Constr. Co.*, 666 A.2d 753, 756 (Pa. Commw. 1995).

⁴²² *Priebe & Sons, Inc. v. United States*, 332 U.S. 407, 413, 68 S. Ct. 123, 92 L. Ed 32 (1947); *DJ Mfg. Corp. v. United States*, 86 F.3d 1130, 1136 (Fed. Cir. 1996).

⁴²³ *DJ Mfg. Corp.*, 86 F.3d at 1135.

⁴²⁴ 261 U.S. 486, 488, 43 S. Ct. 420, 67 L. Ed. 760 (1923).

⁴²⁵ *Buckley v. State*, 140 N. J. Super. 289, 356 A.2d 56, 69, 71 (1975); but see *Nomeollini Constr. Co. v. State of Cal. ex rel. Dep't of Water Resources*, 19 Cal. App. 3d 240, 245-46, 96 Cal. Rptr. 682 (1971) (court said that apportioning delay was an "uncomplicated fact finding process").

⁴²⁶ *Six Companies v. Joint Highway Dist.*, 311 U.S. 180, 185, 61 S. Ct. 186, 85 L. Ed 114 (1940).

cludes damages for the delay in completing the contract.⁴²⁷ The majority rule is based on the notion that abandonment of the contract constitutes abandonment of the liquidated damages clause, limiting the owner to those damages that it can actually prove. The minority view holds that the abandonment should not deprive the owner of the benefit of the liquidated damage clause.⁴²⁸

Liquidated damages are not assessed after substantial completion of the project.⁴²⁹ Once substantial completion is achieved, further overruns in contract time are assessed on the basis of direct engineering costs until actual physical completion has occurred.⁴³⁰ Problems occur when the contractor is dilatory in completing punch list work, and the amount assessed for direct engineering costs is not enough to be an incentive to complete the work promptly. If the situation becomes too bad, default termination may be an option, coupled with recovery for costs incurred by the owner in completing punch list items.⁴³¹

Liquidated damages save the time and expense of attempting to prove delay damages. This may have particular significance when the specified sum includes damages for inconveniences to the state and the traveling public.⁴³² Liquidated damages are generally viewed with favor by the courts and will be enforced if they are reasonable. All an owner has to do, to enforce the clause, is introduce the clause in evidence and prove the number of days of delay that are inexcusable. The burden is on the contractor, as the defaulting party, to prove that the clause is not enforceable.⁴³³ There are caveats, however. Care should be taken in drafting liquidated damage clauses for particular projects. Liquidated damages that are too high may be unenforceable and discourage other contractors from bid-

⁴²⁷ *L. Romano Co. v. Skagit County*, 148 Wash. 367, 268 Pac. 898, 901 (Wash. 1928).

⁴²⁸ *Pacific Employers Ins. Co. v. City of Berkeley*, 158 Cal. App. 3d 145, 155–56, 204, Cal. Rptr. 387 (1984).

⁴²⁹ *Phillips v. Ben Hogan Co.*, 267 Ark. 1104, 594 S.W.2d 39, 49 (1980).

⁴³⁰ *Olympic Painting Contractors*, ASBCA No. 15,773, 72-2, BCA ¶ 9549 (1972). Substantial completion has been defined as

[w]hen the contract work has progressed to the extent that the Contracting Agency has full and unrestricted use and benefit of the facilities, both from the operational and safety standpoint, and only minor incidental work, replacement of temporary substitute facilities, or correction or repair remains to physically complete the total contract....”

Washington State Standard Specification 1-08.9 (2000).

⁴³¹ *F&D Constr. Co.*, ASBCA No. 41,441, 91-1 BCA ¶ 23, 983(1991) (“If a contractor refused to complete punch list work or the corrections are unduly prolonged, the contractor may be deemed to have abandoned the contract.”).

⁴³² The state transportation agencies may, with FHWA concurrence (for federally-aided projects), include amounts as liquidated damages to cover user benefit losses caused by delay. 23 C.F.R. ch. 1, 635.127(c).

⁴³³ *DJ Mfg. Corp. v. United States*, 86 F.3d 1130, 1134 (Fed. Cir. 1996).

ding, thus reducing competition. Worse yet, those who do bid may include a contingency in their bids to cover the assessment of liquidated damages. When liquidated damages are too low, some contractors may decide to accept liquidated damage assessment rather than take more expensive steps to avoid delay.

Historically, liquidated damages assessed by state highway departments were equated with increased engineering and administration costs. The AASHTO *Guide Specifications for Highway Construction* included tables representing an estimate of the nationwide average of construction engineering (CE) costs. State agencies were left on their own in setting rates for projects. For years, the FHWA regulations referred to, and included, these tables for guidance.⁴³⁴ Currently, FHWA regulations allow liquidated damage sums to include daily CE costs and such other additional amounts as liquidated damages in each contract, “to cover other anticipated costs of project related delays or inconveniences to the SHA or the public. Costs resulting from winter shutdown, retaining detours for an extended time, additional demurrage, or similar costs as well as road user delay costs may be included.”⁴³⁵

The modern view is that liquidated damages should not only reflect daily CE costs applicable to the project, but also the more intangible, but equally real, impacts on the traveling public caused by the delay in completing an urgently needed public facility. The liquidated damage rates may be project specific, or they may be in the form of a table or schedule developed for a range of projects based on project costs or project types.⁴³⁶

b. Termination for Default

Construction contracts usually contain a termination for default clause. The clause specifies events that constitute contractor default. One of the events specified in the clause is the contractor’s inability to meet the contract schedule.⁴³⁷ The default provision allows the owner to terminate the contract when it becomes reasonably apparent that the contractor’s lack of progress has reached a point where it is unlikely that the contractor can complete the contract on time.⁴³⁸ When this occurs,

⁴³⁴ O.F. FINCH, *Legal Implications in the Use of Penalty and Bonus Provisions of Highway Construction Contracts: The Use of Incentive and Disincentive Clauses as Liquidated Damages for Quality Control and for Early Completion*, SELECTED STUDIES IN HIGHWAY LAW 1582 - N63.

⁴³⁵ 23 C.F.R. ch. 1 § 635.127(c).

⁴³⁶ 23 C.F.R. ch. 1 § 635.127(a). Subsection (f) of the regulation also authorizes the use of incentive provisions for early completion.

⁴³⁷ *McDonnell Douglas Corp. v. United States*, 182 F.3d 1319, 1328 (Fed. Cir. 1999) (contractor’s ability to meet the contract schedule is a fundamental obligation of a government contract).

⁴³⁸ The owner’s determination that the contractor is in default may be reviewed under one of two standards. The majority rule is that the owner determination should be based on whether a reasonable person in the owner’s position would be satisfied with the contractor’s performance or believe that the

the owner may demand a revised progress schedule showing how the contractor intends to complete the project on schedule.⁴³⁹

An owner has several options under the default clause when the contractor defaults. The owner may tender the work to the performance bond surety to complete the project. If the surety “accepts the tender,” it will retain a completion contractor and enter into a takeover agreement with the owner.⁴⁴⁰ If the surety refuses the tender, the owner can sue the surety and the defaulting contractor for increased costs in completing the project, including damages for late completion.⁴⁴¹

There are limitations on the owner’s power to terminate. For example, the owner may waive the contractor’s failure to complete the work on time by establishing a new completion date and by not assessing liquidated damages.⁴⁴² Another example is the effect of a Chapter 11 bankruptcy filing while the contract is ongoing. An unfinished contract is an executory contract, and as such, an asset of the debtor’s (contractor’s) estate. The owner must obtain an order from the bankruptcy court granting relief from the automatic stay imposed when the bankruptcy petition is filed. A termination, in violation of the automatic stay, is null and void.⁴⁴³ A third limitation is substantial completion. Once substantial completion is achieved, the contract cannot be terminated for default.⁴⁴⁴ Substantial completion occurs when the agency has full and unrestricted use of the facility, both from an operational and safety standpoint.⁴⁴⁵

work could not be timely completed. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 383 (1980). The other standard is whether the owner’s determination that the contractor would not complete on time was made in good faith. *Action Eng’g. v. Martin Marietta Alum.*, 670 F.2d 456, 458–60 (3d Cir. 1982) (applying California law).

⁴³⁹ Construction contracts usually contain a provision requiring a supplemental progress schedule when the contractor is behind schedule. Refusal to provide a supplemental schedule may be further proof of the contractor’s unwillingness or inability to complete the project on time.

⁴⁴⁰ *La. Ins. Guaranty Ass’n v. Rapides Parish Police Jury*, 182 F.3d 326 (5th Cir. 1999).

⁴⁴¹ See discussion in Part A of the preceding Subsection.

⁴⁴² *APAC-Georgia, Inc. v. Department of Transp.*, 221 Ga. App. 604, 472 S.E.2d 97, 100 (1996); *Sun Cal, Inc. v. United States*, 21 Cl. Ct. 31, 38–40 (1990) (waiver of liquidated damages and negotiation of new liquidated damages clause, even without execution of new agreement, waived right to terminate).

⁴⁴³ 11 U.S.C. § 362; *Harris Products, Inc., ASBCA 30426*, 87-2 BCA ¶ 19,807 (1987).

⁴⁴⁴ *Olson Plumbing & Heating Co. v. United States*, 602 F.2d 950 (Ct. Cl. 1979); *but see* note 431 concerning contractor’s refusal to complete punch list work.

⁴⁴⁵ See note 430 *supra*.

The burden of proving that the contractor could not complete on time rests with the owner.⁴⁴⁶ A wrongful default termination is a breach of contract entitling the contractor to damages, unless the contract contains a termination for convenience clause.⁴⁴⁷ When the contract contains a termination for convenience clause (most contracts do), a wrongful termination is automatically converted to a termination for the owner’s convenience. This eliminates a breach of contract claim, including recovery for lost profits on uncompleted work, and restricts the contractor’s recovery to the remedy provided in the clause.⁴⁴⁸

⁴⁴⁶ *Lisbon Contractors, Inc. v. United States*, 828 F.2d 759, 763 (Fed. Cir. 1987).

⁴⁴⁷ *Morrison Knudson Corp. v. Fireman’s Fund Ins. Co.*, 175 F.3d 1221 (10th Cir. 1999).

⁴⁴⁸ *District of Columbia v. Organization for Env’tl. Growth*, 700 A.2d 185, 199–200 (D.C. App. 1997); *A.J. Temple Marble & Tile, Inc. v. Long Island R.R.*, 172 Misc. 2d 442, 659 N.Y.S.2d 412, 414 (N.Y. Sup. 1997) (contractor terminated for convenience on a fixed-price contract could not receive more than the contract price.); *see also Best Form Fabricators, Inc. v. United States*, 38 Fed. Cl. 627, 637 (Ct. Cl. 1997).

SECTION 6

**CONSTRUCTION CLAIMS
AND LITIGATION**

This Section focuses on construction claims brought by contractors against state transportation agencies. The Section is arranged into four subsections. The first subsection deals with contract claims procedures. The next two subsections discuss the major liability and damage issues that are usually presented in a large construction claim. The last subsection concludes with a discussion of the trial strategies and considerations that may be used in preparing and defending a construction claim in a typical litigation setting.

A. CLAIM PROCEDURES

1. Introduction

In deciding whether a claim brought by a contractor should be settled administratively or litigated, the agency must be able to evaluate the claim. Is it likely that the contractor will be successful if the case is tried? If so, what kind of monetary exposure is the agency facing? What will it cost to defend the case in terms of money and agency resources? Will an adverse result create a bad precedent, or conversely, will an unwarranted settlement just encourage more claims?¹

To assess these concerns, an agency must have information about the claim. The agency must understand the contractor's theory on entitlement or liability, the provisions in the contract on which the contractor relies, and what the contractor has in the way of documentation supporting its position. The owner must know how much is sought, how that amount was calculated, and the facts that support those calculations.

Claim procedures allow an owner to investigate the claim and document the facts while they are still fresh. Early notice of a potential claim also allows an owner to evaluate the impact that the claim could have on the owner's construction program. This can have real significance to a public agency that is operating under tight budgetary constraints.

Generally, it is also in the contractor's interest to submit a well-documented claim. A poorly documented claim, in all likelihood, will be rejected, leaving litigation or arbitration as the only means available to the contractor for resolving the dispute.

Contract claims that are not settled by the parties must be referred to a neutral third party for resolution. In the case of state transportation agencies, the "final remedy" for resolving claims can vary widely. They can range from litigation to arbitration conducted by the American Arbitration Association. Some states have created boards and commissions to decide claims, subject to some judicial review. Several states use a mix of litigation and arbitration, specifying arbitration as the sole remedy for claims under a specific dollar amount and providing for litigation for claims over that

¹ While an early resolution of the claim is usually in the owner's best interest, claims that lack merit should not be settled simply to make them go away. A policy of settling everything and litigating nothing often encourages more claims.

amount. The administrative procedures used by the states to review claims, and the final remedies available to the contractor if the claims are not settled, are listed in a Table in Part 3 of this Subsection.

The variations in the methods used by the states as final remedies stem from their policy on sovereign immunity as a bar to contract claims. Many states have judicially recognized that immunity from suit is waived through contracting. Other states have statutorily waived or abolished sovereign immunity for breach of contract claims. The Table in Part 3 of this Subsection contains a summary showing how each state has dealt with sovereign immunity as a defense against parties seeking redress from a state for breach of contract.

2. Immunities from Suit

a. Sovereign Immunity

Sovereign immunity, unless waived, protects a state, its agencies, and officers from lawsuits,² and applies to contract claims against a state.³ The doctrine of sovereign immunity is based on the ancient common law maxim that, "the King can do no wrong," and therefore, he cannot be held liable for his acts or omissions.⁴ The modern justification for the doctrine has been characterized as a means of protecting the public purse: "Sovereign immunity protects the public fisc, and therefore, the public welfare by limiting assaults on the public fisc."⁵

Generally, sovereign immunity can be impliedly waived by conduct, or expressly by legislation.⁶ A number of states have judicially recognized that a state waives its immunity from suit for breach of contract by contracting for goods and services.⁷ The rationale supporting this view was explained by the Delaware Supreme Court.

It must be assumed that the General Assembly, in granting the State Highway Department the power to contract intended that it should have the power to enter into only valid contracts. A valid contract is one which has mutuality of obligation and remedy between the parties to it (citations omitted). It follows therefore, that in

² S.J. Groves & Sons v. State, 93 Ill. 2d 397, 444 N.E.2d 131, 67 Ill. Dec. 92 (Iowa 1982); 72 AM. JUR. 2D, *States, Territories and Dependencies*, §§ 92 & 93 (2d ed. 2001), *Stone v. Ariz. Highway Comm'n*, 93 Ariz. 384, 381 P.2d 107 (Ariz. 1963).

³ *Federal Sign v. Tex. So. Univ.*, 951 S.W.2d 401, 412 (Tex. 1997) (dismissing claim for breach of contract based on sovereign immunity).

⁴ *Stone v. Highway Comm'n*, *supra* note 2, at 109; Jaffe, *Suits Against Governments and Officers: Sovereign Immunity*, 77 HARV. L. REV. 1 (1963).

⁵ Hocking, *Federal Facility Violations of the Resource Conservation and Recovery Act and the Questionable Role of Sovereign Immunity*, 5 ADMIN. L. J. 203 (1991).

⁶ *Stone v. Highway Comm'n*, *supra* note 2, at 111.

⁷ The Table in Part 3.b *infra* lists those states that have taken that position, including case citations.

authorizing the State Highway Department to enter into valid contracts the General Assembly has necessarily waived the State's to suit immunity for breach by the State of that contract.⁸

Other states have enacted legislation that waives or abolishes sovereign immunity as a defense to lawsuits for breach of contract.⁹ Not all states, however, permit private parties to litigate their contract claims in courts of general jurisdiction. Some states, for example, have a state claims board or Court of Claims to determine claims against the state that arose from contracts entered into by the state.¹⁰ And in Texas, sovereign immunity for breach of contract is not waived by the act of contracting.¹¹ The court, however, noted that, "There may be other circumstances where the State may waive its immunity *by conduct* other than simply executing a contract so that it is not always immune from suit when it contracts," (emphasis added).¹²

In *Aer-Aerotron v. Texas Department of Transportation*,¹³ the court held that the Department's immunity from suit was waived by conduct that went beyond the mere act of contracting. In that case, the Department contracted with Aerotron to supply radios for a total contract amount of \$468,550. In the first year of the contract, the Department increased the number of radios from 125 to 300, raising the total contract price to \$993,900. Aerotron alleged, in its complaint, that it had shipped the radios and the Department had accepted them, but failed to pay, forcing Aerotron into bankruptcy. Aerotron further alleged that the State, by accepting goods and services, increasing its order, requesting and receiving technical assistance, and by twice promising to pay the balance due, waived its immunity from suit for breach of contract. The court held that the State waived its immunity from suit by engaging in actions that "fully implicated it in the performance of the contract."¹⁴

In *Texas Department of Transportation v. Jones Bros. Dirt & Paving Contrs.*,¹⁵ the court held that the contractor's petition for breach of contract must allege facts showing that immunity from suit was waived by conduct that goes beyond the act of contracting. The contractor's failure to make this showing deprived the trial

court of jurisdiction over the contractor's breach of contract claim.

b. Eleventh Amendment Immunity

The Eleventh Amendment to the United States Constitution provides: "The judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by citizens of another state, or by citizens or subjects of any foreign state."

While the Amendment, by its terms, does not bar suits against a state by its own citizens, the Supreme Court has consistently held that an unconsenting state is immune from suits brought in federal courts by the state's own citizens, as well as citizens of another state.¹⁶

Eleventh Amendment immunity applies even though a state is not named as a party to the lawsuit, when it is clear that the state is the real party in interest and the state officials are only nominal defendants.¹⁷

Abrogation of Eleventh Amendment immunity can occur in two ways. First, a state may expressly waive its immunity.¹⁸ Second, Congress may abrogate the immunity, but only if Congress expresses an intent to do so and the legislation is pursuant to a valid exercise of Congressional power.¹⁹

Unless Congress abrogates a state's immunity, any suit by private parties in federal court seeking to impose a liability that must be paid from public funds in the state treasury is barred by the Eleventh Amendment.²⁰

3. Administrative Claim Procedures and Remedies

The administrative procedures used by state transportation agencies to resolve claims are governed by the standard specifications in the agencies' construction contracts. This subpart examines the claims specifications used by several state transportation agencies,²¹ and the AASHTO Guide Specifications. These specifications illustrate the elements that a claims specification should contain. In this regard, much of the discussion focuses on the Florida Department of Transportation,²²

⁸ *George & Lynch Co. v. State*, 57 Del. 158, 197 A.2d 734, 736 (Del. 1964).

⁹ The Table in Part 3.b *infra* lists those states that have enacted legislation waiving sovereign immunity.

¹⁰ New York, for example, has a State Court of Claims to determine contract claims, N.Y. Court of Claims Law § 9. Pennsylvania has similar legislation creating a Board of Claims to determine breach of contract claims against the Commonwealth, 62 PA. CONS. STAT. § 1724. Other states that have adopted similar approaches are listed in the Table in Part 3 of this Subsection.

¹¹ *Federal Sign Co. v. Tex. So. Univ.*, 951 S.W.2d at 408–09.

¹² *Id.* at 408 n.1.

¹³ 997 S.W.2d 687 (Tex. App. 1999).

¹⁴ *Id.* at 691.

¹⁵ 24 S.W.3d 893, 901 (Tex. App. 2000).

¹⁶ *Hans v. La.*, 134 U.S. 1, 16, 10 S. Ct. 504, 33 L. Ed. 842 (1890); *Duhne v. N.J.*, 251 U.S. 311, 40 S. Ct. 154, 64 L. Ed. 280 (1920); *Employees v. Department of Public Health and Welfare*, 411 U.S. 279, 93 S. Ct. 1614, 36 L. Ed. 2d 251 (1973); *Edelman v. Jordan*, 415 U.S. 651, 663, 94 S. Ct. 1344, 39 L. Ed. 2d 662 (1974).

¹⁷ *Ford Motor Co. v. Department of Treasury*, 323 U.S. 459, 464, 65 S. Ct. 347, 89 L. Ed. 389 (1945). *Edelman v. Jordan*, 415 U.S. at 663.

¹⁸ *Edelman v. Jordan*, *id.* at 673.

¹⁹ *Green v. Mansouer*, 474 U.S. 64, 68, 88 L. Ed. 2d 371, 106 S. Ct. 423 (1985).

²⁰ *Edelman v. Jordan*, 415 U.S. at 674.

²¹ Arizona, California, Florida, New York, Oregon, Pennsylvania, South Dakota, and Washington.

²² Florida Department of Transportation Standard Specifications for Road and Bridge Construction (2000).

although elements from other state specifications are also examined as part of this discussion.

This subpart also summarizes the internal administrative review practices employed by the states in dealing with contract disputes and the final remedies available to contractors who are dissatisfied with the agencies' decisions.

a. Claims Specifications

A typical claims specification contains the following elements: (1) notice of the claim, and waiver of the claim if notice is not provided; (2) furnishing of sufficient information to enable the agency to evaluate the claim; (3) an internal administrative process; and (4) a certification stating that the claim is made in good faith and reflects what the contractor believes it is owed. Each of those elements are discussed below.

The first element requires notice of a potential claim. Failure to provide such notice waives the claim. For example, the AASHTO Guide Specification provides in part that the contractor must "[n]otify the Engineer in writing of any intent to file a claim."²³ This specification also provides that "the Contractor waives any claim for additional compensation if the Engineer is not notified or is not afforded proper facilities for strict accounting of actual costs."

Prompt notice of a potential claim before any disputed work is performed serves several public purposes. Prompt notice allows the agency to take early steps to change the work, as necessary, to mitigate damages and avoid extra or unnecessary expenses.²⁴ It also allows the agency to keep track of the costs associated with the disputed extra work.²⁵ Notice provisions for failure to comply with claim filing procedures are judicially enforced.²⁶

The second function of a claims specification is to allow the owner to obtain sufficient information about the claim so that it can determine whether to settle or reject the claim. This function requires the contractor to explain the basis of its claim and the amount of additional compensation sought, including time extensions, if any. The specification also requires the contractor to submit documentation supporting the claim. The language used in the specification to implement this function can be specific or generalized.

²³ AASHTO Guide Specification § 105.18 (1998); *see also* California Specification 9-1.04; Pennsylvania Specification 9.105-14; South Dakota Specification 5.17.

²⁴ *A.H.A. Gen. Constr., Inc. v. N.Y. City Housing Auth.*, 92 N.Y.2d 2D, 699 N.E.2d 368, 376, 677 N.Y.S.2d 9 (N.Y. 1998).

²⁵ *Id.*

²⁶ *Blankinship Constr. Co. v. State Highway Comm'n*, 222 S.E.2d 442 (N.C. 1976); *Main v. Department of Highways*, 206 Va. 143, 142 S.E.2d 524, 530 (Va. 1965); *Absher Constr. Co. v. Kent Sch. Dist.*, 78 Wash. App. 137, 890 P.2d 1071, 1073 (1995); *Ritangela Constr. Corp. v. State*, 183 A.D. 2d 817, 584 N.Y.S.2d 108, 110 (1992); *Glynn v. Gloucester*, 21 Mass. App. Ct. 390, 487 N.E.2d 230, 233 (1986); *PYCA Indus. v. Harrison County*, 177 F.3d 351 (5th Cir. 1999).

The Florida claims specification²⁷ is a good example of a specification that is very specific in enumerating what the claim must contain. This specification requires that the claim contain the following information:

- A detailed factual statement of the claim, including the items of work affected and pertinent dates.
- An identification of all pertinent documents and the substance of any material oral communications relating to the claim, and the identity of the persons involved in the communications.
- An identification of the provisions of the contract that support the claim, and the reasons why such provisions support the claim, including the provisions of the contract that allegedly have been breached and the actions constituting such breach.
- The amount of additional compensation sought, with a breakdown of the amount showing: (1) job site labor expenses; (2) additional materials and supplies together with invoices and receipts establishing such costs; (3) a list of additional equipment costs claims, including each piece of equipment and the rental rate claimed for each—owner-owned in-house rate, rented, or Blue Book; (4) any other additional direct costs or damages, and all documentation in support thereof; (5) any direct costs or damages and all documentation in support thereof; and (6) a list of the specific dates and the exact number of days sought for a time extension and the basis for entitlement to time for each day for which a time extension is sought, including a detailed description of the events or circumstances that caused the delay.

Submittal of a written claim containing this type of information is a condition precedent to entitlement for additional compensation or time.²⁸ The Florida Standard Specification also requires that the contractor must submit its claim within 90 calendar days after the affected work is completed for projects with an original contract amount of \$3 million and within 180 calendar days for projects greater than \$3 million, thus allowing the contractor sufficient time to document its claim.²⁹

To guard against the contractor revising its claim after the claim has been submitted, the Specification prohibits the contractor from increasing the amount of the claim or the basis for entitlement. The Specification provides that:

The Contractor shall be prohibited from amending either the basis of entitlement or the amount of any compensation or time stated for any and all issues claimed in the contractor's written claim submitted hereunder, any circuit court, arbitration or other formal claims resolution proceeding should be limited solely to the basis of enti-

²⁷ Specification 5-12 (2000). The California Standard Claims Specification is more generalized. Section 9-1.04 (1999) requires the contractor to submit notice of a potential claim on a standard form (CEM-680). When the affected work is completed, the contractor must submit substantiation of its actual costs. Failure to do so waives the claim.

²⁸ Florida Standard Specification 5-12 (2000).

²⁹ *Id.*, 5-12.2.1.

tlement and the amount of any compensation or time stated for any and all issues claimed in the Contractor's written claim submitted hereunder. This shall not, however, preclude a contractor from withdrawing or reducing any of the basis of entitlement and the amount of any compensation or time stated for any and all issues claimed in the contractor's written claim submitted hereunder at any time.³⁰

The audit provisions of the Florida Standard Specifications are also specific.³¹ They enumerate in detail the types of records that may be audited. These include, but are not limited to, daily time sheets, foreman's daily reports, diaries, payroll records, material invoices and purchase orders, lists of company owned equipment, subcontractor payroll certificates, job cost reports, general and subsidiary ledgers used to record costs, and cash disbursement journal and financial statements for all years reflecting the operations on the project, including income tax returns for those years.³²

Also subject to audit are all documents reflecting the contractor's actual profit and overhead during the years the contract was being performed, and for each of the 5 years prior to the commencement of the contract. Aside from defending against a total cost claim,³³ the question of whether a contractor makes or loses money on a fixed-price, competitively bid contract is ordinarily not legally relevant. An exception may apply where there are large profits and defective work.³⁴ But beyond legal relevance is practical relevancy. Did the contractor or subcontractor make or lose money? This type of information can be useful in formulating negotiation strategies, particularly when the contractor has pass-through claims from subcontractors who have suffered large losses and may be on the verge of bankruptcy.³⁵

The Florida Specification also requires the contractor to make its bid documents available for audit³⁶ and all worksheets used to evaluate the cost components of the claim, including all documents that establish the specific time periods and individuals involved and the hours and wage rates for such individuals.

In addition, a specification should permit the owner to audit depreciation records on all company equipment

irrespective of whether those records are maintained by the contractor, its accountant, or others. This should include any other source documents used by the contractor for internal purposes in establishing the actual cost of owning and operating its equipment.³⁷ Computer software used to prepare the claim should also be subject to audit.³⁸

The audit specifications should provide that, as a condition precedent to recovery on any claim, the contractor, subcontractors, and suppliers must keep sufficient records to support and document their claims. The specification should also provide full access to such records to allow the auditors to verify the claim and make copies of such records, as determined necessary by the auditors. Finally, the specification should provide that failure to retain sufficient records to verify the claim, and failure to provide full and reasonable access to such records, waives the claim or any portion of the claim that cannot be verified.³⁹

One final consideration: Care should be taken in selecting the auditor. The auditor may be called upon to testify to his or her findings if the claim is not settled. Thus, consideration should be given not only for the auditor's professional competence, but also for his or her ability as an expert witness.

The third element of a typical claims specification is the administrative process that the agency will follow in reviewing the claim. In general, the initial review is made by the resident engineer. If the claim is not resolved at this level, it will be reviewed at a higher level. For example, Arizona follows a three-step process: (1) review by the resident engineer, (2) review by the district engineer, and (3) review by the state engineer.⁴⁰ Oregon has a four-step process with the stated purpose of resolving claims at the lowest possible level in the agency.⁴¹ The administrative review process used by the states is illustrated in the Table shown later in this subpart.

The agency is required to act in good faith in evaluating the claim,⁴² and moreover, the law presumes that public officials act in good faith in carrying out their duties.⁴³ Thus, a claim should not be rejected for minor defects. But what should the agency do when the claim is materially defective? This question can be important because failure to comply with claim procedures may waive the claim. Sending the claim back for more information, however, may waive any defense that the claim is barred because of the contractor's failure to comply with the claim procedures specified in the contract.

³⁰ *Id.*, 5-12.3.

³¹ *Id.*, 5.12.14.

³² The Specification used by the Washington State Department of Transportation allows the agency to audit financial statements for 3 years preceding execution of the contract and 3 years following final acceptance of the contract, in addition to auditing financial statements for all years reflecting operations relating to the contract. Standard Specification 1-09.12 (2000).

³³ Claims based on the total cost method are discussed in Subsection C.4 of this Section.

³⁴ Defective work may explain why the profits are so large. The counter argument is that admission of large profits may be too prejudicial. *See* Federal Evidence Rule 403.

³⁵ Pass-through claims are discussed in Subsection C.4 of this Section.

³⁶ Escrow bid documentation specifications are discussed later in this Subsection.

³⁷ WSDOT Standard Specification C1-09.12(3)(20) (2000).

³⁸ *Id.*, 1-09.12(3)(22) (2000).

³⁹ Florida Standard Specification, *supra* note 28.

⁴⁰ Arizona Standard Specification 105.21 (2000).

⁴¹ Oregon Standard Specification 00199.40 (1996).

⁴² *Sutton Corp. v. Metro. Dist. Comm'n*, 423 Mass. 200, 667 N.E.2d 838 (1996).

⁴³ *D.C. v. Organization for Env'tl. Growth, Inc.*, 700 A.2d 185, 201 (D.C. App. 1997).

To preserve this defense, the letter should specify why the claim is deficient, and that the claim is waived. However, if the agency is willing to leave the door open for future negotiations, the letter may state that the agency is willing to engage in further negotiations, but only with the understanding that to do so will not prejudice the agency's waiver defense, and that the defense will be asserted if the claim is litigated or arbitrated.⁴⁴

The administrative review aspect of a claims specification specifies when the agency will respond to the claim.⁴⁵ Failure to respond constitutes a denial of the claim.⁴⁶ If the claim is not resolved at the project level, the contractor may request further review of the claim until the internal administrative process is exhausted.⁴⁷

The fourth and final element is the format for certifying the claim. While there is no standardized format, the contractor is generally required to certify that the claim is true and fully documented.⁴⁸ The California specifications require that the claim must be accompanied by a notarized certificate certifying, under penalty of perjury and with specific reference to the California False Claims Act,⁴⁹ that the claim for additional compensation and time, if any, is a, "true statement of the actual costs incurred and time sought, and is fully documented and supported under the contract between the parties."⁵⁰

⁴⁴ Whether the claim will be deemed as waived may depend upon whether the owner can show that it was prejudiced by the contractor's failure to comply fully with the notice of claim requirements. *A.H.A. General Constr. Co. v. N.Y. Housing Auth.*, 92 N.Y.2d, 20, 699 N.E.2d 368, 374, 677 N.Y.S.2d 9 (1998) (strict compliance with notice requirements required); *Absher Constr. Co. v. Kent Sch. Dist.*, 77 Wash. App 137, 890 P.2d 1071, 1095 (showing of prejudice not required to enforce notice provision); *New Pueblo Constructors, Inc. v. State*, 144 Ariz. 95, 696 P.2d 185, 188 (1985) (showing of prejudice required—applying federal contract law).

⁴⁵ Section 5-12.4 of the Florida Standard Specifications provides for a response within 90 days for claims on contracts having an original amount of \$3 million or less and 120 days for contracts having an original amount greater than \$3 million. The WSDOT Specification provides for a response based on the size of the claim: 45 calendar days for claims under \$100,000 and 90 calendar days for claims of \$100,000 or more. The time may be extended if necessary. Standard Specification 1-09.11(2) (2000).

⁴⁶ Florida Specification, *supra* note 45.

⁴⁷ The Arizona specification, for example, uses a three-step hearing process. If the contractor does not accept the project engineer decision, the contractor may request a review by the district engineer and then the State Engineer. Standard Specification 105.21 (2000).

⁴⁸ South Dakota Standard Specification 5.17 (1998); New York Standard Specification 109.05F (1995). Both specifications require that certifications be made under oath before a notary public.

⁴⁹ The California False Claims Act is discussed in Subpart 4 of this Subsection.

⁵⁰ Standard Specification 9-1.04 (1999).

The California Claims Specification⁵¹ requires that any claim for overhead costs must be supported by an audit report of an independent certified public accountant. But the state may, at its discretion, conduct its own audit of overhead costs. The specification further provides that any costs or expenses incurred by the State in reviewing any claim not supported by the contractor's cost accounting or other records shall be deemed to be damages incurred by the state within the meaning of the California False Claims Act.

The claims specifications may contain other features that protect the owner's interests. For example, the Florida Specification enumerates the types of consequential damages that are not recoverable.⁵² These include, but are not limited to, such damages as loss of bonding capacity, loss of bidding opportunities, interest paid on money borrowed to finance the work, and loss of financing. Claim preparation expenses, attorney fees, expert witness fees, and the cost of litigation are also not recoverable. Acceleration costs are also not allowed, except where the contractor was directed by the agency to accelerate the work at the agency's expense.

The Florida Specification⁵³ contains two other interesting features. It makes settlement discussions between the contractor and the agency inadmissible in court proceedings or arbitration brought by the contractor. The Specification also provides that no claim can be filed in court or no demand can be made for arbitration until after final acceptance of the contract.⁵⁴

b. State Dispute Resolution Procedures and Remedies

The most common method for resolving state highway construction claims is litigation. Arbitration is a distant second, followed by special courts and boards. These methods vary because of the manner and extent in which the states have waived sovereign immunity. The following Table lists each state, summarizes how sovereign immunity was waived, and generally describes the internal administrative processes used by each state in reaching a decision on whether to settle or deny a contractor's claim. The Table also summarizes the final remedy available to a contractor who is unwilling to accept the agency's decision.

⁵¹ *Id.*

⁵² Standard Specification 5-12.10.

⁵³ Standard Specification 5-12.12.

⁵⁴ Standard Specification 5-12.4. *Metropolitan Dade County v. Recchi America, Inc.*, 734 So. 2d 1123 (Fla. App. 1999) (contractor must follow contract claim procedures prior to commencement of suit).

STATE	ADMINISTRATIVE PROCEDURES	FINAL REMEDY
Alabama sovereign immunity judicially waived. <i>State Highway Dept. v. Milton Constr. Co.</i> , 586 So. 2d 872 (Ala. 1991).	Agency decision may be appealed to a Claims Committee composed of agency personnel not involved in the project. The Claims Committee decision may be accepted or rejected by the agency head. Contractor may request a hearing by a Claims Appeal Board. The Board is a standing committee composed of three members, one of whom is appointed by the state, one by a contractor's association, and the third jointly by the state and association. The Board's decision is not binding on the state.	Litigation.
Alaska sovereign immunity waived by statute. Statute 09.50.250 (express authority to contract waived immunity).	Resident Engineer's decision may be appealed to the Contracting Officer, which in turn may be appealed to the Commissioner of Transportation for a final agency decision.	Litigation. Statute 36.30.685. (Trial <i>de novo</i> if Commissioner's final decision made without a hearing).
Arizona sovereign immunity judicially waived. <i>Stone v. Arizona Highway Comm'n</i> , 93 Ariz. 384, 381 P.2d 107, 109 (Ariz. 1963).	Initial decision by the Project Engineer with final review by the State Engineer or his or her representative.	For claims of \$200,000 or less—arbitration pursuant to AAA Construction Industry Rules. Over \$200,000—litigation in Maricopa County Superior Court.
Arkansas retains sovereign immunity, but allows claims to be heard by administrative claims commission, Ark. Code § 19-10-201 <i>et. seq.</i>	Initial decision by the Resident Engineer, with successive appeals to the Chief Engineer.	Appeal to the State Claims Commission, which is composed of five members appointed by the Governor, two of whom must be attorneys. Decisions of the Commission may be reviewed by the Legislature.
California sovereign immunity judicially waived. <i>Souza & McCue Constr. Co. v. The Superior Court</i> , 57 Cal. 2d 508, 370 P.2d 338, 20 Cal. Rptr. 634 (1962).	Initial decision by the Project Engineer. Review by District Highway Director. Settlements at the District level may be subject to approval by the Headquarters Construction Department.	Statute makes arbitration the sole remedy. Sections 10240–10240.13, Ch. 1, Div. 2, Public Contract Code. Arbitrator's decision is subject to judicial review for findings of fact not supported by substantial evidence and errors of law.
Colorado sovereign immunity judicially waived. <i>Ace Flying Service, Inc. v. Colorado Dept. of Agriculture</i> , 136 Colo. 19, 314 P.2d 278 (Colo. 1957).	Initial decision by Project Engineer, with appeal to the District Engineer and then to the Chief Engineer, who refers the claim to a review board composed of three members: one appointed by the State, one appointed by the contractor, and the third by the two members. Board's recommendation referred to Chief Engineer, who makes the final decision.	Litigation.
Connecticut sovereign immunity waived by statute, Conn. Gen. Stats. § 4-160.	Claim may be submitted to claims commissioner, who may authorize suit against state on claim that presents issue of law or fact under which state would be liable if it were private person.	Action must be brought within 1 year of commissioner's ruling in judicial district in which claimant resides, or in Hartford or

STATE	ADMINISTRATIVE PROCEDURES	FINAL REMEDY
		district in which claim arose if non-resident.
Delaware sovereign immunity judicially waived. <i>George & Lynch, Inc. v. State</i> , 57 Del. 158, 197 A.2d 734, 736 (1964).	Initial decision by the Division Engineer, with an appeal to the Contract Claims Committee and a further appeal to the Secretary of Transportation.	Arbitration by the AAA under the Construction Industry Arbitration Rules.
Florida sovereign immunity waived by statute (FLA. STAT. ANN. § 337.19) (2002).	Initial decision at the District level, with appeal to the Claims Review Committee, which is composed of three agency members. Final decision may be made by the Secretary of Transportation.	Litigation claims under \$50,000.00 may be arbitrated.
Georgia State Constitution, Art. 1, Sec. II, Paragraph IX (c) waives sovereign immunity for breach of contract actions.	Initial review by the Project Engineer, with successive appeals to the State Highway Engineer, who has final administrative authority to settle contract claims.	Litigation.
Hawaii sovereign immunity waived by statute. HAW. REV. STAT. § 661.	Initial review by the Resident Engineer, and if not settled, then to the District Engineer. If not settled at that level, then to the Chief Engineer, who has final administrative authority to settle claims.	Litigation.
Idaho sovereign immunity judicially waived. <i>Grant Constr. Co. v. Burns</i> , 92 Idaho 408, 443 P.2d 1005, 1009 (Idaho 1968).	Claim filed with the Resident Engineer for determination by the District Engineer. Decision may be appealed to the State Highway Administrator and thereafter to the Transportation Board for a <i>de novo</i> hearing. The Board's decision is not binding.	Litigation.
Illinois State Constitution, Art. XIII, Sec. 4, abolished sovereign immunity except as provided by the Legislature.	Claim filed with the Project Engineer for referral to the Engineer of Construction. Claim may be referred to a three-member claims board. The Board makes a recommendation to the Director of Highways, who has final administrative authority.	Three-Judge Court of Claims established by statute (I.R.S. c37 § 439.24 <i>et. Seq.</i>). No appeal from the court's decision.
Indiana sovereign immunity waived by statute. Code § 34-4-16-1.1.	Claim filed with District. Decision may be appealed to Commissioner.	Litigation.
Iowa Code § 613.11 waived immunity to suits against the Department of Transportation for construction contract claims. Judicial waiver. <i>See Kersten Co. v. Dept. of Social Services</i> , 207 N.W.2d 117, 120 (Iowa 1973).	Claim filed with Project Engineer. Contractor may request meeting with the agency for review and final agency decision.	Contractor may elect with agency approval to submit the claim to non-binding arbitration by three-member panel: one member chosen by contractor, one by agency, and the third by the other two arbitrators. Litigation if nonbinding arbitration fails to settle the claim.
Kansas sovereign immunity judicially waived. <i>Parker v. Hufty Rock Asphalt Co.</i> , 136 Kan. 834, 18 P.2d 568, 569 (1933).	Claim filed with Area Engineer, with appeal to the Secretary of Transportation, who may either authorize an administrative hearing before a hearing officer or appoint a three-member claims panel. The Secretary may accept or reject the recommendations made by the hearings officer or the panel.	Litigation.
Kentucky sovereign immunity waived by statute. KY. REV. STAT. § 45A 245.	Claim filed with the Project Engineer. Successive appeals to the Commissioner of Highways, who may authorize an administrative hearing for a nonbinding recommendation. The Commissioner has final admin-	Litigation. Case tried to the court sitting without a jury.

STATE	ADMINISTRATIVE PROCEDURES	FINAL REMEDY
	Administrative authority to settle the claim.	
Louisiana State Constitution, Art. 12, Sec. 10(A), waived sovereign immunity.	Claim may be filed with the Project Engineer. Successive appeals to the Chief Engineer, who has the final administrative authority to settle claims.	Litigation.
Maine statute waived sovereign immunity. ME. REV. STAT. tit. 5, § 1510-A.	Claim filed with Project Engineer. Appeal to the Commissioner of Transportation, who has the final administrative authority to settle claims.	Appeal to State Claims Commissioner. Claims heard <i>de novo</i> . Appeal to Superior Court hearing <i>de novo</i> without a jury.
Maryland sovereign immunity waived by statute. MD. STATE GOV'T CODE § 12-201(a).	Claim filed with District Engineer, with final decision by the Procurement Officer.	State Board of Contract Appeals. Board decisions, other than those decided under the small claims expedited process, are subject to judicial review. A contractor also has the option of bypassing the Board and going directly to state court.
Massachusetts, <i>M. De Matteo Constr. Co. v. Commonwealth</i> , 156 N.E.2d 659 (1959) (Interpreting general law giving superior courts jurisdiction for contract claims against state agencies.).	Agency Claims Committee, which makes recommendation to the Chief Engineer, who submits decisions to the Public Works Commission for approval. The contractor can request the Commission to hold a hearing before an administrative law judge.	Litigation. A contractor may bypass the Commission and go directly to court from an unfavorable decision by the Chief Engineer.
Michigan sovereign immunity judicially waived. <i>Hersey Gravel Co. v. State Highway Dept.</i> , 305 Mich. 333 9 N.W.2d 567, 569 (Mich. 1943).	Claim filed with the District Office. The claim, if not settled, is referred to the Central Office for review and decision. The Chief Engineer/Deputy Director of Highways has final administrative authority to settle the claim.	Court of Claims—One judge sitting without a jury. Court of Claims decisions may be appealed in the same manner as other trial court decisions.
Minnesota sovereign immunity waived by statute. MINN. STAT. §§ 3.751, 161.24.	Claim filed with the Project Engineer. If not settled at that level, it is referred to the Assistant District Engineer—Construction. The Claims Engineer has final administrative authority to settle the claim.	Litigation.
Mississippi sovereign immunity waived by statute. MISS. CODE ANN. § 11-45-1.	Claim filed with Project Engineer, who refers the claim to the District Engineer for review and recommendation and then further referral to the agency Director, who has final administrative authority to settle the claim.	Litigation. Claims of \$25,000.00 or less may be submitted to the State Arbitration Board composed of three members: one selected by the State, one selected by a contractor's association, and the third by the other two members. Claims over \$25,000.00 may be arbitrated by agreement of the parties.
Missouri judicial recognition that sovereign immunity waived by contracting. <i>V.S. D'Carlo Constr. Co. v. State</i> , 485 S.W.2d 52, 56 (Mo. 1972).	Claims filed with the Transportation Commission Secretary and referred to a Claims Committee. The Committee makes a recommendation to the Chief Engineer for determination. The contractor may appeal the Chief Engineer's decision to the Commission or go directly to court.	Litigation. Arbitration may be used under the Uniform Arbitration Act, if the parties agree.
Montana judicial recognition	Agency determination following review by	Litigation.

STATE	ADMINISTRATIVE PROCEDURES	FINAL REMEDY
that sovereign immunity waived. <i>Meens v. State Bd of Educ.</i> , 127 Mont. 515, 267 P.2d 981, 984 (Mont. 1954).	the agency Legal Division and audit of the claim.	
Nebraska sovereign immunity waived by statute. NEB. REV. STAT. § 25-21, 201.	Claim filed with Project Manager, who refers the claim to the District Engineer. The Director–State Engineer has final administrative authority to settle the claim.	Litigation.
Nevada sovereign immunity waived by statute. NEV. REV. STAT. § 41.031.	Claim filed with Resident Engineer, who forwards the claim to the Highway Claims Review Board, which is composed of an agency member, a Nevada contractor, and a registered professional engineer from the private sector. Board's recommendation submitted to the Agency Director, who has final administrative authority to resolve the claim.	Litigation.
New Hampshire sovereign immunity waived by statute. N.H. REV. STAT. ANN. § 491.8.	Claim filed with the Engineer, whose determination may be appealed by the contractor to the Transportation Commissioner, who has final administrative authority to resolve the claim.	The contractor has a choice: (1) litigation (court hears case sitting without a jury), or (2) an appeal to the Transportation Appeals Board—a three-member board appointed by the Governor. Board decisions may be appealed directly to the State Supreme Court.
New Jersey sovereign immunity waived by statute. N.J. STAT. ANN. § 59.13-1 to .10.	Claim filed with Regional Director, who may submit claim to the Claims Committee composed of four agency members and a Deputy Attorney General. The Committee submits its recommendation to the Deputy Commissioner for a final determination.	Litigation. A contractor may file suit at any stage in the agency's administrative proceedings. Claims may be submitted to arbitration if the parties agree.
New Mexico sovereign immunity waived by statute. N.M. STAT. ANN. § 57-1-23.	Claim filed with the Project Manager, who refers the claim to the District Engineer. The contractor may appeal to the Secretary, who may assign the claim to the agency's Claims Board, which is composed of retired engineers and consultants. The Board makes a recommendation to the Secretary, who has final administrative authority to settle the claim.	Litigation. Claims of \$150,000.00 or less may be arbitrated if the parties agree. Each party appoints an arbitrator and the two choose the third member. The arbitration proceedings are conducted in accordance with the Uniform Arbitration Act.
New York Statute (Ct. Cl. Act., § 8) establishes a Court of Claims to hear claims against the State.	Claim submitted to the Regional Director. The Commissioner of Transportation has final administrative authority to resolve the claim.	16-member Court of Claims. Claims heard by one judge sitting without a jury.
Oklahoma judicial recognition that sovereign immunity waived. <i>State Board of Public Affairs v. Principal Funding Corp.</i> , 1975 OK 144, 542 P.2d 503, 505–6 (1975).	Claim filed with Resident Engineer. Appeal to Division Engineer for a hearing if claim is not resolved. Appeal to a three-member Board of Claims appointed by Director and contractor. Board makes recommendation to Highway Commission, which has final administrative authority to resolve the claim.	Litigation.
Oregon sovereign immunity	Claim filed with Project Manager, with	For claims under

STATE	ADMINISTRATIVE PROCEDURES	FINAL REMEDY
waived by statute. OR. REV. STAT. § 30.320.	successive appeals to the State Region Engineer and the State Contract Administration Engineer. If not resolved at those levels, claims between \$25,000 to \$250,000 must be submitted to a three-member Claims Review Board for nonbinding arbitration. Board members are selected by the State and the contractor from a panel previously developed by the State and the construction industry. Claims over \$250,000 may also be submitted to the Board if the parties agree.	\$25,000, there is mandatory arbitration by a single arbitrator, pursuant to AAA Construction Industry Arbitration Rules. Contractor may also demand arbitration if the claim is \$250,000 or less. Litigation for claims over \$250,000, unless the parties agree to arbitration.
Pennsylvania sovereign immunity waived by statute. 62 PA. CONS. STAT. § 1711.1.	Claim filed with District Engineer. Appeals to the Construction Claims Review Committee.	Three-member Board of Claims appointed by the Governor. The Board's decision may be appealed by the State or the contractor to the Commonwealth Court of Pennsylvania.
Rhode Island sovereign immunity waived by statute. R.I. GEN. LAWS § 37-13.1-1.	Claim filed with agency's construction office. Review by Claims Unit and Claims Board, which submits its recommendation to the Director, who has final administrative authority to settle the claim.	Litigation. Case tried to the court sitting without a jury.
South Carolina sovereign immunity waived by statute. S.C. CODE ANN. § 57-3-620.	Claim must be made on form provided by the agency and filed with the Resident Construction Engineer. Claim may be supplemented as required by the agency. If the claim is not resolved, it is referred to the Claims Committee appointed by the State Highway Engineer. The Committee makes its recommendation to the State Highway Engineer, who has final authority to resolve the claim.	Litigation.
South Dakota sovereign immunity waived by statute. S.D. CODIFIED LAWS ANN., § 31-3-24.	Claim must be filed on an agency form with the Project Engineer. The form requires the contractor to furnish additional information as required by the agency. Claim, if not resolved, may be referred to the agency's Claim Committee, which makes its recommendation to the State Highway Engineer, who has final administrative authority to settle the claim.	Litigation.
Tennessee sovereign immunity waived by statute. TENN. CODE ANN. § 9-8-101 <i>et. seq.</i>	Claim filed with the Project Engineer, with appeals to the Transportation Commissioner, who has final administrative authority to settle the claim.	Three-member Claims Commission appointed by the Governor. The Commission's decision can be appealed in the same manner as any trial court decision.
Virginia sovereign immunity waived by statute. VA. CODE ANN. § 8.01-192, <i>et. seq.</i> ; Specific authorization for suits on highway contract claims. VA. CODE ANN., § 33-1.382, <i>et. seq.</i>	Claim filed with Resident Engineer. Review and approval by Chief Engineer. Appeal to Commissioner of Highways. A settlement by the Commissioner is subject to approval by the Attorney General and the Governor.	Litigation. Case tried to the court sitting without a jury.
Washington sovereign immunity	Claim filed with Project Engineer. Review	Arbitration is the sole

STATE	ADMINISTRATIVE PROCEDURES	FINAL REMEDY
waived by statute. WASH. REV. CODE ch. 4.92.010. Specific authorization for suits and highway contracts. WASH. REV. CODE ch. 47.28.120.	and approval by Construction Engineer. If claim denied, an appeal may be made to the Secretary of Transportation.	remedy for claims under \$250,000 under AAA rules. Litigation for claims over \$250,000 in the Thurston County Superior Court, unless the parties agree to arbitration.
West Virginia sovereign immunity waived by statute. W. VA. CODE § 14-2-1 through 29.	Claim filed with Project Engineer. Successive appeals to Highway Commissioner, who has final administrative authority to settle claims.	Litigation. Three-judge Court of Claims.
Wisconsin sovereign immunity waived by statute. WIS. STAT. ANN. § 775.01 (statute allows suit if claim denied by Legislature).	Claim filed with the Project Engineer. Successive appeals to the Secretary of Transportation.	Five-member Claims Board. The Board's recommendation is submitted to the Legislature. If the Legislature denies the claim, the contractor may sue.
Wyoming sovereign immunity waived by statute. WYO. STAT. § 24-2-101.	Claim filed with Resident Engineer. Appeal to the Superintendent and Chief Engineer, who has final administrative authority.	Litigation.

Generally, the states have a similar administrative approach to the resolution of construction claims: A claim is filed with the engineer in charge of the project, usually the project or resident engineer. If the claim is not resolved at that level, the contractor may appeal to higher administrative authority. If the claim is not resolved by the agency through its internal review process, the contractor may pursue its final remedy. At this point, the types of remedies available to the contractor vary.

The most common final remedy for resolving highway construction claims is litigation.⁵⁵ A few states use a mix of litigation and arbitration.⁵⁶ Several states specify arbitration as the final remedy for resolving construction claims.⁵⁷ Some states provide for boards or commissions with some judicial review.⁵⁸ This divergence in remedies is due largely to the extent and manner in which sovereign immunity was waived by the state legislatures.

4. The Federal and California False Claims Acts—An Overview

The Federal Government and the State of California have enacted legislation dealing with fraudulent claims. The Federal False Claims Act was enacted in 1863, shortly after the Civil War.⁵⁹ The Act was aimed at preventing fraud in federal procurement, a practice that was prevalent during the Civil War. The Act was later split into civil⁶⁰ and criminal statutes.⁶¹ In 1986, the Act was amended⁶² to allow employees to bring *qui tam*⁶³ actions against their employers, as well as other reforms prompted by abuses in military procurement. The Act provides for civil penalties up to \$10,000 for each false claim⁶⁴ and criminal sanctions of fines and imprisonment of up to 5 years.⁶⁵ The main thrust of the

Act is to provide a civil remedy in cases of fraud against the Government. It accomplishes this purpose, in part, by authorizing private parties to bring suit against persons who have defrauded the Government.⁶⁶ It encourages such person to bring *qui tam* actions by providing financial incentives and protection from retaliation by employers.⁶⁷

The Act authorizes a cause of action against a person who knowingly presents a false claim.⁶⁸ A claim includes any request or demand for money or property from the Government or from a contractor, grantee, or other recipient when the Government provides any portion of the money or property that is requested. This provision of the Act casts a wide net, extending coverage to state agencies and other government recipients that receive federal funds.⁶⁹ Thus, a contractor who submits a false claim to a state agency that pays the claim, in whole or in part, with federal aid, will be deemed to have submitted a claim to the Federal Government and may be subject to prosecution under the Act.

The Act provides “standing” to a private person to sue in the name of the Government. The Act outlines the procedure to be followed. The *qui tam* complaint is filed under seal in the Federal District Court where the action is brought. A copy of the complaint is served on the United States Attorney General and the local United States Attorney. The United States Attorney has 60 days to decide whether to intervene and take over the lawsuit or let the *qui tam* plaintiff proceed with the suit. This procedure encourages private actions to vindicate the public interest, but it also gives the Government the opportunity to protect other interests by giving it time to decide whether it should intervene.⁷⁰

An important decision involving the False Claims Act, from a state’s perspective, is *Vermont Agency of Natural Resources v. United States ex rel. Stevens*.⁷¹ In that case, the relator, Jonathan Stevens, brought a *qui tam* action against a state agency in the United States District Court for the District of Vermont alleging that the agency had submitted false claims to the EDA in

⁵⁵ Thirty-one states provide for some form of litigation. See Table, *supra*.

⁵⁶ Arizona, Oregon, and Washington. See Table, *supra*.

⁵⁷ California, Delaware, and North Dakota. See Table, *supra*.

⁵⁸ Idaho, Maryland, Ohio, Pennsylvania, and Tennessee are examples. See Table. Decisions of the Maryland State Board of Contract Appeals are subject to judicial review, as with other civil cases.

⁵⁹ 12 Statute 696 (1863); *United States v. Bornstein*, 423 U.S. 303, 309–10, 96 S. Ct. 523, 46 L. Ed. 2d 514 (1976); see Comment, The Constitutionality of Qui Tam Actions, 99 YALE L.J. 341 (1989).

⁶⁰ 31 U.S.C. § 3729.

⁶¹ 18 U.S.C. § 287.

⁶² 31 U.S.C. § 3729 (1986).

⁶³ *Qui tam* is an abbreviated Latin phrase meaning one who sues for the King and for himself. See Comment, *supra* note 59, at 341 n.1. A *qui tam* action is one brought by an informer pursuant to a statute to recover damages for the government and for himself. *Erickson v. American Institute of Bio-Sciences*, 716 F. Supp. 908 (E.D. Va. 1989).

⁶⁴ 18 U.S.C. § 287.

⁶⁵ 18 U.S.C. § 287.

⁶⁶ The *qui tam* plaintiff can receive as his or her share of the damages between 25 percent and 30 percent of the recovery for proceeding with the suit, and between 15 percent and 25 percent of the recovery if the government proceeds with the suit. Employees are entitled to protection from their employers and may sue them for damages and other relief if the employees are fired, harassed, or otherwise harmed because of their actions in furtherance of bringing or providing information concerning false claims. 31 U.S.C. § 3730.

⁶⁷ 31 U.S.C. § 3730(h).

⁶⁸ *Id.* However, a state is not a “person” for purposes of *qui tam* liability under the False Claims Act. *Vt. Agency of Natural Resources v. United States Ex Rel-Stevens*, 529 U.S. 765, 780, 120 S. Ct. 1858, 146 L. Ed. 2d 836 (2000).

⁶⁹ *United States ex rel. Davis v. Long’s Drugs, Inc.*, 411 F. Supp. 1144, 1147 (S.D. Cal. 1976).

⁷⁰ *United States ex rel. Lujan v. Hughes Aircraft Co.*, 67 F.3d 242 (9th Cir. 1995).

⁷¹ 529 U.S. 765, 120 S. Ct. 1858, 146 L. Ed. 2d 836 (2000).

connection with federal grant programs that it had administered. The agency moved to dismiss, arguing: (1) that a State (or state agency) is not a person subject to the Act; and (2) that a *qui tam* action in federal court is barred by the Eleventh Amendment.⁷² The District Court denied the motion, the Second Circuit affirmed,⁷³ and the Supreme Court granted certiorari.⁷⁴

The Court by a 7 to 2 decision reversed.⁷⁵ The Court held that a State or a state agency is not a person within the meaning of the False Claims Act and therefore, not subject to the liabilities imposed by the Act. However, Justice Breyer, in his concurring opinion at page 1871, said that, “I read the Court’s decision to leave open the question whether the word ‘person’ encompasses States when the United States itself sues under the False Claims Act.”

The California False Claims Act⁷⁶ was closely modeled after the Federal Act. There are, however, some differences. The Federal Act provides whistle blower protection on an *ad hoc* basis.⁷⁷ The California Act, on the other hand, prohibits an employer from making any policy to prevent employees from disclosing information to a government agency.⁷⁸ The California Act imposes joint and several liability for acts committed by two or more persons.⁷⁹ The California Act imposes liability on the beneficiary of the false claim when the beneficiary subsequently discovers that the claim was false and fails to disclose this to the Government.⁸⁰ The California Act also allows a larger recovery for *qui tam* plaintiffs.⁸¹ As noted earlier, the California Department of Transportation incorporates the sanctions imposed by the California Act in its Standard Specifications governing contract claims.

Both Acts are based on the principle that those who contract with the Government must act with scrupulous regard for the requirements of the law and their contractual obligations.⁸² Those who contract with the Gov-

ernment “must turn square corners.”⁸³ A contractor’s failure to be scrupulous in its dealings with the Federal Government and the State of California can result in serious financial consequences, including the loss of bidding privileges⁸⁴ and forfeiture of claims for additional compensation.⁸⁵

5. Escrow Arrangements To Preserve Bid Documents

As discussed earlier, the right to audit is an important tool for resolving claims. One area that should be subject to audit is the contractor’s bid documents.⁸⁶ Such documents, for example, may be relevant in a total cost claim involving the reasonableness of the contractor’s estimated costs, or time for performing the work, as reflected in the bid,⁸⁷ or as a baseline to measure the cost of changes to the work that occur during contract performance. The right to audit, however, has little value if there is nothing to audit. Recognizing this, some states have included an escrow bid documentation specification in their construction contracts.⁸⁸ This type of specification requires the contractor to place its bid documents with an escrow agent, usually a bank, to ensure that the documents will be available for use by the owner in the event of a claim.⁸⁹

The term “bid documentation” should be broadly defined. The term should include all quantity take-offs, crew size, equipment, and calculations showing estimated rates of production. The bid documents should include quotations from subcontractors and suppliers whose quotations were used to arrive at the prices con-

⁸³ *Digioia Bros. Excavating, Inc. v. City of Cleveland*, 135 Ohio App. 3d 436, 734 N.E.2d 438 (Ohio App. 1999); *United States v. ex. rel. Compton v. Midwest Specialties, Inc.*, 142 F.3d 296, 302 (6th Cir. 1998).

⁸⁴ *Stacy & Witbeck, Inc. v. City and County of S.F.*, 36 Cal. App. 4th 1074, 1094, 44 Cal. Rptr. 2d 472 (Cal. App. 1995).

⁸⁵ Contractor who attempted to bribe government contracting officer forfeited all claims, including a subcontractor’s “pass-through” claim and was assessed treble the amount of the bribe. *Supermix, Inc. v. United States*, 35 Fed. Cl. 29 (1996).

⁸⁶ The contract specifications may specifically enumerate “bid documents” as documents that the owner may audit in evaluating the contractor’s claim. Florida Standard Specification 5-12.14 and Washington Standard Specification 1-09.12(3)23 are examples.

⁸⁷ *S. Le Roland Constr. Co. v. Beall Pipe Tank Co.*, 14 Wash. App. 297, 540 P.2d 912, 917 (1975). Calculating the contractor’s damages is discussed in Subpart C of Section 6.

⁸⁸ Montana, New Jersey, Oregon, South Carolina, and Washington. See DARRELL W. HARP, *Preventing and Defending Against Highway Construction Contract Claims: The Use of Changed or Differing Site Conditions Clauses and New York State’s Use of Exculpatory Contract Provisions and No Claims Clauses* (National Cooperative Highway Research Program Legal Research Digest No. 28); Arizona Standard Specification 103.11.

⁸⁹ The specification may provide that failure to provide the bid documentation as specified will render the bid nonresponsive. Arizona Standard Specification 103.11(E).

⁷² 162 F.3d 195, 199 (2d Cir. 1998).

⁷³ *Id.* at 208.

⁷⁴ 527 U.S. 1034, 119 S. Ct. 2391 (1999).

⁷⁵ 529 U.S. 765, 120 S. Ct. 1858, 146 L. Ed. 2d 836 (2000). Justice Scalia delivered the opinion of the Court, in which Chief Justice Rehnquist and Justices O’Connor, Kennedy, Thomas, and Breyer joined. Justice Breyer filed a concurring statement, in which Justice Ginsburg joined. Justice Stevens dissented, joined by Justice Souter.

⁷⁶ CAL. GOV’T CODE § 12650 *et. seq.*

⁷⁷ 31 U.S.C. § 3730.

⁷⁸ CAL. GOV’T CODE § 12653.

⁷⁹ CAL. GOV’T CODE § 12651(c).

⁸⁰ CAL. GOV’T CODE § 12651(a)(8).

⁸¹ CAL. GOV’T CODE § 12652(g) (33 percent of the recovery if the State proceeds with the suit and 50 percent if the action is prosecuted by the *qui tam* plaintiff); 28 U.S.C. § 3730(d) (25 percent if the Government prosecutes and 30 percent if the *qui tam* plaintiff prosecutes the action).

⁸² *United States v. Aerodex, Inc.*, 469 F.2d 1003 (5th Cir. 1972).

tained in the bid proposal. The contractor's allocation of equipment costs, indirect costs, contingencies, markup, and any other costs allocated to and included in bid items should also be included. If the bid documents were developed using computer generated software, the specification should require that the information be furnished in hard copy, and that the contractor identify the name and version of the computer software that was used.⁹⁰

The specification should contain safeguards to assure that the information is complete and legible. The specification should require the contractor to submit an affidavit with the bid documents listing all of the documents in the escrow container. The affidavit should be signed by the person authorized to execute bid proposals, attesting that the affiant has personally examined the bid documentation, that the affidavit lists all of the documents used in preparing the bid, and that all of the documentation is included in the container placed in escrow.⁹¹

After the documents are placed in escrow, the agency can verify the documents to ensure completeness and legibility. Completeness is assured by comparing the documents to those listed in the affidavit. Incomplete submittals or illegible documents may be corrected by a supplemental submittal. The verification process is a practical requirement. To learn after the project is over that the bid documents in the escrow container are incomplete or illegible may be too late. By then, the original documents may be lost or discarded. If the documents are illegible because of poor copying, they would be of little value. Illegible documents rarely refresh memories in depositions.

The bid documents remain in escrow during the life of the contract or until the contractor submits a claim, at which time the documents may be obtained by the owner for its use in evaluating the claim. The owner will instruct the escrow agent to release the bid document container to the contractor after the project is completed and the contractor has signed a release of all claims.⁹²

The WSDOT's escrow bid documentation specification was challenged by the Associated General Contractors of Washington in a lawsuit.⁹³ Because of Washington's liberal public disclosure laws,⁹⁴ contractors voiced concern about the confidentiality of bid information. They claimed that the information contained trade secrets, the disclosure of which could undermine their competitive positions.⁹⁵ The court upheld the specification.⁹⁶

⁹⁰ Arizona Standard Specification 103.11(D) (2000).

⁹¹ Arizona Standard Specification 103.11(B).

⁹² Arizona Standard Specification 103.11(C).

⁹³ Associated Gen. Contractors of Wash. v. State, Thurston County Cause No. 86-2-01972-1 (1986).

⁹⁴ Ch. 42.17, WASH. REV. CODE.

⁹⁵ *Contractors Challenge Bidding Rule*, ENGINEERING NEWS RECORD (Oct. 23, 1986), at 40.

B. CONTRACTORS' CLAIMS AGAINST OWNERS AND DESIGN PROFESSIONALS

1. Introduction

Contracts are based on expectations. The law protects those expectations by providing a remedy when they are not fulfilled, due to some default by the other contracting party. "The controlling policy consideration underlying the law of contracts is the protection of expectations bargained for."⁹⁷ The expectations that the contractor has bargained for are to complete the project on time and make a profit. Usually, it's when these expectations are not fulfilled that claims arise.

Generally, claims by contractors against owners may be grouped into categories. This Subsection discusses those categories.⁹⁸ Before discussing the various theories of liability, mention should be made about some of the differences between public and private construction contracts. In addition to the procedural limitations imposed by sovereign immunity,⁹⁹ government contracts may also implement social and economic policies as part of the public works contracting process. Minority and Disadvantaged Business Enterprise Requirements¹⁰⁰ and labor and wage standards¹⁰¹ are some examples.

Although public and private contracts differ in many respects, generally speaking a state, by entering into a contract with a private party for goods and services, absent a statute or contractual provision to the contrary, waives its sovereign immunity and impliedly consents to the same liabilities as a private party.¹⁰² This Subsection discusses those liabilities.

2. Contract Interpretation

Disputes about what the contract requires are a fertile source for claims by contractors. The contracting parties may disagree about how certain work should be paid for,¹⁰³ the scope of the work called for by the con-

⁹⁶ The contractor may, however, seek a protective order to protect information that, if disclosed, could harm its competitive position.

⁹⁷ *Sensenbrenner v. Rust, Orling & Neale, Architects, Inc.*, 236 Va. 419, 374 S.E.2d 55, 58 (1988).

⁹⁸ The law dealing with damages, discussed in Subsection C *infra*, measures how those unfilled expectations may be compensated.

⁹⁹ See generally Subsection A, *supra* of this Section.

¹⁰⁰ See generally Subsection A, of Section 4.

¹⁰¹ See generally Subsection B, of Section 4; see also 3 SANDS & LIBONATI, LOCAL GOVERNMENT LAW § 22.05.50 (2000).

¹⁰² *Clark County Constr. Co. v. State Highway Comm'n*, 248 Ky. 158, 58 S.W.2d 388 (Ky. 1933); *Architectural Woods, Inc. v. State*, 598 P.2d 1372 (Wash. 1979).

¹⁰³ *Dick Enterprises, Inc. v. Department of Transp.*, 746 A.2d 1164, 1168 (Pa. Commw. 2000); (dispute over the rate of pay for certain excavation that the contract required); *R.W. Duntleman Co. v. Village of Lombard*, 281 Ill. App. 3d 929, 666 N.E.2d 762, 217 Ill. Dec. 93 (1996) (dispute over whether pay-

tract,¹⁰⁴ and the responsibility for events occurring during contract performance that affect the work.¹⁰⁵ When the parties disagree about the contractual rights and duties, they may resort to litigation asking the court to interpret their contract.¹⁰⁶

a. Principles of Contract Interpretation

When parties to a contract dispute the meaning of their agreement and resort to litigation, the court will examine the contract language to determine whether it is ambiguous.¹⁰⁷ The court's basic purpose in interpreting the contract is to give effect to the intention of the parties as it existed when they entered into their contract.¹⁰⁸ Only the objective intentions of the parties, as expressed in their contract, is relevant.

If, however, it were proved by twenty bishops that either party, when he used the words, intended something else than the usual meaning which the law imposes upon them, he would still be held, unless there were some mutual mistake or something else of the sort. Of course, if it appear by other words, or acts, of the parties, that they attribute a peculiar meaning to such words as they use in the contract, that meaning will prevail, but only by virtue of the other words, and not because of their unexpressed intent.¹⁰⁹

Contract interpretation begins with the plain language of the contract to determine whether the language is ambiguous.¹¹⁰ In analyzing the language, the court will prefer an interpretation that gives a reason-

ment should be made under "pavement removal" or "special excavation").

¹⁰⁴ *Earth Movers v. State*, Dep't of Transp., 824 P.2d 715 (Alaska 1992) (dispute over whether the contract gave the contractor the right to erect temporary road closure signs or whether the State could erect them); *Western States Constr. v. United States*, 26 Cl. Ct. 818 (1992).

¹⁰⁵ *DiGioia Bros. Excavating v. City of Cleveland*, 135 Ohio App. 3d 436, 734 N.E.2d 438 (1999) (dispute over whether the contract was ambiguous in designating responsibility for coping with underground utilities); *Central Ohio Vocational Bd. of Educ. v. Peterson Constr. Co.*, 129 Ohio App. 3d 58, 716 N.E.2d 1210, 1213 (1998) (dispute over the meaning of the term, "Full Depth," in the contract, as it related to the depth of removal of unsuitable material).

¹⁰⁶ In some states, the determination as to what the contract requires may be made by a board of claims or by an arbitrator depending on what the law provides as the contractor's "final remedy." See Subsection A.3.b of this Section listing by state the final remedy available to contractors.

¹⁰⁷ *Metric Constructors, Inc. v. United States*, 44 Fed. Cl. 513, 520 (1999).

¹⁰⁸ RESTATEMENT OF CONTRACTS § 201 (2d); 11 WILLISTON ON CONTRACTS, § 32:2 (4th ed. 1999) *Kass v. Kass*, 91 N.Y.2d, 554, 696 N.E.2d 174, 673 N.Y.S.2d 350 (N.Y. 1998); 5 CORBIN ON CONTRACTS, § 24 (rev. ed. 1993); *Leo F. Piazza Paving Co. v. Foundation Contractors, Inc.*, 128 Cal. App. 3d 583, 591, 177 Cal. Rptr. 268 (1981).

¹⁰⁹ *Hotchkiss v. National City Bank of N.Y.*, 200 Fed. 287, 293 (S.D. N.Y. 1911), *aff'd*, 231 U.S. 50 (1913).

¹¹⁰ *Gould, Inc. v. United States*, 935 F.2d 1271, 1274 (Fed. Cir. 1991).

able and consistent meaning to all parts of the contract, avoiding, if possible, an interpretation that leaves a portion of the contract meaningless, superfluous, or achieves an unreasonable or absurd meaning.¹¹¹

The interpretation of a contract is a matter of law.¹¹² Only when a contract is ambiguous will extrinsic evidence be considered in interpreting the contract.¹¹³ Usually when the contract language is clear and unambiguous, the court will not consider extraneous circumstances, such as prior negotiations or trade practices for its interpretation.¹¹⁴ This is generally referred to as the "plain meaning" rule and is applied in most states.¹¹⁵

A few states follow the "context" rule of contract interpretation rather than the "plain meaning" rule.¹¹⁶ Under the "context" rule, an ambiguity in the meaning of the contract need not exist before evidence of the circumstances surrounding the making of the contract is admissible to ascertain the parties' intent. The Parol Evidence rule is not violated because the evidence is not offered to contradict or vary the meaning of the agreement. To the contrary, it is being offered to explain what the parties may have intended.

The "context" rule is based on the premise that the uncertainties of language in clearly expressing intent make ambiguity an unreliable test for determining what the parties actually intended. The Arizona Supreme Court in commenting on the "context" rule said:

Under the view embraced by Professor Corbin and the Second Restatement, there is no need to make a preliminary finding of ambiguity before the judge considers extrinsic evidence. Instead, the court considers all the proffered evidence to determine its relevance to the parties' intent and then applies the parol evidence rule to exclude from the fact finder's consideration only the evidence that contradicts or varies the meaning of the agreement....¹¹⁷

¹¹¹ *Patterson*, *The Interpretation and Construction of Contracts*, 64 COLUM. L. REV. 833 (listing the maxims of contract interpretation); RESTATEMENT OF CONTRACTS § 203 (2d 1981). *Dick Enterprises v. Department of Transp.*, *supra* note 103.

¹¹² *Hol-Gar Mfg. Corp. v. United States*, 169 Ct. Cl. 384, 51 F.2d 972, 974 (Ct. Cl. 1965); RESTATEMENT OF CONTRACTS § 212(2) (2d 1979).

¹¹³ *Sylvania Elec. Products, Inc. v. United States*, 198 Ct. Cl. 1061, 458 F.2d 994, 1005 (Ct. Cl. 1972); E. Posner, *The Parol Evidence Rule, The Plain Meaning Rule and the Principles of Contractual Interpretation*, 146 U. PA. L. REV. 533 (1998).

¹¹⁴ *R. B. Wright Constr. Co. v. United States*, 919 F.2d 1569, 1572-73 (Fed. Cir. 1990) (specification requiring three coats of paints clear and unambiguous; trade practice of applying one coat not relevant).

¹¹⁵ See the Table in this part of the Subsection listing the states that follow the "plain meaning" rule.

¹¹⁶ See the Table referred to in note 116 for the states that follow the "context" rule.

¹¹⁷ *Taylor v. State Farm Mut. Auto Ins. Co.*, 175 Ariz. 148, 854 P.2d 1134, 1138-39 (1993) (citations omitted); see also 3 CORBIN ON CONTRACTS, § 542 (1992 supp.); RESTATEMENT OF CONTRACTS § 212 (2d 1981).

The “context” rule should not apply where one of the parties did not participate in the drafting of the contract.¹¹⁸ Likewise, the “context” rule should not apply to public works that are competitively bid based on contract documents furnished by the owner.¹¹⁹

States that follow the “plain meaning” rule and the “context” rule are shown in the following Table.

¹¹⁸ *Morton Inter. v. Aetna Cas. & Sur. Co.*, 106 Ohio App. 3d 653, 666 N.E.2d 1163, 1170 (Ohio App. 1995) (insured did not participate in drafting endorsement, hence there was no evidence of mutual intent other than the language of the contract).

¹¹⁹ An exception would be technical terms that have a special meaning in the construction trade. *See Western States Constr. Co. v. United States*, 26 Ct. Cl. 818, 824 (1992).

STATE	"PLAIN MEANING" RULE	"CONTEXT" RULE	CITATION
Alabama	X		<i>Pacific Enterprises Oil Co. v. Howell Petroleum Corp.</i> , 614 So. 2d 409, 414 (1993)
Alaska		X	<i>Stepanav v. Homer Elec. Ass'n</i> , 814 P.2d 731, 734 (1991)
Arizona		X	<i>Taylor v. State Farm Mut. Auto Ins. Co.</i> , 854 P.2d 1134, 1140 (1993)
Arkansas	X		<i>City of Lamar v. City of Clarksville</i> , 863 S.W.2d 805, 810 (1993)
California	X		<i>Brookwood v. Bank of America.</i> , 53 Cal. Rptr. 2d 515, 517 (1996)
Colorado	X		<i>Peters v. Smuggler-Durant Min. Corp.</i> , 910 P.2d 34, 41-42 (1995)
Connecticut	X		<i>Herbert S. Newman & Partners v. CFC Constr. Ltd.</i> , 674 A.2d 1313, 1317-18 (1996)
Florida	X		<i>Emergency. Assocs. v. Sassano</i> , 664 So. 2d 1000, 1002 (Fla. App. 1995)
Georgia	X		<i>Hartley-Selvey v. Hartley</i> , 410 S.E.2d 118, 120 (1991)
Idaho	X		<i>City of Idaho Falls v. Home Indem. Co.</i> , 888 P.2d 383, 386 (1995)
Illinois	X		<i>Klemp v. Hergott Group</i> , 641 N.E.2d 957, 962 (Ill. App. 1994)
Indiana	X		<i>In re. of Forum Group, Inc.</i> , 82 F.3d 159, 163 (7th Cir. 1996) (Applying Indiana Law)
Iowa	X		<i>Howard v. Schildberg Constr. Co.</i> , 528 N.W.2d 550, 554 (1995)
Kansas	X		<i>D.R. Lauck Oil Co. v. Breitenback</i> , 893 P.2d 286, 288 (Kan. App. 1995)
Louisiana	X		<i>Lewis v. Hamilton</i> , 652 So. 2d 1327, 1329 (1995)
Maryland	X		<i>Taylor v. Feissner</i> , 653 A.2d 947, 955 (Md. App. 1995)
Massachusetts	X		<i>J.F. White Contracting Co. v. Mass. Bay Transp. Auth.</i> , 666 N.E.2d 518 (Mass. App. 1996)
Michigan	X		<i>Pierson Sand & Gravel Inc.</i> , 851 F. Supp. 850, 858 (W.D. Mich. 1994) (Applying Michigan Law)
Minnesota	X		<i>Michalski v. Bank of Am.</i> , 66 F.3d 993, 996 (8th Cir. 1995) (Applying Minnesota Law)
Mississippi	X		<i>Century 21 Deep S. Properties, v. Keys</i> , 652 So. 2d 707, 716 (1995)
Missouri	X		<i>Lake Cable Inc. v. Trittler</i> , 914 S.W.2d 431, 435-6 (Mo. App. 1996)
Montana	X		<i>Carbon County v. Dain Bosworth Inc.</i> , 874 P.2d 718, 722 (1994)
Nebraska	X		<i>C.S.B. Co. v. Isham</i> , 541 N.W.2d 392, 396 (1996)
New Jersey	X		<i>Sons of Thunder Inc. v. Borden Inc.</i> , 666 A.2d 549, 559 (N.J. Super. A.D. 1995)
New Mexico		X	<i>C.R. Anthony Co. v. Loretto Mall</i>

STATE	"PLAIN MEANING" RULE	"CONTEXT" RULE	CITATION
			<i>Partners</i> , 817 P.2d 238, 242 (1991)
New York	X		<i>Cook v. David Rozenholc & Associates</i> , 642 N.Y.S.2d 230, 232 (App. Div. 1996)
North Carolina	X		<i>Estate of Waters v. C.I.R.</i> , 48 F.3d 838, 844 (4th Cir. 1995) (Applying North Carolina Law)
North Dakota	X		<i>Jones v. Pringle & Herigstad</i> , 546 N.W.2d 837, 842 (1996)
Ohio	X		<i>Stone v. Nat. City Bank</i> , 665 N.E.2d 746, 752 (Ohio App. 1995)
Oregon	X		<i>Housing Auth. of Portland v. Martini</i> , 917 P.2d 53, 54 (Or. App. 1996)
Pennsylvania	X		<i>Holt v. Dept. of Pub. Welfare</i> , 678 A.2d 421, 423 (Pa. Commw. 1996)
Rhode Island	X		<i>Clark-Fitzpatrick, Inc. v. Franki Foundation Co.</i> , 652 A.2d 440, 443 (1994)
South Carolina	X		<i>Friarsgate, Inc. v. First Fed. Sav. & Loan Ass'n.</i> , 454 S.E.2d 901, 905 (1995)
Tennessee	X		<i>Cummin's v. Vaughn</i> , 911 S.W.2d 739, 742 (Tenn. App. 1995)
Texas	X		<i>Gen. Devices Inc. v. Bacon</i> , 888 S.W.2d 497, 502 (Tex. App. 1994)
Vermont		X	<i>Isbrandsen v. North Branch Corp.</i> , 556 A.2d 81, 84 (1988)
Virginia	X		<i>Capitol Commercial Properties, Inc. v. Vina Enterprises, Inc.</i> , 462 S.E.2d 74, 77 (1995)
Washington		X	<i>Berg v Hudesman</i> , 801 P.2d 222, 228 (Wash. 1990)
Wyoming	X		<i>Treemont, Inc. v. Hawley</i> , 886 P.2d 589, 592-3 (1994)

If the meaning of the contract is unclear, the court may employ certain general rules in interpreting what it means.¹²⁰ The rules are only aids to assist the court in determining what the parties intended when they entered into their contract.¹²¹ When a contract is subject to two or more possible interpretations, one of which is reasonable and the other or others are not, the court will adopt the interpretation that gives a reasonable and effective meaning to all of the contract provisions.¹²² An interpretation that is unreasonable will be rejected.¹²³

Another standard rule is that words will be given their plain and ordinary meaning, unless the context in which they are used makes it clear that they have a special or technical meaning.¹²⁴ The court may apply its own understanding of what the words mean,¹²⁵ or it may use a dictionary to define the meaning of the words.¹²⁶ Another standard rule is that specific provisions will govern or qualify general provisions.¹²⁷ But this rule will not apply where other provisions of the contract clearly resolve any conflict between a specific provision and a general provision.¹²⁸ Applying these rules and other maxims of interpretation,¹²⁹ it is the court's function to ascertain and give effect to the parties' intent. It is not the court's function "to re-write the provisions of the contract when the terms of the contract, taken as a whole, are clear."¹³⁰

¹²⁰ See Patterson, *The Interpretation and Construction of Contracts*, 64 COLUM. L. REV. 833 (1964) (listing the maxims of contract interpretation); RESTATEMENT OF CONTRACTS § 202 (2d 1981).

¹²¹ *Eurick v. Pemco Ins. Co.*, 108 Wash. 2d 338, 738 P.2d 251, 252 (1987).

¹²² *Dick Enters. v. Commw., Dep't of Transp.*, 746 A.2d 1164, 1170 (Pa. Commw. 2000) (court accepted State's interpretation as to the appropriate payment rate for certain excavation materials).

¹²³ *Metric Contractors, Inc. v. United States*, 44 Fed. Cl. 513, 521 (1999) (court found, as a matter of law, that the contractor's interpretation that it was not required by the contract to install certain equipment was unreasonable).

¹²⁴ *Western States Constr. Co. v. United States*, 26 Ct. Cl. 818 (1992).

¹²⁵ *A-Transport Northwest Co. v. United States*, 36 F.3d 1576, 1583-84 (Fed. Cir. 1994).

¹²⁶ *Akron Pest Control v. Radar Exterminating Co.*, 216 Ga. App. 495, 455 S.E.2d 601, 602-03 (1995).

¹²⁷ *Dick Enters. v. Department of Transp.*, *supra* note 122, at 1169.

¹²⁸ *Id.* (information on the contract plans resolved apparent conflict between the special provisions and other provisions of the contract relating the types of excavation).

¹²⁹ See generally E. Patterson, *The Interpretation and Construction of Contracts*, 64 COLUM. L. REV. 833 (1964) and Posner, *The Parol Evidence Rule, The Plain Meaning Rule, and the Principles of Contractual Interpretation*, 146 U. PA. L. REV. 533 (1997), relating to contract interpretation.

¹³⁰ *Dick Enters. v. Dep't of Transp.*, *supra* note 122, at 1168. When a contract term is unambiguous, the court cannot give the language another meaning regardless of how reasonable it

b. Order of Precedence Clauses

Government construction contracts often consist of a number of documents, such as standard specifications, special provisions, amendments to the standard specifications, plans, and cross-sections.¹³¹ Some of these documents may conflict with each other. To resolve inconsistencies between the documents, the contract may contain an Order of Precedence clause that specifies which of the conflicting documents takes precedence over the other, thus resolving the conflict.¹³² For example, the clause may provide that the contract plans take precedence over the special provisions, so that if there is a conflict between the two, the plans will govern.¹³³ The clause is a practical way of resolving conflicting provisions that would otherwise make the contract ambiguous. The clause has been consistently recognized as a valid and effective agreement by the parties as to how such conflicts are to be resolved.¹³⁴

c. Resolving Contractual Ambiguities

When the court is unable to determine the meaning of the disputed language using the rules of contract interpretation, the court may admit parol evidence to resolve the ambiguity.¹³⁵ The evidence may consist of a course of dealings between the parties, or trade practices that are relevant to the dispute.¹³⁶ How the parties act during contract performance "before the advent of controversy, is often more revealing than the dry language of the written agreement by itself."¹³⁷ When parol evidence is admitted to explain the parties' intent, their intent is no longer a question of law but is a question of fact for the trier of fact to determine.¹³⁸

might be to do so. *Triax. Pacific v. West*, 130 F.3d 1469 (Fed. Cir. 1997).

¹³¹ *Dick Enters.*, *Id.* at 1165, n.1.

¹³² For an example of an Order of Precedence clause, see 48 C.F.R. § 52.214-29.

¹³³ Pennsylvania DOT Standard Specification § 105.04, referred to in *Dick Enters.*, *supra* note 122, at 1169.

¹³⁴ *John A. Volpe Constr. Co. VACAB*, 638-68-1 BCA 6857, 31, 705-06 (1968); *Scherrer Constr. Co. v. Burlington Memorial Hosp.*, 64 Wis. 2d 720, 221 N.W.2d 855 (Wis. 1974).

¹³⁵ *Central Ohio Joint Vocational Sch. Dist. v. Peterson Constr.*, 129 Ohio App. 3d 58, 716 N.E.2d 1210, 1213 (Ohio App. 1998). RESTATEMENT OF CONTRACTS § 213 (2d 1979), 6 CORBIN ON CONTRACTS, § 583 (1993) (int. ed.); 1 WILLISTON ON CONTRACTS, § 33:1 (4th ed. 1999).

¹³⁶ *Sea-Land Service, Inc. v. United States*, 213 Ct. Cl. 555, 553 Fed. 651, 658 (1977); *Max M. Stoeckert, d/b/a Univ. Brick & Tile Co. v. United States*, 183 Ct. Cl. 152, 391 F.2d 639, 645 (Ct. Cl. 1968); RESTATEMENT OF CONTRACTS §§ 222-23 (2d 1979).

¹³⁷ *Macke Co. v. United States*, 199 Ct. Cl. 552, 556, 467 F.2d 1323, 1325 (1972).

¹³⁸ *Hillis Motors, Inc. v. Haw. Auto. Dealers Ass'n*, 997 F.2d 581, 588 (9th Cir. 1993).

When a contract is susceptible to more than one reasonable interpretation, it is ambiguous.¹³⁹ If the ambiguity is not resolved, the language will be construed against the party that drafted the language.¹⁴⁰ This is the rule of *Contra Proferentem*. Its purpose is to protect the party who did not create the ambiguity by construing the ambiguity against the party who wrote it.¹⁴¹ Ordinarily, the public agency drafts the contract documents. Thus, the ambiguity is usually construed against the agency and the contractor's interpretation is controlling. The rule of *Contra Proferentem* has its limits. A bidder cannot take advantage of a patent ambiguity. The bidder has a legal duty to inform the owner about the error. Failure to do so bars any claim for extra compensation that could have been avoided had the error been disclosed to the owner.¹⁴² This duty exists regardless of the reasonableness of the contractor's interpretation so long as the ambiguity is obvious.¹⁴³ In *J.H. Berra Constr. v. Missouri Hwy. & Transp. Comm'n*, the court said:

Case law has held that this type of policy, known as the patent ambiguity doctrine, "was established to prevent contractors from taking advantage of the government, protect other bidders by assuring that all bidders bid on the same specifications, and materially aid the administration of government contracts by requiring that ambiguities be raised before the contract is bid, thus avoiding costly litigation after the fact..."¹⁴⁴

The duty to seek clarification of a patent ambiguity may also be imposed by an express contract provision. The following is an example of this type of clause:

The contractor shall take no advantage of any apparent error or omission in the plans or specifications. If the contractor discovers such an error or omission, he shall immediately notify the engineer. The engineer will then make such corrections and interpretations as may be

deemed necessary for fulfilling the intent of the plans and specifications.¹⁴⁵

In determining whether the ambiguity is patent, the court views the language from the position of a reasonably prudent contractor.¹⁴⁶ However, a contractor is entitled to rely on an Order of Precedence clause in the contract and need not seek clarification if the ambiguity is resolved by that clause.¹⁴⁷

3. Breach of Contract Claims and Equitable Adjustments Under Specific Contract Clauses

As a general rule, a contractor cannot sue for breach of contract when the claim arose under a specific contract clause providing for a price adjustment.¹⁴⁸ Often, damages for breach of contract and an equitable adjustment under the contract are priced in the same manner. This is consistent with the purpose in awarding compensatory damages for breach of contract and compensation based on an equitable adjustment. Both are designed to put the contractor in the same economic position it would have been in if the breach,¹⁴⁹ or the change,¹⁵⁰ had not occurred. There are instances, however, where the amount of compensation will vary depending on the legal theory upon which the claim is based. For example, a claim based on breach of contract for adverse site conditions may include compensatory damages for the affect of the condition upon unchanged work. Under many DSC clauses, the equitable adjustment provisions of the clause prohibit recovery for impact costs. Thus, in defending claims, care should be taken to assure that the claim is based on the appropriate legal theory.

Aside from considerations about damages,¹⁵¹ claims based on breach of contract and contract price adjustment clauses have two things in common: a contractual basis for the claim and the requirement of causation. The contractual basis for breach may be the owner's failure to perform an express or implied promise in the contract.¹⁵² The contractual basis for an equitable ad-

¹³⁹ *R.W. Dunteman Co. v. Village of Lombard*, 281 Ill. App. 3d 929, 666 N.E.2d 762 (1996); *Metric Contractors, Inc. v. NASA*, 169 F.3d 747, 751 (Fed. Cir. 1999); *Dick Enters. v. Department of Transp.*, 746 A.2d 1164, 1170 (Pa. Commw. 2000); *Community Heating & Plumbing Co. v. Kelso*, 987 F.2d 1575, 1579 (Fed. Cir. 1993); *Mayer v. Pierce County Medical Bureau*, 80 Wash. App. 416, 909 P.2d 1323, 1326 (1995).

¹⁴⁰ 5 CORBIN ON CONTRACTS, § 24.27 (rev. ed. 2001).

¹⁴¹ *Mastrobuono v. Shearson Lehman Hutton*, 514 U.S. 52, 63, 115 S. Ct. 1212, 131 L. Ed. 2d 76 (1995); *Metric Contractors, Inc. v. United States*, 44 Fed. Cl. 513, 523 (1999), *United States v. Seckinger*, 397 U.S. 203, 216, 905 S. Ct. 880, 25 L. Ed. 2d 224 (1970).

¹⁴² *D'Annunzi Bros. v. N.J. Transit Corp.*, 245 N.J. Super 527, 586 A.2d 302, 304 (1991); *Sipco Services & Marine, Inc., v. United States*, 41 Fed. Cl. 176, 215 (1998). *Blount Bros. Constr. Co. v. United States*, 171 Ct. Cl. 478, 346 F.2d 962, 971-72 (Ct. Cl. 1965); see also Section 5, Subsection B(6), "Nondisclosure," *supra*.

¹⁴³ *Fortec Constructors v. United States*, 760 F.2d 1288, 1291 (Fed. Cir. 1985).

¹⁴⁴ 14 S.W.3d 276, 281 (Mo. App. 2000) (quoting *Community Heating & Plumbing Co. v. Kelso*, 987 F.2d 1575, 1580 (Fed. Cir. 1993)) (citations omitted).

¹⁴⁵ Missouri Standard Specification, § 105.4.1.

¹⁴⁶ *Delcon Constr. Corp. v. United States*, 27 Fed. Cl. 634, 637 (1993).

¹⁴⁷ *Hensel Phelps v. United States*, 888 F.3d 1296 (Fed. Cl. 1989).

¹⁴⁸ *J.F. White v. Mass. Bay Transp. Auth.*, 40 Mass. App. Ct. 937, 666 N.E.2d 518, 519 (1996); *Wildner Contracting v. Ohio Turnpike Comm'n*, 913 F. Supp. 1031 (N.D. Ohio 1996); *Hensel Phelps Constr. Co. v. King County*, 57 Wash. App. 170, 787 P.2d 58, 61 (1990); *Hoel-Steffen Constr. Co. v. United States*, 197 Ct. Cl. 561, 456 F.2d 760 (Ct. Cl. 1972).

¹⁴⁹ 11 CORBIN ON CONTRACTS § 992 (1993 int. ed); 24 WILLISTON ON CONTRACTS § 64:1 (4th ed. 1999).

¹⁵⁰ *Bruce Constr. Corp. v. United States*, 163 Ct. Cl. 97, 324 F.2d 516, 518 (Ct. Cl. 1963); *Pacific Architects & Engineers v. United States*, 203 Ct. Cl. 499, 491 F.2d 734, 739 (Ct. Cl. 1974).

¹⁵¹ Damages are discussed in Subsection C of this Section.

¹⁵² *State v. Eastwind, Inc.*, 851 P.2d 1348, 1350 (Alaska 1993) (requiring the contractor to perform work in a manner

justment is a specific contract clause that provides for price adjustment in the contract amount and/or an extension of contract time if certain events covered by the clause occur during contract performance. The DSC clause, the Changes clause, and the Suspension of Work clause are some examples.¹⁵³

Once the contractual basis for the claim is established, the contractor must prove that there is a causal link or nexus between the contractual right asserted and the event that caused the injury. Suppose, for example, that the contract provided that the project site would be available to the contractor when the contract was signed by the owner. The contract is signed, but the site is not available, causing the contractor to stand by until the site is available. There is a causal link between the right asserted (the contractual right to begin work when the contract was executed) and the event (site not available) that caused the contractor to incur additional expense. The additional costs are factually tied to the event—the non-availability of the site as promised in the contract. The next step in the process is for the contractor to prove damages, which is discussed in the next subsection.

4. Subcontractor Pass-Through Claims

There is no contractual privity of contract between the project owner and a subcontractor.¹⁵⁴ In the absence of privity, a subcontractor has no standing to sue the owner contractually, either directly or as a third beneficiary of the contract between the owner and the prime

contractor.¹⁵⁵ But the owner may be liable to a subcontractor on a pass-through basis.

When a public agency breaches a construction contract with a contractor, damage often ensues to a subcontractor. In such a situation, the subcontractor may not have legal standing to assert a claim directly against the public agency due to a lack of privity of contract, but may assert a claim against the general contractor. In such a case, a general contractor is permitted to present a pass-through claim on behalf of the subcontractor against the public agency....¹⁵⁶

Although the subcontractor has no standing to sue the owner, it can sue the prime with whom it has privity. The prime in turn can sue the owner “passing-through” the subcontractor’s claim. Usually the prime and the subcontractor will enter into an agreement in which the prime agrees to pursue the sub’s claim against the owner and pay any recovery to the sub. In exchange, the sub waives its claims against the prime. The agreement will contain language that it is not a release of the subcontractor’s claim. This is to avoid any argument that the claim is waived under the *Severin* doctrine.

Under the *Severin* doctrine, a prime contractor may sue an owner for damages that the owner caused the subcontractor only when the prime contractor seeks reimbursement for damages it paid the subcontractor, or when the prime contractor remains liable to the subcontractor for damages.¹⁵⁷ In *Severin*, both the prime contractor and the subcontractor incurred damages because of owner delay. The prime was allowed to recover its damages, but it was not allowed to recover on behalf of its subcontractor. The prime contractor was not liable to its subcontractor because the subcontract contained a clause waiving delay damages. Since the prime contractor was not liable to the subcontractor, the owner was not liable for the subcontractor’s damages. The rule has been stated as follows:

different than called for in the contract); *Hubbard Constr. Co. v. Orlando/Orange County Expressway Auth.*, 633 So. 2d 1154 (App. Div. 5 Dist. 1994) (imposing a stricter standard to test the density of a highway embankment than required by the contract); *APAC Georgia, Inc. v. Department of Transp.*, 221 Ga. App. 601, 472 S.E.2d 97, 100–01 (1996) (failure to coordinate design changes between prime contractors as required by an express provision in the contract); *D.H. Blattner & Sons v. Fireman’s Ins. Co.*, 535 N.W.2d 671, 675–77 (Minn. App. 1995) (breach of implied warranty as to the correctness of the plans and specifications—following *United States v. Spearin*, 248 U.S. 132 (1918)); *Beltrone Constr. Co. v. State*, 256 A.D. 2d 992, 682 N.Y.S.2d 299 (1998) (failure to coordinate concurrent prime contractors); *Chantilly Constr. Corp. v. Department of Highways*, 6 Va. App. 282, 369 S.E.2d 438, 444 (1988) (defective specifications); *Zook Bros. Constr. Co. v. State*, 171 Mont. 64, 556 P.2d 911, 915 (1976) (failure to provide right-of-way); *Gilbert Pacific Corp. v. State Dep’t of Transp.*, 110 Or. App. 171, 822 P.2d 729, 732 (1991) (defective plans and specifications); *Procon Corp. v. Utah Dep’t of Transp.*, 876 P.2d 890 (Utah App. 1994) (changing the angle of a cut in a highway embankment from that shown in the plans was a breach); *John W. Goodwin, Inc. v. Fox*, 1994 Me. 33, 725 A.2d 541 (1999) (failure to make timely progress payments).

¹⁵³ See generally Section 5, Subsections A (The Changes Clause) and B (Differing Site Conditions).

¹⁵⁴ *Jensen Constr. Co. v. Dallas County*, 920 S.W.2d 761, 772 (Tex. App. 1996).

¹⁵⁵ *Del Guzzi Constr. Co. v. Global Northwest, Ltd.* 105 Wash. 2d 878, 719 P.2d 120, 125 (1986); *Tarin v. Tinley*, 3 P.2d 680 (N.M. App. 1999); *Linde Enters., Inc. v. Hazelton City Auth.*, 412 Pa. Super. 67, 602 A.2d 897, 899 (1992); *Lundeen Coatings Corp. v. Department of Water & Power*, 232 Cal. App. 3d 816, 833, 283 Cal. Rptr. 551 (Cal. App. 1991).

¹⁵⁶ *Howard Contracting, Inc. v. G.A. MacDonald Constr. Co.*, 71 Cal. App. 4th 38, 60, 83 Cal. Rptr. 2d 590 (1998). See also *Buckley & Co. v. State*, 140 N.J. Super. 289, 356 A.2d 56, 73 (1975), for cases from other jurisdictions holding that lack of privity between the subcontractor and the owner does not bar a pass-through claim. A pass-through claim was not allowed, however, where sovereign immunity was only waived with respect to parties who had contracted directly with the state. *APAC-Carolina v. Greensboro-High Point Airport Auth.*, 110 N.C. App. 664, 431 S.E.2d 508, 511 (1993).

¹⁵⁷ *Severin v. United States*, 99 Cl. Ct. 435, 443 (1943); *cert. denied*, 322 U.S. 733, 645 Ct. 1045 (1944); see also *Department of Transp. v. Claussen Paving Co.*, 346 Ga. 807, 273 S.E.2d 161, 164 (Ga. 1980); *Kensington Corp. v. Department of State Highways*, 74 Mich. App. 417, 253 N.W.2d 781, 783 (1977); *John B. Pike & Son, Inc. v. State*, 169 Misc. 2d 1037, 647 N.Y.S.2d 654 (N.Y. Ct. Cl. 1996).

Since our decision in the *Severin* case, *supra*, this court has repeatedly delineated the only ground's upon which a prime contractor may sue the government for damages incurred by one of its subcontractors through the fault of Government. The decided cases make it abundantly clear that a suit of this nature may be maintained only when the prime contractor has reimbursed its subcontractors for the latter's damages or remains liable for such reimbursement in the future....¹⁵⁸

The burden, however, is on the owner to show that the prime contractor has no legal obligation to share any recovery with the subcontractor. In *Blount Bros. Constr. Co. v. United States*, the court said: "To come under the 'Severin' Doctrine the defendant must show, through some contractual terms or a release, that the plaintiff-prime is not liable to the subcontractor."¹⁵⁹ This is consistent with the rule that standing to sue is an affirmative defense for the owner to raise and prove.¹⁶⁰

The *Severin* doctrine does not apply to a subcontractor claim for an equitable adjustment when the equitable adjustment clause in the prime contract is included in the subcontract, either directly or by incorporation through a flow-down clause unless the owner can prove that the subcontractor has released or waived its claim.¹⁶¹

A typical flow-down clause provides that the subcontractor is obligated to the prime contractor to the same extent as the prime contractor is obligated to the owner and that the subcontractor is entitled to the same rights granted the prime contractor by the owner under the main contract.¹⁶² For example, the DSC clause in the prime contract may be incorporated into the subcontract by the flow-down clause and a DSC claim may be asserted by a prime contractor against the owner on behalf of the subcontractor.¹⁶³ Where, however, the DSC clause is not incorporated into the subcontract, there is no contractual basis for a DSC claim.¹⁶⁴

¹⁵⁸ *J. L. Simmons v. United States*, 304 F.2d 886, 888 (Ct. Cl. 1962).

¹⁵⁹ 171 Ct. Cl. 478, 346 F.2d 962, 965 (Ct. Cl. 1965).

¹⁶⁰ The majority view is that the Severin defense is an affirmative defense and as such the owner has the burden of proof, not the contractor. *Frank Coluccio Constr. v. City of Springfield*, 779 S.W.2d 550, 552 (Mo. 1989); *Gilbert Pacific Corp. v. State Dep't of Transp.*, 110 Ore. App. 171, 822 P.2d 729 (1991). But in *Department of Transp. v. Claussen Paving Co.*, 246 Ga. 807, 273 S.E.2d 161 (1980), the court held that the prime contractor has the burden of proving that it is liable to the subcontractor.

¹⁶¹ *Owens-Corning Fiberglass Corp. v. United States*, 190 Ct. Cl. 211, 419 F.2d 439, 457 (Ct. Cl. 1969), *University of Alaska v. Modern Constr., Inc.*, 522 P.2d 1132, 1139 (Alaska 1974); *Buckley & Co. v. State, Dep't of Transp.*, 140 N.J. Super. 289, 356 A.2d 56, 73 (1975).

¹⁶² Form No. 5, Associated General Contractors of America (AGC).

¹⁶³ *Umpqua River Nav. Co. v. Crescent City Harbor Dist.*, 618 F.2d 588, 594 (9th Cir. 1980).

¹⁶⁴ *Keith A. Nelson Co. v. R.L. Jones, Inc.*, 604 S.W.2d 351, 354 (Texas 1980) (no changed conditions clause in subcontract; subcontractor could not recover for changed conditions).

The prime contractor's pass-through claim against the owner cannot exceed the amount of the prime contractor's liability to the subcontractor.¹⁶⁵ The prime contractor, however, is entitled to a markup on the amount it recovers on behalf of its subcontractors.¹⁶⁶

5. Other Theories of Recovery

a. Unjust Enrichment

Unjust enrichment is a theory imposed by operation of law. The theory is based on the principle that a person unjustly enriched should be legally required to make restitution for the benefits received, if doing so does not violate any law, or conflict with an express provision in the parties' contract.¹⁶⁷ The theory usually arises in situations where there is no express contractual basis for recovery.¹⁶⁸ Recovery based on unjust enrichment is not permitted where it is barred by sovereign immunity,¹⁶⁹ violates a statute,¹⁷⁰ or conflicts with an express contract provision that covers the subject matter of the claim.¹⁷¹

To recover for unjust enrichment, a contractor must prove: (1) that a benefit was conferred; (2) that the

¹⁶⁵ *John B. Pike & Son, Inc. v. State*, 169 Misc. 2d 1034, 647 N.Y.S.2d 654, 656 (1996).

¹⁶⁶ *Pa. Dep't of Transp. v. James D. Morrissey, Inc.*, 682 A.2d 9, 16 (Pa. 1996) (8 percent markup allowed).

¹⁶⁷ *Aloe Coal Co. v. Department of Transp.*, 164 Pa. Commw. 453, 643 A.2d 757 (1994); *230 Park Ave. Assocs. v. State*, 165 Misc. 2d 920, 630 N.Y.S.2d 855 (1995); *J.A. Sullivan Corp. v. Commw.*, 397 Mass. 789, 494 N.E.2d 374, 377 (1986); 5 WILLISTON CONTRACTS, § 805 (1970).

¹⁶⁸ *Leroy Callender, P.C. v. Fieldman*, 252 A.D. 2d 468, 676 N.Y.S.2d 152, 153 (1998). Subcontractors may try to assert this type of claim when they have not been paid by the prime contractor for their work, but there is no unjust enrichment when the owner has paid the prime contractor, since equity will not require the owner to pay twice. *International Paper Co. v. Futhey*, 788 S.W.2d 303, 306 (Mo. App. 1990).

¹⁶⁹ *Gregory v. Hunt*, 24 Fed. 3d 781(6th Cir. 1994) (court applied Tennessee law holding that sovereign immunity was waived only with respect to breach of an express, written contract and that sovereign immunity barred a claim based on an implied contractual obligation); *Cleansoils Wisconsin, Inc. v. State Dep't of Transp.*, 229 N.W.2d 903, 910 (Wis. App. 1999) (State did not consent to be sued for unjust enrichment); *But see J. A. Sullivan Corp. v. Commonwealth*, 397 Mass. 789, 494 N.E.2d 374, 377 (1986) (State could not avoid claim for unjust enrichment based on sovereign immunity).

¹⁷⁰ *Parsa v. State*, 64 N.Y.2d 143, 474 N.E.2d 235, 237, 485 N.Y.S.2d 27 (1984) (New York statute required contracts in excess of \$15,000 to be in writing and approved by the comptroller); *Seneca Nursing Home v. Kan. State Bd. of Social Welfare*, 490 F.2d 1324, 1332 (10th Cir. 1974) (statute made state immune from liability for implied contracts although a unilateral contract was found to exist).

¹⁷¹ *P.J. Wildner Contracting Co. v. Ohio Turnpike Comm'n*, 913 F. Supp. 1031, 1043 (N.D. Ohio 1996); *Jensen Constr. Co. v. Dallas County*, 920 S.W.2d 761, 774 (Tex. App. 1996); *Mountain Pacific Chapter A.G.C. of America v. State of Wash.*, 10 Wash. App. 406, 518 P.2d 212, 214 (1974).

owner knew that it was being conferred; and (3) that it would be inequitable for the owner to retain the benefit without paying for its value.¹⁷² There cannot be any recovery where the contractor had no reasonable expectation of being paid for its services.¹⁷³

The value of the benefit is determined on a *quantum meruit* basis.¹⁷⁴ The value of the benefit is measured by the actual costs the contractor incurred in performing the work.¹⁷⁵ But those costs will be disallowed to the extent they are shown to be excessive or unreasonable.¹⁷⁶

b. Mutual Mistake of Fact

Another possible theory of recovery is mutual mistake. A mutual mistake occurs when contracting parties erroneously believe that some basic fact that affects contract performance is true. One party may seek to reform the contract so that it reflects what the parties actually intended.¹⁷⁷ The common law doctrine of mutual mistake has been applied by the Court of Claims to allow a contractor to recover additional performance costs caused by a mutual mistake about the necessity for an additional step in a manufacturing process. The court held that neither party bore the burden caused by the mistake, and reasoned that the equitable resolution to the dispute was to reform the contract and split the additional costs equally between the parties.¹⁷⁸

The doctrine applies only to mutual mistakes about existing facts at the time of contracting. The doctrine does not apply to mistakes about future events,¹⁷⁹ or to risks that the contractor has assumed.¹⁸⁰

c. Failure to Require a Statutorily Mandated Payment Bond

Public property is not subject to mechanics' liens. Subcontractors¹⁸¹ on public work projects who are not paid for their work have no lien rights against the public improvement.¹⁸² The rule is based on public policy. "It requires very little imagination to realize how disruptive the attachment and attempted foreclosure of such liens might be to the orderly operation of state and local government."¹⁸³ Subcontractors who are not paid for their work may not have any recourse against the prime contractor because of the latter's insolvency. The subcontractor's only recourse may be the payment bond and the retainage withheld by the public owner from progress payments.¹⁸⁴

A public agency may be liable to unpaid subcontractors if it fails to require the prime contractor to obtain a payment bond from a surety. Some public bond statutes impose liability on the agency when it fails to require a bond.¹⁸⁵ Other bond statutes do not expressly impose liability on the agency for its failure to obtain a bond.¹⁸⁶ Courts have reached mixed results where a bond statute does not expressly impose liability. Some courts have held that a subcontractor had a direct right of action against the agency for its failure to require a bond.¹⁸⁷ Other courts have found no right of action, declining to create a cause of action where none had been created by statute.¹⁸⁸

¹⁷² Concrete Products Co. v. Salt Lake County, 734 P.2d 910, 911 (Utah 1987); Black Lake Pipe Line Co. v. Union Constr. Co., 538 S.W.2d 80, 86 (Tex. 1976); McDonald v. Hayner, 43 Wash. App. 81, 715 P.2d 519, 522 (1986).

¹⁷³ Aloe Coal Co. v. Department of Transp., *supra* note 168, at 767-68.

¹⁷⁴ J.A. Sullivan Corp. v. Commonwealth, *supra* note 168, at 378-79; 1 CORBIN ON CONTRACTS § 1.20 (rev. ed. 2001); 26 WILLISTON ON CONTRACTS § 68:1 (4th ed. 2003).

¹⁷⁵ United States ex rel. Susi Contracting Co. v. Zara Contracting Co., 146 F.2d 606, 611 (2nd Cir. 1944); RESTATEMENT OF CONTRACTS § 347-48 (2d).

¹⁷⁶ Acme Process Equip. Co. v. United States, 171 Ct. Cl. 324, 347 F.2d 509, 530 (Ct. Cl. 1965), *rev'd. on other grounds*, 385 U.S. 138, 87 S. Ct. 350.

¹⁷⁷ RESTATEMENT OF CONTRACTS § 155 (2d 1979).

¹⁷⁸ National Presto Indus. v. United States, 167 Ct. Cl. 749 338 F.2d 99, 111-12 (Ct. Cl. 1964); *see also* Atlas Corp. v. United States, 895 F.2d 745, 750 (Fed. Cir. 1990) (court denied contractor's claim based on mutual mistake).

¹⁷⁹ Westinghouse Elec. Corp. v. United States, 41 Fed. Cl. 229, 238 (1998); RESTATEMENT OF CONTRACTS § 151 (2d).

¹⁸⁰ Knieper v. United States, 38 Fed. Cl. 128, 139-40 (1997); RESTATEMENT OF CONTRACTS § 152 (2d).

¹⁸¹ The term subcontractors as used in this Subsection *also* refers to materialmen.

¹⁸² Wells-Stewart Constr. Co. v. Martin Marrietta Corp., 103 Ariz. 375, 442 P.2d 119, 124 (Ariz. 1968); J.S. Sweet Co. v. White County Bridge, 714 N.E.2d 219, 222 (Ind. App. 1999).

¹⁸³ City of Evansville v. Verplank Concrete & Supply, 400 N.E.2d 812, 816 (Ind. Ct. App. 1980).

¹⁸⁴ Payment bond provides protection to those who furnish materials and services for public improvements. Davidson Pipe Supply v. Wyoming County Inds. Dev. Agency, 85 N.Y.2d 281, 648 N.E.2d 468, 469-70, 624 N.Y.S.2d 92 (1995); Retainage: city not liable to unpaid subcontractor for failure to withhold retainage from prime contractor's progress payments. Murname Assocs. v. Harrison Garage Parking Corp., 239 A.D. 2d 882, 659 N.Y.S.2d 665, 667 (N.Y. A.D. 1997).

¹⁸⁵ OR. REV. STAT. § 279.542.

¹⁸⁶ WASH. REV. CODE § 39.08.010 does not impose liability on state agencies, but rather only on counties, cities, and towns.

¹⁸⁷ Northwest Steel Co. v. School Dist. No. 16, 76 Or. 321, 148 Pac. 1134, 1135 (1915); City of Atlanta v. United Elec. Co., 202 Ga. App. 239, 414 S.E.2d 251, 253 (1991); Dekalb County v. J.A. Pipeline, 437 S.E.2d 327 (Ga. 1993).

¹⁸⁸ Accent Store Designs, Inc. v. Marathon House, Inc., 647 A.2d 1223 (R.I. 1996); *See also* Ihr v. City of Duluth, 56 Minn. 182, 59 N.W. 960 (Minn. 1894); Freeman v. City of Chanute, 63 Kan. 573, 66 Pac. 647, 649 (Kan. 1901); ABC Supply Co. v. City of River Rouge, 216 Mich. App. 396, 549 N.W.2d 73, 76 (1996).

d. Inapplicability of Tort Law

The remedy for breach of contract is designed to put the nonbreaching party in the same position it would have been in had the breach not occurred. It is designed to protect the intentions of the parties, but it has been held that tort law was designed to protect social policies.¹⁸⁹ Claims for nonperformance of contractual obligations are based on breach of contract, not tort.¹⁹⁰

Tort damages are not permitted in a breach of contract action unless the event constituting the breach was accompanied by conduct that amounts to a traditional common law tort.¹⁹¹ In the absence of such conduct, courts will generally enforce the breach of a contractual obligation through contract law.¹⁹² The policies underlying tort and contract remedies were stated by the Virginia Supreme Court.¹⁹³

The controlling policy consideration underlying tort law is the safety of persons and property—the protection of persons and property from losses resulting from injury. The controlling policy consideration underlying the law of contracts is the protection of expectations bargained for. If that distinction is kept in mind, the damages claimed in a particular case may more readily be classified between claims for injuries to persons or property on the one hand and economic losses on the other.

6. Claims Against the Owner's Design Professional and the Economic Loss Limitation on Liability

At common law, design professionals (typically architects and engineers) were not liable for the contractor's economic losses caused by defective plans and specifications. Design professionals could be legally responsible for personal injury and physical property damage caused by defective design, but not for economic damage suffered by third parties.¹⁹⁴ Traditionally, design professionals were retained by project owners. They owed their allegiance to the owners with whom they had contracted, not to the contractors with whom they

had no contractual relationship.¹⁹⁵ The lack of contractual privity as a bar to suits by contractors against design professionals for economic damages began to erode with the advent of products liability law.

The law imposes upon every person who enters upon an active course of conduct the positive duty to use ordinary care so as to protect others from harm. A violation of that duty is negligence. It is immaterial whether the person acts in his own behalf or under contract with another. *** We cannot ignore the half century of development in negligence law originating in *MacPherson* [*MacPherson v. Buick Motor Co.*, 217 N.Y. 382, 111 N.E. 1050 (1916)] and are impelled to conclude that the position and authority of a supervising architect are such that he ought to labor under a duty to the prime contractor to supervise the project with due care under the circumstances, even though his sole contractual relationship is with the owner....¹⁹⁶

The rule has evolved in some jurisdictions that a contractor can sue a design professional in negligence for economic loss despite lack of privity between them.¹⁹⁷ The standard of care owed by the design professional and the failure to meet that standard requires expert testimony, unless the error is so obvious that expert testimony is not necessary.¹⁹⁸ The same rules apply to construction managers, who, as the name implies, are employed by owners to manage their construction projects.¹⁹⁹

Under the economic loss rule, design professionals are not liable, either in tort or contract law, for economic losses suffered by contractors with whom they have no contractual privity.²⁰⁰ The economic loss rule is based on the policy that a contractor's remedy for economic losses lies in the area of contract law, not tort law.²⁰¹ Courts that follow the economic loss rule often note that the rule provides predictability in allocating risk in the construction industry.²⁰² The fee for design services, for example, does not have to include premiums for errors and omissions coverage for economic loss due to construction delays caused by defective plans

¹⁸⁹ *Sensebrenner v. Rust et al.*, 236 Va. 419, 374 S.E.2d 55, 58 (1988); *Erlich v. Menezes*, 21 Cal. 4th 543, 981 P.2d 978, 982, 87 Cal. Rptr. 2d 886 (Cal. 1999).

¹⁹⁰ *State v. Transamerica Premier Ins. Co.*, 856 P.2d 766, 772 (Alaska 1993).

¹⁹¹ *Erlich v. Menezes*, 981 P.2d at 983 (tortious conduct would include fraud, deceit, or an intent to cause severe harm to the non-breaching party). In addition, sovereign immunity, unless waived, would bar tort claims against state agencies.

¹⁹² *State v. Trans America Premier Ins. Co.*, *supra* note 191; *see also*, *Foreman & Mills, Inc. v. Belcher Oil Co.*, 11 Cal. 4th 85, 900 P.2d 669, 682, 44 Cal. Rptr. 420 (Cal. 1995) (Mosk, J., concurring and dissenting).

¹⁹³ *Sensebrenner v. Rust et al.*, 374 S.E.2d at 58.

¹⁹⁴ The term "economic loss" includes increased costs of contract performance and consequent loss of profits. *See*, Barrett, Jr., *Recovery of Economic Loss in Tort for Construction Defects: A Critical Analysis*, 40 S.C. L. REV. 891, 892 (1989).

¹⁹⁵ Annotation, *Tort Liability of Project Architect for Economic Damages Suffered by Contractor*, 65 A.L. R. 3d 249, 252 (1975).

¹⁹⁶ *Shoffner Indus. v. W.B. Lloyd Constr. Co.*, 42 N.C. App. 259, 257 S.E.2d 50, 55 (1979).

¹⁹⁷ *See* states listed in Table later in this subpart; *see also* RESTATEMENT OF TORTS § 552 (2d).

¹⁹⁸ *Garaman, Inc. v. Williams*, 912 P.2d 1121, 1123 (Wyo. 1996).

¹⁹⁹ *James McKinney & Son, Inc. v. Lake Placid 1980 Olympic Games, Inc.*, 92 A.D. 2d 991, 461 N.Y.S.2d 483, 486 (A.D. 1983); *John E. Green Plumb. & Heating Co. v. Turner Constr. Co.*, 500 F. Supp. 910, 912–13 (E.D. Mich. 1980).

²⁰⁰ *Floor Craft Floor Covering, Inc. v. Parma Community Gen. Hosp.*, 54 Ohio St. 3d 1, 560 N.E.2d 206, 208 (Ohio 1990); *Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist.*, 124 Wash. 2d 816, 881 P.2d 986, 989–90 (1994).

²⁰¹ *Sensebrenner v. Rust/Orling & Neale*, 374 S.E.2d at 58; *Berschauer/Phillips Constr. Co.*, *id.*

²⁰² *Id.*

and specifications. “The fees charged by architects, ...are founded on their expected liability exposure as bargained and provided in the contracts.”²⁰³

A number of jurisdictions have concluded that lack of contractual privity will not bar a tort action by a contractor against a design professional for economic damages.²⁰⁴ Other jurisdictions have reached an opposite conclusion, holding that a party cannot sue for economic loss in the absence of privity. The following Table lists many of the states that follow the economic loss rule and many that do not follow that rule.

²⁰³ Berschauer-Phillips Constr. Co., 881 P.2d at 992.

²⁰⁴ Insurance Co. of North America v. Town of Manchester, 17 F. Supp. 2d 81, 86 (D. Conn. 1998).

State	Economic Loss Rule Followed	Economic Loss Rule Not Followed	Citation
Alabama		X	<i>E.C. Ernest Inc. v. Manhattan Const. Co.</i> , 531 F.2d 1026 (5th Cir. 1979) (applying Alabama law).
Alaska		X	<i>Mattingly v. Sheldon Jackson College</i> , 743 P.2d 356, 360 (Ak. 1987).
Arizona		X	<i>Donnelly Constr. Co. v. Osberg/Hunt/Gilleland</i> , 677 P.2d 1292, 1294 (Ariz. 1984).
California		X	<i>JAire Corp. v. Gregory</i> , 24 Cal. 3d 799, 598 P.2d 60, 64 (1979). See also <i>Dept. of Water and Power v. City of Los Angeles v. ABB Power T&D Co.</i> , 902 F. Supp. 1178, 1188 (1995).
Connecticut		X	<i>Insurance Co. of N.A. v. Town of Manchester</i> , 17 F. Supp. 2d 81, 85 (D. Conn. 1998) (applying Connecticut Law).
Delaware	X		<i>Danforth v. Acorn Structures, Inc.</i> , 608 A.2d 1194, 1196 (1992).
Florida		X	<i>Morgansais v. Heathman</i> , 744 So. 2d 973, 978 (Fla. 1999).
Hawaii	X		<i>City Express Inc. v. Express Partners</i> , 959 P.2d 836, 840 (1998).
Illinois	X		<i>Anderson Elec. Inc. v. Ledbetter Erection Corp.</i> , 503 N.E.2d 246, 247 (Ill. 1986).
Louisiana		X	<i>Gurtler, Hebert & Co. v. Weyland Mach. Shop Inc.</i> , 405 So. 2d 660, 662 (La. App. 1981).
Massachusetts	X		<i>Priority Finishing Corp. v. LAL Constr. Co.</i> , 667 N.E.2d 290 (Mass. App. 1996).
Michigan		X	<i>Bacco Constr. Co. v. American Colloid Co.</i> , 384 N.W.2d 427, 434 (Mich. App. 1986).
Minnesota		X	<i>Prichard Bros., Inc. v. Grady Co.</i> , 428 N.W.2d 391 (Minn. 1988).
Mississippi		X	<i>City Council of Columbus v. Clark-Dietz & Associates-Engineers, Inc.</i> ,

State	Economic Loss Rule Followed	Economic Loss Rule Not Followed	Citation
			550 F. Supp. 610, 624 (N.D. Miss. 1980) (applying a Mississippi law).
Montana		X	<i>Jim's Excavating Services v. HKM Assocs.</i> , 878 P.2d 248, 254 (Mont. 1994).
Nebraska		X	<i>John Day Co. v Alvine & Associates, Inc.</i> , 510 N.W.2d 462, 466 (Neb. App. 1993).
New Jersey		X	<i>New MEA Constr. Corp. v. Harper</i> , 497 A.2d 534, 540 (N.J. Super. 1985).
New York		Suit allowed if functional privity is established.	<i>Port Auth. of N.Y. v. Rachel Bridge Corp.</i> , 597 N.Y.S.2d 35 (A.D. 1993) (functioning privity established); <i>Pile Foundation Constr. Co. v. Berger-Lehman Assocs.</i> , 676 N.Y.S.2d 664 (A.D. 1998).
North Carolina		X	<i>APAC-Carolina v. Greensboro High Point</i> , 431 S.E.2d 508, 517 (N.C. App. 1993).
Ohio	X		<i>Floor Craft v. Parma Com. Gen. Hosp.</i> , 560 N.E.2d 206, 208 (Ohio 1990).
Rhode Island	X		<i>Forte Bros Inc. v. Nat. Amusements Inc.</i> , 525 A.2d, 1301, 1303 (1987).
South Carolina	X		<i>Cullom Mech. Constr. Inc. v. S.C. Baptist Hospital</i> , 520 S.E.2d 809, 813 (S.C. App. 1999).
Tennessee		X	<i>John Martin Co. v. Morse/Diesel, Inc.</i> , 819 S.W.2d 428, 431 (Tenn. 1991) (adopting Section 552, Restatement (2d)).
Utah	X		<i>Anderson Towers Owners Ass'n v. CCI Mech., Inc.</i> , 930 P.2d 1182, 1189 (Utah 1996).
Virginia	X		<i>Blake Constr. Co. v. Alley</i> , 353 S.E.2d 724, 726 (Va. 1987).
Washington	X		<i>Berschauer/Phillips Constr. v. Seattle Sch. Dist.</i> , 881 P.2d 986, 990 (Wash. 1994).
Wisconsin		X	<i>A.E. Inv. Corp. v. Link Builders</i> , 214 N.W.2d 764, 768 (1974).

State	Economic Loss Rule Followed	Economic Loss Rule Not Followed	Citation
Wyoming	X		<i>Rissler & McMurray Co. v. Sheridan Area Water Supply Dist.</i> , 929 P.2d 1228, 1234–35 (Wyo. 1996).

C. CONTRACTORS' CLAIMS—DAMAGES

1. Introduction

After entitlement is established, the contractor must prove damages.²⁰⁵ Generally speaking, damages for breach and an equitable adjustment under the contract are measured in the same way. The general measure of damages for breach of contract is to put the nondefaulting party in as good a position, pecuniarily, as it would have been if the breach had not occurred.²⁰⁶ Similarly, an equitable adjustment is designed to keep a contractor whole when the government modifies the contract.²⁰⁷ The operative word is “equitable.” The adjustment in the contract price should not give either party an advantage that it would not have had had there been no change. The measure of an equitable adjustment is “the difference between what it would have reasonably cost to perform the work as originally required and what it would reasonably cost to perform the work as changed.”²⁰⁸ A contractor who has underestimated his bid or incurred unanticipated costs may not use a change order as an excuse or opportunity to shift its own losses or risks to the owner.²⁰⁹

The kinds of damages sought by a contractor may vary. They may include the cost of added labor, additional equipment costs, unabsorbed home office overhead expense, and delay and impact costs. These costs may be presented in different ways. They may be based on actual costs or estimates. They may be priced as discrete claim items, or they may be based on an approximation, using a jury verdict approach.²¹⁰ This sub-

²⁰⁵ Entitlement may be based upon breach of contract or upon some remedy granting provision of the contract. *See generally*, subsection B, *supra*.

²⁰⁶ *Al and Zack Brown, Inc. v. Bullock*, 238 Ga. App. 246, 518 S.E.2d 458, 461 (1999); 11 CORBIN ON CONTRACTS, § 992 (1993 int. ed.). 24 WILLISTON ON CONTRACTS § 64:1 (4th ed. 1999).

²⁰⁷ *Bruce Constr. Corp. v. United States*, 163 Ct. Cl. 97, 324 F.2d 516, 518 (Ct. Cl. 1963); *Morrison Knudsen Corp. v. Fireman's Fund Ins. Co.*, 175 F.3d 1221, 1234 n.8 (10th Cir. 1999).

²⁰⁸ *D.C. v. Organization for Envtl. Growth*, 700 A.2d 185, 203 (D.C. App. 1997) (quoting *Modern Foods, Inc.*, ASBCA No. 2090, 57-1 BCA ¶ 1229, 1957 WL 4960).

²⁰⁹ *Pacific Architects and Eng'rs Inc. v. United States*, 203 Ct. Cl. 499, 491 F.2d 734, 739 (Ct. Cl. 1974); *Nager Elec. Co. v. United States*, 194 Ct. Cl. 835, 442 F.2d 936, 946 (Ct. Cl. 1971).

²¹⁰ *See Joseph Pickark's Sons Co. v. United States*, 209 Ct. Cl. 643, 532 F.2d 739, 742–44 (1976).

section discusses the types of damages and costs that a contractor may seek, and the traditional methods that may be used to prove damages.

2. Contract Clauses Limiting Recovery

The amount of an equitable adjustment may be limited by the specific provisions of the contract. The DSC clause used by most states is one example. That clause does not allow additional compensation for any effects of the condition on unchanged work.²¹¹ Another example is the suspension of work clause, which does not allow profit on delay costs.²¹² Generally, clauses imposing limits on the amount that can be recovered under the contract are enforceable.²¹³

A contractor may attempt to avoid the effect of those kinds of limiting clauses by claiming damages based on breach of contract. Whether such efforts are successful depends upon whether the contractor can prove that the changes were so substantial that they were beyond the general scope of the work specified in the contract. Changes of that magnitude may be a breach of contract.²¹⁴ If the change is within the general scope of the contract, the limitations on recovery apply.²¹⁵ The question of whether the change is within the general scope of the contract may be a question of fact,²¹⁶ of law,²¹⁷ or a mixed question of fact and law.²¹⁸

Most construction contracts contain clauses that limit an owner's exposure for damages for breach of contract. No-damage-for delay clauses are a common example of this type of clause.²¹⁹ Another example is clauses excluding liability for consequential damages.²²⁰ A con-

²¹¹ The DSC clause mandated by FHWA for use on federally-aided state highway projects contains the same limitation. 23 C.F.R. § 635.109(a)(1)(iv).

²¹² 23 C.F.R. § 635.109(a)(2)(ii).

²¹³ *J.F. White v. Mass. Bay Transp. Auth.*, 40 Mass. App. Ct. 937, 666 N.E.2d 518 (1996); *Hensel Phelps Constr. Co. v. King County*, 57 Wash. App. 170, 787 P.2d 58, 65 (1990).

²¹⁴ *V.C. Edwards Contracting Co. v. Port of Tacoma*, 83 Wash. 2d 7, 514 P.2d 1381, 1383 (1973); *Triple Cities Constr. Co. v. State*, 194 A.D. 2d 1037, 599 N.Y.S.2d 874, 876 (1993). *See also* § 5.A.5, “Cardinal Changes,” *supra*.

²¹⁵ *See cases cited in note 213 supra*.

²¹⁶ *V.C. Edwards, supra note 215*, 514 P.2d at 1383–84.

²¹⁷ *Foster Constr. C.A. Co. and Williams Bros. v. United States*, 193 Ct. Cl. 587, 435 F.2d 873, 880 (Ct. Cl. 1970).

²¹⁸ *Hensel Phelps Constr. Co., supra note 214*, 787 P.2d at 61–62.

²¹⁹ *See* § 5.C.4., *supra*.

²²⁰ *See, e.g.*, Washington Standard Specification 1-09.4 (no claim for consequential damages of any kind will be allowed).

tracting party may validly waive its remedies for breach of contract by assenting to a clause limiting damages for breach of contract. Such clauses are enforceable unless they violate some specific public policy defined in a statute or legal precedent.²²¹

3. Damage Principles

Certain principles apply in determining damages. The most basic principle is the purpose for awarding damages. Damages are awarded by courts, boards, and arbitrators in an attempt to put the nonbreaching party in the same position that it would have occupied had the breach not occurred.²²² Another principle is that damages will not be awarded based on speculation or conjecture.²²³ But damages need not be proven with exact certainty, if the claimant clearly proves that it has suffered damages caused by the defaulting party.²²⁴ It is sufficient if the evidence allows a judge or jury to make a reasonable approximation of the amount of damages without resorting to conjecture or speculation.²²⁵ However, leniency in allowing an approximation of the amount of damages does not relieve the contractor of its burden of proving liability, causation, and resultant injury.²²⁶

A party seeking damages for breach of contract has a duty to take reasonable steps to avoid or mitigate losses resulting from the breach.²²⁷ The burden of proving that the claimant failed to mitigate damages rests with the nondefaulting party.²²⁸ The party seeking damages must also show that the costs claimed are reasonable and were caused by the event or default on which the claim is based.²²⁹ Under federal construction law, prior to 1987, a contractor's actual costs were presumed reasonable. The Government had the burden of proving that the contractor's actual costs were unreasonable.²³⁰

²²¹ Canal Elec. Co. v. Westinghouse Elec. Co., 406 Mass. 369, 548 N.E.2d 182, 187 (Mass. 1990); Solar Turbines, Inc. v. United States, 23 Ct. Cl. 142, 157 (1991). See also the limitations on the use of no-pay-for-delay clauses discussed in Section 5.C, *supra*.

²²² 11 CORBIN ON CONTRACTS, § 992; 24 WILLISTON ON CONTRACTS, § 64:1 (4th ed. 1999), 1353 (3d ed. 1968).

²²³ Berley Indus. v. City of N.Y., 45 N.Y.2d 683, 688, 385 N.E.2d 281, 283, 412 N.Y.S.2d 589 (1978).

²²⁴ Wunderlich Contracting Co. v. United States, 173 Ct. Cl. 180, 351 F.2d 956, 968–69 (Ct. Cl. 1965).

²²⁵ Daly Constr. v. Garrett, 5 F.3d 520, 522 (Fed. Cir. 1993).

²²⁶ Wunderlich Contracting Co., *supra*, note 225, 351 F.2d at 968–69.

²²⁷ P.T. & L. Constr. Co. v. State Dep't of Transp., 108 N.J. 539, 531 A.2d 1330, 1335 (1987) (contractor must absorb expenses that would have been avoided if it had been conscientious in its investigation).

²²⁸ Hardwick v. Dravo Equip. Co., 279 Or. 619, 569 P.2d 588, 591 (1977).

²²⁹ Wunderlich Contracting Co., *supra* note 225, at 969; Berley Indus., 385 N.E.2d at 282–83.

²³⁰ Bruce Constr. Corp. v. United States, 163 Ct. Cl. 97, 324 F.2d 516, 519 (Ct. Cl. 1963).

In 1987, there was an amendment to the FAR eliminating that presumption and shifting the burden from the Government to the contractor to show that its actual costs were reasonable.²³¹ The presumption that a contractor's actual costs are reasonable may also be negated by evidentiary rules.²³² This is consistent with the general rule that the burden is on the contractor to prove that its claimed costs are reasonable.²³³

Quantum meruit is a term that relates to how damages are measured; it is not a theory of recovery although it may be used to avoid unjust enrichment.²³⁴ Literally, it means, "As much as he has deserved."²³⁵ It is used to measure damages where extra work was performed that was not covered by the contract,²³⁶ or where work was performed and accepted without the presence of an authorized contract.²³⁷ The value of the benefit conferred is usually measured by the actual reasonable costs incurred by the contractor in performing the work, plus markup for overhead and profit.²³⁸

Quantum meruit recovery is not allowed where the work is covered by a specific contractual remedy,²³⁹ or where the circumstances are such that the contractor could not reasonably expect to be paid for the work.²⁴⁰

4. Methods of Calculating Damages

There is no single method for calculating damages. If the contract does not establish a method for calculating damages, the contractor may try to prove damages using various methods. This subpart discusses the traditional methods that may be used to prove damages resulting from changes or delays caused by the owner.

a. Discrete Cost Method

The discrete cost method calculates the increased costs of changes or delays to the work on an item-by-item basis. The actual costs incurred because of changes or delays are segregated, assigned to each item, and documented in the contractor's cost account-

²³¹ 48 C.F.R. § 31.201.3 (1987). See Morrison Knudsen Corp. v. Fireman's Fund Ins. Co., 175 F.3d 1221, 1244, n. 30 (10th Cir. 1999).

²³² Pa. Dep't of Transp. v. United States, 226 Ct. Cl. 444, 643 F.2d 758, 763 (1981).

²³³ 13 AM. JUR. *Building and Construction Contracts* § 122 (2d ed. 2000).

²³⁴ See Subsection B.5.a, *supra*.

²³⁵ BLACK'S LAW DICTIONARY (7th ed. 1999).

²³⁶ V.C. Edwards Contracting Co. v. Port of Tacoma, 7 Wash. App. 883, 503 P.2d 1133, 1136 (1972).

²³⁷ Ridley v. Pipe Maintenance Services, 83 Pa. Commw. 425, 477 A.2d 610, 612 (1984) (invalid contract).

²³⁸ Cities Serv. Gas Co. v. United States, 205 Ct. Cl. 16, 500 F.2d 448, 457 (Ct. Cl. 1974); Port Chester Elec. Constr. Corp. v. HBE Corp., 782 F. Supp. 837, 845 (S.D. N.Y. 1991).

²³⁹ Hensel Phelps Constr. Co. v. King County, 57 Wash. App. 170, 787 P.2d 58, 61 (1990).

²⁴⁰ *Id.*

ing records.²⁴¹ This method is preferred by the courts because it is considered to be the best evidence of actual damages.²⁴²

Estimated costs may be permitted if actual costs are unavailable, and the contractor has a valid reason for not having actual cost information. But the claim may be denied if the contractor could easily have kept records of its actual costs caused by owner action or fault, but did not, and has no valid excuse for not keeping records.²⁴³

The discrete method of calculating damages for breach of contract or an equitable adjustment under a remedy granting clause provides the owner with documented, actual costs tied directly to items of work that have been changed or delayed.

b. Total Cost Method

Under the total cost method, the contractor recovers the difference between the total cost of performing the work and the bid price, plus a reasonable profit.²⁴⁴ This method is disfavored by the courts and can only be used where there is no other means of determining damages.²⁴⁵ It is disfavored because it suffers from the following defects. First, it presumes that the bid was reasonable. If the bid is unreasonably low, the difference between the contractor's total costs to perform the contract and its bid is increased, thereby increasing the contractor's damages solely by underbidding the project and not by incurring additional costs caused by the owner.²⁴⁶ Second, this method assumes that the owner, not the contractor, is responsible for all of the increased costs. This defect further assumes that the contractor was not responsible for any increase in the cost of the work, passing along to the owner increased costs that

may have resulted from the contractor's inefficiency, or from events for which the owner was not responsible.²⁴⁷

While courts disfavor the total cost method, they do not prohibit its use. Its use is based on the principle that, "Where a contractor is entitled to an adjustment, the contracting entity should not be relieved of its liability for the same merely because the contractor is unable to prove its increased costs within a mathematical certainty."²⁴⁸ Essentially, the courts will allow this method to be used if there is no better method for proving damages, and the following safeguards can be established:

- The bid was reasonable and properly prepared. This may be determined by comparing the bids submitted by the other bidders with the contractor's bid.²⁴⁹
- The total costs expended were reasonable.²⁵⁰
- The contractor is not responsible for the additional costs.²⁵¹

These safeguards or prerequisites to the use of this method must be proved by a preponderance of the evidence.²⁵² Failure to prove them requires that the total cost claim be dismissed.²⁵³ If a jury is allowed to hear evidence of damages calculated on a total cost method, the jury must be instructed by the court not to allow damages based on total costs unless these safeguards are established.²⁵⁴ The owner should consider presenting evidence challenging the contractor's total cost figures rather than counting on the jury, or a judge in a bench trial, to deny the claim in its entirety because the contractor failed to establish the foundational prerequisites for use of the total cost method.²⁵⁵

²⁴⁷ See cases cited in note 245, *supra*. See also MCBRIDE & TOUHEY, *GOVERNMENT CONTRACTS*, § 23.40[2].

²⁴⁸ *AMP-Rite Elec. Co. v. Wheaton Sanitary Dist.*, 220 Ill. App. 3d 130, 580 N.E.2d 622, 640, 162 Ill. Dec. 659 (1991).

²⁴⁹ *Youngdale & Sons Constr. Co. v. United States*, 27 Fed. Cl. 542-43.

²⁵⁰ *Servidone Constr. Corp.*, 931 F.2d at 861-62.

²⁵¹ *AMP-Rite Elec. Co.*, 580 N.E.2d at 641 (citing *J.D. Hedin Constr. Co. v. United States*, 347 F.2d 235, 346-47 (Ct. Cl. 1965); *Neal & Co. v. United States*, 36 Fed. Cl. at 638. The contractor does not have the burden, however, to show that it mitigated its damages; the burden of proving that the contractor failed to mitigate its damages rests with the owner. *Hardwick v. Dravo*, 279 Or. 619, 569 P.2d 588, 591 (1977).

²⁵² *John F. Harkins Co. v. School Dist. of Phila.*, 313 Pa., *supra* 425, 460 A.2d 260, 265 (1983).

²⁵³ *Neal & Co. v. United States*, 36 Fed. Cl. at 638.

²⁵⁴ *Geolar, Inc. v. Gilbert/Commonwealth, Inc.*, 874 P.2d 937, 945 (Alaska 1994); *Anchorage v. Frank Coluccio Constr. Corp.*, 826 P.2d 316, 328 (Alaska 1992).

²⁵⁵ See *Pa. Dep't of Transp. v. James D. Morrissey*, 682 A.2d 9, 14 (Pa. 1996). (The court noted that the agency did not present any evidence to contradict the contractor's testimony concerning liability for damages). The total cost method may be used to calculate damages for a major contract item. See *S.J. Groves & Sons & Co. v. State*, 50 N.C. App. 1, 77-79, 273 S.E.2d 465 (1980) (contractor used total cost method to calculate damages for unclassified excavation work after encountering a changed condition. Court applied same foundational

²⁴¹ *American Line Builders v. United States*, 26 Cl. Ct. 1155, 1193 (1992) ("Plaintiff's calculation of the additional work required by reference to time and labor records from the project is far more helpful to this court than the defendant's unsupported assertions, because plaintiff's calculations reflect work actually performed, not hypothetical labor time projects.")

²⁴² *Dawco Constr. Co. v. United States*, 930 F.2d 872, 882 (Fed. Cir. 1991); *American Line Builders Inc., id.*; *Con-Vi-Rio of Texas v. United States*, 538 F.2d 348 (Cl. Ct. 1976); *D.C. v. Organization for Env'tl. Growth*, 700 A.2d 185, 203 (D.C. App. 1997); *New Pueblo Constructors, Inc. v. State*, 144 Ariz. 95, 696 P.2d 185, 194 (1985).

²⁴³ *Dawco Constr. Co. v. United States*, 930 F.2d at 882.

²⁴⁴ *New Pueblo Constructors, Inc. v. Department of Transp.*, 696 P.2d at 194; *Neal & Co. v. United States*, 36 Fed. Cl. 600, 638 (Ct. Cl. 1996); *Servidone Constr. Corp. v. United States*, 931 F.2d 860, 861-62 (Fed. Cir. 1991).

²⁴⁵ *New Pueblo Constructors, id.*; *Green Constr. Co. v. Department of Transp.*, 164 Pa. Commw. 566, 643 A.2d 1129, 1136 (1994); *Servidone Constr. Corp., id.*; *Modern Builders, Inc. v. Manke*, 29 Wash. App. 86, 615 P.2d 1332, 1337-38 (1980), *Huber, Hunt Nichols v. Moore*, 67 Cal. App. 278, 136 Cal. Rptr. 603, 621-22 (1977).

²⁴⁶ *Youngdale & Sons Constr. Co. v. United States*, 27 Fed. Cl. 516, 541 (1993); *Servidone Constr. Corp.*, 931 F.2d at 861.

The total cost method is a simple way of calculating damages. Essentially, it converts a fixed-price contract into a cost-plus contract. This method assumes that the bid for performing the work was reasonable and accurately computed. It assumes the contractor's increased costs were reasonable and that the owner, not the contractor, or factors for which the owner was not reasonable, caused the costs to increase. It is disfavored as a matter of law because it piles assumption upon assumption, and as such becomes speculative. The assertion that it is too difficult to segregate impact and delay costs and allocate them to specific work items is not enough to justify the total cost method. The contractor should be required to prove that its accounting system and its use of cost codes do not permit allocation of specific costs to discrete events, where the effects of impacts and disruptions on unchanged work are so intertwined that allocation of those costs are highly impracticable.²⁵⁶

c. Modified Total Cost Method

The modified total cost method is simply the total method adjusted to satisfy two of the prerequisites for the use of the total cost method.²⁵⁷ Under the modified total cost approach, deductions are actually made for costs attributable to the contractor,²⁵⁸ and for underbidding where the evidence indicates that the contractor's bid was too low.²⁵⁹ This approach is designed to eliminate two of the deficiencies inherent in the total cost method: the assumption that the bid was realistic and the assumption that all of the excess costs were the responsibility of the owner.²⁶⁰

The problem with this approach is that it shifts the burden of proof. It is a fundamental rule of law that a claimant has the burden of proving its damages.²⁶¹ In contrast with the discrete method of proving damages, a contractor using the modified total method can, if it chooses, allocate some of its increased costs to obvious self-inflicted wounds, leaving it to the owner to prove that there are other costs that should also be the con-

prerequisites for repricing the entire contract on a total cost basis in repricing major contract item).

²⁵⁶ Neal & Co. v. United States, 36 Fed. Cl. 600, 641 (Fed. Cl. 1996).

²⁵⁷ Servidone Constr. Co. v. United States, 931 F.2d at 862; Youngdale Constr. Co. v. United States, 27 Fed. Cl. at 541; Seattle Western Indus. v. David Mowat Co., 750 P.2d 245 (Wash. 1988); Nebr. Pub. Power Dist. v. Austin Power, Inc., 773 F.2d 960, 968 (8th Cir. 1985).

²⁵⁸ For example, in State Highway Comm'n v. Brasel & Sims Constr. Co., 688 P.2d 871 (Wyo. 1984), damages were reduced by a deduction for increased labor costs due to "over-manning."

²⁵⁹ Servidone Constr. Co. v. United States, 931 F.2d at 862.

²⁶⁰ Youngdale & Sons Constr. Co. v. United States, 27 Fed. Cl. at 541.

²⁶¹ See Subpart C.3, "Damage Principles," this Section, *supra*.

tractor's responsibility.²⁶² The following factors should be considered in defending claims based on a total or modified total cost method.²⁶³

- The contractor's bid work-up sheets should be examined to determine how the contractor put the bid together. The examination should be made to determine whether the contractor bid too low on some aspects of the work or made assumptions in bidding that were unrealistic or unfounded. The analysis may also consider whether the bid was unbalanced with respect to items that seriously overran or underran.
- Nonimpacted items of work should be compared with similar impacted items of work. This is referred to as the "measured mile" analysis.
- Financial records obtained through an audit should be analyzed by experts.
- An engineering and schedule analysis should be performed to identify concurrent delays.²⁶⁴

This type of analysis allows the owner to determine when the contractor is attempting to obtain additional compensation for mistakes that the contractor made in its bid and during contract performance. Considerable lay and expert testimony may be required to prove these factors and may likewise be rebutted by similar evidence presented by the contractor. This type of analysis is also of major import, because the total or modified total cost methods will not be permitted if the prerequisites to their use are not established by the contractor,²⁶⁵ or at least one of the prerequisites to their use are disproved by the owner.²⁶⁶

d. Jury Verdict

The "jury verdict" method is used by courts to determine (much like a jury would) a fair and reasonable amount that should be awarded as an equitable adjustment, or as damages for breach of contract. It is used by courts to reconcile conflicting testimony, and not as a method of proving damages.²⁶⁷ The prerequisites for using this method are: (1) clear proof that the contractor is entitled to damages for breach of contract or an equitable adjustment; (2) sufficient evidence to allow the court to make a reasonable estimation as to the amount of damages; and (3) proof that there was no

²⁶² D. HARP, *Preventing and Defending Against Highway Construction Contract Claims: The Use of Changes or Differing Site Conditions Clauses and New York State's Use of Exculpatory Contract Provisions and Contract Clauses*, in SELECTED STUDIES IN HIGHWAY LAW (National Cooperative Highway Research Program Legal Research Digest No. 28, 1993).

²⁶³ *Id.* at 29.

²⁶⁴ See § 5.C.4.b, *supra*.

²⁶⁵ Neal & Co. v. United States, 36 Fed. Cl. at 638.

²⁶⁶ Youngdale & Sons Constr. Co. v. United States, 27 Fed. Cl. at 541.

²⁶⁷ District of Columbia v. OFERGO, 700 A.2d at 204; Delco Elec. Corp. v. United States, 17 Ct. Cl. 302, 323-24 (1989), *aff'd*, 909 F.2d 1495 (Fed. Cir. 1990).

more reliable method of computing damages.²⁶⁸ The jury verdict method may not be used, and the claim may be dismissed, where the contractor could have kept records of its actual increased costs, but did not, and has no justifiable excuse for not doing so.²⁶⁹

e. Force Account

Specifications used by state transportation agencies in their construction contracts usually contain force account provisions.²⁷⁰ Force account provisions allow the agency to pay for contract changes on a time and material basis when the contractor and the agency cannot agree on a price for the change.²⁷¹ Occasionally, force account has been used by contractors to price equipment for large claims. This occurs when the specifications provide that the price adjustment for a change, a DSC, or a contract termination for convenience will be determined by agreement of the parties, or if they cannot agree, by force account. This type of pricing can result in a real advantage to a contractor by using rates from a manual to price its equipment rather than its actual equipment costs.²⁷² Generally, force account should not be used to price large claims. To prevent this, the contract should provide that no claim for force account shall be allowed unless ordered in writing by the engineer prior to the performance of the work.

5. Cost Categories

Aside from miscellaneous and subcontractor expenses, a contractor's cost in performing work may be grouped into four general categories: labor, materials, equipment, and overhead. These costs can be further classified as either direct or indirect. Direct costs are those tied to a specific construction activity, while indirect costs that cannot be tied to specific work items are treated as part of overhead.

Most contractors keep detailed cost records for their projects. This allows them to account for the cost of labor, materials, and equipment used for a particular construction activity. When new or extra work is undertaken, a cost code can be established for that activity. However, the determination of extra labor hours resulting from labor inefficiency may be impossible to

identify and segregate from the man-hours expended to perform the original contract work.²⁷³

a. Increased Labor Costs

Direct labor costs consist of the base wages and fringe benefits that are paid to personnel who perform a specific segment of construction. The wages of an ironworker, for example, can be determined from payroll records and allocated to steel erection work. Accounting for added labor costs caused by extra work is easy if those costs are clearly allocated to a new cost code established for that purpose. Where the difficulty occurs is when the original contract work is impacted by the contract change, reducing the efficiency of the contractor's labor force. This may be due to delay causing work to be performed during adverse weather, or causing work to be performed out of sequence, or from trade stacking and over-manning to meet an accelerated completion schedule.

One method for proving inefficiency is to compare specific units of work performed under normal circumstances with the same kind of work affected by the change. This is usually referred to as the "measured mile" approach.²⁷⁴ Another method is to estimate an inefficiency percentage and apply that percentage to labor costs. For instance, in one case, the court allowed a 10 percent increase for labor inefficiency caused by work being performed out-of-sequence.²⁷⁵ An analysis of this kind requires expert testimony,²⁷⁶ and may rely on industry studies.²⁷⁷ However, a comparison of actual labor costs to the amount estimated in the original bid has been rejected. The court said that this approach has the same shortcomings inherent in the total cost

²⁷³ "Construction Claims and Damages, Entitlement Analysis," J. Hainline, AASHTO Annual Meeting (Oct. 1991); TRB Legal Workshop (July 1992).

²⁷⁴ *Gen. Ins. Co. v. Hercules Constr. Co.*, 385 F.2d 13, 20-21 (8th Cir. 1967). See *Clark Concrete Contractors v. Gen. Services Admin.*, GSBGA No. 14340 99-1 BCA § 30280 (1999) (Board allowed contractor to use the "measured mile" approach to several different categories of work affected by design changes made during construction).

²⁷⁵ *Youngdale & Sons Constr. Co. v. United States*, 27 Fed. Ct. at 558.

²⁷⁶ *Luria Bros. & Co. v. United States*, 177 Ct. Cl. 676, 369 F.2d 701, 712 (Ct. Cl. 1967).

²⁷⁷ J.A. HANERS & R.M. MORGAN, COLD REGIONS RESEARCH AND ENGINEERING LABORATORY SPECIAL REPORT 172 (May 1972) discusses the effect of cold weather on human performance and capabilities; *Work Efficiency Decreases at Abnormal Temperatures*, CONSTRUCTOR MAGAZINE, Associated General Contractors of America (May 1972). This issue also lists a number of conditions that affect productivity and characterize the percent of loss if the condition is minor, average, or severe. Some examples: very hot or very cold weather, minor (10 percent), average (20 percent), severe (30 percent). Learning curve, minor (5 percent), average (15 percent), severe (25 percent). The publication notes that these factors are for reference only and may vary from contractor to contractor, crew to crew, and job to job.

²⁶⁸ *WRB Corp. v. United States*, 183 Ct. Cl. 409, 425.

²⁶⁹ *Dawco Constr., Inc. v. United States*, 930 F.2d 872, 881 (Fed. Cir. 1991); see *D.C. v. OFERGO*, 700 A.2d at 204 (for additional citations).

²⁷⁰ Colorado DOT Standard Specification 109.4 (1999) and Washington DOT Standard Specification 1-09.6 (2000) are examples.

²⁷¹ *I.A. Constr. Corp. v. Department of Transp.*, 139 Pa. Commw. 509, 591 A.2d 1146, 1149-50 (1991); *Department of Transp. v. Anjo Constr. Co.*, 666 A.2d 753, 760 (Pa. Commw. 1995).

²⁷² Pricing equipment is discussed in the next subpart C.

method: the labor estimate may be too low and the cost overrun may be due, at least in part, to problems that are not the owner's fault.²⁷⁸ Inefficient labor claims are frequently found in acceleration claims.²⁷⁹ Excessive overtime can affect work output and lower efficiency through physical fatigue. Stacking of trades within limited work areas causes congestion, affecting efficiency. There are also indirect labor costs. Field supervision costs may be increased when a delay or a change extends the project. Field supervisions costs for extended project durations should be documented as to the additional time spent on the project, rather than using an inefficiency factor as a markup on the total supervisory costs. A contractor may also recover premium pay for overtime work and for second and third shift work, where work is accelerated due to owner-caused delay. There is no recovery, however, where premium time was not due to an owner-caused breach.²⁸⁰ But wage increases for work performed in a later time period than planned, due to owner delay, may be recovered.²⁸¹

b. Increased Cost of Materials

An increase in the cost of materials due to owner-caused delay is compensable. The claim should not include shipping charges, since the contractor would bear those costs irrespective of when the materials were delivered, unless the shipping costs also increased.

Some contracts include an escalation clause allowing a price adjustment for certain products that increase in price during contract performance. Petroleum products are an example of materials where the price may rise suddenly.²⁸²

c. Increased Equipment Costs

Most contracts establish how equipment should be priced and refer to equipment costing guide manuals.²⁸³ These manuals are published by a number of organizations.²⁸⁴ In general, equipment costs are broken down

into two categories: rented and owned. Payment for rented equipment is based on paid invoices. When equipment is rented from rental companies or other contractors, the amount paid will be allowed, if it is reasonable and the rental was an arms-length transaction. However, in federal procurement where the equipment is rented from a division, subsidiary, or organization under the common control of the contractor, the allowability of the rental charges is determined by regulation.²⁸⁵ In addition, under federal regulations, certain costs, such as maintenance and minor repairs necessary to keep the equipment operational, may be allowed.²⁸⁶

The contract specifications may control the costs allowed for owned equipment. For example, recovery for owned equipment may be limited to rates established by an equipment rental agreement with the AGC, or the contractor's actual ownership and operating costs, whichever is less.²⁸⁷ Some contractors who own equipment do not keep sufficient records to establish their actual equipment costs.²⁸⁸ In the absence of a regulation or directive that allows or requires the use of published rates, contractors must prove that their records are inadequate to establish their actual ownership rates before they can use published rates.²⁸⁹ When the actual cost of equipment ownership can be determined, those costs must be used.²⁹⁰

Contractors are generally entitled to compensation to cover their equipment costs during a period where work is suspended or delayed.²⁹¹ Recovery for idle equipment is denied, however, where the contractor could have used the equipment elsewhere.²⁹² This is consistent with the contractor's common law duty to mitigate its damages.²⁹³ Standby rates for idle equipment are usu-

General Contractors; Labor Surcharge and Equipment Rental Rates, The California Dep't of Transportation; Tool and Equipment Rental Schedule, National Electrical Contractor's Association.

²⁸⁵ 48 C.F.R. ch. 1 §§ 31.105(d)(2)(c); 31.205.36(b)(3).

²⁸⁶ 48 C.F.R. § 31.105(d)(2)(c)(ii)(A).

²⁸⁷ For example, Colorado specifies the Dataquest Blue Book for establishing equipment rental. The hourly rental rate is based on the Blue Book Monthly Rate published by Dataquest times a rate adjustment factor times the regional adjustment average divided by 176 (working hours in a month). Colorado Standard Specifications § 109.04(c) (1999).

²⁸⁸ These costs include: equipment depreciation, taxes and insurance, capital investment, *i.e.*, return on money spent on equipment.

²⁸⁹ *Meva Corp. v. United States*, 206 Ct. Cl. 203, 511 F.2d 548, 559 (Ct. Cl. 1975), *Nolan Bros. v. United States*, 194 Ct. Cl. 1, 437 F.2d 1371, 1379–80 (Ct. Cl. 1971) (regulations allowed use of published notes).

²⁹⁰ *Meva Corp., id.*

²⁹¹ *Zook Bros. Constr. Co. v. State*, 171 Mont. 64, 556 P.2d 911, 917 (1976); *Peter Salucci & Sons, Inc. v. State*, 110 N.H. 136, 268 A.2d 899, 910 (1970).

²⁹² *Excavation-Constr., Inc., ENG BCA No. 3858, 82-1 BCA ¶ 15,770, at 78, 058 (1982).*

²⁹³ See Subpart 3, *supra*.

²⁷⁸ *Manshul Constr. Corp. v. Domitory Auth. of N.Y.*, 79 A.D. 2d 383 436 N.Y.S.2d 724, 729 (N.Y. App. 1981); *Joseph Pickard's Sons & Co. v. United States*, 209 Ct. Cl. 643, 532 F.2d 739, 449 (Ct. Cl. 1976).

²⁷⁹ *Hensel Phelps Constr. Co. v. King County*, 57 Wash. App. 170, 787 P.2d 58, 60 (1990).

²⁸⁰ *Public Constructors v. State*, 55 A.D. 2d 368, 390 N.Y.S.2d 481, 487 (1977).

²⁸¹ *Gardner Displays Co. v. United States*, 346 F.2d 585, 589 (Ct. Cl. 1965).

²⁸² *Id.*

²⁸³ *Quality Asphalt Paving, Inc. v. State of Alaska, Dep't of Transp. & Public Facilities*, 71 P.3d 865, 873–74 (Alaska 2003).

²⁸⁴ Rental Rate Blue Book for Construction Equipment. Rates can be weekly or monthly. The latter has lower rates than the former. Rental Rates Compilation, Associated Equipment Distributors; Construction Equipment Ownership and Operating Expense Schedule, U.S. Army Corps of Engineers; Contractor's Equipment Cost Guide, The Associated

ally priced at actual ownership rates or 50 percent of equipment manual rates.²⁹⁴ The standby reduction reflects the cost of owning the equipment, but not the wear and tear on the equipment and “FOG” (fuel, oil, and grease costs), since the equipment is not operating during the suspension or delay period.

d. Home Office Overhead

Home office overhead represents those costs necessary to conduct business. It includes salaries, rent, depreciation, taxes, insurance, utilities, office equipment, data processing costs, legal and accounting expenses, office supplies, and other miscellaneous general and administrative expenses.²⁹⁵ Because of their nature, these expenses are indirect and cannot be directly traced to any particular contract.²⁹⁶

When a contract is delayed, home office expenses may accrue beyond the amount allocated by the contractor in its bid. Since there is little or no work, there is little or no income from contract progress payments to absorb those costs.²⁹⁷ Those costs become “unabsorbed.”²⁹⁸ Thus, contractors who have incurred unabsorbed or extended home office expenses during a period of owner-caused delay have been permitted to recover those costs as part of their damages for compensable delay.²⁹⁹ The costs are compensable because they were incurred due to owner-caused delay, but not reimbursed as part of the contract price.³⁰⁰

i. The Eichleay Formula.—The Eichleay formula is a method of approximating home office overhead expenses caused by delay. It computes home office overhead expenses on the basis of a pro rata amount per day and then multiplies that amount times the number of days that the project was delayed. The result is the amount of home office overhead damages.³⁰¹ Its use as a method of calculating home office overhead damages for federal construction contracts spans over 40 years.³⁰² The basic formula consists of the following steps:

²⁹⁴ L. L. Hall Contr. Co. v. United States, 177 Ct. Cl. 870, 379 F.2d 559, 568 (1967); Zook Bros. Constr. Co. v. State, 556 F.2d at 917 (standby rate was 50 percent of hourly rate established by the Montana State Highway Dep’t).

²⁹⁵ Contractors include some amount in their bids to cover home office expenses incurred during the duration of the contract. Aetna Casualty & Sur. v. Chapel Hill Indep. Sch. Dist., 860 S.W.2d 67,672 (Tex. 1993).

²⁹⁶ Wickham Contracting Co. v. Fischer, 12 F.3d 1574, 1578 (Fed. Cir. 1994).

²⁹⁷ West v. All State Boiler, Inc., 146 F.3d 1368, 1372 (Fed. Cir. 1998).

²⁹⁸ In Eichleay Corp., ASBCA No. 5183, 60-2 BCA ¶ 2688 (1960).

²⁹⁹ *Id.*

³⁰⁰ Wickham Contracting Co. v. Fischer, 12 F.3d at 1577.

³⁰¹ Eichleay Corp., *supra* note 298; Melka Marine, Inc. v. United States, 187 F.3d 1370, 1374–75 (Fed. Cir. 1999). It is the accepted method for calculating home office overhead damages in federal construction contracts. Wickham Contracting Co. v. Fischer, 12 F.3d at 1577.

³⁰² From 1960 to the present. *Id.*

<u>STEP 1</u>	<u>Delayed contract billings</u>		Total home office overhead incurred during contract period.		Overhead allocable to the contract.
	Total billings during contract period.	X		=	
<u>STEP 2</u>	<u>Allocable overhead</u>	=	Overhead per day allocable to delayed contract.		
	Total number of days of contract performance				
<u>STEP 3</u>	Daily overhead rate	X	Number of days of delay.	=	Unabsorbed overhead damages.

The formula has undergone certain modifications. For example, it is important that the actual period of contract performance be used, not the number of days planned or scheduled for contract performance.

Because the formula attempts to determine the amount of overhead attributable to the *actual period of performance* of the delayed contract, the per diem rate is necessarily obtained by dividing this figure by the number of days of *actual performance*. Dividing by the number of days of the original contract period distorts the formula.³⁰³

Another modification is that the actual delay beyond the scheduled completion date must be used, not the suspension period. The Federal Circuit has stated, “We clarify that it is the delay at the end of performance resulting from the suspension that results in unabsorbed overhead expenses which a contractor may recover under *Eichleay*.”³⁰⁴

To use *Eichleay*, the contractor must also show that it was on standby and that it was unable to take on replacement work during the suspension: work that provides the “same amount of money for the same period toward overhead costs as the government contract.”³⁰⁵ The standby test requires that the contractor remain ready to perform and that it was impractical for the contractor to obtain other work to which it could reallocate its home office overhead expenses.³⁰⁶ In addition, *Eichleay* should not apply where the original contract duration is extended by change order work, when the added work provides sufficient income to absorb the contractor’s proportionate share of home office expenses.³⁰⁷

³⁰³ *Golf Landscaping, Inc. v. Century Constr. Co.*, 39 Wash. App. 895, 696 P.2d 590, 593–94 (1984) (emphasis in original, citation omitted) (using the actual period of performance instead of the original contract period changed the *per diem* rate from \$209.88 to \$109.98).

³⁰⁴ *West v. All State Boiler*, 146 F.3d at 1368, 1381 (Fed. Cir. 1998) (changed the period for computing damages from 58 days—the suspension period—to 22 days, the extension period beyond the scheduled completion date).

³⁰⁵ *Mecka Marine, Inc. v. United States*, 187 F.3d at 1379.

³⁰⁶ See *West v. All State Boiler*, 146 F.3d at 1373. However, a contractor’s inability to take on replacement work because of bonding limitations would not be an excuse for not obtaining replacement work. See *Satellite Elec. Co. v. Dalton*, 105 F.3d 1418, 1420 (Fed. Cir. 1997).

³⁰⁷ *Community Heating & Plumbing Co. v. Kelso*, 987 F.2d 1575, 1580–81 (Fed. Cir. 1993); *Almayer v. Johnson*, 79 F.3d 1129, 1133 (Fed. Cir. 1996).

One state has rejected the *Eichleay* formula as too speculative,³⁰⁸ while other states have permitted its use in calculating delay damages.³⁰⁹ *Eichleay* has been criticized for allowing damages without first determining whether additional overhead costs were actually incurred. It may also include damages for construction shut-down periods, such as weather or other non-owner-caused events, when the contractor would normally be idle. The formula also assumes that the daily overhead cost is a fixed cost, when in fact the costs are an approximation based on costs that are variable.³¹⁰

Another criticism is that the daily rate of overhead expense may be disproportionate when there is a small amount of work remaining. In *Berley Industries v. City of New York*, the court said; “The damages computed under the *Eichleay* formula would be the same in this case whether the plaintiff had completed only 1% or 99% of the job on the scheduled completion date of May 7, 1971.”³¹¹ But despite criticism, acceptance of the *Eichleay* formula seems to be growing.³¹²

³⁰⁸ *Berley Indus. v. City of N.Y.*, 45 N.Y.2d 683, 385 N.E.2d 281, 283, 412 N.Y.S.2d 589 (1978).

³⁰⁹ California: *Howard Contracting, Inc. v. McDonald Constr. Co.*, 71 Cal. App. 4th 38, 54–55, 83 Cal. Rptr. 2d 590 (1998) (City of Los Angeles conceded that *Eichleay* was the proper industry standard for analyzing construction delay claims); Connecticut: *Southern New England Contracting Co. v. State*, 165 Con. 644, 345 A.2d 550, 559–60 (Conn. 1974); Florida: *Broward County v. Russell, Inc.*, 589 So. 2d 983 (Fla. App. 1991); Massachusetts: *PDM Plumbing & Heating, Inc. v. Findlen*, 13 Mass. App. Ct. 950, 431 N.E.2d 594, 595 (1982); Ohio: *Conti Corp. v. Ohio Dep’t of Adm. Servs.*, 629 N.E.2d 1073, 1077 (1993); Washington: *Golf Landscaping v. Century Constr. Co.*, 39 Wash. App. 395, 696 P.2d 590, 592–93 (1984). Virginia: *Fairfax County Redevelopment and Housing Auth. v. Worchester Bros. Co.*, 257 Va. 382, 514 S.E.2d 147, 150–51 (1999).

³¹⁰ *Berley Indus. v. City of N.Y.*, 385 N.E. at 284; D. Harp, *Preventing and Defending Against Highway Construction Claims* (National Cooperative Highway Research Program Legal Research Digest No. 28, 1993); R.A. Maus, *Assessing Damages on Construction Claims*, paper presented at AASHTO annual meeting (1991); M.K. Love, *Theoretical Delay and Overhead Damages*, 30 PUB. CONT. L.J. 33 (Fall 2000); Watson, *Unabsorbed Overhead Costs and the Eichleay Formula*, 147 MIL. L. REV. 262 (1995); P.A. McGeehan and C.O. Strouss, *Learning from Eichleay: Unabsorbed Overhead Claims in State and Local Jurisdictions*, 25 PUB. CONT. L.J. (Winter 1996).

³¹¹ *Berley*, 385 N.E.2d at 284. Under federal construction law, the amount of work remaining when work is suspended is only relevant to show whether the contractor could have taken on replacement work during the delay period. *Satellite Elec.*

ii. *Other Methods of Determining Home Office Overhead Expenses.*—Methods other than the Eichleay formula may be used to calculate home office overhead expenses. Using a contractor's usual markup rate in preparing bids is one such method for determining home office costs during an extended contract period. Under this method, the direct cost incurred during the extended period is multiplied by the percentage markup. The result is the home office overhead damages for the extended contract.³¹³ A similar method is the use of a fixed markup rate specified in the contract. For example, the FDOT has a standard clause that contains the following formula:³¹⁴

$$D = \frac{A \times C}{B}$$

Where: A = original contract amount
 B = original contract time
 C = 8%
 D = Average overhead per day.³¹⁵

The Colorado Department of Transportation has a standard clause that determines home office overhead for the extended contract period by adding 10 percent of the total cost of additional wages for nonsalaried labor as a result of the delay and the cost of additional bond, insurance, tax, equipment costs, and extended job site overhead. No additional home office overhead expenses are allowed.³¹⁶ Instead of a fixed percentage rate, the overhead clause may contain a declining scale. As the value of the direct costs increase, the allowance markup percentages on direct costs decrease.³¹⁷

Home office overhead claims usually arise because work is suspended or delayed, not because the duration of the contract is extended by added work. Contractually-fixed markups do not address home office expenses where work is suspended because no work is performed during the suspension period, and the only direct costs that are being incurred are idle equipment on standby, field facilities, and perhaps field supervision. Those

Co. v. Dalton, 105 F.3d at 1420 (96.7 percent of the work had been completed when the contract was suspended; the value of the remaining work was less than \$30,000).

³¹² See *supra* note 316, for states where Eichleay has been used to compute delay damages. See also note, *Home Office Overhead as Damages for Construction Delays*, 7 GA. L. REV. (1983).

³¹³ A.T. Kelmens & Sons v. Reber Plumbing & Heating Co., 139 Mont. 115, 360 P.2d 1005, 1011 (1961).

³¹⁴ Standard Specification 5.12.6.2 (2000).

³¹⁵ The amount calculated by this formula includes job site overhead as well as extended home office overhead. Standard Specification 5.12.6.2 (2000).

³¹⁶ Standard Specification 109.10 (1999).

³¹⁷ See *Reliance Ins. Co. v. United States*, 931 F.2d 863, 865 (Fed. Cir. 1991) (10 percent overhead on first \$20,000, 7 ½ percent overhead on next \$30,000, and 5 percent overhead on balance over \$50,000).

costs may form an inadequate base for determining home office overhead costs during the suspension period. In this situation, some other method must be used to calculate unabsorbed overhead, if the *Eichleay* formula is not used. Most methods require assistance from accountants or other financial experts in analyzing the contractor's books and records.³¹⁸

Judicial tuning of the *Eichleay* formula may make it more palatable to owners. Limiting use of the formula to situations where the contractor cannot take on replacement work,³¹⁹ but must “standby” still gives the owner some options. If the delay could be extensive, the owner can tell the contractor to seek other work until the problem causing the delay can be resolved. The owner may also have the option of terminating the contract for convenience, where the contract contains a termination for convenience clause. This option allows the owner to avoid further delay damages, which may be cheaper than allowing the damages to continue.

6. Delay and Disruption Damages

Delay and disruption are events occurring during contract performance that affect the work.³²⁰ Although not synonymous, a delay may disrupt work and a disruption may delay contract performance. But the damages that flow from delay and disruption are different. Delay damages typically include extended overhead, both in the home office and field; idle equipment during standby; and escalated labor and material costs due to inflation. The damages that flow from disruption are loss of productivity and usually increased labor costs due to inefficiency. To recover delay damages, the contractor must show that the delay extended the project beyond the scheduled completion date or an earlier completion date, if the contractor can prove that it intended to finish early and was prevented from doing so.³²¹ It is not necessary to show that project completion was delayed to establish damages for disruption. The “ripple” effect refers to the impact that one contract has on other contracts and is considered as consequential damages and not recoverable in a suit for breach of contract.³²²

³¹⁸ See *e.g.*, *Manshul Constr. Corp. v. Dormitory Auth. of New York*, 79 A.D. 2d 383, 436 N.Y.S. 724, 730 (1981). Based on proof, the following formula was used: (1) total home office overhead, (2) minus the amount of home office overhead allocated to other contracts, and (3) multiplied by the percentage of the owner's liability as determined by the jury (hence 75 percent) for delaying completion beyond the contract completion date.

³¹⁹ *Melka Marine, Inc. v. United States*, 187 F.3d 1370, 1376–77 (Fed. Cir. 1999).

³²⁰ A changes clause may entitle a contractor to an equitable adjustment for the effect that a change has upon unchanged work. However, under most DSC clauses—an exception is the standard federal construction clause—impact costs are not allowed. See Subsections A and B of § 5, *supra*.

³²¹ See Subsection 5.C.3, *supra*.

³²² *Smith v. United States*, 34 Fed. Cl. 313, 326 (1995). The only federal construction case where “ripple” damages were

The nexus between entitlement and damages is causation. It ties entitlement to damages and establishes the effect that the event had upon contract performance. For example, assume that a highway construction contract provided that a bridge, to be constructed under another contract, would be available to the contractor on September 1. The bridge provides access for grading equipment to the western portion of the project site. The bridge is not available until October 1. The project completion date is extended 1 month. The contractor is on standby during September and has a claim for idle equipment and extended overhead. The three elements of a claim have been established: breach or entitlement (bridge not available on September 1 as promised); damages (extended overhead and idle equipment); and causation (unavailability of the bridge caused the damages. If the bridge had been available, the equipment would have been working, not idle, and the project would not have been delayed).

Now assume that the contractor was tied up on another, separate project and even if the bridge had been available, the project would still be delayed. In short, a concurrent delay³²³ has occurred. The owner delayed the contractor and the contractor delayed itself. Neither party can recover damages from the other for the delay. Assume now that the equipment is on-site on September 1 and goes on standby, but because of heavy rain, part of September is too wet to perform earthwork. Thus, there are some days in September when the equipment would have been idle. Also, the project completion date would have been extended by those days in September that were unworkable. Under this scenario, the owner would only be partially responsible for the delay. A simple case. The only thing that might be in dispute, other than equipment standby rates and overhead damages, is whether certain days were or were not workable. No scheduling analysis is needed to identify concurrent delays and other events that could affect causation.

Now assume that a project involves over 3000 construction activities performed by the general contractor and nine subcontractors. Assume further that the project was scheduled for completion in 2 years but took 3. Assume that the contractor claims: (1) that the project was mismanaged by the owner's construction manager, (2) that the plans contained numerous errors, (3) that DSCs were encountered, (4) that numerous unilateral change orders were issued that remain in dispute, (5) that the owner's representatives were unreasonably slow or missed turn-around dates in reviewing shop drawings and other submittals, (6) that the owner's representatives were unreasonably slow in responding to the contractor's requests for information about plan clarifications, and (7) that there was over-inspection

allowed is Ingalls Shipbuilding Div., ASBCA No.17579, 78-1 BCA ¶ 13,038 (1978). Recovery was permitted only because of the specific language contained in the Suspension of Work clause. *Smith v. United States*, 34 Fed. Cl. at 326.

³²³ See Subsection 5.C.2.C, *supra*.

and other owner interferences with the work. Assume the owner's construction manager denies the contractor's allegations and claims that the contractor's wounds and problems were self-inflicted, (8) assume the owner's architect/engineer (designer) denies that the plans are defective and claims that the requests for information were submitted only to further a claim that the contractor intended to make from the outset of the project, and (9) assume the subcontractors, several of whom have filed bankruptcy, have submitted claims to the general contractor, who has passed them on to the owner.

The claim is for breach of contract, delay, disruption and other impacts on the work, extra work caused by defective plans, DSCs, and remission of liquidated damages. There are also claims for lost opportunities, business destruction, and consultant and attorneys' fees. The contract and the law recognize concurrent delay as a defense to delay claims. The DSCs clause in the contract does not allow impact damages for the effects of the condition upon unchanged work, but changes clauses may allow such damages unless the contract contains a "no-pay-for-delay" clause. This is a large, complex claim and will require a detailed causation analysis using a CPM to assign responsibility for delay, and determine which clause will be enforceable.

7. CPM Schedules

a. CPM Scheduling

A CPM schedule graphically depicts the sequence and duration in which certain work activities must be performed to complete the project within the time specified in the contract. The contractor estimates the order and duration of each important work activity. This estimate is then programmed by a computer, which produces a schedule showing each critical work item. The line on the schedule depicting those activities, their durations, and their interdependencies is the critical path.³²⁴ The critical path is not rigid. It may change as conditions change during contract performance. For example, non-critical items of work may become critical if they are unduly delayed, affecting the critical path.

Originally, CPM scheduling was developed as a management tool to assist both owners and contractors. CPM scheduling allowed contractors to plan and control

³²⁴ *Haney v. United States*, 230 Ct. Cl. 148, 676 F.2d 584, 595 (Ct. Cl. 1982) (describing the critical path method). The durations shown in the schedule to perform critical activities shows early and late starts and early and late finishes for those activities. Any additional or spare time between the time necessary to complete the activity on schedule is usually referred to as float time, but using up the float will not delay the scheduled completion of that activity. One view is that neither the contractor nor the owner own float; it exists for the benefit of the project and is available to either party. The owner can issue a change order, but does not need to grant a time extension if the duration of the float is adequate to cover the change. The contractor can use the float as needed to re-allocate resources.

their work with more precision and reliability than they could using a bar chart.³²⁵ CPM scheduling allowed an owner to determine whether the contractor's plan for performing the work would allow the project to be completed within the time specified in the contract. It also allowed both the contractor and the owner to monitor the work as construction progressed to determine if the work was on schedule and identify potential problems that could delay completion of the project.³²⁶

b. The Use of Scheduling Analysis for Delay and Disruption Claims

CPM scheduling has been used to analyze delay and disruption claims. For delay claims, the contractor has to show that the event causing the delay actually delayed work on the critical path.³²⁷ The schedule analysis focuses on comparing two project schedules: The "as-planned" schedule (the schedule the contractor intended to follow in constructing the project), and the "as-built" schedule, which shows how the project was actually constructed. The comparison identifies project delays. Once delays are identified, the cause of the delay can be analyzed and responsibility for the delay determined. This is the "but-for" schedule, which shows how the project would have progressed had the events causing the delay not occurred.³²⁸ In preparing this schedule, it is necessary to determine what activities have been delayed and the extent of the delays. The analysis should address any concurrent delay.³²⁹ This can be done by identifying delays that are not the owner's fault. The "but-for" schedule must be accurate.³³⁰ Disruption may be proved by a similar analysis. The "as-planned" and "as-built" schedules can be compared to show the difference between how the work should have been performed and how it was actually performed. This allows the analyst to focus on the events that caused the disruption and the extent or duration of the disruption. Scheduling analysis requires the use of experts.

The contract should require the contractor to furnish the owner a complete scheduling and plotting software

³²⁵ Bar charts do not depict the interdependencies between critical activities, a feature necessary in scheduling work in large, complex projects involving numerous activities.

³²⁶ Harp, *supra* note 263, at 35–36.

³²⁷ Neal & Co. v. United States, 36 Fed. Cl. 600, 643–44 (1996).

³²⁸ The as-built schedule is a historical fact. It shows how the project was actually constructed and is prepared from project records and interviews with project personnel. The as-planned schedule is a projection of what the contractor thought would occur with respect to construction of the project, and not a historical fact like the as-built schedule. The but-for schedule depicts how the project would have been constructed but for the owner's delays. See *Youngdale & Sons Constr. Co. v. United States*, 27 Fed. Cl. 516, 550–51 (1993).

³²⁹ Concurrent delay is discussed in § 5.C.2.d.

³³⁰ Edwin J. Dobson, Jr. v. Rutgers, State Univ., 157 N.J. Super, 357, 384 A.2d 1121 (1978).

package used by the contractor in preparing the claim. The contract should provide that the software package is licensable by the owner to avoid copyright disputes. The contract should also require a copy of a floppy disk containing the contractor's progress schedule data files as part of its original schedule submittal. The data files contained in the floppy disk should be sufficiently complete to allow an independent analysis of the schedule using the scheduling software package. A contractor who claims delay damages should be required to show how and the extent to which the critical path was delayed. The owner should be in the position of reviewing whether the claim is supported, and not in the position of trying to determine how the various claim events impacted the critical path. Justifying the claim is the contractor's responsibility, not the owner's. Failure to provide this information should be reason for rejecting the delay claim.

In light of the massive effort of appellant's delay expert (findings 147), appellant clearly could have reconstructed and inputted the change order information at the proper times into the CPM schedule had appellant prepared and maintained proper records as to when the change order and constructive change work had been performed, (finding 167). Appellant's failure to prepare and maintain these records is clearly inexcusable in light of the clear contract requirements that this type of information be provided to maintain the accuracy of the CPM schedule (finding 16 ¶ 1.4 & ¶ 15). Accordingly, appellant's delay claims cannot be granted.³³¹

8. Consequential Damages, Other Costs, and Profit

a. Consequential Damages

When a project is delayed by the owner, the contractor may make a claim for lost profits on other projects that the contractor was unable to bid because of the delay. The contractor may assert that the delayed project tied up its bonding capacity, preventing it from bidding other projects where bonding was required. To support its claim, the contractor may submit a list of projects that it intended to bid, its success rate in submitting winning bids, and its profit history. Generally, such claims are denied as too speculative because they are based on assumptions or possibilities, not probabilities.³³²

³³¹ Santa Fe Eng'rs, ASBCA Nos. 24578, 25838, and 28687, 94-2 BCA ¶ 26,872, at 133, 753 (1994).

³³² *Manshul Constr. Corp. v. Dormitory Auth.*, 111 Misc. 2d 209, 444 N.Y.S.2d 792, 803 (1981) (a case of first impression in New York). See also *Golf Landscaping, Inc. v. Century Constr. Co.*, 39 Wash. App. 895, 696 P.2d 590 (1984); *United States v. Merritt Meridian Constr. Corp.*, 95 F.3d 153, 161 (2d Cir. 1996). In *Manshul Constructions*, the court characterized the contractor's assumptions that it would obtain other contracts and make a profit as wishful and too speculative to stand as a matter of law, 444 N.Y.S.2d at 803–04. See also *Land Movers, Inc. and O.S. Johnson-Dirt Contractors (JV)*, ENGBCA No. 5656, 91-1BCA ¶ 23,317, at 14–15 (1990), (Board said that it was unaware of any Board or federal court decision where

Recovery for lost profits due to lost business opportunities, however, has been allowed when such damages were reasonably foreseen and contemplated by the parties when the contract was made, are a probable consequence of a breach, and can be proven with reasonable certainty.³³³ An owner seeking an order from a court summarily dismissing a lost profits or lost opportunities claim should focus on the remote and speculative nature of such damages, forcing the contractor to show that they were contemplated by the parties when the contract was let, that they are a probable consequence of the breach, and that they can be proven with reasonable certainty. If the contractor cannot make that showing, the claim should be dismissed as a matter of law.³³⁴

Contracts may contain clauses barring consequential damages.³³⁵ Inclusion of this type of clause serves two purposes: First, it bars lost profit claims and other consequential damage.³³⁶ Second, inclusion of the clause clearly establishes that consequential damages were eliminated by the parties as a probable consequence of a breach when the contract was signed. As noted earlier, this is an element (among others) that the contractor must prove to recover lost profits.

b. Financing Costs

In the absence of a clause in the contract or a statute barring recovery, interest paid on money borrowed to finance the work may be recovered, if the contractor can prove that the money was borrowed solely because of owner-caused delays and extra work.³³⁷ To recover, the contractor must show that interest was paid to an in-

consequential damages were allowed); *Zook Bros. Constr. Co. v. State*, 171 Mont. 64, 556 P.2d 911, 918 (Mont. 1976) (loss due to contractor having to sell its equipment not allowed).

³³³ *Hadley v. Baxendale*, 9 Ex. 341, 156 Eng. Rep. 151 (1854); *Lass v. Mont. State Highway Comm'n*, 483 P.2d 699, 704 (Mont. 1971); *Larsen v. Walton Plywood Co.*, 65 Wash. 2d 1, 390 P.2d 677, 687 (1964); *Gouger & Veno, Inc. v. Diamond-head Corp.*, 29 N.C. App. 366, 224 S.E.2d 278, 279 (1976).

³³⁴ *Manshul Constr. Corp. v. Dormitory Auth.*; 444 N.Y.S.2d at 802-04; *Golf Landscaping, Inc. v. Century Constr. Co.*, 696 P.2d at 594-95.

³³⁵ The Standard Specifications used by Colorado (Spec. 109.10 (1999)), Florida (Spec. 5-12.10 (2000)) and Washington (Spec. 1-09.4.4 (2000)) are examples of this type of clause.

³³⁶ The clause may enumerate the kinds of consequential damages that are barred. For example, the Florida Standard Specification (5-12.9) provides that there is no liability for consequential damages including, but not limited to: loss of bonding capacity, loss of bidding opportunities, loss of credit standing, loss of financing, insolvency, loss of other work, cost of financing, and interest paid on money borrowed to finance the job.

³³⁷ *Gevyn Constr. Corp. v. United States*, 827 F.2d 752, 754 (Fed. Cir. 1987); *Bell v. United States*, 186 Ct. Cl. 189, 404 F.2d 975, 984 (Ct. Cl. 1968); *Drano Corp. v. United States*, 594 F.2d 842, 847 (Ct. Cl. 1979); *Westland Constr. Co. v. Chris Berg, Inc.*, 35 Wash. 2d 284, 215 P.2d 683, 690 (1950). *But see* 48 C.F.R. § 102.

dependent entity, such as a bank. In other words, the contractor cannot recover interest on funds that it furnished to itself to finance the extra work or delay costs.³³⁸ The contractor must be able to trace the interest paid for the borrowings,³³⁹ and prove that the borrowed funds were actually used to finance the extra work or delay costs caused by the owner.³⁴⁰ Recovery will be denied if the contractor cannot segregate the interest paid on the borrowings from the interest paid on its general line of credit.³⁴¹

c. Prejudgment Interest

Recovery of prejudgment interest may be allowed when the claim is liquidated³⁴² or sovereign immunity does not apply.³⁴³ Damages are not liquidated where the amount owed requires determination by a jury.³⁴⁴

Prejudgment interest, when owed, runs from the date on which payment is due until it is paid.³⁴⁵ Under the Contract Disputes Act,³⁴⁶ federal agencies are required to pay interest on contract claim settlements or awards from the date the contracting officer receives a properly certified claim until the claim is paid.³⁴⁷ Some states have adopted "prompt payment" acts. Under these acts, a state agency is liable for interest, at a specified rate, if it fails to make a payment due the contractor within 30 days after receiving the contractor's invoice.³⁴⁸

³³⁸ *Gevyn Constr. Corp. v. United States*, 827 F.2d at 753-54.

³³⁹ *Neb. Public Power Dist. v. Austin Power, Inc.*, 773 F.2d 960, 973 (8th Cir. 1985).

³⁴⁰ *Neb. Public Power, id.*; *Cal-Val Constr. Co. v. Mazur*, 636 S.W.2d 391, 392 (Mo. App. 1982).

³⁴¹ *State Highway Comm'n v. Brasel & Sims Constr. Co.*, 688 P.2d 871 (Wyo. 1984).

³⁴² A claim is liquidated when the amount of the claim can be determined without reliance on opinion or discretion, *Simes Constr. Co. v. Wash. Public Power Supply System*, 28 Wash. App. 10, 621 P.2d 1299, 1304 (1980), or by reference to a fixed standard in the contract such as Force Account provisions, *Fiorito Bros. v. Department of Transp.*, 53 Wash. App. 876, 771 P.2d 1166, 1167 (1989).

³⁴³ *Architectural Woods, Inc. v. State*, 92 Wash. 2d 521, 598 P.2d 1372, 1375 (1979). (Sovereign immunity waived by entering into the construction contract). But a state may expressly preclude liability for prejudgment interest. *P.T. & L. Constr. v. State Dep't of Transp.*, 108 N.J. 539, 531 A.2d 1330, 1344 (1987).

³⁴⁴ *Green Constr. Co. v. Kan. Power & Light Co.*, 1 F.3d 1005, 1010 (10th Cir. 1993).

³⁴⁵ *Paliotta v. Department of Transp.*, 750 A.2d 388, 394 (Pa. Commw. 1999); *Department of Transp. v. Anjo Constr. Co.*, 666 A.2d 753, 760 (Pa. Commw. 1995).

³⁴⁶ 41 U.S.C. § 611.

³⁴⁷ *Youngdale & Sons Constr. Co. v. United States*, 27 Fed. Cl. 516, 562 (1993).

³⁴⁸ For example, *see* Alaska Statute § 36.90.200.

d. Bond and Insurance Costs

Increased bond and insurance costs caused by owner delay are compensable³⁴⁹ unless recovery is precluded by a “no-pay-for-delay” clause in the contract.³⁵⁰ Increased bond and insurance costs may be included as part of an equitable adjustment under a changes clause where added work or compensable delay extends the contract’s duration.³⁵¹

e. Attorney Fees

Under the “American Rule,” each litigant bears its own attorneys’ fees.³⁵² However, there are exceptions to the rule. One exception is where the contract allows fees to the prevailing party.³⁵³ Another exception is where fees are allowed by statute.³⁵⁴ In addition to contractual provisions and statutes as grounds for awarding fees, courts have awarded fees based on equity,³⁵⁵ or for federal construction where legal fees are incurred by the contractor as costs of performing the contract, as opposed to costs associated with prosecuting a claim.³⁵⁶ This rule has been applied in state public works disputes.³⁵⁷

f. Claim Preparation Costs

The rule that attorneys’ fees are not allowed in claims against the Government applies to claim preparation costs.³⁵⁸ Legal, accounting, or consulting costs incurred in connection with the prosecuting of a Contract Disputes Act claim are unallowable because they were not incurred to benefit contract performance. However, like attorneys’ fees, consulting costs incurred

during contract performance that result from changes ordered by the Government may be recoverable.³⁵⁹ Alaska follows this view.³⁶⁰

g. Profit and Markup

A contractor is entitled to a reasonable profit on the cost of performing extra work,³⁶¹ even if the original contract price (bid) did not contain any profit.³⁶² The rate of profit allowed may consider the risks and difficulties involved in performing changed or extra work.³⁶³ The contract may specify the profit rate or specifically preclude profit on certain costs, such as delay costs incurred under a Suspension of Work clause.³⁶⁴

A contractor may also recover overhead allocable to direct costs incurred due to owner-caused delays or extra work. Overhead is usually calculated as a percentage of the direct costs, but does not include any recovery for unabsorbed or extended home office overhead. Those costs are calculated separately as discussed earlier.³⁶⁵ A contractor may also be entitled to a markup on the award of extra costs to its subcontractor on a pass-through claim.³⁶⁶

D. CONSTRUCTION CONTRACT LITIGATION: TRIAL PREPARATION AND STRATEGIES

1. Introduction

Construction claims seem inevitable.³⁶⁷ Virtually every construction project has disputes over money, time extensions, or both. The disputes are usually resolved by the parties through negotiations. When they

³⁴⁹ *Luria Bros. & Co. v. United States*, 177 Ct. Cl. 646, 369 F.2d 701 (Ct. Cl. 1966).

³⁵⁰ See § 5.C.

³⁵¹ Harp, *supra* note 262, at 32.

³⁵² *Urban Masonary Corp. v. N&N Contractors*, 676 A.2d 26, 33 (D.C. App. 1996). Alaska follows the “English Rule,” which allows the prevailing party to recover attorneys’ fees from the losing party. *Ryan v. Sea Air, Inc.*, 902 F. Supp. 1064, 1070 (D.C. Alaska 1995) (applying Alaska law).

³⁵³ *Urban Masonary Corp. v. N&N Contractors, id.*

³⁵⁴ Equal Access to Justice Act, 28 U.S.C. § 2412; see *Mega Constr. Co. v. United States*, 29 Fed. Cl. 396, 479 (1993); See also WASH. REV. CODE § 39.04.240 (allows the prevailing party (either the contractor or the agency) to recover reasonable attorneys’ fees in a public works construction contract dispute).

³⁵⁵ *Public Utility Dist. No. 1 v. Kottsick*, 86 Wash. 2d 388, 545 P.2d 1, 3 (1976) (bad faith or wantonness).

³⁵⁶ *Appeal of S & E Contractors*, AEC BCA No. 97-12-72, 74-2 BCA ¶ 10, 676 (1974) at 50,695 (fees allowed when they are a necessary expense in carrying out changes to the contract ordered by the Government). But if the fees are not performance related, they are not recoverable. *Singer Co. v. United States*, 568 F.2d 695, 720–21 (Ct. Cl. 1977).

³⁵⁷ *Anchorage v. Frank Coluccio Constr. Co.*, 826 P.2d 316 (Alaska 1992).

³⁵⁸ *Singer Co. v. United States*, 568 F.2d 695, 720–21 (Ct. Cl. 1977).

³⁵⁹ *Bill Strong Enters. v. Shannon*, 49 F.3d 1541, 1549 (Fed. Cir. 1995). This case traces the history of decisions and regulations addressing the allowability of legal and consulting costs related to federal construction contracts.

³⁶⁰ See *Anchorage v. Frank Coluccio Constr. Co.*, 826 P.2d at 330 (applying the rule in *Singer* that fees incurred in prosecuting a claim that is not associated with contract performance are not recoverable; citing and quoting from a federal Board of Contract Appeals decision); *Fiorito v. Goerig*, 27 Wash. 2d 615, 179 P.2d 316, 319 (1947) (consultant fees not recoverable in the absence of express contractual or statutory provisions permitting recovery).

³⁶¹ *United States v. Callahan Walker Constr. Co.*, 317 U.S. 56, 61, 63 S. Ct. 113, 87 L. Ed. 49 (1942).

³⁶² *Keco Indus., ASBCA 15184*, 72-2 BCA ¶ 9576, at 44, 733-4 (1972) (5 percent profit allowed).

³⁶³ *American Pipe & Steel Corp., ASBCA 7899*, 64 BCA ¶ 4058, at 19,904 (1964).

³⁶⁴ See 48 C.F.R. § 52.242-14(b).

³⁶⁵ See § 6.C.5.d., *supra*.

³⁶⁶ *Pa. Dep’t of Transp. v. James D. Morrison, Inc.*, 682 A.2d 9, 16 (Pa. Commw. 1996). Subcontractor pass-through claims are discussed in § 6 B.4., *supra*.

³⁶⁷ This chapter incorporates *Trial Strategy and Techniques in Contract Litigation*, by K.T. Hoegstedt and Orrin F. Finch, published in SELECTED STUDIES IN HIGHWAY LAW (Transportation Research Board 1979).

are not settled, the next step may be litigation or arbitration.³⁷¹

While the rules for trying cases may vary from jurisdiction to jurisdiction, the litigation process is generally the same in most jurisdictions. The contractor, who is typically the plaintiff, files a complaint in court against the owner for damages.³⁶⁹ The owner files a response in the form of an answer denying the claim.³⁷⁰ The answer may assert affirmative defenses,³⁷¹ which if proven would bar or limit the claim. The answer may also include a counterclaim.³⁷²

Once the case is at issue and the parties have formally stated their positions, pretrial discovery takes place, usually through interrogatories, document production requests, and depositions.³⁷³ In addition, either party may try to narrow the case and define the issues that will be tried through requests for admissions and pretrial orders.³⁷⁴ Pretrial motions may be made to dismiss claims or even to dismiss the lawsuit in its entirety.³⁷⁵ Motions in limine may be made to exclude evidence and prevent witnesses from testifying about matters that are not admissible.³⁷⁶

Consideration should be given to requesting the court to preassign a large, complex construction case to one judge for all pretrial motions and the trial. In some jurisdictions this may be automatic, but in others it may require a motion by the party to have the case preassigned. Consideration should also be given to bifurcating the case into a liability phase and then a damage phase, if liability is found.³⁷⁷ Counsel should consider the use of summaries where the documents are too voluminous to be conveniently examined in court.³⁷⁸ In

complex or extended cases, a trial judge may permit the jurors to take notes. If the jurors are permitted to take notes, the jurors should be instructed by the court to be guided by their own individual recollections of the evidence and not be swayed by one juror who took copious notes. Finally, care should be taken in drafting jury instructions. Jury instructions must do more than just accurately state the law; they must also be understandable. "A charge ought not only be correct, but it should also be adapted to the case and so explicit as not to be misunderstood or misconstrued by the jury."³⁷⁹

When discovery is completed, the case is ready for trial and a trial date is set.³⁸⁰ The keys to success in litigation are often expressed in two words: preparation and credibility. These keys are interrelated. A solid strategy is also important in trying the case. Construction litigation often involves a mass of details and acts that may impact numerous construction activities. It is therefore essential that the case be simplified and presented in a way that will persuade a judge, jury, or an arbitrator that the agency's position is fair and legally correct.

Careful preparation is also important to avoid over-preparing the case, which can waste time and money, and under-preparation, which can be disastrous. The construction trial lawyer should develop a plan at the outset of the case to guide case preparation between these two extremes. The purpose of this subsection is to suggest ways that will assist the trial lawyer in preparing and trying the case. While the focus of this subsection is on defending claims against public owners, much that is said here may also be used by owners in prosecuting claims against contractors.

2. Trial Preparation—Organizing the Case

There are several preliminary steps in organizing the case. The first step is understanding the claim. A good place to start is with the claim that the contractor filed with the agency as part of the administrative claim process.³⁸¹ This is especially true when the contract requires that the claim contain sufficient information to ascertain the basis and the amount of the claim.³⁸² If the claim lacks the required detail, it may be subject to dismissal where compliance with the claims specification is a contractual condition precedent to judicial re-

³⁷¹ See Subsection 6.A, listing the "Final Remedy" established for state transportation agencies.

³⁶⁹ A similar process is used to initiate arbitration. For example, if the contract specifies arbitration by the American Arbitration Association (AAA), arbitration is initiated by filing a demand for arbitration with the AAA.

³⁷⁰ A party may file an answer in response to a demand for arbitration. See Construction Industry Arbitration Rules and Mediation Procedures, Rule R-4(b) (American Arbitration Association 2003) [AAA Constr. Rules]. The Rules may be obtained from the AAA Customer Service Department, 140 W. 51st Street, New York, N.Y. 10020-1203, telephone: (212) 484-4000, fax no: (212) 765-4874. AAA rules are also available on AAA's Web site at www.adr.org.

³⁷¹ Subpart 6.D.6.b *infra* discusses affirmative defenses. The appendix to this Subsection lists affirmative defenses that may apply.

³⁷² See, e.g., FED. R. CIV. P. 13; AAA Constr. Rule R-4(b).

³⁷³ Discovery methods are discussed in Subsection 6.A.4.a.

³⁷⁴ Requests for admission and pretrial motions are discussed in Subsections 6.D.4.a and 6.D.6.c respectively *infra*.

³⁷⁵ See FED. R. CIV. P. 56.

³⁷⁶ See G.O. Kornblum, *The Voir Dire, Opening Statement, and Closing Argument*, 23 PRAC. LAW. No. 7 at 1, 21 (1977).

³⁷⁷ FED. R. CIV. P. 42 and advisory committee note to 1966 amendment.

³⁷⁸ See FED. R. EVID. 1006.

³⁷⁹ DiGioia Bros. Excavating Co. v. Cleveland Dep't of Pub. Util., 135 Ohio App. 3d 436, 734 N.E.2d 438, 453 (1999) (citing *Aetna Ins. Co. v. Reed*, 33 Ohio St. 283, 395 (1878)).

³⁸⁰ In some jurisdictions, a trial date is not set until the parties certify that the case is ready for trial. If the case has been preassigned, a trial date is usually set before discovery is completed. Usually, the court will set a discovery cut-off date some time in advance of the trial date. All discovery must be completed by that date, and extension of the discovery period requires court approval.

³⁸¹ See § 6.A.3., Administrative Claims Procedures and Remedies, *supra*.

³⁸² See generally the discussion of the Florida claims specifications in Subpart 6.A.3.a *supra*.

lief.³⁸³ Another source of information is the complaint, although most complaints contain broad allegations and few specifics. The attorney should also review the final acceptance papers, where the contract requires the contractor to reserve its claims and to release those claims that are not reserved.³⁸⁴

After reviewing the claim documents, the next step is usually a meeting with agency personnel to discuss the claim.³⁸⁵ The meeting has several purposes. The primary purposes are to obtain more information about the claim, help develop the agency's position in the lawsuit, answer questions, explain legal procedures, and explain what will be expected of those involved. A secondary purpose is to refresh and reinforce the knowledge and memories of others through a group discussion. The meeting is also an opportunity for the attorney to make preliminary judgments about whom he or she could call as witnesses in the case.

The meeting should be orderly, but also uninhibited. Project personnel should be encouraged to speak freely, or even refute what others have said when they disagree. This too serves several purposes. First, it provides an opportunity to resolve differing recollections or interpretations of events that occurred during construction. Second, it is also an opportunity to assess the relative merits of the agency's position with respect to the claim. It is far better to learn about problems with the agency's position in a meeting like this than in a deposition or, even worse, at trial.

Consideration should be given to recording the meeting. If the meeting is recorded, the attorney can listen later to the recording with a greater understanding of what was said. Often statements made during a meeting become more meaningful after the attorney has become more familiar with the facts of the case. Normally, conversations between agency personnel and the agency's attorney, in preparation for litigation, should be privileged under both the attorney-client privilege and the attorney work-product privilege. But as a practical matter, the attorney should not automatically assume that such conversations are privileged and therefore immune from discovery. Instead, the attorney should carefully review the prece-

dents of his or her jurisdiction before deciding whether to memorialize conversations in recordings.³⁸⁶

a. *The Claims Summary*

Following the meeting, the attorney should have enough information to develop a "claim summary" for the attorney's trial notebook. The summary should contain the following information and be inserted loose-leaf in the notebook to allow pages to be added or replaced as the attorney becomes more familiar with the facts. The summary may contain:

- A brief description of the project, together with a simple drawing or sketch illustrating the construction features involved in the claim.
- A chronology of the project showing: (1) when the contract was executed, (2) when the contractor was given notice to proceed, (3) when the contractor began work, (4) when substantial completion occurred, and (5) when final acceptance occurred.
- The number of days that the contract overran, if applicable.
- The bid price.
- Significant change orders.
- Time extensions.
- Edition of the Standard Specifications that applies to the contract.
- Significant plan sheets from the contract plans and why they are significant.
- Any amendments to the Standard Specifications.
- Any permits issued by governmental agencies that affect construction.
- Pertinent special provisions.
- A reference to pertinent photos and videos, what they show, and who has custody.
- Significant diary entries, inspector's daily reports, memoranda, and letters identified during the meeting with project personnel.
- List of significant subcontractors and material suppliers who may have information pertinent to the claim, but do not have pass-through claims.
- Job site arrangements, such as material storage areas, haul roads, and access restrictions that may affect construction.
- List of contractor personnel whom agency personnel believe may have information pertinent to the claim and a brief description of what that information entails.
- Significant weather days by date that affected construction.
- Consultants who participated in the preparation or review of the contract plans and specifications, soils reports, and shop drawings, as they pertain to the claim.
- Brief statement of the contractor's position regarding each claim.
- Brief statement of the owner's position regarding each claim.
- Pertinent case law and statutes (citations).

³⁸³ *Metropolitan Dade County v. Recchi Amer., Inc.*, 734 So. 2d 1123 (Fla. App. 1999) (contractor must follow contract claim procedures prior to commencement of suit). The contract should also preclude the contractor from increasing the amount of the claim or the basis for entitlement after the claim has been filed. See Florida Standard Specification 5-12.3 (contractor claim is limited to amount and basis for entitlement that is stated in written claim, and may not be amended in court proceeding or arbitration).

³⁸⁴ California Department of Transportation Standard Specification 9-1.07B (2002) and New York Standard Specification 109-14 (2002) are examples.

³⁸⁵ The meeting often includes a visit to the project site, which is usually helpful in understanding the claim.

³⁸⁶ The subject of attorney-client and work-product privileges is discussed in Subsection 6.D.2.e. *infra*.

- Project personnel and their connection with the claim, general observations about them from the meeting, and their phone numbers and fax number.

Typically, the next step in the process is to file an answer to the complaint. This pleading is the principal vehicle for stating the owner's position in the case. Under most court rules, it must be a section by section response admitting or denying each numbered paragraph of the complaint. The answer may also contain affirmative defenses and counterclaims. Affirmative defenses may include any factual or legal defense that is appropriate.³⁸⁷ Failure to assert a mandatory counterclaim (one involving the same contract that gives rise to the claim) in the answer may waive the counterclaim.³⁸⁸

b. The Litigation Team

There are some initial considerations in organizing the litigation team and developing a litigation plan. Construction litigation can be very expensive. Because it can be so expensive, an owner should consider whether the case can be resolved short of trial through further negotiations or mediation.³⁸⁹ If so, the initial preparation of the case should be limited to those steps necessary for effective mediation. Experts should be retained early, but given limited assignments necessary for the mediation process. Discovery should be limited to a few key depositions, or there even should be a moratorium on depositions, except perhaps for record depositions for subcontractors, suppliers, or other nonparties.³⁹⁰ These steps are important in achieving a cost-effective resolution of the case. If mediation is not successful, then the more expensive and laborious discovery and case preparation can begin. Typically, in a large construction case, the litigation team will be composed of a lead trial counsel, other attorneys as necessary, paralegals, support staff, and experts who can either be in-house experts, retained experts, or both.

c. Locating and Retaining Experts

Most complex construction cases will require the use of expert testimony. Claims consultants are usually retained at an early stage to assist the litigation team in developing an overall trial strategy, as well as assist in more discrete tasks such as developing issues for document coding and assisting in the preparation of discovery requests. The claims consultant can also assist in the selection of other experts needed to cover gaps in the case.

³⁸⁷ The Appendix to this Subsection contains a list of affirmative defenses.

³⁸⁸ See FED. R. CIV. P. 13.

³⁸⁹ Mediation is discussed in § 7.

³⁹⁰ Records can be obtained from nonparties voluntarily or by subpoena duces tecum at a records deposition. Federal Rule of Civil Procedure 45 protects nonparties by requiring them to attend a deposition not more than 100 miles from where they reside, are employed, or transact business in person.

In selecting an expert witness, it is important, even critical, to keep in mind that the expert will probably testify if the case goes to trial. Therefore, the person selected must not only be an expert and qualified to testify, but the expert must be a good witness, someone who will impress the judge or jury. In addition to being credible, the expert should be experienced in litigation and be able to think and handle himself or herself under cross-examination. The expert should be able to present ideas clearly and persuasively in plain language. Ideally, the expert should be able to make the complex simple and readily understandable by a judge or jury. Above all, the expert should be able to present opinions in a comprehensible, convincing, and understandable manner on direct examination and defend them in the same way under hostile cross-examination.

Where do you find a claims consultant to help defend the claim? One source is to ask other lawyers whom they have retained in similar cases. Another source is a national list of construction experts published by the American Bar Association. The list will usually include several attorneys as references. In checking with the references, you should ask each attorney whether the expert testified for that attorney. If not, obtain from the expert the names of attorneys for whom the expert has testified.³⁹¹

Some considerations in retaining an expert include the following. First, always retain the individual who will testify, not a firm that will select the witness. The agreement for consultant services can be with the firm, but the agreement should specify the person that will testify, if requested by the attorney.³⁹² For example, the standard agreement used by the Washington State Department of Transportation provides that, "the Consultant shall designate (*name of expert*) to provide factual and expert consultation to owner and testify as an expert witness, if so designated by owner's counsel." Second, the agreement should also provide that work and work product produced by the consultant shall be deemed confidential until the owner desires to designate the consultant as an expert witness: All information developed by the consultant should be confidential and should not be revealed by the consultant to any other person or organization without the express consent of the owner or by court order.

³⁹¹ M. Beisman, *How To Choose a Construction Expert*, 37 PRACT. LAW. No. 7, at 19 (1991).

³⁹² The agreement for the consultant's services should not state that the consultant will testify as an expert witness, but only that the consultant may be asked to testify if requested by the defendant. To designate the expert as a witness in the agreement, instead of as a possible witness, raises several problems. First, it exposes the expert to being deposed because the expert is not a consulting expert who cannot be deposed until designated as a testifying expert. Second, it provides ammunition for cross-examination: Why did the unbiased expert agree to testify to his or her opinions before the expert even investigated the claim?

d. The Litigation Plan

The litigation plan is an outline identifying the key issues in the case. The issues in the outline are given numbers for use in coding and indexing documents, and form the basis for establishing a method of retrieval. The better and more complete the outline, the more efficient retrieval will be. This portion of the outline should be done by someone who has a good understanding of the case and is thoroughly familiar with a computerized litigation support system. Usually, that person is the claims consultant. At this point in the litigation, a decision should be made whether to retain an outside litigation support firm or use an in-house computer and in-house staff for coding documents with issue numbers. This presupposes that a decision has been made to use a computerized system instead of a manual index and retrieval system. An outside support firm should be used if the agency does not have experience using an in-house computer for litigation support.

The plan should also designate the attorneys and paralegals who will have primary responsibility for certain issues and for gathering and controlling documents. The plan should provide for the development of a standard form for coding and indexing the categories of information that will be stored in the computer. The form should contain a line for a Bates number³⁹³ that has been stamped on each page of each document. The coder reviews a document and fills out the form for entry in the computer. An alternative is use of an imaging system in which documents are electronically scanned and stored on disks for later retrieval.

The plan should also provide for a chart showing various tasks that have to be performed, who is responsible for performing them, and the time allotted for performing each task. The chart can be a simple bar chart, or for the more technically inclined, a CPM chart. But whatever its form, its purpose is to provide direction for the overall team effort in preparing the case. The plan should also contain a budget estimating the cost of case preparation up to the time of trial.

e. Attorney-Client and Work-Product Privileges

The attorney-client privilege is recognized in every state.³⁹⁴ Generally, the privilege applies to conversations between a government entity to the same extent that privilege would apply between a private entity and

³⁹³ Each category in the database is represented by an eight digit number that is consecutively numbered. These numbers, which identify all documents in the computer by category, are commonly known as Bates numbers. The numbers can be coded to identify the type of document, the source from which it was obtained, the importance of the document, and whether the document is privileged. For example, all documents in the 10000000 series may be coded as contractor's documents, all documents in the 20000000 series as owner's documents, and all documents in the 30000000 series as designer (A/E) documents.

³⁹⁴ *Ford Motor Co. v. Leggat*, 904 S.W.2d 643, 647 (Tex. 1995).

its attorney.³⁹⁵ The cases recognize "the need of the government client for assurance of confidentiality equivalent to a corporation's need for confidential advice."³⁹⁶ However, scholarly opinion is divided with respect to whether government entities should have the privilege.³⁹⁷

The work-product privilege protects an attorney's efforts in preparing a case for litigation.³⁹⁸ The privilege extends to confidential communications between the employees of a corporation and the corporation's attorneys, where such communications are necessary in enabling the corporation to obtain legal advice and prepare for litigation.³⁹⁹ The work-product privilege, like the attorney-client privilege, has been extended to government entities.⁴⁰⁰ The privilege protects communications between an attorney and a consulting expert who will not be called to testify at trial.⁴⁰¹ But the privilege is waived when the expert is identified as a witness who will be called to testify,⁴⁰² or when the consulting expert's report is provided to a testifying expert.⁴⁰³

³⁹⁵ *California: People ex rel. Dep't of Public Works v. Glen Arms Estate, Inc.*, 230 Cal. App. 2d 841, 854, 41 Cal. Rptr. 303 (1964); *New Jersey: Matter of Grand Jury Subpoenas Duces Tecum*, 241 N.J. Super. 18, 574 A.2d 449, 454 (1989); *New York: Mahoney v. Staffa*, 184 A.D.2d 886, 585 N.Y.S.2d 543, 544 (1992); *Ohio: State ex. rel. Thomas v. Ohio State Univ.*, 71 Ohio St. 2d 245, 643 N.E.2d 126, 131 (1994); *Washington: Amoss v. University of Wash.*, 40 Wash. App. 666, 700 P.2d 350, 362 (1985); *see also Coastal States Gas Corp. v. Department of Energy*, 617 F.2d 854, 863 (D.C. Cir. 1980); *Roberts v. City of Palmdale*, 5 Cal. 4th 363, 20 Cal. Rptr. 330, 853 P.2d 496 (1993) (privilege extended by statute to public entity).

³⁹⁶ *Matter of Grand Jury Subpoenas, id.* at 455.

³⁹⁷ *See L.A. Barsdate, Attorney-Client Privilege for the Government Entity*, 97 YALE L. J. 1725 (1988); Note, *The Applicability and Scope of the Attorney-Client Privilege in the Executive Branch of the Federal Government*, 63 B.U.L. REV. 1003 (1982).

³⁹⁸ *Hickman v. Taylor*, 329 U.S. 495 (1947); FED. R. CIV. P. 26(b).

³⁹⁹ *Upjohn Co. v. United States*, 449 U.S. 383 (1981); STRONG, MCCORMICK ON EVIDENCE, 87-1, at 320 (4th ed. 1992).

⁴⁰⁰ L.M. Cohen, *Expert Witness Discovery Versus the Work Product Doctrine: Choosing a Winner in Government Contracts Litigation*, 27 PUB. CONT. L.J. 719 (1998); *see also State ex rel. State Bd. of Pharmacy v. Otto*, 866 S.W.2d 480 (Mo. App. W.D. 1993).

⁴⁰¹ *Crenna v. Ford Motor Co.*, 12 Wash. App. 824, 532 P.2d 290 (1975) (non-testifying expert's opinion not discoverable based on superior court rule that mirrors FED. R. CIV. P. 26(b)(4)(A)); *Morrow v. Stivers*, 836 S.W.2d 424 (Ky. App. 1992).

⁴⁰² *Karn v. Ingersoll-Rand*, 168 F.R.D. 633, 635 (N.D. Ind. 1996) (information given by an attorney to an expert witness had to be disclosed; disclosure could not be avoided by claiming that the information was work product).

⁴⁰³ *Heitmann v. Concrete Pumping Machinery*, 98 F.R.D. 740,742 (E.D. Mo. 1983).

3. Gathering and Managing Documents

There are several keys to the successful preparation of a large construction case. You must understand the claim, you must have a theory as to why the claim is not valid, you must have the facts to support your theory, and you must have the resources to prove those facts. This subsection focuses on obtaining documents and then organizing them so that they can be retrieved from storage, as needed, in an orderly and efficient manner for use in defending the claim.

Generally, the facts about what occurred during a construction project are found in two places: the recollections of personnel associated with the project and the project documents. Organizing and managing documents is often the most time consuming and laborious task in case preparation. This subsection offers some suggestions about where to obtain project documents and what to do with them once they are obtained.

a. Gathering Documents

Where do we get documents? The answer seems obvious: from the contractor, first, and lower tier subcontractors and materialmen that have pass-through claims or whom we suspect may have useful information. Other obvious sources are the agency's own records and those of its design consultant, if the claim is based on defective plans and specifications. Obtaining records from this latter source may require a decision by the agency as to whether it intends to make a claim against the designer for indemnification. Designers are usually reluctant to open their records to inspection by someone who intends to sue them. Often, the designer will want to know, early in the case, what the agency's position is on that issue.

Another obvious source is the records of the contractor's claim consultant, especially the software used by the consultant to generate "as-built," "as-planned," and "but-for" schedules to support delay and impact claims. The contract should require the submission of this type of information as part of the administrative claims process. If not, then this information probably cannot be obtained until the consultant is designated as an expert witness. When that designation is made, the consultant's work product is discoverable.

There are, however, some less obvious sources of information. For example, ask the project office if the contractor obtained any documents from the agency before the lawsuit or even the claim was filed. The agency should have a policy of making a copy of or keeping a record of every document furnished to the contractor after a claim has been made or a dispute has arisen. If the agency did not keep a record or copies, the information will have to be obtained through discovery, usually through an interrogatory. Counsel for the agency should contact FHWA to see if the contractor has obtained any documents from that agency through

the Freedom of Information Act (FOIA).⁴⁰⁴ Counsel should also contact other federal regulatory agencies such as the Coast Guard, the Army Corps of Engineers, or the Department of Labor about documents obtained from them under FOIA requests, when the claim involves actions by these agencies or involves matters within their jurisdiction.

Another source of information is the performance bond surety. The surety may require a contractor to make a report to the surety about the project and the contractor's basis and evaluation for claims that it has against the owner. Counsel should request the surety to furnish the information without having to resort to a subpoena duces tecum. Counsel should also check with local regulatory agencies about any documents that the contractor may have obtained from them. Counsel should also contact other bidders to see how they bid the work and if they are willing to help.

Usually other bidders or contractors on the project are reluctant to get involved, but not always. For example, in one case the second bidder testified for the State of Washington that in making its bid it included the cost of reinforcing steel bars in certain precast concrete members, even though steel bars were not shown in the plans. The contractor, who was the low bidder, claimed that it did not include the cost of steel bars in its bid because they were not shown on the plans, and that bars had to be used to prevent the concrete members from cracking when they were removed from the concrete forms. The contractor claimed additional compensation for the steel and other damages. The representative of the second low bidder was a powerful witness. His testimony helped persuade the judge that the cost of steel was incidental and should have been included in the bid price because the members could not be made without steel, and that the contractor, as an experienced concrete fabricator, should have known this.

b. Organizing the Documents

Once the documents are gathered, they can be photocopied, microfilmed, or imaged. Under this latter process, each document page is placed on a scanner, which takes an image of the document, similar to a photocopier, and stores the image on a disk. Documents that have been microfilmed can be reproduced as hard copies.

There are, however, certain steps that should be taken before the documents are stored and organized for later use. The first step is to stamp an identifying eight-digit number on the lower right hand corner of each page of each document.⁴⁰⁵ After the documents

⁴⁰⁴ 5 U.S.C. § 552; *see also* O.F. FINCH and G. A. GREEN, FREEDOM OF INFORMATION ACTS, FEDERAL DATA COLLECTIONS AND DISCLOSURE STATUTES APPLICABLE TO HIGHWAY PROJECTS AND THE DISCOVERY PROCESS (National Cooperative Highway Research Program Legal Research Digest No. 33, 1995).

⁴⁰⁵ *See* note 393 *supra* describing the Bates numbering system.

have been stamped, they should be put in chronological order. Once documents are arranged in chronological order, the next step is to develop a working set that can be used for coding the documents. This involves two more steps. The first task is to cull duplicate copies. Care must be taken in performing this task. Only duplicate copies that are identical are removed. If one copy of a memorandum is clean and the other copy has marginalia, they are not duplicates, they are separate documents. Once duplicate material is culled from the working set, the next step is to eliminate documents that clearly have nothing to do with the lawsuit. Irrelevant documents, however, should not be discarded. They should be kept in separate, chronological files in case they become relevant.

The next step in the development of a database is the method used to store and retrieve the documents in the working set. The traditional way is to store hardcopies in notebooks in numerical order and put the notebooks on shelves in the document repository. The latest method of storing and retrieving documents is imaging, or scanning the documents onto disks. The image produced by the computer on a screen or by a printer is an exact reproduction of the original document, including all notations or other marginalia. Imaging eliminates storage problems. Its disadvantage is that it is more expensive than photocopying. Its advantage is decreased storage space and greater efficiency. As technology improves, the cost of imaging should become cheaper.

The final step is to index the documents for later retrieval. Indexing can be done either by computer or manually.⁴⁰⁶ The index should contain fields that identify the issues, the individuals, and the events and transactions that are important to the case. Indexing involves objective and subjective coding. The coding sheet used by the coder for objective coding typically contains the following fields of information.⁴⁰⁷

- Document Number. These are the Bates numbers stamped on the first and last page of the document. If the document is one page, only one number is used.

- Date of the document.
- Author.
- Recipient.
- Persons mentioned in the document text.
- Carbon copy recipients.
- Document type (letter, memo, diary, etc.).
- Coder.

The coding sheet may also contain fields that relate to the interpretation of a document and its relevance to the case. This involves subjective coding and may include the following fields:

⁴⁰⁶ If a manual system is used, issue books can be prepared that contain all documents that pertain to each issue or to a particular witness. Documents pertaining to more than one issue or witness can be cross-referenced in the issue book.

⁴⁰⁷ The information is objective because it can be gleaned from the document by the coder without interpretation or analysis.

- Issue(s).
- Priority (routine; hot, i.e., extremely important to the case).

- Privileged. This should identify the type of privilege involved, attorney-client, and work-product. This is useful in responding to an interrogatory asking about documents that have been withheld from production to opposing counsel and the basis for the privilege.

- Summary. This section allows the reviewer to make an abstract or summary of the document. Generally, use of this field is discouraged since the attorney will read the document. Thus, a summary in view of the time and expense to make it is usually not worthwhile.

Caution should be taken not to use too many codes, particularly issue codes. If the database becomes too complicated, it will be difficult to work with and may even fail. Access to the computer should be limited to only those who have been given passwords. Subjective coding should be done by personnel who are knowledgeable about the case and the issues.

Optical Character Recognition (OCR) is another technological feature that can be used for document control. This process can be used with documents that contain a substantial number of pages. Although each page is imaged, OCR reviews only those pages that relate to a certain subject or a particular item. OCR allows the computer to locate the specific information within the document and make it readily available for review. Once the information is coded and stored in a computer database, the system will search, sort, and provide specific information. The system can search large volumes of information in a very short period of time. It can list all documents a particular person authorized or received regarding a certain topic during a particular time frame. This is very helpful in preparing a person for his or her deposition. The computer has a perfect memory. It can access any information stored in the system. If used properly, the computer can be a great tool; if used improperly, it can be a disaster. Thus, certain things should be carefully considered before creating a litigation support system. They include:

- What information will you want from the computer system? The information the computer provides is only as good as the information given it.
- How much will the system cost? Is the cost justified in light of what is involved in the case?
- Should the claims consultant manage the documents? If not, is the agency's system compatible with any system that the consultant may be using?

Control and management of the opponent's documents involves the same process used to manage your own documents. However, there are some things that should be kept in mind. If your opponent will be numbering its documents, try to agree on a numbering sequence that does not conflict with your numbering system. If your opponent does not intend to number its documents, request permission to number them when they are reviewed. Numbering the documents is a good way of keeping track of whether all documents are produced. Review the production of the opponent's docu-

ments carefully to determine whether any documents are withheld. If you are not permitted to number the documents, make an inventory of what was reviewed. This can be done with a dictating machine. If the agency and the contractor have the same document in their files, do not treat them as duplicates. Both should be put in the database. The Bates number will identify the source of the document.⁴⁰⁸ Fields can be added to the database that relate specifically to the opponent's documents, such as the date it was produced, and whether it was part of an original production or identified in an interrogatory answer and then later produced.

The time, effort, and money spent in developing the database is wasted if the information contained in the database cannot be retrieved quickly. It is important to design the system correctly. Redesigning the system or trying to patch it up later with bandaids can be expensive and delay trial preparation.

When the records of the contractor or any adverse party are made available for inspection, they should be copied rather than simply inspected. It is often difficult to determine, in a quick inspection, the significance of a particular document. Documents that may have appeared insignificant earlier may become significant as more information is developed about the case. Technical assistance may be obtained from consultants about the types of documents that should be inspected. This information should be included in the litigation plan. This plan should list each claim, the information needed from the contractor to analyze the claim, the methodology that will be used to analyze the claim, the estimated number of hours that are needed to perform the analysis, the priority given to the task, and whether the documents have been produced. The information can be shown in a spread sheet format as follows:

⁴⁰⁸ See *supra* note 393.

Claim	Analysis	Estimate of Hours	Priority	Documents Required	Documents Produced
Home Office Overhead	1. Analyze General Ledger Cost Data	100	High	1. General Ledger	1. Yes
	2. Analyze Home Office Overhead Costs and Make Adjustments for Costs That are Not Time Related or Do Not Correspond to the Claimed Delay Period			2. Contractor's Explanation of Corporate Overhead Allocations in Claimed Overhead Pool	2. No
	3. Prepare a Revised Home Office Overhead Rate Per Calendar Day to be Applied to Allowable Delay Days			3. Inquiries to Contractor about Certain Costs.	3. No

Counsel should try to obtain documents from the opposing party and from third parties by agreement. Counsel should seek advice from the retained consultants in identifying documents that should be sought. The experts will use the right nomenclature in identifying documents, avoiding disputes over what is being requested. Counsel should insist that all documents withheld under a claim of privilege be identified together with the basis for the privilege. If opposing counsel refuses, this information can be obtained by interrogatories. Whether the privilege is valid or not can be tested by a motion to compel production of the document and, if necessary, by an in camera inspection of the document by the court.⁴⁰⁹ Counsel for the owner should also arrange, if possible, for the financial experts to review the contractor's cost records. Similar arrangements should be made with subcontractors who have pass-through claims. Once informal discovery is exhausted, formal discovery should begin.

4. Formal Discovery

Aside from depositions, discussed later, the principal discovery methods are interrogatories (written questions to your opponent) and requests for production of documents. Also, requests for admission may be used to narrow issues, eliminate having to offer evidence to prove certain facts, authenticate documents, and establish a foundation for dispositive motions.

a. Interrogatories

Interrogatories should be carefully drafted. Routine use of form or boilerplate interrogatories should be discouraged. Form interrogatories should be used mainly as a guide in organizing and drafting interrogatories that are tailored to the case. The interrogatories or questions should be simple, easily understood, and in plain English. Technical terms used in the questions should be defined in the definitional section of the preface or introduction to the interrogatories. Compound

questions and questions with qualifying subordinate clauses should be avoided. Simple, declaratory sentences should be used. This avoids objections and makes the use of the interrogatories at trial more effective. Each question should be followed by an appropriate space for the answer.

Using numerous subparts for the answers can be confusing. The better practice is to have individual questions and individual spaces for each answer.

The interrogatory set should contain a preface. The preface should provide definitions and instructions that are to be used in answering the questions. Careful preparation of the preface helps reduce objections and may be useful at trial in excluding documents that were not identified in the answers. Thus, a broad, all encompassing definition of the terms "documents" and "identify" will help eliminate an argument about whether an interrogatory called for identification of a particular document or a particular person.⁴¹⁰

Interrogatories can be used to obtain information about the allegations in a complaint. Each allegation in the complaint can be broken down into a series of questions asking about the facts upon which the allegation is based, the events relating to the allegation, the identity of persons who have knowledge of those facts, the identity of documents containing information about those facts, and the identity of persons who have custody of those documents.⁴¹¹

Interrogatories can be used to explore a party's opinions or contentions that relate to facts or the application of law to fact.⁴¹² Contention interrogatories can be written in different ways. These include: (1) asking the opposing party to state all facts upon which it bases some contention; (2) asking the opposing party to ex-

⁴¹⁰ R.M. Gelb, *Standard Paragraphs in Interrogatories*, 28 PRAC. LAW. No. 4, at 51 (1982). This article contains suggestions on how to draft interrogatories, regardless of the subject matter of the litigation. It also offers examples of introductory language and definitional sections that can be used in drafting interrogatories.

⁴¹¹ FED. R. CIV. P. 26(b)(1).

⁴¹² FED. R. CIV. P. 33 advisory committee note.

⁴⁰⁹ 8 WIGMORE, EVIDENCE § 2322 (rev. ed. 1961).

plain how the law applies to the facts; or (3) even asking the opposing party to state the legal basis for its contentions.⁴¹³ A party, however, may be able to defer answering contention interrogatories if the party can show that such interrogatories are more properly answered at or near the end of the pretrial phase of the litigation.⁴¹⁴ Thus, under some liberal discovery rules, an opponent may be compelled to disclose the legal as well as factual basis for its claims.⁴¹⁵

Interrogatories can be used to require the opposing party to identify expert witnesses whom it intends to call at trial and the subject matter on which the expert is expected to testify.⁴¹⁶ This information, provided in the answer to the expert witness interrogatory, can be explored in detail when the expert is deposed.

The basic function of interrogatories is to provide facts, identify persons who have knowledge concerning those facts, and identify documents containing information about those facts. They can be used for specific purposes, such as inquiring about whether certain documents have been lost or destroyed and how damages were calculated. But beyond these uses, the effectiveness of interrogatories is limited. This is so for one basic reason: lawyers write the answers to interrogatories, not witnesses. Keeping this limitation in mind, the number of interrogatories that a party can serve is limited by the federal rules and may be similarly limited by state or local court rules as well.⁴¹⁷ Ordinarily, the limitation on the number of interrogatories that is permitted by rule cannot be avoided through the use of numerous subparts.⁴¹⁸

When interrogatories are received, they should be promptly reviewed to determine if any are objection-

⁴¹³ *McCormick-Morgan, Inc. v. Teledyne Indus.*, 134 F.R.D. 275, 286, *rev'd in part on other grounds*, 765 F. Supp. 611 (N.D. Cal. 1991).

⁴¹⁴ *Id.*

⁴¹⁵ FED. R. CIV. P. 33(b) advisory committee note; *McCaugherty v. Sifferman*, 132 F.R.D. 234, 249 (N.D. Cal. 1990).

⁴¹⁶ FED. R. CIV. P. 33(c); *see also* FED. R. CIV. P. 26(b)(4)(A).

⁴¹⁷ FED. R. CIV. P. 33(a) (limiting number of interrogatories to 25); *Clark v. Burlington Northern R.R.*, 112 F.R.D. 117, 119 (N.D. Miss. 1986) (rule is designed to eliminate the previously common practice of serving sets of interrogatories consisting of hundreds of unrelated and mostly irrelevant boiler plate or form interrogatories).

⁴¹⁸ Some local rules specify that "subparts" are to be counted. *See, e.g., Armstrong v. Snyder*, 103 F.R.D. 96, 103 (E.D. Wis. 1984). *But see Clark, id.* at 118 (court considered subparts to be so integrally related as to make up single question); *Myers v. U.S. Paint Co.*, 116 F.R.D. 165 (D. Mass. 1987) (court declined to mechanically count each subparagraph as a separate interrogatory). Whether the subparts count as individual interrogatories will generally depend on whether the subparts bear any relationship to the primary question or to each other. *Myers*, 116 F.R.D. at 165. Also, local rules may provide for counsel to stipulate to a greater number of allowable interrogatories. *Armstrong*, 103 F.R.D., at 104 (citing E.D. Wis. L.R. 7.03).

able. In most jurisdictions, failure to serve objections within a specified time period waives the objection.⁴¹⁹ In addition to specific objections to specific interrogatories, counsel should consider making general objections, as appropriate. The following are some examples of general objections.

- Defendant objects to these Discovery Requests to the extent that they may be construed as calling for information or documents subject to a claim of privilege or otherwise immune from discovery, including, without limitation, information protected by the attorney-client or work-product doctrine.

- Defendant objects to these Discovery Requests to the extent that they seek facts, documents, and/or information already known to plaintiff.

- Defendant objects to providing confidential or proprietary information or producing documents that contain such information until a properly framed protection order is entered.

- Defendant objects to the "Definitions and Instructions" to the extent that they call for information from individuals or entities over whom the defendant has no control. Defendant further objects to the discovery requests as oppressive, unduly burdensome, and not reasonably calculated to the discovery of admissible evidence.

A common practice for answering questions that are marginally objectionable is to couple the answer with an objection. This does two things: First, it preserves the objection for trial. If the objection is sustained, the answer cannot be used in the trial.⁴²⁰ Second, it avoids raising the ire of the court in having to rule before trial on an objection that is marginal.

Federal Rule of Civil Procedure 33(d) allows a party to produce its business records in response to an interrogatory when the answer to the interrogatory may be found in the records and "the burden of deriving or ascertaining the answer is substantially the same for the party serving the interrogatory as for the party served." To avoid Rule 33(d) and obtain complete answers, the party serving the interrogatory must show that the burden of deriving the information from the records is heavier on it than on the other party.⁴²¹

b. Request for Production of Documents

When documents cannot be obtained on a voluntary basis, they may be obtained from a party to the lawsuit through a request for production of documents,⁴²² and from nonparties by a subpoena duces tecum.⁴²³ In re-

⁴¹⁹ FED. R. CIV. P. 33(b)(4).

⁴²⁰ Interrogatories may be used as evidence at trial. FED. R. CIV. P. 33(c). They can be read to the jury or read by the judge in a bench trial.

⁴²¹ *P.R. Aqueduct & Sewer Auth. v. Clow Corp.*, 108 F.R.D. 304, 307 (D.P.R. 1985) (citing former FED. R. CIV. P. 33(c)); *see also Daiflon, Inc. v. Allied Chemical Corp.*, 534 F.2d 221 (10th Cir. 1976).

⁴²² FED. R. CIV. P. 34.

⁴²³ FED. R. CIV. P. 45(a).

requesting documents, a party should try to specify particular categories of documents, rather than a broad request for all documents. Usually, this type of request will be met with a response that documents not privileged will be available for inspection and copying on a certain date and at a certain place during normal business hours.

The request should specify that the documents are to be produced in their original files in the manner in which they are kept. The request should require identification of all documents that are not produced. The request can be accompanied by an interrogatory requiring that for each document not produced, the party must identify: (1) the type of document withheld; (2) the date, author, and addressee of the document; (3) the general subject matter of the document; (4) the identity of any persons copied;⁴²⁴ and (5) the type of privilege asserted. The privilege can be tested by a motion to compel production of the document.

Information about what to ask for can be obtained from the consultants. In addition, the litigation plan should list the documents that should be obtained. The plan can be updated as documents are obtained, allowing counsel to keep a running record of what has been produced and what still has to be obtained.

c. Requests for Admission

Requests for admission require an opponent to admit or deny a particular fact or contention.⁴²⁵ Like interrogatories, requests for admission should be simple, straightforward, and clear. Each request should deal with a single fact or contention and be worded so that the response must either admit or deny the fact or contention.⁴²⁶ Requests for admission can be used to establish a foundation for a dispositive motion⁴²⁷ or a partial summary judgment.⁴²⁸ Requests for admission can be used to authenticate documents attached to the request and to establish documents as business records. The

⁴²⁴ Disseminating the document to someone outside the scope of the privilege may waive the privilege. *Ulibarri v. Superior Court*, 184 Ariz. 382, 909 P.2d 449, 452 (1995).

⁴²⁵ FED. R. CIV. P. 36.

⁴²⁶ *Id.* A party may recover its costs in proving a fact or contention that was denied. FED. R. CIV. P. 37(c)(2).

⁴²⁷ For example, a request for admission could be used to establish as a fact that the contractor failed to provide written notice of its intention to file a claim before proceeding with what it claims was extra work. That failure can then be the basis for dismissal of the claim. *A.H.A. Gen. Constr., Inc. v. N.Y. City Housing Auth.*, 92 N.Y.2d 20, 677 N.Y.S.2d 9, 699 N.E.2d 368 (1998); *Absher Constr. Co. v. Kent Sch. Dist.*, 77 Wash. App. 137, 890 P.2d 1071 (1995) (summary judgment granted dismissing claim).

⁴²⁸ *Kiewit-Grice v. Wash. State Dep't of Transp.*, Thurston County Superior Court No. 89-2-02756-6 (1989) (partial summary judgment granted limiting damages claimed in the lawsuit to the amount reserved in the final contract estimate, even after contractor denied in its response to a request for admission that its claim was so limited).

contents of writings and photographs may also be proved by written admissions.⁴²⁹

Under the Federal Rules of Civil Procedure, requests for admission can be used as a discovery device concerning the opposing party's theories. Requests for admission concerning contentions that relate to fact or the application of law to fact are permitted.⁴³⁰ Requests that are denied should be followed up with interrogatories asking for the basis of the denial.⁴³¹

d. Depositions

Depositions are important in case preparation and trial strategy. Counsel can learn from the witness (lay or expert) what the witness's testimony will be at trial. If the witness changes the testimony at trial from what was said in the deposition, the inconsistent statements can be used to impeach the witness. Depositions are also an opportunity to try and elicit admissions from the opposing party or its managing agents, which can be used at trial as substantive evidence. Preparing for and defending the deposition are equally important. Inadequate witness preparation or failure to protect the witness from unfair or abusive questioning can have serious consequences. Depositions, like most things, have two sides: one side is taking the deposition, the other is defending it.

i. Taking the Deposition.—Depositions can be expensive. The party taking the deposition (the interrogator) usually pays an hourly attendance fee for the court reporter, and if the deposition is ordered, pays in addition a set amount per page for the original and for a copy.⁴³² Any party may order the deposition or a copy.⁴³³ If an expert is being deposed, the party taking the deposition customarily pays for the expert's time at the deposition and the time spent that was reasonably necessary in preparing for the deposition. Travel expenses may be involved if the expert has to travel to the place where the deposition is taken.⁴³⁴ Because depositions can be expensive, the first considerations should be: "Why am I taking this deposition?" and "What do I hope to ac-

⁴²⁹ FED. R. EVID. 1007.

⁴³⁰ FED. R. CIV. P. 36(a).

⁴³¹ *Id.* At one time, a common practice was to combine requests for admission with interrogatories. The interrogatory following each request asked why the request was denied. Some jurisdictions prohibit combining requests for admission and interrogatories in a single pleading, because if admissions are not denied within the 30 days allowed for response, they are deemed admitted. *See, e.g.*, FED. R. CIV. P. 36(a). Where the practice of combining them is prohibited, denials can be followed up in a separate set of interrogatories.

⁴³² Some reporters may waive the appearance fee if the deposition transcript is ordered.

⁴³³ Usually, the party defending the deposition does not order the deposition, but will order a copy of the deposition if it is ordered by the opposing party.

⁴³⁴ Where both sides have the same number of experts, the parties may agree to pay for their own expert's time and travel costs.

comply?" The usual answer is knowledge about what the witness will say at trial and the ability to pin down the witness to a particular story, so that if the testimony at trial varies from that story, the deposition can be used to impeach the witness. But depositions can also be used to learn about potential witnesses, about documents that have not been produced, and about events that may bear on liability or damages. Depositions may be used to perpetuate testimony for use at trial for a witness who will not be able to testify in person. Depositions, under rules similar to Federal Rule of Civil Procedure 30(b)(6), also allow a party to obtain information from a representative of an organization concerning particular matters.⁴³⁵ Depositions are the only method of obtaining information from a nonparty who is unwilling to cooperate.

Once the decision to take the deposition is made, the next step is to develop a deposition outline. The outline should focus on the objectives in taking the deposition and be divided into topics, in order of importance. Each topic should identify the points that the interrogator wishes to establish with the witness. Evidentiary gaps that need to be filled in should be highlighted in the outline. Avoid an outline that always proceeds in chronological fashion or that always begins with the witness's educational background and work experience. Consider varying the approach to catch the witness off guard. Avoid questions about facts that have been clearly established in interrogatory answers, unless there is something to be gained by asking about them. Interrogatory sets verified by the deponent should be used to develop facts further, as appropriate. This is especially true in depositions of expert witnesses. The standard interrogatories dealing with the expert's opinions and the facts upon which those opinions are based provide a good segue for detailed questioning about the expert's opinions.

Few depositions in construction cases are conducted without the use of documents. The documents that will be used in a deposition should be arranged to avoid having to shuffle through them during the deposition. One method is to keep each exhibit in a separate labeled folder. The documents can be premarked as exhibits by the court reporter in advance of the deposition,⁴³⁶ and each folder can be numbered with the

⁴³⁵ FED. R. CIV. P. 30(b)(6) requires the entity to designate one or more persons to testify about the matters listed in the subpoena.

⁴³⁶ Numbering of deposition exhibits should be consecutive throughout all depositions by all parties. Counsel should stipulate to this procedure at the first deposition. For example, the exhibits used in the deposition of Ms. X taken by the contractor should be marked No. 1 through No. 20. The exhibits taken in the next deposition taken by the owner would be marked beginning as No. 21 through 40. The first exhibit in the third deposition would be marked No. 41 and so on. Consider using one court reporter or court reporter service for all depositions. This allows the court reporter to have a master deposition list that can be brought to every deposition allowing the witness to be shown a document marked as an exhibit

exhibit number and arranged in chronological order. Each folder should contain the exhibit that will be handed to the witness and retained by the court reporter, a courtesy copy for opposing counsel, and a working copy for the interrogator. The exhibit number can be keyed into the deposition outline under the appropriate topic. The interrogator's working copy can contain notes and questions about the document. This allows counsel to focus entirely on the working copy in asking questions, avoiding having to skip back and forth between the outline and the document. This makes the examination smoother and more effective and helps reduce mistakes and confusion.

Another cost saving device, for out-of-state witnesses or witnesses in other cities, is the use of telephone depositions. Telephone depositions are cost-effective when it is not important to observe the witness's demeanor or to confront the witness face-to-face. Video-taped depositions should be considered when the witness will not be available to testify at trial, and the witness's appearance and demeanor will be impressive.⁴³⁷

Usually, the depositions of persons who will be called to testify at trial as experts are deferred until all other discovery has been completed. Scheduling depositions can be done either informally by agreement of counsel, or by an order establishing a discovery schedule. If an order is entered, it should require that the depositions of expert witnesses will be completed by a specific date, and further provide that all experts must formulate the opinions, to which they will testify, prior to the date of their depositions.

The order should also address the situation where the expert changes his or her opinion after having been deposed. The order can provide that if that occurs, the opposing party must be notified of the change, and be allowed to take a supplemental deposition with respect to the changes. The order should also prohibit any further changes in the opinion after a specified date, unless the party can show good cause as to why the change should be allowed.

The attorney should prepare for the expert's deposition by educating himself or herself about the subject matter. Consult your own expert who can educate you in the "basics" of the subject and provide you with questions to ask and why they should be asked. This will prepare you to ask follow-up questions. Talk to other lawyers about their experiences with the witness. Review any articles or other written materials authored by the expert. Review any depositions and trial testimony transcripts that other attorneys have and are willing to share.

in an earlier deposition. By agreeing on one reporter for all depositions, the parties can obtain competitive bids from court reporters and save money.

⁴³⁷ See generally D.R. SUPLEE & D.S. DONALDSON, *THE DEPOSITION HANDBOOK* (3d ed. 1999).

Consider the place where the deposition should be held. Usually, the best place to take the expert's deposition is at the expert's office. This allows greater access to the expert's work file and eliminates any excuse by the expert for inadvertently leaving part of the expert's work file back at the office. If the deposition is not held at the expert's office, consider serving a subpoena duces tecum upon the expert to bring the case file to the deposition, including all written instructions, information, and requests that he or she was given relating to the case.⁴³⁸ The subpoena duces tecum should also require the expert to bring materials of any kind used by the expert, or by anyone who assisted the expert.

The primary purpose in taking the expert's deposition is discovery. A secondary purpose is to impeach the witness when his or her testimony during the trial differs from what was said in the deposition. The statements in the deposition that the expert later contradicts are usually in response to questions furnished by the interrogator's expert. Therefore, it is important to write down questions given to you by your expert and ask them exactly as they are written. Aside from potential impeachment questions, and other questions given to you by your expert, you should ask broad, open-ended questions that are designed to obtain information. The attorney should not worry that the answers may hurt.⁴³⁹ It is better to know what the expert will say and address it at trial than to be ambushed. Ask the expert to explain his or her answers as appropriate. Make sure that you have obtained everything that the expert has to say about a particular topic. Leave nothing undiscovered. Keep asking questions until you have exhausted everything connected with the expert's opinion and there is nothing further to discover. Insist on answers. If the expert refuses to answer, call the judge for a ruling by telephone, if possible, or make a record for a motion to compel an answer and for sanctions.⁴⁴⁰ Above all, listen to the answer. Some attorneys, in thinking about the next question, fail to listen carefully to what the expert has said. Failure to listen prevents follow-up questions. Before concluding the depo-

sition, check your outline again to make sure that you covered everything. Bring your expert to the deposition. Check with your expert to see if anything else should be asked.

The deposition of the opposing expert typically includes certain topics. They are:

- Qualifications and resume.
- Prior testimony in other cases and details.
- When was the expert retained and by whom.
- What was the expert asked to do.
- What facts did the expert rely upon.
- Who or what was the source(s) for those facts.
- What documents did the expert review and why.
- Who furnished those documents to the expert.
- What information did the expert obtain from those documents and how did the expert use that information in formulating opinions.
 - Did the expert verify information provided by others and if so, how.
 - What is the expert being paid for the work and what has the expert been paid to date (ask to see the expert's invoices for work performed).
 - Whether compensation is contingent upon the outcome of the case (the answer is almost always no, but the question should be asked).
 - If there is no discovery cutoff order, whether the opinions are final, or what further work the expert plans on doing and why. There should be a follow-up deposition if the opinions are revised.
 - Whether assumptions were made in forming opinions and what those assumptions were, why they were made, and how the opinion would be affected if the assumptions were incorrect.⁴⁴¹
 - Whether the expert knows your expert and the opposing expert's opinion of your expert.
 - When appropriate, try to narrow the differences between your expert and the opposing expert.
 - Ask what the witness did to prepare for the deposition, what materials he or she reviewed, and whom he or she consulted.⁴⁴²

The deposition of an opposing expert is an opportunity to learn what the expert will testify to at trial. If the attorney properly takes advantage of the opportunity, the attorney should be prepared for cross-examination and should not be surprised by the testimony.

All depositions should be indexed so that essential points for cross-examination are not overlooked. Usually, indexing is done by a paralegal. However, the attorney who will conduct the cross-examination should

⁴³⁸ This may raise questions about work product and protection of an attorney's mental impressions and theories. See *Karn v. Ingersoll Rand*, 168 F.R.D. 633 (N.D. Ind. 1996) (generally, whatever the expert has considered in formulating the opinion is discoverable); see also L.M. Cohen, *Expert Witness Discovery Versus the Work Product Doctrine: Choosing a Winner in Government Contracts Litigation*, 27 PUB. CONT. L.J. 719 (1998); L. Mickus, *Discovery of Work Product Disclosed to a Testifying Expert Under the 1993 Amendments to the Federal Rules of Civil Procedure*, 27 CREIGHTON L. REV. 773 (1994); Comment, *Discoverability of Attorney Work Product Reviewed by Expert Witnesses: Have the 1993 Revisions to the Federal Rules of Civil Procedure Changed Anything?* 69 TEMP. L. REV. 451 (1996).

⁴³⁹ An exception is where the deposition can be used by the opponent because the witness is not available for trial, and the court allows the deposition to be read to the jury or read by the judge in a bench trial.

⁴⁴⁰ See FED. R. CIV. P. 37(a).

⁴⁴¹ A good expert's logic in formulating opinions is often unassailable, assuming that the premises are correct. Where the expert may be vulnerable is in the assumptions that the expert makes, or the facts upon which the expert relies.

⁴⁴² Material used in preparation for a deposition may be discoverable. *Al-Rowaishan Establishment Universal Trading & Agencies, Ltd. v. Beatrice Foods Co.*, 92 F.R.D. 779, 780 (S.D. N.Y. 1982); FED. R. EVID. 612 (writings used to refresh recollection while testifying or before testifying discoverable).

review the deposition transcript rather than simply rely on the index.

ii. Defending the Deposition.—The first phase in defending a deposition is to prepare the witness to testify. The level of detail that is necessary depends upon the witness. Expert witnesses who are old hands at testifying need little preparation other than to discuss potential problem areas in their analysis and conclusions and to review any documents that they may be questioned about and any conflicting testimony from other witnesses.

Witnesses who have little or no experience should be thoroughly prepared. Begin by finding out if they have ever had their deposition taken. If they have not been deposed before, explain to them what a deposition is, why it is important, and how it can be used at trial. Also review the mechanics of a deposition, including the seating arrangements, the oath taken by the witness, and the role of the court reporter.⁴⁴³ Certain rules or guidelines should also be discussed. These include the following:

- Listen carefully to the question. Make sure you understand the question before you answer. If you do not know the answer, say so. Never guess unless you make it clear that your answer is an estimate or approximation.

- Never interpret the question. It is the examiner's job to ask clear and understandable questions. It is not the witness's responsibility to try to figure out what is being asked. If the question is unclear, ask that it be rephrased.

- Answer only the question that is asked. Do not volunteer information not called for by the question. For example, if you are asked how long have you lived at your current address, say "10 years" and stop. The answer "10 years" is responsive to the question. Adding, "and before that I lived in New York for 5 years," is not responsive; it volunteers information not called for by the question.

- Never get angry or argue. Take your time and think before you answer.

- Stop when you have finished your answer and wait for the next question. Some examiners will stare at the witness, creating a pregnant pause that suggests to the witness that the answer is incomplete, as if to say, "well go on, there must be more." This is nothing more than a tactic; don't fall for it.

- Do not make facetious remarks. The transcript will not reflect the irony.

- Always tell the truth. You can never be tripped up by truthful answers. Stick to your answers. An examiner may try to shake your testimony by creating doubt in your own mind about the accuracy or completeness of your answers. Tell your story truthfully and stick to it. Do not concede that you could be wrong or equivocate about your answer.

- Do not try to sell your story to the interrogator, no matter how fair or charming he or she may appear.

- Do not talk to your lawyer unless it is critical, except to ask for a break.

- Witnesses must be able to respond to questions in their areas of responsibility. If such a witness says, "I do not know," or "I do not recall," this can hurt your case.

- The witness may be asked whether his or her testimony was discussed with the attorney defending the deposition. The question is legitimate; however, any inquiry about what was discussed is not, if the witness is the client and discussions are privileged. If the discussions are privileged, the attorney should instruct the witness not to answer. If the interrogator persists, the attorney should stop the deposition and seek a protective order and sanctions.

- Advise the witness that you will tell him or her not to answer only when the question invades a privilege, is harassing, or is clearly not relevant.

An attorney defending a deposition should not be a "potted plant," nor should he or she be an active participant. The attorney defending the deposition should protect the witness from harassment and abuse by the interrogator and protect the record by objecting to improper questions. The defending attorney should not coach the witness or inject himself or herself into the proceedings by making comments to the witness such as, "If you recall," after a question is asked. Someone once said that when a defending attorney speaks, the words should start with, "I object." While this is too restrictive, it does suggest limits to the role of the attorney in defending a deposition.

The following are excerpts from a general federal court order governing depositions in the Western District of Washington. The order exemplifies how depositions should be conducted.

(a) *Examination.* If there are multiple parties, each side should ordinarily designate one attorney to conduct the main examination of the deponent, and any questioning by other counsel on that side should be limited to matters not previously covered.

(b) *Objections.* The only objections that should be raised at the deposition are those involving a privilege against disclosure, or some matter that may be remedied if presented at the time (such as the form of the question or the responsiveness of the answer), or that the question seeks information beyond the scope of discovery. Objections on other grounds are unnecessary and should generally be avoided. All objections should be concise and must not suggest answers to, or otherwise coach, the deponent. Argumentative interruptions will not be permitted.

(c) *Directions Not to Answer.* Directions to the deponent not to answer are improper, except on the ground of privilege or to enable a party or deponent to present a motion to the court or special master for termination of the deposition on the ground that it is being conducted in bad faith or in such a manner as unreasonably to annoy, embarrass or oppress the party or the deponent, or for appropriate limitations upon the scope of the deposition (e.g., on the ground that the line of inquiry is not relevant nor reasonably calculated to lead to the discovery of

⁴⁴³ SUPLEE & DONALDSON, *supra* note 437, § 10.13.

admissible evidence). When a privilege is claimed, the witness should nevertheless answer questions relevant to the existence, extent or waiver of the privilege, such as the date of the communication, who made the statement in question, to whom and in whose presence the statement was made, other persons to whom the statement was made, other persons to whom the contents of the statement have been disclosed, and the general subject matter of the statement.

(d) *Responsiveness*. Witnesses will be expected to answer all questions directly and without evasion, to the extent of their testimonial knowledge, unless directed by counsel not to answer.

(e) *Private Consultation*. Private conferences between deponents and their attorneys during the actual taking of the deposition are improper, except for the purpose of determining whether a privilege should be asserted. Unless prohibited by the court for good cause shown, such conferences may, however, be held during normal recesses and adjournments.

(f) *Conduct of Examining Counsel*. Examining counsel will refrain from asking questions he or she knows to be beyond the legitimate scope of discovery, and from undue repetition.

(g) *Courtroom Standard*. All counsel and parties should conduct themselves in depositions with the same courtesy and respect for the rules that are required in the courtroom during trial.

e. Discovery Problems

Discovery is the most abused phase of the litigation process. Responses to discovery requests are, on occasion, used as tactical weapons to delay and even to mislead the opponent. Stonewalling document productions is not unusual. Some say that this type of conduct is endemic to an adversary system that requires lawyers to zealously represent their clients. Others say that such conduct violates the Rules of Professional Conduct and is unethical. It is not the purpose of this section to debate either side. The topic is raised merely to suggest some techniques that may be used to deal with such conduct. If your opponent makes frivolous objections to interrogatories or refuses to produce documents, file a motion to compel answers to the interrogatories and compel production of documents. Ask the court to impose appropriate sanctions, including attorneys' fees caused by your opponent's action or foot dragging.⁴⁴⁴ Judges have no patience for responses that are misleading and contrary to the purposes of discovery. Such conduct "is most damaging to the fairness of the litigation process."⁴⁴⁵

⁴⁴⁴ FED. R. CIV. P. 11 and 37.

⁴⁴⁵ Wash. State Physicians Insurance Exchange & Ass'n v. Fisons Corp., 122 Wash. 2d 299, 858 P.2d 1054, 1080 (1993); see also Dondi Prop. Corp. v. Commerce Savings and Loan Ass'n, 121 F.R.D. 284 (N.D. Tex. 1988); Comment, *Sanctions Imposed by Courts on Attorneys Who Abuse the Judicial Process*, 44 U. CHI. L. REV. 619 (1977); Note, *The Emerging Deterrence Orientation in the Imposition of Discovery Sanctions*, 91 HARV. L. REV. 1033 (1978).

Another abuse is the tactics of the "Rambo" type lawyer. Counsel should conduct themselves in depositions with the same courtesy and respect for the rules required in the courtroom during trial.⁴⁴⁶ In this sense, the deposition room is an extension of the courtroom. If the rules are not followed and the attorney becomes abusive, adjourn the deposition and seek a protective order and attorney fees. Ask the court to make the attorney personally responsible to pay the fee, not the attorney's client. For significant depositions that could be troublesome, ask the court to appoint a discovery master to preside over the deposition. Schedule a discovery motion before the court for entry of a discovery order like the one discussed earlier. During the motion, ask the court for permission to send to the judge a copy of any deposition in which there is improper conduct by your opponent. Tell the judge that such conduct will be highlighted in the deposition and will be sent to the judge to allow the court to monitor discovery. This only works if the case is preassigned to one judge. The potential for sanctions that this poses will usually prevent or discourage improper or abusive deposition tactics.

There is a natural reluctance to run to the court for help in discovery disputes. Instead, trial lawyers, who are naturally aggressive, have a tendency to slug it out, to fight fire with fire. Unfortunately for the client, this type of response does not work well. It does not produce the information or documents needed to prepare the case. The tendency to respond in kind should be resisted. Help should be sought from the court to resolve serious discovery problems. That is the court's job, and involving the court is the best way to protect your client's interests.

5. Preparing the Engineering Witness To Testify

Generally, witnesses in a construction case consist of project personnel and experts. For the owner, the principal employee witness is usually the project engineer or chief inspector. Occasionally, in cases involving technical engineering issues, the owner may call staff engineers who are experts in a particular field of engineering or call outside technical experts as witnesses.

Often, engineers who are called to testify have little or no experience as witnesses in a trial. In preparing the engineer to testify, it is important to emphasize that a trial is an adversary proceeding. The engineer must realize that the basic principles and facts that the engineer has regarded as true may be questioned. Engineers inexperienced in the courtroom arena often assume that their role is to dispense the facts to the court, which then will automatically result in a decision. This somewhat naive assumption misperceives the nature of the adversary system of justice.

The attorney should tell the engineer that the outcome of the case may depend upon the credibility of the

⁴⁴⁶ M. Frankel, *The Search for Truth: An Umpireal View*, 123 U. PA. L. REV. 1031 (1975) (attorney's ethical duty to seek the truth even when it does not advance his or her client's interests).

engineer's testimony. The attorney must convince the engineer of the importance of his or her role as a credible witness. The attorney should emphasize that the engineer knows more about engineering than the attorney does, or more about what happened on the project than the attorney, since the engineer was there and the attorney was not. The witness must understand that the credibility of his or her testimony may depend more on the witness's demeanor than what the witness says. In answering questions, the witness should talk to the jury and make eye contact with them. Although the answer is important, it is not always the answer itself that determines the outcome of the case. Other factors may influence a jury more, including factors such as the engineer's experience, courtroom demeanor, and overall credibility.

An attorney who has an articulate and perceptive witness has an advantageous position. While these qualities are to some degree individual characteristics, an attorney can help cultivate those qualities in a witness through effective trial preparation. One technique is to have another attorney cross-examine the witness to sharpen those qualities. Another technique is to put the witness through a mock direct and cross-examination that is videotaped. The witness can later view the videotape as part of further trial preparation. Also, a witness will occasionally ask the attorney to furnish the witness with a written list of the questions that will be asked. Whether either of these practices is followed depends upon whether there is an attorney-client privilege prohibiting the cross-examiner from exploring what was said and done by the attorney and the witness during trial preparation. The better practice is to put the questions to the witness orally, and not have the witness answer from a written list. Written answers to the questions should never be furnished by the attorney to the witness for obvious practical and ethical reasons. Most of us have heard the horror story of the witness who, while on the witness stand, pulls out a list of questions and answers that were given to the witness by the attorney.

The task of the engineering witness is to persuade the court and jury that the witness's opinions are reasonable and result in the correct solution to the problem, and to do so in plain, nontechnical terms. The engineering expert witness should not rest his or her testimony on harsh technical specifications or strict contract provisions. The witness should understand the underlying policies that the contract provisions serve. Judges and juries will consider and be influenced by those policies in enforcing those provisions, without feeling that the result is harsh or unfair. If the engineer understands the policy behind the technical provision, the witness will be less likely to rely on a mere recital of the provision itself, and will be able to explain it in more understandable terms. Moreover, in most instances there is a valid and salutary purpose to be served by each contract provision, harsh as it may seem. This is particularly true in the case of contracts

subject to competitive bidding requirements.⁴⁴⁷ The attorney should ensure that in answering questions, the engineer should consider, as appropriate, the purpose of a particular contract provision and not merely rely on the literal wording of the provision itself.

6. Pretrial Strategies and Considerations

a. Judge or Jury

If the contractor did not file a jury demand, should the agency demand a jury? Often, this may be a difficult question. The decision of whether to try the case to a judge or to a jury may depend upon a variety of considerations. How will the parties be perceived by the jury? Will the owner be regarded as fair and evenhanded in the way it managed the project? Will the contractor appear to be fair in its demands, or opportunistic and overreaching? Who has the equities—Or as one lawyer once put it: who will be perceived as the “bad guy”? Who will the judge be? Is judicial bias a concern? If so, can the agency seek recusal? Is the case more legal than factual? Is the case too complex for a jury?⁴⁴⁸

These considerations (among others) lead to the ultimate question: From the public owner's standpoint, is it better to try the case to a judge or to a jury?

b. The Answer and Affirmative Defenses

Traditionally, the answer to the complaint in a construction case will deny the essential allegations in the complaint, placing the dispute at issue. In addition, most answers will contain affirmative defenses. An exhaustive list of potential affirmative defenses is included in the Appendix to this subsection. Failure to plead an affirmative defense may result in a waiver of the defense.⁴⁴⁹ However, wholesale inclusion of affirmative defenses without any factual or legal basis is unwise and may, in some jurisdictions, result in sanctions.⁴⁵⁰ Counsel should thoroughly review and investigate the case to be certain that all appropriate affirmative defenses are included in the answer. If new affirmative defenses are discovered after the answer

⁴⁴⁷ For example, the New York Court of Appeals has articulated the public policy considerations that underlie notice requirements in public works contracts. *A.H.A. General Constr., Inc. v. N.Y. City Housing Auth.*, 92 N.Y.2d 20, 677 N.Y.S.2d 9, 699 N.E.2d 368, 376 (1998) (timely notice of claim or extra work allows a public agency to make necessary adjustments in the work, mitigate damages, document costs, and maintain the integrity of the public bidding process).

⁴⁴⁸ *Green Constr. Co. v. Kan. Power & Light Co.*, 1 F.3d 1005, 1011 (10th Cir. 1993) (motion to strike the jury, on the ground that the case was too complex to be generally comprehensible, was denied); R.O. Lempert, *Civil Juries and Complex Cases: Let's Not Rush to Judgment*, 80 MICH. L. REV. 68 (1981); Note, *The Right to a Jury Trial in Complex Civil Litigation*, 92 HARV. L. REV. 898 (1979).

⁴⁴⁹ 71 C.J.S. *Pleading* § 199-200; FED. R. CIV. P. 12.

⁴⁵⁰ FED. R. CIV. P. 11.

has been filed, counsel should promptly file a motion to amend the answer to include the new defense or defenses.⁴⁵¹ Several affirmative defenses often available to the owner in a construction case are failure to file timely notice of the contractor's claim,⁴⁵² finality of the engineer's decision on some aspect of the claim,⁴⁵³ and failure to reserve claims in the acceptance document as required by the contract.⁴⁵⁴

⁴⁵¹ Another device is a "Notice of Trial Amendment." The notice tells opposing counsel that the attorney for the defendant will move at trial to amend the answer to include the defenses set forth in the notice in the same detail as they would be in the answer. This puts opposing counsel on notice and gives counsel an opportunity to conduct discovery about the defenses before the trial.

⁴⁵² *A.H.A. Gen. Constr., Inc. v. N.Y. City Housing Auth.*, *supra* note 447; *see supra* § 5.A.7 and 5.B.4.

⁴⁵³ Where the engineer has authority to render final decisions regarding contract interpretations, courts will uphold the decision unless it was: (1) arbitrary or capricious; (2) based on clear mistake; (3) unsupported by substantial evidence; or (4) based on an error of law. *J. J. Finn Elec. Service, Inc. v. P&H Gen. Contractors, Inc.*, 13 Mass. App. Ct. 973, 432 N.E.2d 116, 117 (1982); *R.W. Dunteman Co. v. Village of Lombard*, 281 Ill. App. 3d 929, 666 N.E.2d 762, 765 (Ill. App. 1996); *Main v. Dep't of Highways*, 206 Va. 143, 142 S.E.2d 524, 529 (1965); *State Highway Dep't v. W. L. Cobb Constr. Co.*, 111 Ga. App. 822, 143 S.E.2d 500, 504-05 (1965); *Ardsley Constr. Co. v. Port Auth. of N.Y. & N.J.*, 75 A.D. 2d 760, 427 N.Y.S.2d 814, 815 (1980). The rule is based on the principle that the parties anticipate that differences may arise, and to avoid further disputes agree to make the engineer the arbitrator of such differences. *State Highway Dep't v. MacDougald Constr. Co.*, 189 Ga. 490, 6 S.E.2d 570, 575 (1939); *State v. Martin Bros.*, 138 Tex. 505, 160 S.W.2d 58, 60 (Tex. 1942). The finality of the engineer's decision has been held to be final and binding only where the contract expressly conferred authority upon the engineer to make the decision. *C.B.I. Na-Con, Inc. v. Macon-Bibb County Water & Sewerage Auth.*, 205 Ga. App. 82, 421 S.E.2d 111, 112 (1992) (contract did not give engineer express authority to decide claims for time extensions and extra compensation).

⁴⁵⁴ Failure to reserve claim on contract acceptance document as required by the contract waived claim. *DiGioia Bros. Excavating v. Cleveland Dep't of Pub. Utils.*, 135 Ohio App. 3d 436, 734 N.E.2d 438, 453 (1999); *United States v. William Cramp & Sons*, 206 U.S. 118 (1907) (contractor who executes a general release cannot later sue for damages or additional compensation in excess of the amount reserved or raise new claims that were not specifically exempted from the releases). The rule extends to subcontractor pass-through claims. Once the subcontractor releases its claim against the prime contractor, the prime contractor cannot revive the claim by attempting to pass it on to the owner. *George Hyman Constr. Co. v. United States*, 30 Fed. Cl. 170, 177-78 (1993); *Miss. State Highway Comm'n v. Patterson Enters. Ltd.*, 627 So. 2d 261, 263 (Miss. 1993). Also, contract standard specifications may specify that failure to reserve the claim in accordance with the contract claim procedures waives the claim. *California Standard Specifications 9-1.07B* (2002); *New York Standard Specifications 109-14* (2002); *Washington State Standard Specifications 1-09.9* (2004).

Construction contracts customarily contain provisions that require contractors to provide formal written notice of claims whenever the contractor believes that it is being required to perform extra work beyond the requirements of the contract. The purpose of the notice provision is to alert the agency, at an early date, that the contractor has a claim. Early notice allows the agency to take appropriate action to protect itself.

Where the only issue is the legal effect of the contract language, summary judgment dismissing the claim is appropriate.⁴⁵⁵ Where the claim is limited to the amount reserved in the final contract estimate, an order in limine limiting the claim to the amount reserved is also appropriate.⁴⁵⁶

c. Pretrial Motions

Pretrial motions may be classified generally as dispositive, partially dispositive, and procedural. A dispositive motion, if granted, disposes of the case. Dispositive motions usually take the form of a motion for summary judgment and are granted only when disposition of the case is not dependent upon any factual determination, and the moving party (the party filing the motion) is entitled to judgment in its favor as a matter of law.⁴⁵⁷ An example is dismissal of a case barred by a statute of limitations. Partial disposition of the case may be made by a partial summary judgment using the same criteria—the facts of a particular issue are not in dispute and the law is in the favor of the moving party. If material facts are in dispute, the court will not grant summary judgment. Judges are reluctant to dispose summarily of a case where the facts are not clear. When the facts are not clear, the nonmoving party is entitled to a presumption that the facts are in its favor, although it cannot rely on this presumption alone, but must present evidence demonstrating that there is a factual dispute. Moreover, judges are often reluctant to summarily dismiss claims that arise from a contractual relationship, preferring to give the party its day in court where it can develop its contentions further and tell the judge or jury the entire story.

Because of a court's general reluctance to grant summary dismissal of the case, some see a tactical disadvantage in moving for summary judgment, unless there is a good chance that it will be granted. An unsuccessful motion for summary judgment alerts the nonmoving party to what it can expect at trial, giving it an opportunity to prepare its defense. However, the motion, even though unsuccessful, can also operate as a discovery tool since it can force the nonmoving party to present its evidence in affidavits in order to establish a

⁴⁵⁵ *Absher Constr. Co. v. Kent School Dist.*, 77 Wash. App. 137, 890 P.2d 1071 (1995).

⁴⁵⁶ A motion in limine precludes counsel and witnesses from mentioning or referring to matters that the court has excluded. *See G.O. Kornblum, The Voir Dire, Opening Statement, and Closing Argument*, 23 PRAC. LAW. No. 7 at 1, 21 (1977).

⁴⁵⁷ FED. R. CIV. P. 56.

factual dispute, thus alerting the moving party to what it can expect at trial. It may also help convince the opposition to adopt a more conciliatory attitude toward settlement.

Procedural motions may involve numerous procedural and housekeeping items. Motions may be made: (1) to allocate time between the parties at trial for the presentation of their respective cases; (2) to publish depositions, interrogatories, and requests for admission; (3) to exclude or obtain an advance ruling on the admissibility of evidence; (4) to determine whether the jury should be able to take notes during the testimony of witnesses; and (5) to determine whether to realign co-defendants and change their order of proof.⁴⁵⁸

Another type of procedural motion that may be used, before and during trial, is a motion in limine to exclude evidence and witnesses.⁴⁵⁹ This type of motion may be used to exclude evidence that is legally inadmissible or overly prejudicial.⁴⁶⁰ The motion may also be used to prevent experts, who were never identified in answers to interrogatories, from testifying. This type of motion can be a powerful tool and should be used whenever improper evidence is anticipated.

d. Trial Briefs and Premarked Exhibits

i. Trial Briefs.—It is usually advisable to file a trial brief in a construction case.⁴⁶¹ The length and details of the brief should be governed by common sense, and to the extent known, the personal preferences of the trial judge.⁴⁶² In addition to suiting the judge's preferences, the length and details of the brief will also depend upon whether the case is jury or nonjury and the extent of the judge's familiarity with the case from pretrial proceedings.

In general, a trial brief serves several purposes. First, it allows counsel to argue the case in advance of trial.⁴⁶³ A popular method of brief writing is to divide the brief into sections: introduction, statement of the

⁴⁵⁸ Traditionally, the order of proof is determined by how the defendants are named in the caption of the complaint filed by the plaintiff. They are named in that order simply because the plaintiff chose to list them that way. The issue may arise, for example, in a case where the agency is named as a co-defendant with its consulting engineer. Arguably, it may be more logical for the party who prepared the plans to present its defense first when the adequacy of those plans is in dispute. *See* Green Constr. Co. v. Kansas Power & Light Co., 1 F.3d 1005 (10th Cir. Kan. 1993); *see also* FED. R. EVID. 611(a).

⁴⁵⁹ *See supra* note 456.

⁴⁶⁰ FED. R. EVID. 403.

⁴⁶¹ Some local court rules require all parties to file trial briefs.

⁴⁶² For example, string-citing cases from other jurisdictions is usually not helpful, unless the issue before the court is one of first impression. Some judges are impressed by policy arguments and how the position urged by counsel comports with that policy.

⁴⁶³ State or local court rules may require a working copy of the brief to be provided to the judge before trial, and it should be provided even in the absence of a requirement.

case, argument, and conclusion. The argument section is further divided into subsections that argue each point that counsel wishes to make. Each subsection should have a heading summarizing the argument. The headings should be indented and italicized or underscored for emphasis.⁴⁶⁴ The trial brief is also an outline of a party's case. In addition to educating and persuading the court, the brief allows the judge to follow the testimony. If the judge is unfamiliar with construction jargon and clauses unique to construction contracts, the brief should contain a glossary explaining technical terms and a section quoting pertinent contract clauses, a brief description of how they work, and their significance to the case. If the brief is extensive, there should be a detailed table of contents to make it easier for the judge to locate issues and statements of law.

The benefits of an extensive brief, where one is warranted, are not as valuable if a jury is involved. With a jury, the education process is limited to testimony, exhibits, instructions, and oral argument. However, the advantage of a knowledgeable judge presiding over the trial should not be overlooked. The judge has the power to veto the verdict, if the judge believes that the jury decided the case incorrectly. Also, the brief may help convince the court that, as a matter of law, the issues must be determined by the plain language of the contract, thus avoiding issues of fact for the jury. In jury cases, the brief should also contain a section that supports the jury instructions requested by the party.

ii. Pre-marked Exhibits.—Trials should be efficient. Efficient trials save money and improve the quality of justice. One way to improve efficiency is to pre-mark exhibits in advance of trial. Each side meets and presents the exhibits that they intend to use at trial. Attorneys should not be overly concerned that disclosing proposed exhibits will reveal trial strategy. By the time of trial, the attorneys will usually be aware of the documents that will be offered as exhibits. After documents are pre-marked, counsel should stipulate to the admissibility of as many documents as possible. Pre-marked exhibits that have been stipulated to may be put in notebooks in numerical order. The exhibits are removed from the book(s) and used with the witnesses, without having to take the time to mark them and lay a foundation. This makes the trial go smoother and faster. Exhibits that are pre-marked but not admitted by stipulation can be handled in the normal manner and their admissibility determined by the court when they are offered.

e. Visual Aids

As trial preparation proceeds, the attorney should consider the use of visual aids to illustrate graphically the party's contentions. Most attorneys are familiar with the value of a chart or diagram of an accident

⁴⁶⁴ *See generally* F.T. Vom Baur, *The Art of Brief Writing*, 22 PRAC. LAW. No. 1, at 81 (1976).

scene in a tort case, or a map indicating the location of comparables in an eminent domain case. Often, just the mention of the type of case suggests the form of the visual aid needed to assist in the presentation of the case. This is not necessarily true in a construction case. The kinds of visual aids that will be helpful will depend upon the complexity of the issues presented and whether they can be better explained by the use of a diagram, chart, model, or computer animation.

i. Charts.—Many of the claims in construction litigation involve delay in completing work. The owner may seek to assess liquidated damages because the work is not completed within the contract time. The contractor may seek damages for owner-caused delays. Charts showing the planned work schedule and the events that transpired affecting the schedule are necessary aids in explaining to the court why the delay occurred and assigning responsibility for the delay.

These charts may take various forms. The most common and accepted method of proving delay, and showing the causal relationship between culpable acts and actual work progress, is CPM scheduling. Another is a chart plotting the contractor's progress against the time it took to complete the project. For example, in a typical highway construction project, this chart will show when the contractor began grading and the amount of grading performed each day. Witnesses can use this chart to show delay and then explain why the delay occurred. Other major construction activities that are in controversy can be depicted in the same manner. The use of a simple bar chart presentation is easily understood.⁴⁶⁵ A bar chart, however, does not illustrate the interrelationships between various work items or demonstrate how a delay of one work item affects other items of work. The CPM chart, if properly used, shows those interrelationships.⁴⁶⁶ This type of schedule analysis is necessary to show the overall effect of concurrent delay on separate items of work.

Some claims or defenses can be better presented by a model or tridimensional chart. For example, in a DSC case, a model or tridimensional chart can illustrate, through color coding in cross-sections, the type of material encountered in the highway prism or borrow site. This allows the viewer to see the type of material that was encountered at various locations throughout the cross-sections.

⁴⁶⁵ Charts can be reduced to notebook size, annotated, and included in the trial notebook for use in cross-examination. For example, if the contractor has claimed that it was unable to place concrete because there were no inspectors on hand, the use of the chart can show that even if there were no inspectors on hand, concrete could not have been placed because of a breakdown in the batch plant. This may establish concurrent delay, preventing delay damages.

⁴⁶⁶ CPM charts simplify complex problems. However, they should not be accepted by courts simply because they have been prepared using a computer. "As-planned" and "but for" schedules contain assumptions, not facts. The court should require the party introducing a CPM schedule to prove that it is accurate and that its assumptions have a factual basis.

ii. Photographs.—Photographs taken during various stages of a construction project can be very helpful. Aerial photos taken on a regular basis can be important evidence in showing lack of progress on a project. Photos showing equipment breakdowns can also be significant in explaining lack of progress. Videos should be taken when the video will document particular problems. Photos and videos should always be dated.

iii. Models.—One of the most dramatic visual aids that an attorney can use in presenting the case is a model. A model can provide a view of the site, depict terrain, or show relationships and concepts that can be illustrated in no other way. Because a model is dramatic, its use requires special consideration.

The first consideration is how will the model be used: Will it be offered in evidence as a reproduction of what it purports to copy, or will it be used as demonstrative evidence to illustrate testimony? If it is offered in evidence as a reproduction, it must be to scale and its accuracy established by testimony, usually by an engineer and the model maker. If it is used for illustrative purposes, it need not be to scale, but it cannot be misleading and must assist the witness in explaining the testimony.⁴⁶⁷

Another consideration is cost. Models are expensive to construct, particularly when they are built to scale. The attorney should weigh the cost of the model against its prospective benefits. The attorney should anticipate how the judge will react to an elaborate and obviously costly model.⁴⁶⁸ If the model does not illustrate an important point in the case, the court may feel that its use is not justified and exclude the model on the ground that its introduction was calculated to impress rather than enlighten.⁴⁶⁹ This is especially relevant where the model is presented by a public agency. Care should be taken so that it does not appear that the agency, with its vast resources, is trying to overwhelm the contractor.

Highway construction cases lend themselves particularly well to the use of models to explain or illustrate testimony. A three-dimensional visual aid, like a picture, can be worth a thousand words. Models make it easier to understand testimony about cuts and fills, super-elevations, embankment compaction, bridges, and other three-dimensional features that are more easily shown by a visual presentation than by oral testimony.

⁴⁶⁷ 29A AM. JUR. 2D *Evidence* § 993 (1994); *Propriety, in Trial of Civil Action, of Use of Model of Object or Instrumentality, or of Site or Premises, Involved in the Accident or Incident*, 69 A.L.R. 2d 424 (1960; supp. 2003); 7 AM. JUR. *Proof of Facts* § 601, "Maps, Diagrams, and Models" (1960).

⁴⁶⁸ If the model maker testifies, he or she will probably be asked how much the model cost. The cost can run into thousands of dollars.

⁴⁶⁹ See generally 3 AM. JUR. 2D *Trials* at 377 (1965).

iv. Overhead Projectors.—Because construction cases rely heavily on documentary evidence, it may be hard for a jury to understand the significance of a document unless they can see the document along with the witness. The use of an overhead projector can solve this problem.⁴⁷⁰ Through its use, the jurors can see the document during the examination of the witness. Projectors can also be used during final argument or even opening statement with respect to documents that have been previously admitted by stipulation. Care should be taken in the type of projector used. Projectors that can be used without having to dim the courtroom lights and that are not noisy should be used. The presentation, to be effective, should be smooth. The attorney should consider having a legal assistant or paralegal operate the projector and handle the transparencies or the original documents if they are placed on the projector.

v. Other Considerations.—Effective demonstrative exhibits illustrate a point clearly and quickly. Juries pay attention to what they understand and reject or ignore what they do not understand. Thus, exhibits should not attempt to convey too much information. They should be limited to one key message that is readily understood.⁴⁷¹ Once the attorney has made the point with the exhibit, the attorney should stop and not be redundant. Juries and judges quickly become tired of hearing the same point over and over.

There are companies that specialize in creating visual aids for use in litigation. They are experts in how to present graphic information. There are also companies that specialize in building scale models. Both types of companies should be consulted in appropriate cases, where the use of a model or innovative graphics will be helpful or necessary. Companies that offer these kinds of services usually advertise in the yellow pages and bar journals. Claims consultants, particularly financial consultants, have computer programs that will produce graphic information in a variety of formats. Consultants are usually the best source of ideas on how to create visual aids for effective presentation of their testimony.

7. The Trial

The presentation, argument, and examination techniques of a construction contract trial are not dissimilar to other types of trials.⁴⁷² There are, however, certain unique aspects that should be considered in the presentation of the case.

⁴⁷⁰ The use of Microsoft Power Point© is another option for presenting documentary evidence.

⁴⁷¹ Billboard advertising and roadside signs are an example. Television commercials are another. They are designed to convey a message.

⁴⁷² See D. Schwartz, *Going to Trial in The United States Claims Court*, 32 PRAC. LAW. No. 1, at 35 (1986). Although the article discusses trying cases in the United States Claims Court, it offers suggestions that the reader may find useful in any bench trial regardless of the forum.

a. The Opening Statement

No single guideline governs how opening statements should be made. Their use is governed by a variety of considerations that depend upon the nature and complexity of the case and whether the case is tried to a judge or jury. There are, however, some guidelines that usually apply.

As a general rule, an opening statement should be presented at the commencement of the trial and not deferred until defense counsel commences his or her case-in-chief. If the opening statement is reserved, there should be a good reason for doing so.⁴⁷³ The opening statement should be a road map of what your case will be and have an overall theme or theory that pieces the case together.⁴⁷⁴ Outline the segments of the trial and their function to allow the jury to have a better understanding of how the trial will proceed. Do not read an opening statement. Counsel should talk directly to the judge or jury and maintain eye contact with them. The use of notes should be minimized. Visual aids, such as photographs, maps, aerials, and models, should be used to explain and illustrate what the evidence will show. Pre-mark the exhibit and obtain permission from the court to use it in the opening statement, if opposing counsel refuses to stipulate to its use. This practice avoids an objection that could harm the effectiveness of the opening statement.

The opening statement should not be argumentative. Opening statements that are argumentative will usually draw an objection, which is likely to be sustained. Although argument must be avoided, counsel should make a strong statement of what he or she intends to prove, remembering that your opponent is entitled to comment in final argument on what you failed to prove. The opening statement should be phrased in simple terms with an explanation of the technical terms that may be used during the trial. However, counsel should never talk down to the jury or appear condescending. Witnesses should be introduced by occupation, not by name. For example, refer to the project engineer as the project engineer, not Mr. James.⁴⁷⁵ The jury should be told how the witnesses fit into the case, and what they will say when they testify.

An opening statement should be comprehensive. As a general rule, an attorney will gain more in educating and conditioning the trier of fact than the attorney will lose in exposing his or her case in advance.⁴⁷⁶ While the opening statement should be comprehensive, it should

⁴⁷³ An exception may be a bench trial where the trial judge is familiar with the case from pretrial proceedings or where counsel can gain a clear tactical advantage by deferring the opening statement. See also Schwartz, *id.*

⁴⁷⁴ M. Mitchell, *A Method for Evolving a Trial Strategy*, 27 PRAC. LAW. No. 4, at 82 (1981). The article offers suggestions for developing a theme.

⁴⁷⁵ Consider personalizing the case by having the project engineer sit with you at counsel table throughout the trial.

⁴⁷⁶ See possible exceptions to this view noted *supra* note 473.

not be redundant. Counsel should avoid covering the same ground over and over. The trier of fact should be favorably impressed by an opening statement that is logical and comprehensive, yet succinct. This type of presentation will enhance the attorney's credibility and the credibility of his or her client's case. In the final analysis, the most important attribute that a trial attorney has is credibility.

b. Direct Examination

Typically, the most important part of any trial is direct examination. More cases are won by direct testimony than by cross-examination or final argument. Because of its importance, counsel should ensure that direct testimony is presented in a way that is easily understood by a judge or jury.

Direct examination should be business-like, not spectacular or dramatic. It should be brief and to the point. Once a point is made, stop. Go on to the next point. Covering the same ground again may do more harm than good. It may weaken the impact of what has been established and irritate the judge and the jury. It may even draw an objection from the court on its own volition, if not from opposing counsel.

The focus should be on the witness, not on the attorney, during the direct examination. A case is won by what the witnesses say. Counsel should not draw attention to himself or herself by pacing back and forth or by engaging in other distracting mannerisms. Questions should be short, clear, and whenever possible phrased in plain, simple English. Construction jargon and technical terms should be used only when necessary, and the witness should be asked to explain them and give examples to illustrate their meaning. Visual aids should be used to explain and illustrate the witness's testimony.⁴⁷⁷

Leading questions should be avoided, not only because they are objectionable, but more importantly because the witness should be testifying, not the lawyer.⁴⁷⁸ A witness who is nothing more than a sounding board for the attorney has little credibility. Some lawyers write out their questions, others do not. Attorneys write down their questions in case they have problems formulating them and as a safeguard when direct examination is interrupted by an objection. Whatever one's preference, it is a good practice to have an outline listing point by point each topic that will be covered with the witness. An outline of this kind should be part of every trial notebook.⁴⁷⁹ The outline should be reviewed with the witness before trial. Psychologically, this is

helpful to the witness since the witness knows, when taking the stand, what the questions will be. Ideally, the direct examination should be like a friendly chat about some aspect of the case. Transitional questions such as "turning now to..." should be used to make the direct smoother and easier to follow. Avoid leading questions by using the "who," "how," "where," and "why" approach in formulating questions.

In preparing witnesses to testify, counsel should discuss certain guidelines with the witness. The witness should be told to listen to the question and answer the question as asked. The witness should be told not to volunteer or elaborate and that you will develop the witness's testimony.⁴⁸⁰

The order in which witnesses are called should be logical, and should allow you to lay out the case the way you want it presented. The conventional trial wisdom that you should begin and end with strong, substantive testimony is not always true. While you should end with a strong witness,⁴⁸¹ you may wish to begin with a minor witness, when that witness's testimony is the starting point for your case. For example, calling the office engineer from a project office to show in a DSC claim that the agency provided the boring logs to the contractor during the bidding phase. This testimony is necessary to establish a foundation that the contractor actually knew or should have known about the soil conditions.⁴⁸² Contractor personnel who are managing agents (superintendents, foremen, project managers) should be subpoenaed and called as adverse witnesses. This permits counsel to ask leading questions and in effect cross-examine them.⁴⁸³ The trial notebook should contain a list of questions that must be asked to lay a foundation for the admission of a document, photograph, or chart. Use of the outline allows counsel to lay a foundation crisply and smoothly, thus enhancing counsel's credibility with the court and the jury.

Sometimes owners feel so strongly about their lack of liability for a construction claim that they ignore damages. Owners should keep in mind that when liability and damages are tried together, large losses by the contractor may influence the trier of fact in making a determination about liability. Moreover, plaintiff's damages may be so poorly presented that doubt is cast on the overall merits of the claim. The dilemma for the defense is whether to offer testimony on damages, or stand on the contractor's failure to meet its burden of proof on damages. There are no rules concerning this dilemma. The strategy in dealing with this problem must be carefully considered and will vary depending

⁴⁷⁷ Witnesses should be asked if the use of a picture or model, or some other visual aid, will assist them in explaining their testimony. This makes it difficult for opposing counsel to object to its use.

⁴⁷⁸ See J. Weinstein, *Examination of Witnesses*, 23 PRAC. LAW. No. 2, at 39 (1977).

⁴⁷⁹ See generally L. Packel and D. Spina, *A Systematic Approach to Pretrial Preparation*, 30 PRAC. LAW. No. 3, at 23, 33 (1984).

⁴⁸⁰ A witness who volunteers information may appear to be biased.

⁴⁸¹ Expert witnesses on liability and damages ordinarily should be called last because they can summarize the case and handle any loose ends.

⁴⁸² The contractor may be charged with knowledge of what the borings show even if the contractor did not examine them. See § 5.B, *Differing Site Conditions*, *supra*.

⁴⁸³ FED. R. EVID. 611(c).

upon the case. However, conventional wisdom tells us that it is probably better to put on some evidence refuting damages as part of the owner's case-in-chief, unless the defense has successfully refuted the damage calculations.

c. Cross-Examination

More books and articles have probably been written about cross-examination than any other phase of a trial. The most dramatic part of any movie or television show featuring a trial is the cross-examination of a key witness. Invariably, writings about cross-examination point out what the cross-examiner should not do—the so-called “don'ts” of cross-examination.⁴⁸⁴ For example, avoid asking open-ended questions such as “why” or “how” of an articulate and knowledgeable hostile witness. Instead ask leading questions that call for a “yes” or “no” answer, or questions to which the witness will give only the answer you anticipate. If you gamble—because you do not know for sure what the witness will say—do so only when the answer cannot hurt your case. Be fair to the witness, do not embarrass the witness, and do not get angry at the witness. The cross-examination should be business-like and have a purpose. Generally, cross-examination can be designed to discredit the witness, or to solicit facts or admissions that can support your case. It should not be used to discover information about the case unless the witness is friendly and cannot possibly say anything that will hurt your case, but even then be cautious. Be thorough, but be brief and do not cover the same points over and over. Make your point and stop.

Should you always cross-examine every witness simply because the witness testified? Conventional trial wisdom says no, if the testimony has not hurt your case.⁴⁸⁵ But if the testimony is damaging, it should not stand unchallenged. Find something you can attack, particularly if the witness is a retained expert. For example, if the witness is a retained expert, explore bias. Through discovery, you should have obtained what the witness's fee arrangement is, how much the witness has been paid, when, by whom he or she was retained, and any other cases in which the opposing attorney or party has engaged the witness.

Counsel should be thoroughly familiar with the deposition testimony of the witness he or she is interrogating. Statements in the deposition transcript that are inconsistent with the witness's testimony at the trial can be used for impeachment, but counsel should avoid the appearance of nitpicking by using a minor or trivial

inconsistency to impeach.⁴⁸⁶ Also, counsel should consult his own expert for areas of cross-examination. This is particularly important in preparing for cross-examination of the opposing party's expert. Your expert can review the deposition transcript of the opposing expert and can suggest questions that should be asked on cross-examination.⁴⁸⁷ But counsel should be careful about asking questions on cross-examination suggested by others (including your own experts) when you do not understand the question. The opposing expert will usually have an answer, and if you do not understand the question you asked you probably will not understand the answer, leaving counsel with the choice of letting the answer stand or asking another question and maybe getting into even more trouble.

One of the problems of cross-examination in a construction case is keeping track of what occurred on the project and how those facts bear on the witness's testimony. This is often true in cross-examining a claims expert or project superintendent or manager who has overall knowledge of the project. One technique is a chart that diagrams the various construction phases of the project, including significant construction activities. This chart allows counsel to keep track of all aspects of the project as they occurred. The chart should be keyed to counsel's trial notebook.⁴⁸⁸ The notebook can contain a section on each phase of the project, including areas to inquire about on cross-examination and documents by exhibit number (if pre-marked), that can be used during the cross-examination.

There are other ways, of course, of preparing for cross-examination. Often, how one prepares is a matter of personal choice. However, prepare for cross-examination before the trial begins. Counsel should know from pretrial discovery what the witness will say and be prepared to deal with it.

d. Presentation of Multiple Claims

Rarely will a construction contract case be limited to a single claim. Once a contractor decides to file suit on one claim, all disputes that have been preserved can be expected to be litigated. Where the lawsuit consists of several claims, the contractor has several methods it can use in presenting its claim. One method is to present each claim separately. The difficulty with this method is that some aspects of the project will be repeated as the facts are developed for each of the claims. The contractor will usually begin with the dominant

⁴⁸⁶ A number of inconsistencies, even though minor, may help convince the trier of fact that the witness is mistaken or lying.

⁴⁸⁷ Usually, an expert's opinion is a logical extension of the premises upon which the opinion is based. Where the expert may be vulnerable is in the premises used to form that opinion, particularly if a premise is an assumption that is not supported by the evidence.

⁴⁸⁸ The trial notebook is usually a three-ring notebook that allows issues and facts to be organized alphabetically or chronologically. See Packel and Spina, *supra* note 479.

⁴⁸⁴ A.S. CUTLER, SUCCESSFUL TRIAL TACTICS 123–30 (4th ed. 1950), “Some Don'ts in Cross Examination.” Irving Younger referred to them as the “Ten Commandments of Cross-Examination” in his evidence seminars (reprinted at www.nebarfnd.org/10commandments.pdf, Nebraska State Bar Foundation Web site).

⁴⁸⁵ See, e.g., CUTLER, *id.*

claim and then proceed to the more minor claims. Another method is to present each claim as it arose in chronological order during the course of the project. This method avoids redundancy by allowing the project facts to be presented in an orderly and sequential manner from the commencement of the project to its completion.

Rather than anticipate which method the contractor will use in presenting its case, the owner may ask the court to rule in advance of trial as to which method must be used.⁴⁸⁹ Knowing in advance how the contractor's case-in-chief will be presented helps the owner organize its cross-examination. Establishing the order in which the claims will be presented makes the trial more efficient and saves the court time.⁴⁹⁰

e. Closing Argument

Some lawyers have a section in their trial notebook to jot down ideas for final argument. Some attorneys review their trial notes and from them develop an outline of their final argument. Others prepare an outline of their final argument before the trial even starts on the assumption that the case is sufficiently well prepared to prevent any surprises.

Whatever technique is used, the final argument should be just that—an argument. Someone once observed that more cases are lost by a poor argument than won by a good one. That is a good admonition for lawyers to follow even if it is not precisely true. The final argument should be carefully prepared. Many who write about trial practice say that the closing argument must tell a story. The lawyer should paint a picture that is so compelling that the judge or jury must find in his or her client's favor. This, of course, is the ideal presentation. Attaining this ideal is even more difficult when the case is complex and involves a multitude of issues.

The closing argument, like other phases of a trial, has certain recognized guidelines that counsel should consider. These guidelines are often referred to as "do's" and "don'ts." For instance, it is improper to refer to matters that are not in evidence.⁴⁹¹ Another "don't" is never read a closing argument to a jury. To be effective and creditable, counsel must talk to the jury. Reading a speech to the jury is not talking to them. If permitted by the court rules, relate and argue how the jury instructions apply to the issues and the conclusions that the jury should reach in deciding the case. Relate the evidence in a way that shows that you proved what you said you would prove in your opening statement. This

ties the opening statement to the closing argument, giving your case continuity and credibility.

Organize documentary evidence in a way that is keyed into your argument. Use enlargements of important documents that the jury can easily read as you argue their significance.⁴⁹²

Some lawyers make very little, if any, preparation for closing argument. They jot down a few notes on a yellow tablet sheet and then speak extemporaneously. Unless you have a natural talent for arguing cases, you should avoid this practice. Take the time to organize the argument in outline form. In concluding your argument, tell the jury that your opponent now has the opportunity to rebut what you have said. Point out that your opponent has this opportunity because plaintiff has the burden of proof. Tell the jury that you will not have an opportunity to respond to your opponent's remarks, but that you do not need that opportunity. Why? Because the evidence itself serves as rebuttal to what he or she may say.

The closing argument is an important part of the trial. Your argument may not win the case, but you should avoid a hastily prepared argument that could lose it.

f. Other Trial Considerations

i. Taking Notes During Trial.—Conventional trial wisdom suggests that the attorney divide each page of a legal tablet down the middle with a vertical line. Notes are placed on one side of the line and comments, questions, or reminders on the other. One problem with this method is that it is an invitation to try to write down everything the witness says. If you accept this invitation, you may miss the jury's reaction to the witness, any nuances in the testimony, objections that should be made, and more important, what the witness is really saying.

In the first place, the attorney does not need to take notes during the direct examination of his or her witness. Second, note taking should be selective. It should be limited to the points that will be covered in cross-examination, and not a re-hash of the direct examination. Points developed through pre-trial discovery, and questions suggested by your experts can be prepared in advance for cross-examination and added to the notes on separate sheets of paper.

Good, complete note taking should not be performed by the trial lawyer. That task should be done by someone else sitting at counsel table.

⁴⁸⁹ FED. R. EVID. 611(a).

⁴⁹⁰ *Id.* Under this rule, the court has the power to "exercise reasonable control over the mode and order of interrogating witnesses and presenting evidence so as to (1) make the interrogation and presentation effective for the ascertainment of the truth, (2) avoid needless consumption of time...."

⁴⁹¹ It is proper to draw reasonable inferences from the evidence. But counsel should avoid overstating what the evidence actually proves.

⁴⁹² A common practice is to enlarge the document on a poster board that is light and easy to handle.

ii. Housekeeping.—Good housekeeping techniques are important. A chart should be kept of each document that is marked as an exhibit. The chart should identify the document, show whether it was admitted, and show whether it was admitted only for illustrative purposes.⁴⁹³ The chart should list the exhibits in numerical order. Pre-marked exhibits can be listed in advance. The task of keeping track of exhibits should be assigned to the paralegal sitting at counsel table with the trial lawyer.

iii. Jury Instructions.—In preparing jury instructions, considerations should be given to the verdict form. A special verdict form submitting questions to the jury may help in focusing the case. For example, the verdict form in a case involving the assessment of liquidated damages could provide as follows:

We, the jury, make the following answers to the questions submitted by the court:

Question No. 1: Should liquidated damages be assessed against the plaintiff?

Answer: (Yes or No) _____.

Question No. 2: If your answer to Question No. 1 is “yes,” then answer the following question: The number of days that should be charged for liquidated damages are _____.

The questions may also ask the jury to focus on the State’s liability. For example:

Question No. 1: Did the State breach its contract with plaintiff by withholding information about the pit site, which was vital for the preparation of plaintiff’s bid?

Answer: (Yes or No) _____.

Question No. 2: Did a differing site condition occur in the pit site as alleged by plaintiff?

Answer: (Yes or No) _____.

If your answer is “no” to all of the above, do not answer any further questions. If your answer is “yes” to any of the above, then answer the following questions:

Question No. 3: Did the breach cause damage to plaintiff’s subcontractor?

Answer: (Yes or No) _____.

Question No. 4: If the answer to Question No. 3 is “yes,” what is the amount of those damages?

Answer: _____.

Question No. 5: If you award damages to plaintiff’s subcontractor, what percentage is plaintiff entitled to as markup for overhead and profit on the amount of those damages?

Answer: _____ percentage.

iv. Excluding Evidence.—Counsel should consider whether evidence proffered by opposing counsel may be excluded by the court as a matter of law. For example, there is some authority, although slight, that expert testimony as to the cause and effect of construction delays is not admissible, because the subject matter is not beyond the common knowledge of the jury.⁴⁹⁴ Defense counsel should also consider excluding the contractor’s employees as experts on delay claims.⁴⁹⁵ Reports prepared for settlement discussions should not be admissible.⁴⁹⁶ Efforts to exclude testimony should be raised by motions in limine.⁴⁹⁷

v. Summaries.—Counsel should consider using summaries of records where the underlying records are so voluminous that it would be impractical to admit them in evidence. To be admissible in summary form, the underlying records themselves must be admissible, and they must be made available to the opposing party for inspection.⁴⁹⁸ Trial courts have wide discretion in determining whether summaries are necessary to expedite the trial, and whether the opposing party had a reasonable opportunity to examine the records.⁴⁹⁹

vi. Trial Preparation for Witnesses.—Witnesses should be provided with general instructions that serve as a guide when they testify.⁵⁰⁰ Witnesses must be warned that they must fully understand each question before they answer. The witnesses should be told that they can have a question repeated or rephrased if they do not understand it.

Witnesses should be reminded that they do not have to answer a question “yes” or “no” during cross-examination if they cannot do so. Even if the witness does answer “yes” or “no,” he or she may explain the answer. If the examining attorney prevents the witness from explaining the answer, the defending attorney can have the witness explain the answer during the re-direct examination.

Witnesses should be advised not to take notes or documents to the witness stand when they testify, or review them in the courtroom before they testify, because the questioning attorney will be entitled to re-

⁴⁹⁴ *Jurgens Real Estate Co. v. R.E.D. Constr. Corp.*, 103 Ohio App. 3d 292, 659 N.E.2d 353, 356–57 (1995).

⁴⁹⁵ FED. R. EVID. 701.

⁴⁹⁶ FED. R. EVID. 408; *but see* *Scott Co. of Calif. v. MK-Ferguson*, 832 P.2d 1000 (Colo. App. 1991) (employee’s analysis of claim’s worth entitled “Settlement Detail” was not an offer of settlement within scope of Rule 408 but was a report prepared in ordinary course of business, and was admissible).

⁴⁹⁷ *See* “Pre-Trial Motions,” subsection 6.D.6.c, *supra*.

⁴⁹⁸ FED. R. EVID. 1006.

⁴⁹⁹ *C.L. Maddox, Inc. v. The Benham Group, Inc.*, 88 F.3d 592, 601 (8th Cir. 1996) (admission of summaries of business records was within trial court’s discretion; all underlying information was available to opposing party as required by rule).

⁵⁰⁰ *See generally* 5 AM. JUR. *Trials* § 888-906 (1965).

⁴⁹³ Ordinarily, exhibits admitted for illustrative purposes are not substantive evidence and do not go to the jury room. *See* *Arnold v. Riddell, Inc.*, 882 F. Supp. 979, 995 (D. Kan. 1995).

view those materials.⁵⁰¹ Any documents they need should be supplied by their attorney. Finally, the witnesses must be aware that they are expected to be knowledgeable in the areas of the construction project in which they were directly concerned. They do not have to be experts in those areas of responsibility where they rely on the expertise of others, such as a project engineer relying on the expertise of a soils engineer or geologist. But the witness must be able to respond to questions in his or her area of responsibility. Witnesses who have been deposed should carefully review their deposition transcripts before testifying.

vii. Present the Case in Plain English.—Counsel and their witnesses must keep in mind that judges and juries base decisions on their understanding of the relevant facts. Because construction cases are often complex, it is essential that the trier of fact does not become lost in technological details. Present the case in plain English and have the witnesses explain technical terms, using examples as appropriate to illustrate their meaning. But never talk down to the trier of fact. The attorney or witness who speaks in a condescending or oversimplified fashion may alienate the judge or jury and harm his or her case.

⁵⁰¹ FED. R. EVID. 612.

APPENDIX⁵⁰²

List of Affirmative Defenses

Denial of liability on the merits
 Engineer's determination of claims final
 Waiver or release of claim rights
 No notice of potential claim
 Failure to give proper, detailed, and timely notice required by contract
 Extra work not ordered in writing
 Work performed was beyond the scope or requirements of the contract
 Failure to protest written change order
 Subject matter of claim covered by an executed change order
 Claim compromised and released
 An election to perform work knowing it was misrepresented by the contract
 Negotiation of final pay warrant releasing any and all claims without reservation
 Payment
 Bid submitted without seeking clarification or interpretation of contract provisions
 Estimated quantities approximate only
 Failure to cooperate with other forces
 Assumption of the risk of unforeseen difficulties
 Superior knowledge and expertise
 Duty to examine plans, specifications, and work site and satisfy himself as to conditions
 Voluntary selection of the method of performance
 Statute of limitations
 Statute of frauds
 Failure to mitigate damages
 Failure to comply with claims statute
 Failure to exhaust contractual remedies
 Unjust enrichment
 No damage
 No damages for delay clause (time extension only)
 Subcontractor's damage without liability (*Severin Doctrine*)
 Collateral source rule
 Damages consequential in nature
 Damages as a result of inefficiencies and matter of the contractor's control and responsibility
 Failure to mitigate damages
 Damage or delay caused by the contractor
 Acts of the engineer beyond scope of authority
 Oral modifications of the contract
 Oral promises or representations
 Acts beyond delegated responsibilities
 Violations of law or contract
 No contractor's license
 Subcontracting in violation of the contract or law
 Violation of prequalification statutes or regulations
 Claim sounds in tort
 Failure to comply with public tort claims statutes
 Sovereign immunity
 Failure to state a cause of action or claims

⁵⁰² Affirmative defenses reproduced from *Trial Strategy and Techniques in Highway Contract Litigation*, NCHRP Research Results Digest No. 108, by Orwin F. Finch and Kingsley T. Hoegstedt (1979).

SECTION 7

OWNERS' RIGHTS AND REMEDIES AND ALTERNATIVES TO LITIGATION

A. OWNERS' RIGHTS AND REMEDIES

1. Introduction

Owners are entitled to have their construction contracts fully performed. A contractor's failure to perform is a breach of contract, entitling the owner to damages.¹ Generally, an owner's damages for breach are of two types: damages for delayed performance and damages for defective performance. Damages for delayed performance is usually addressed by a liquidated damage clause in the construction contract as discussed earlier.² The second type of damages, defective performance, and other related issues are discussed in this subsection.

2. Contract Performance

As a general rule, contractors must strictly comply with contract specifications.³ The owner is entitled to receive full performance with the contract specifications, even if that exceeds what is necessary for a satisfactory result.⁴ In addition, the strict compliance rule enhances the integrity of the competitive bidding system by requiring contractors to bid on the basis of meeting contract requirements.⁵

The strict compliance rule, however, is not absolute. Once the work is complete, the rule is tempered by the doctrine of substantial completion. Under this doctrine, the owner is legally required to accept nonconforming work in exchange for a reduction in the contract price.⁶

¹ Failure to perform any term of the contract, no matter how minor, is a breach, entitling the owner to at least nominal damages. 4 ARTHUR CORBIN, CORBIN ON CONTRACTS § 946 (1951); *Delta Envir. v. Wysong & Miles Co.*, 510 S.E.2d 690, 698 (N.C. App. 1999) (nominal damages can be one dollar).

² See "Owner's Remedies for Delay," § 5.C.7, *supra*.

³ *United States v. Wunderlich*, 342 U.S. 98 (1951); *United States ex rel. Compton v. Midwest Specialties, Inc.*, 142 F.3d 296 (6th Cir. 1998); *DiGioia Bros. Excav. v. Cleveland Dep't of Pub. Util.*, 734 N.E.2d 438 (Ohio App. 1999); *R.B. Wright Constr. Co. v. United States*, 919 F.2d 1569 (Fed. Cir. 1990); *Metric Constructors, Inc. v. United States*, 44 Fed. Cl. 513, 523 (1999).

⁴ *R.B. Wright Constr. Co. v. United States, Id.*; *Am. Elec. Contracting Corp. v. United States*, 579 F.2d 602 (Ct. Cl. 1978); *J.L. Malone & Assocs. v. United States*, 879 F.2d 841 (Fed. Cir. 1989); ARTHUR CORBIN, CORBIN ON CONTRACTS § 946 (1951). Owner entitled to reject shop drawings that do not strictly comply with contract specifications. *McMullan & Son, Inc.*, ASBCA 21159, 77-1 BCA ¶ 12, 453 (1977).

⁵ *Troup Bros. v. United States*, 643 F.2d 719, 723 (Ct. Cl. 1980). Bids that do not comply with the invitation for bids are nonresponsive. *George Harms Constr. Co. v. Ocean County Sewerage Auth.*, 394 A.2d 360 (N.J. Super. Ct. App. 1978).

⁶ *Ujdar v. Thompson*, 878 P.2d 180 (Idaho App. 1994); *Ahlers Bldg. Supply v. Larsen*, 535 N.W.2d 431 (S.D. 1995); 3A ARTHUR CORBIN, CORBIN ON CONTRACTS § 701 (1951); 13 AM. JUR. 2D *Building and Construction Contracts* § 46 (2000); 5 WILSTON ON CONTRACTS § 805 (3d ed. 1962); *Granite Constr. Co. v. United States*, 962 F.2d 998 (Fed. Cir. 1992), *cert. de-*

Substantial completion of a construction contract occurs where the work is substantially complete and the structure or facility can be used for its intended purpose.⁷ The contract may define when substantial completion occurs. For example, the WSDOT defines substantial completion as work that, "has progressed to the extent that the Contracting Agency has full and unrestricted use and benefit of the facilities both from the operational and safety standpoint and only minor incidental work...remains to physically complete the total contract."⁸

Substantial completion has other legal consequences in addition to allowing the contractor to recover for the value of its work. Liquidated damages are not assessed after substantial performance has occurred.⁹ Once substantial completion is achieved, liquidated damages may be reduced, and further overruns in contract time are assessed based on direct engineering and other related costs until all of the contract work has been physically completed.¹⁰ Another consequence is that once substantial completion is achieved, the contract cannot be terminated for default.¹¹

The doctrine of substantial completion is an equitable doctrine, designed to avoid forfeiture¹² and economic waste.¹³ The doctrine only applies where the contractor acted in good faith, and its failure to perform fully was not intentional.¹⁴

nied, 506 United States 1048 (1993); *Hannon Elec. Co. v. United States*, 31 Fed. Cl. 135 (1994); *Kirk Reid Co. v. Fine*, 139 S.E.2d 829 (Va. 1965).

⁷ *Granite Constr. Co. v. United States, Id.*; Restatement, Contracts (Second) § 348; Annotation, 41 A.L.R. 4th 131 (1985); 13 AM. JUR. 2D *Building and Construction Contracts* § 48 (2000).

⁸ Washington DOT Standard Specification 1-08.9.

⁹ *Phillips v. Hogan Co.*, 594 S.W.2d 39 (Ark. App. 1980); *Great Lakes Dredge & Dock Co. v. United States*, 96 F. Supp. 923 (Ct. Cl. 1952); *Lindwall Constr. Co.*, ASBCA No. 23,148, 79-1 BCA ¶ 13,822 (1979); Paul H. Gantt and Ruth Brelaver, *Liquidated Damages in Federal Government Contracts*, 47 B.U.L. REV. 71 81-82 (1967); Robert S. Peekar, *Liquidated Damages in Federal Construction Contracts*, 5 PUB. CONT. L. J. 129, 146 (1972).

¹⁰ For example, see Kansas DOT Standard Specification 1.08.08 (1996); North Dakota DOT Standard Specification 1.08.04 (1997); Washington State DOT Standard Specification 1.08.09 (2000).

¹¹ *Olson Plumbing & Heating Co. v. United States*, 602 F.2d 950 (Ct. Cl. 1979). However, if a contractor refuses to complete punch list work, or the corrections are unduly prolonged, the contractor may be deemed to have abandoned the contract. *Appeal of F&D Constr. Co.*, ASBCA No. 41,441 91-2 BCA, ¶ 23, 983 (1991).

¹² *Stevens Constr. Corp. v. Carolina Corp.*, 217 N.W.2d 291 (Wis. 1974).

¹³ *Granite Constr. Co. v. United States*, 962 F.2d 998 (Fed. Cir. 1992), *cert. der.*, 506 U.S. 1048 (1993). Economic waste is discussed in subpart 3A *infra*.

¹⁴ 13 AM. JUR. 2D *Building and Construction Contracts* § 47; 41 A.L.R. 4th 131, 189.

3. Remedies for Defective Performance

a. Repair or Replacement of Defective Work

The general measure of damages for defective performance is the lesser amount of either: (1) the reasonable cost of remedying the defects or omissions, or (2) the difference between the market value of the performance actually rendered and the market value of what the owner would have received, if the contract had been fully performed.¹⁵

But what if the structure or facility has no market value? This is usually the case with respect to most public improvements such as bridges and highways, because they are not bought and sold, and therefore have no market value.¹⁶ In such cases, the market value rule does not apply, and the public owner is entitled to recover damages based on the reasonable cost of remedying the defects or omissions.¹⁷ The application of the "cost to remedy" rule will not apply where the cost would be so clearly unreasonable as to constitute "economic waste."¹⁸ However, the doctrine of economic waste does not apply where the defects or omissions affect the integrity of the structure.¹⁹ Also, there can be no substantial performance where the defect is structural, because the defect affects the soundness of the building and its use for its intended purpose.²⁰ In the

¹⁵ *Spring Indus. v. Ohio Dep't of Transp.*, 575 N.E.2d 226 (Ohio App. 1990) (reduction in contract price based on market value of nonconforming asphalt); *State Property and Bldg. Com. v. H.W. Miller Constr. Co.*, 385 S.W.2d 211 (Ky. 1964) (damages for defective construction of state office building based on reduction in market value); 13 AM. JUR. 2D *Building and Construction Contracts*, § 80; Annotation, 41 A.L.R. 4th 131; Restatement (Second) Contracts § 348 (1981); *Commercial Contractors v. United States*, 154 F.3d 1357 (Fed. Cir. 1998).

¹⁶ Annotation, 31 A.L.R. 5th 171 (1995); *Tuscaloosa County v. Jim Thomas Forestry Consultants*, 613 So. 2d 322 (Ala. 1992); *Department of Transp. v. Estate of Crea*, 483 A.2d 996 (Pa. Commw. 1977); *Shippen Township v. Portage Township*, 575 A.2d 157 (Pa. Commw. 1990).

¹⁷ *Granite Constr. Co. v. United States*, 962 F.2d 98 (Fed. Cir. 1992), *cert. der.*, 506 U.S. 1048 (1993). *Commercial Contractors v. United States*, 154 F.3d 1357 (Fed. Cir. 1998); Restatement (Second) Contracts § 348 (1981); *Rhode Island Turnpike and Bridge Auth. v. Bethlehem Steel Corp.*, 379 A.2d 344 (R.I. 1977) (cost to correct defective painting on bridge did not constitute "economic waste," even though cost was approximately 25 percent of \$19 million contract price).

¹⁸ Economic waste occurs when the cost of remedying defects is clearly disproportionate to the probable loss in value caused by the defects. *Commercial Contractors v. United States*, 154 F.3d 1357 (Fed. Cir. 1998); Restatement (Second) Contracts § 348 (1981).

¹⁹ *Id.*

²⁰ *O.W. Grun Roofing & Constr. Co. v. Cope*, 529 S.W.2d 258 (Tex. Civ. App. 1975); *Spence v. Ham*, 57 N.E. 412 (N.Y. 1900). *Commercial Contractors v. United States*, *id.* at 1372 ("structural defects are deemed to cause such a great loss in value that the cost of remedying such defects is almost never considered to be out of proportion to that loss").

absence of substantial performance, the owner may only be liable in *quantum meruit* to the extent that the work performed has some actual value to the owner.²¹ But some courts have denied the contractor any recovery.²²

The owner is obligated to specify the items of work that have to be corrected and provide the contractor with a reasonable opportunity to correct them.²³ A refusal by the owner to allow the contractor a reasonable opportunity to correct the defects is a breach and may waive the defects.²⁴

b. Reduction in the Functional Life of the Improvement

Public owners should be entitled to recover for the reduction in the functional life of an improvement when repairs are not feasible. One example is a paved road. Under normal wear and tear, the road should be useable for a certain number of years before it has to be repaved.

Assume for example that a road that is properly constructed has a functional life of 20 years. Assume further that defects in the surface of the road have reduced the road's functional life to 15 years. In this sense, the road's value has been reduced by 25 percent (functional life: 15 years instead of 20 years, or 25 percent of what it should have been). To make the owner whole, it should be entitled to a 25 percent reduction in the contract price.²⁵

An alternative to a reduction in the contract price is an agreement by the contractor to repave the road at its own expense if the road wears out sooner than it should. An agreement of this type should be guaranteed by a commercial surety bond in case the contractor is no longer in business when the road wears out.

c. Disincentive Specifications as Liquidated Damages for Defective Work

Another variation in quantifying damages for substandard work is the use of disincentive clauses. Disincentive clauses establish the outer limits of performance: work that is superior and work that is unacceptable. The specification establishes a graduated payment schedule for work between those two levels. Payment for work that is substandard but acceptable will be reduced in accordance with the graduated payment schedule. Those downward adjustments are ap-

²¹ 13 AM. JUR. 2D *Building and Construction Contracts* § 84; Annotation, 41 A.L.R. 4th 131.

²² See cases collected in Annotation, 41 A.L.R. 4th at 139-42.

²³ *Hartford Elec. Applicators of Thermalux, Inc. v. Alden*, 363 A.2d 135 (Conn. 1975).

²⁴ *Carter v. Kruger*, 916 S.W.2d 932 (Tenn. Ct. App. 1995).

²⁵ *Black Top Paving Co. v. Department of Transp.*, 466 A.2d 774 (Pa. Commw. 1983) (credit assessed for nonconforming work).

plied to the unit bid price, reducing the amount paid for the work.²⁶

The legal question that the use of disincentive clauses raises is whether such clauses are a penalty and thus unenforceable, or liquidated damages and thus enforceable. For example, in *Complete General Construction v. Ohio Department of Transportation*, the specifications for the construction of concrete pavement provided that the contractor was to be paid in proportion to the degree that the work complied with the standard specifications in the contract.²⁷ Under this provision, the contractor was paid less than the contract price when the work failed to meet minimum acceptable standards. The contractor sued, claiming that the disincentive clause was a penalty, and thus unenforceable. The court disagreed, holding that the clause was a valid liquidated damage clause.

A disincentive clause, to be enforceable, must be a reasonable means of estimating damages that cannot otherwise be easily computed. A disincentive clause that is found to be a penalty is void, and the owner must prove actual damages.²⁸ In this regard, care should be taken in justifying and quantifying the liquidated damage provisions.²⁹

d. Administrative Setoffs

The cost of remedying defective work may be withheld by the owner from money owed to the contractor, usually from contract payments or retainage. This is a form of “self-help” recognized by the common law as an administrative setoff. The Government has the same right as any creditor to setoff debts owed the Government by the contractor against an indebtedness that the Government owes the contractor.³⁰

The right extends to setoffs between separate contracts that the owner has with the contractor.³¹ The deduction may be made even though the debt owed by the contractor is unliquidated and arose from a separate transaction.³² The contractor can challenge the

setoff, and a board or court can determine whether the withholding was proper. This protects the contractor against withholdings that are unwarranted or improper.³³ Deductions should be reasonably prompt so that the contractor’s position with its subcontractors is not prejudiced.³⁴

The right to setoff has some limitations. The right does not extend to contract payments owed to a performance bond surety for completing the contract after the original contractor has defaulted.³⁵ “When the surety pays construction expenses under its performance bond obligations, it receives the contract proceeds free from setoff by the government, because the surety receives the proceeds as a subrogee of the government as well as the contractor.”³⁶ The government, however, is entitled to setoff debts owed by the original contractor against contract proceeds claimed by the surety under its payment bond.³⁷

The rule that the payment bond surety’s claim to contract proceeds is subordinate to an owner’s right of setoff does not apply to contract retainage withheld by an owner for the benefit of subcontractors, materialmen, and laborers. When a surety pays those claimants after the contractor has failed to pay them, the surety is subrogated to the claimant’s rights to the retainage. That right of subrogation is superior to the owner’s right of setoff against the contract retainage.³⁸ Whether a surety can enforce that right against a state agency holding retainage depends upon whether the state has waived sovereign immunity.³⁹

4. Unauthorized Acceptance of Defective Work

Ordinarily, project inspectors are not authorized to alter the contract by accepting work or materials that do not conform to contract specifications. Usually, the authority to change or modify the contract is vested in

(Md. 1947) and *Eyer v. Richards & Conover Hardware Co.*, 55 P.2d 60 (Okla. 1936).

²⁶ *Philco Constr. Co.*, DOTCAB 67-33, 68-2 BCA ¶ 7110 (1968).

²⁷ *Southwest Eng. Co.*, NASA 87-4 BCA 2515, 68-1 BCA 6977 (1968). Public works “Prompt Pay” acts may require the agency to notify the contractor within a specified number of working days that payment is being withheld. *See, e.g.*, WASH. REV. CODE 39.76.011(2)(b).

²⁸ *Aetna Cas. & Sur. Co. v. United States*, 435 F.2d 1082 (5th Cir. 1970); *Trinity Universal Ins. Co. v. United States*, 382 F.2d 317 (5th Cir. 1967); *Morrison Assur. Co. v. United States*, 3 Ct. Cl. 626 (1983).

²⁹ *Morrison Assur. Co.*, *id.* at 632.

³⁰ *United States v. Munsey Trust Co.*, 332 U.S. 234 (1947).

³¹ *Nat. Sur. Corp. v. United States*, 118 F.3d 1542 (Fed. Cir. 1997).

³² *Liberty Mutual Ins. Co. v. Sharp*, 874 S.W.2d 736 (Tex. App. 1994) (suit by surety against state agency for agency setoff against retainage dismissed based on sovereign immunity); *see* § 6.21.A., *supra*, containing a table listing the States that have waived sovereign immunity.

²⁶ 3 ORRIN F. FINCH, *Legal Implications in The Use of Penalty and Bonus Provisions in Highway Construction Contracts: The Use of Incentive and Disincentive Clauses as Liquidated Damages for Quality Control and for Early Completion*, in SELECTED STUDIES IN HIGHWAY LAW 1582, N-80 (hereinafter FINCH); *see also* Transportation Research Record 1056 for a collection of technical papers on statistical quality control.

²⁷ 593 N.E.2d 487 (Ohio Ct. Cl. 1990).

²⁸ *State of Ala. Hwy. Dep’t v. Milton Constr. Co.*, 586 So. 2d 872 (Ala. 1991).

²⁹ FINCH, *supra* note 26, at 1582, N83.

³⁰ *United States v. Munsey Trust Co. of Washington, D.C.*, 332 U.S. 234 (U.S. Ct. Cl. 1947); *Cecile Indus. v. Cheney*, 995 F.2d 1052 (Fed. Cir. 1993).

³¹ *Mega Constr., Inc. v. United States*, 29 Fed. Cl. 396 (1993); *Dale Ingram, Inc. v. United States*, 475 F.2d 1177 (Ct. Cl. 1973); *Project Map, Inc. v. United States*, 486 F.2d 1375 (Ct. Cl. 1973).

³² *Warren Little & Lund v. Max J. Kuney*, 796 P.2d 1263 (Wash. 1990); *but see H.J. McGrath Co. v. Wisner*, 55 A.2d 793

the engineer for state construction contracts,⁴⁰ and in the contracting officer for federal construction contracts.⁴¹

As a general rule, the Federal Government and state governments are not bound by the unauthorized acts of their representatives.⁴² The doctrine of “apparent authority,” which allows private parties to be bound by the unauthorized acts of their agents, clothed with apparent authority to act on their behalf, does not apply to federal and state governments.⁴³

However, an unauthorized acceptance may bind the government, if it is ratified by a person whose actual authority is to accept nonconforming work or materials.⁴⁴ Ratification occurs when the ratifying contract official has knowledge of the unauthorized acceptance and expressly or impliedly approves the acceptance.⁴⁵ However, ratification will not be applied where the contractor does not prove that the person with authority to bind the government had knowledge of the unauthorized acceptance and either expressly or tacitly approved it.⁴⁶

The unauthorized acceptance may be used by the contractor as proof that its interpretation of the specification, which coincided with the inspector’s, was reasonable.⁴⁷ The contractor is entitled to perform in accordance with its interpretation of the contract, provided that its interpretation was reasonable.⁴⁸

5. Latent Defects

Contract specifications usually address defects in construction discovered after final acceptance has occurred. Some specifications reflect the common law rule that final acceptance, without any reservations, waives defects in construction that the owner knew about, or

could have discovered by the exercise of reasonable care.⁴⁹ Only patent defects are waived; latent defects survive acceptance because they are unknown and therefore cannot be voluntarily waived.⁵⁰

Contract specifications, based on the common law rule, typically provide that acceptance is final and conclusive except for latent defects, fraud, gross mistake amounting to fraud, or rights under contract warranties.⁵¹ Under this type of clause, the owner has no remedy for defects discovered after final acceptance unless the defect is latent, the result of fraud, or covered by warranty.⁵²

Some states include “anti-waiver” provisions in their contracts. These specifications negate any inference that patent defects are waived because of final acceptance. For example, the specification may provide that:

The Department shall not be precluded or estopped by any measurement, estimate, or certificate made either before or after the completion and acceptance of the work and payment therefor, from showing the true amount and character of the work performed and materials furnished by the contractor, nor from showing that any such measurement, estimate, or certificate is untrue or is incorrectly made, nor that the work or materials do not in fact conform to the contract. The Department shall not be precluded or estopped, notwithstanding any such measurement, estimate, or certificate and payment in accordance therewith, from recovering from the contractor or his sureties, or both, such damage as it may sustain by reason of his failure to comply with the terms of the contract. Neither the acceptance by the Department, or any representative of the Department, nor any payment for or acceptance of the whole or any part of the work nor any extension of time, nor any possession taken by the Department, shall operate as a waiver of any portion of the contract or of any power herein reserved, or of any right to damages. A waiver of any breach of the contract shall not be held to be a waiver of any other or subsequent breach.⁵³

Under this type of specification, the owner does not waive its right to damages for patent defects discovered after final acceptance. To establish waiver, the contractor must prove that the owner intentionally waived the

⁴⁰ AASHTO Guide Specification 104.03 (1998); Arizona DOT Specification 104.04 (1996); California DOT Specification 104.4 (1996); California DOT Specification 4.10.3 (1995); Florida DOT Specification 4.3.2.1 (1996); Texas DOT Specification 10.3.2(B) (1996).

⁴¹ 48 C.F.R. 43.102(A).

⁴² MCQUILLIAN, MUNICIPAL CORPORATIONS § 29.04 (3d ed.); Noel v. Cole, 655 P.2d 245 (Wash. 1982); ECC Intern. Corp. v. United States, 43 Fed. Cl. 359 (1999); Williams v. United States, 127 F. Supp. 617 (Ct. Cl. 1955).

⁴³ Noel v. Cole, *id.*; Williams v. United States, *id.*

⁴⁴ Dan Rice Constr. Co. v. United States, 36 Fed. Cl. 1 (1996); Dolmatch Group Ltd. v. United States, 40 Fed. Cl. 431 (1998).

⁴⁵ Aero-Arbe, Inc. v. United States, 39 Fed. Cl. 654 (1997); Williams v. United States, 127 F. Supp. 617 (Ct. Cl. 1955).

⁴⁶ EWG Assocs., Ltd. v. United States, 231 Ct. Cl. 1028 (1982); United States v. Beebe, 180 343 (1901); Dolmatch Group Ltd. v. United States, 40 Fed. Cl. 421 (1998); Restatement (Second) Agency, § 91 (1957).

⁴⁷ Canupp Trucking, Inc., Comp. Gen. Dec., B-261127 (1996).

⁴⁸ Constructors Metric Inc. v. United States, 44 Fed. Cl. 513 (1999) (court rejected contractor’s interpretation of specifications as unreasonable).

⁴⁹ 13 AM. JUR. 2D *Building and Construction* § 63; Mt. View Evergreen/Improvement and Service Dist. v. Casper Concrete Co., 912 P.2d 529 (Wyo. 1996); United States v. Lembke Constr. Co., 786 P.2d 1386 (9th Cir. 1986); Stevens Constr. Corp. v. Carolina Corp., 217 N.W.2d 291 (Wis. 1974); United Technologies Corp. v. United States, 27 Fed. Cl. 393 (1992).

⁵⁰ United Technologies v. United States, *Id.*; Mastor v. David Nelson Constr. Co., 600 So. 2d 555 (Fla. App. 1992); Shaw v. Bridges-Gallagher, Inc., 528 N.E.2d 1349 (Ill. App. 1988).

⁵¹ 48 C.F.R. ch. 1, 52.246-12; Georgia DOT Standard Specification 107.20; Arkansas DOT Standard Specification 107.20.

⁵² United States v. Lembke Constr. Co., 786 P.2d 1386 (9th Cir. 1986).

⁵³ Nebraska DOT Standard Specification 107.18; Washington DOT Standard Specification 1-07.27.

defect by accepting the work without reservation.⁵⁴ “Anti-waiver” clauses reveal the intent of the parties to eliminate the binding effect of final acceptance of the work.⁵⁵

One survey revealed that claims made by some States for defective work discovered after final acceptance were either settled administratively or shortly after litigation commenced.⁵⁶ There are probably various reasons why contractors chose to settle. First is the contractor’s desire to maintain its reputation and good will with the agency. A second reason is the merits of the agency’s claim. The contractor, of all the parties, should be able to recognize whether the work is defective. Third is the cost of litigation, if the claim is not settled. And finally, in most cases, it is probably cheaper for the contractor to effect repairs than to pay the owner the cost of having someone else do the work.

In the absence of an “anti-waiver” clause, the key determination in most litigation involving defects discovered after final acceptance is whether the defect was patent or latent.⁵⁷ This is largely a matter of proof. The owner, to establish liability, must prove that the defect was latent, that it existed before final acceptance, and did not occur after the project was accepted.⁵⁸

6. Statutory Time Limitations as a Bar to Recovery for Construction Defects Discovered After Final Acceptance

a. Statutes of Limitation and Statutes of Repose—How They Differ

Statutes of limitation and statutes of repose are similar in that both prescribe time periods within which lawsuits must be commenced. They differ as to when the time periods begin to run.⁵⁹ A statute of limitations usually begins to run when the claim accrues. Generally, a claim accrues when a claimant or potential claimant knew or should have known, through reason-

able diligence, that it had a claim for which relief from a court could be sought.⁶⁰

A statute of repose begins to run from a certain event specified in the statute.⁶¹ Statutes of repose that apply to improvements to real property usually specify substantial completion of the improvement as the event that causes the statute to run.⁶² Once the statutory time period has elapsed, the claim is extinguished and cannot be revived.⁶³ A statute of repose reflects a legislative policy determination that, “a time should come beyond which a potential defendant will be immune from liability for his past acts and omissions.”⁶⁴

Under a statute of limitations, a contractor is subject to potential liability until the claim accrues and the time period for commencing suit has elapsed.⁶⁵ Under a statute of repose, any liability for construction defects is extinguished once the time period has run even though the owner is unaware that it has been damaged, because the defect did not manifest itself until after the statutory period had elapsed.⁶⁶ In short, time ran out before the owner had an opportunity to pursue relief for the defect.⁶⁷

Whether a particular statute is a statute of limitations or a statute of repose is a question of statutory construction.⁶⁸ Usually, a statute is characterized as a statute of repose if the statutory period for commencing suit is triggered by the occurrence of an event, irrespective of whether the potential plaintiff knew or should have known that he or she had a cause of action.⁶⁹

We recognize the fundamental difference in character of [the statute of repose] provisions from the traditional concept of a statute of limitations. Rather than establishing a time limit within which action must be brought, measured from the time of accrual of the cause of action, these provisions cut off the right of action after a speci-

⁵⁴ V.P. Owen Constr. Co. v. Dunbar, 532 So. 2d 835 (La. App. 1988).

⁵⁵ Metropolitan Sanitary Dist. of Greater Chicago v. Anthony Pontarelli & Sons, Inc., 288 N.E.2d 905, 915 (Ill. App. 1972).

⁵⁶ D.W. HARP, LIABILITY OF CONTRACTORS TO STATE TRANSPORTATION DEPARTMENTS FOR LATENT DEFECTS IN CONSTRUCTION AFTER PROJECT ACCEPTANCE (National Cooperative Highway Research Program Legal Research Digest No. 39, 1997). The article lists sixteen states that have had projects with latent defects at some time in the past. Most settled without litigation. A few settled after litigation commenced. None went to trial.

⁵⁷ Harris v. Williams, 679 So. 2d 990 (La. App. 1996).

⁵⁸ M.A. Mortenson & Co. v. United States, 29 Fed. Cl. 82 (1993).

⁵⁹ Corkill v. Knowles, 955 P.2d 438 (Wyo. 1998); Cheswold Volunteer Fire Co. v. Lambertson Constr. Co., 462 A.2d 416 (Del. Super. 1984).

⁶⁰ Gibson v. Department of Highways, 406 S.E.2d 440 (W. Va. 1991); Metropolitan Life Ins. Co. v. M. A. Mortenson Cos., 545 N.W.2d 394 (Minn. App. 1996); City of Gerling v. Patricia G. Smith Co., 337 N.W.2d 747 (Neb. 1983).

⁶¹ Corkill v. Knowles, 955 P.2d 438 (Wyo. 1998); Russo Farms, Inc. v. Vineland Bd. of Educ., 675 A.2d 1077 (N.J. 1996); Trinity River Auth. v. URS Consultants, Incorporated-Texas, 889 S.W.2d 259 (Tex. 1994).

⁶² See table in subpart 60, *infra*, listing events that trigger the statutes.

⁶³ Com. v. Owens-Corning Fiberglass Corp., 385 S.E.2d 865 (Va. 1989).

⁶⁴ *Id.* at 867. See Monson v. Paramount Homes, Inc., 515 S.E.2d 445 (N.C. App. 1999).

⁶⁵ See, e.g., Bellevue Sch. Dist. v. Braiser Constr. Co., 691 P.2d 178 (Wash. 1984) (suit for construction defects 20 years after improvement was completed).

⁶⁶ Com. v. Owens-Corning Fiberglass Corp., 385 S.E.2d 865 (Va. 1989).

⁶⁷ Funk v. Wollin Silo & Equip., 435 N.W.2d 244 (Wis. 1989); Corkill v. Knowles, 955 P.2d 438 (Wyo. 1998).

⁶⁸ Smith v. Liberty Nursing Home, Inc., 522 S.E.2d 890 (Va. App. 2000).

⁶⁹ Corkill v. Knowles, 955 P.2d 438 (Wyo. 1998); Com. v. Owens-Corning Fiberglass, 385 S.E.2d 865 (Va. 1989).

fied time measured from the delivery of a product or the completion of work. They do so regardless of the time of the accrual of the cause of action or of notice of the invasion of a legal right.⁷⁰

In addition to the question of how a limitations statute should be classified, there may also be issues regarding the constitutionality of a statute of repose and whether a limitation statute applies to actions brought by a state in its own behalf. These issues are discussed in the following subparts of this section.

b. Constitutionality—Statutes of Repose

Statutes of repose have been declared unconstitutional in a few states on several grounds. First, the statutes have been viewed as providing special immunity from suit to architects, engineers, and contractors without specifying a rational basis for immunity.⁷¹ Second, the statutes denied open access to the courts,⁷² without expressing a strong public necessity for the provision.⁷³ Access was denied because the statute could extinguish a potential cause of action before a person knew that it has been injured by defective or negligent construction.⁷⁴

Several states have reenacted their repose statutes, after the statutes were declared unconstitutional, specifically spelling out the public necessity for their creation.⁷⁵ For example, in *Craftsman Builder's Supply v. Butler Mfg.*, the court said,

In enacting that statute, the legislature specifically found that exposing providers to liability after the possibility of injury has become highly remote is a clear social and economic evil in that it creates costs and hardships to providers and citizens of the state which include (1) liability insurance costs, (2) records storage costs, (3) un-

⁷⁰ Bauld v. J.A. Jones Constr. Co., 357 So. 2d 401, 402 (Fla. 1978); see also Univ. of Miami v. Bogorff, 583 So. 2d 1000, 1003 (Fla. 1991); *Craftsman Builder's Supply v. Butler Mfg.*, 974 P.2d 1194, 1202 (Utah 1999).

⁷¹ Phillips v. ABC Builders, 611 P.2d 821 (Wyo. 1980); *Loyal Order of Moose Lodge 1785 v. Cavaness*, 563 P.2d 143 (Okla. 1977); *Broome v. Truluck*, 241 S.E.2d 739 (S.C. Super. 1978). In *McFadden v. Ten-T Corp.*, 529 So. 2d 192, 198 (Ala. 1988), the court noted that statutes of repose were often the result of lobbying efforts by the American Institute of Architects, the National Society of Professional Engineers, and the Associated General Contractors of America.

⁷² Thirty-eight states have open court provisions in their constitutions. *Craftsman Builder's Supply v. Butler Mfg.*, 974 P.2d 1194, 1204 (Utah 1999) (citing David Schumau, *The Right to a Remedy*, 65 TEMP. L. REV. 1197, 1202, n.25 (1992)). The Utah open courts clause provides in part that, "All courts shall be open and every person...shall have remedy by due course of law." Utah Const. art. I, § 11.

⁷³ See *Overland Constr. Co. v. Sirmons*, 369 So. 2d 572 (Fla. 1979).

⁷⁴ *Jackson v. Mannesmann Demag Corp.*, 435 So. 2d 725 (Ala. 1983); *Horton v. Goldminer's Daughter*, 785 P.2d 1087 (Utah 1989); *Kallas Millwork Corp. v. Square D Co.*, 225 N.W.2d 454 (Wis. 1975).

⁷⁵ FLA. STAT. 95.11(3)(c)(1980); WIS. STAT. ANN. 893.89 (1982); UTAH CODE ANN. § 78 – 12-25.5 (1996).

due and unlimited liability risks during the life of both a provider and an improvement, and (4) difficulties in defending against claims asserted many years after completion of an improvement (citation omitted). To remedy this perceived evil, the legislature enacted Utah Code Ann. § 78—12-25.5, which eliminates an injured party's remedy for injury to person or property arising out of an improvement to real property after a set number of years when the possibility of injury and damage becomes highly remote and unexpected.⁷⁶

The reenacted Florida and Utah statutes have been held constitutional.⁷⁷ These jurisdictions now follow the majority of state courts, which hold that statutes of repose are constitutional.⁷⁸ One study has revealed that the vast majority of claims brought for design defects were brought within 10 years after the improvement was completed.⁷⁹

c. Nullum Tempus

Under the common law doctrine of *nullum tempus*,⁸⁰ a state and its agencies were exempt from statutes of

⁷⁶ 974 P.2d 1194, 1199 (Utah 1999).

⁷⁷ *Sabal Chase Homeowners Ass'n v. Walt Disney World Co.*, 726 So. 2d 796 (Fla. App. 1999); *Craftsman Builder's Supply v. Butler Mfg.*, 974 P.2d 1194 (Utah 1999).

⁷⁸ *Klein v. Catalano*, 437 N.E.2d 514, 524 (Mass. 1982) (court discusses the various public interests that are served by a statute of repose); *Rosenberg v. Town of North Bergen*, 293 A.2d 662 (N.J. Super. 1972); *Arkansas: Carter v. Hartenstein*, 455 S.W.2d 918 (1970); *Delaware: Cheswold Vol. Fire v. Lambertson Constr.*, 462 A.2d 416 (Del. Super. 1983); *California: Barnhouse v. City of Pinole*, 183 Cal. App. 3d 171 (1982); *Colorado: Yarbo v. Hilton Hotels Corp.*, 655 P.2d 811 (Colo. 1983); *Georgia: Mullis v. Southern Co. Services, Inc.*, 296 S.E.2d 579 (1982); *Idaho: Twin Falls Clinic & Hospital Bldg. Corp v. Hamill*, 644 P.2d 341 (1982); *Illinois: Cross v. Ainsworth Steel Co.*, 557 N.E.2d 906 (Ill. App. 1990); *Kentucky: Carney v. Moody*, 646 S.W.2d 40 (1983); *Maryland: Whiting-Turner Contracting Co. v. Coupard*, 499 A.2d 178 (1985); *Michigan: O'Brien v. Hazelet & Erdal*, 299 N.W.2d 336 (1980); *Missouri: Blaska v. Smith & Entzeroth, Inc.*, 821 S.W.2d 822 (1991); *Nevada: Wise v. Bechtel Corp.*, 766 P.2d 1317 (1988); *North Carolina: Lamb v. Wedgewood South Corp.*, 286 S.E.2d 876 (N.C. App. 1982); *Ohio: Gamble Deaconess Home Ass'n v. Turner Constr. Co.*, 470 N.E.2d 950 (Ohio App. 1984); *Pennsylvania: Freezer Storage, Inc. v. Armstrong Cork Co.*, 382 A.2d 715 (1998); *Virginia: Hess v. Snyder Hunt Corp.*, 392 S.E.2d 817 (1990); *Washington: Yakima Fruit & Cold Storage Co. v. Central Heating & Plumbing Co.*, 503 P.2d 108 (1972). The following law review articles discuss the constitutional implications raised by statutes of repose: 18 CATH. U. L. REV. 361 (1969); 38 VAND. L. REV. 627 (1985); 65 TEP. L. REV. 1101 (1994). See also 25 PUB. CONT. L. J. 1101 (1996).

⁷⁹ *Gibson v. Department of Highways*, 406 S.E.2d 440, 447 (W. Va. 1991) (citing study showing that 99.6 percent of claims for design and defective construction are brought within 10 years).

⁸⁰ *Nullum tempus* is derived from "*nullum tempus occurri regi*," which is translated as "time does not run against the King." BLACK'S LAW DICTIONARY 1069 (6th ed. 1990); *Rowan Cty. Bd. of Educ. v. U.S. Gypsum*, 418 S.E.2d 648, 653 (N.C. 1992); *Guaranty Trust Co. of N.Y. v. United States*, 304 U.S. 126, 132 (1938).

limitations generally applicable in civil lawsuits between private parties.⁸¹ Historically, the *nullum tempus* doctrine was based upon sovereign power and prerogative.⁸² The contemporary *nullum tempus* doctrine is based on public policy: The public should not suffer because its officials failed “to promptly assert causes of action which belong to the public.”⁸³

Several states have codified the common law rule of *nullum tempus* by enacting statutes that exempt the states from the operation of a statute of limitations unless the statutes, by their terms, expressly include the states.⁸⁴ A number of states, however, have taken a different tack by abrogating the *nullum tempus* doctrine, either statutorily or through court decisions. The following table lists each state where the limitations apply to lawsuits brought by the state, unless a pertinent statute expressly excludes a state from the operation of a statute of limitations. Table A provides citations to the applicable statutes or court decisions that have abrogated *nullum tempus*, the applicable limitation period affecting claims for defective construction, and the event that triggers the running of the statute.

⁸¹ Department of Transp. v. Rockland Constr. Co., 448 A.2d 1047 (Pa. 1982); Hamilton County Bd. of Educ. v. Asbestospray Corp., 909 S.W.2d 783, 785 (Tenn. 1995); Port Auth. of N.Y. & N.J. v. Bosco, 475 A.2d 676 (N.J. App. Div. 1984); Colorado Springs v. Timberlane Associates, 824 P.2d 776, 778 (Colo. 1992); “a majority of states, when filing lawsuits in the posture of plaintiffs are immune from statutes of limitations, except where their respective legislatures have decided otherwise.” N.J. Educ. Facilities Auth. v. Conditioning Co., 567 A.2d 1013, 1016 (N.J. Super. A.D. 1989).

⁸² People v. Asbestospray, 616 N.E.2d 652, 654 (Ill. App. 1993); United States v. Thompson, 98 U.S. 486, 489 (1878).

⁸³ People v. Asbestospray, *id.*; Shootman v. Department of Transp., 926 P.2d 1200, 1203 (Colo. 1996); State ex rel. Condon v. City of Columbia, 528 S.E.2d 408, 413 (S.C. 2000); Guaranty Trust Co. v. United States, 304 U.S. 126, 132 (1938).

⁸⁴ Arizona: Statute 12-510 (1987); Hawaii: Statute 657-1-5; Mississippi: Statute Ann. 51-1.51; Tennessee: Statute 28-1-113; Virginia: Statute 8.01-231; *but see* Com. v. Owens-Corning Fiberglass Corp., 385 S.E.2d 865 (Va. 1989) (state’s cause of action extinguished when the time limitation of the statute of repose has run).

TABLE A

STATE	<i>NULLUM TEMPUS</i> ABROGATED BY:	TIME PERIOD, TRIGGERING EVENT, AND STATUTE
Alaska	STAT. 9.10.120 (1997).	Six years from accrual of cause of action. STAT. 9.10.120 (1997).
California	Civ. Proc. Sec. 345 (1984).	Within 4 years after discovery, but no later than 10 years after substantial completion. Civ. Proc. 337.15 (1982).
Colorado	Abrogated by court decision: <i>Shootman v. Dept. of Trans.</i> , 926 P.2d 1200 (Colo. 1996).	Within 2 years after claim accrues, but not more than 6 years after substantial completion. REV. STAT. 13-80-104 (2001).
Florida	STAT. ANN. 95.011 (1977).	Four years after defect is discovered or should have been discovered, but not more than 15 years after completion of the contract. STAT. 95.11(c) (1995).
Georgia	CODE ANN. 9-3-1 (1933).	Eight years after contract completion. CODE ANN. 9-3-51 (1968).
Idaho	CODE 5-225 (1881).	Six years from final completion of improvement. CODE 5-241 (1965).
Illinois	CODE 13-214. Use of the term "body politic" in the statute of repose included the state in its coverage. <i>People v. Asbestospray Corp.</i> , 616 N.E.2d 652 (Ill. App. 1993).	Not more than 10 years from acceptance of the improvement. CODE 5/13-214 (1993).
Kansas	STAT. ANN. 60-521. Limitations do not apply when action arises out of governmental functions. <i>State ex rel Schneider v. McAfee</i> , 578 P.2d 281 (Kan. 1978).	Within 5 years after cause of action has accrued. STAT. ANN. 60-511 (1966).
Kentucky	REV. STAT. 413.150. <i>See Louisville & N.R. Co. v. Siler</i> , 186 F. 176 (C.C.E.D. Ky. 1911).	Within 10 years from completion. REV. STAT. 413.120.
Massachusetts	GEN. L. 260.18 (1902). <i>See Com. v. Owens-Corning Fiberglass Corp.</i> , 650 N.E.2d 365 (1995).	Within 3 years after cause of action accrues, but not more than 6 years from the earlier of (1) acceptance of the project; or (2) opening the facility to public use; or (3) acceptance by the contractor of a final estimate prepared by the agency; or (4) substantial completion. GEN. L. 260 § 2.
Minnesota	STAT. 541.01 (1986). <i>See City of St. Paul v. Chicago M. & St. P. Ry. Co.</i> , 48 N.W. 17 (Minn. 1891).	Two years after discovery of defect, but not more than 10 years after substantial completion. STAT. 541.051 (1990).
Missouri	REV. STAT. 516.360 (1929).	Within 10 years from completion of improvement, but limitation does not apply if the defect was concealed or resulted in an unsafe condition. REV. STAT. ANN. 25-218 (1991).

Montana	CODE ANN. 27-2-103 (1991).	Not more than 10 years after completion of improvement. STAT. 27-2-208 (1999).
Nebraska	Rev. STAT. ANN. 25-218 (1991).	Within 4 years from discovery, but not more than 10 years beyond the time of the act giving rise to the cause of action. STAT. 25-223 (1976).
New Jersey	Abrogated by court decision: <i>N.J. Ed. Facilities Auth. v. Gruzen Partnership</i> , 592 A.2d 559 (1991). Legislature then enacted a 10-year statute of limitations applicable to state claims. STAT. 2A 14-1.1 and .2. See <i>State v. Cruz Constr. Co.</i> , 652 A.2d 741 (N.J. Super. A.D.) (1995).	Within 10 years from completion of construction. REV. STAT. 2A: 14-1.1 (1998). Limitation does not apply if defect arises from fraudulent concealment or gross negligence. STAT. 2B 14-1-1 B(2).
North Carolina	GEN. STAT. 1-30. Limitation only applies when state acts in a proprietary capacity. <i>Rowan County Bd. Of Educ. v. United States Gypsum Co.</i> , 418 S.E.2d 648 (N.C. 1992).	Within 6 years from breach or substantial completion. STAT. 1-50(5) A (1996). Limitation does not apply to defects caused by fraud or gross negligence, STAT. 1-50(5)(E).
North Dakota	CODE 28.01-23 (1943).	Not more than 10 years after substantial completion. The time to commence suit is extended 2 years if the injury occurs in the tenth year after substantial completion. CODE 28-01.44 (1989).
Oregon	CODE 28.01-23 (1943).	Within 10 years after substantial completion. REV. STAT. 12.135(1).
South Carolina	Abrogated by court decision: <i>State ex rel. Condon v. City of Columbia</i> , 528 S.E.2d 408 (S.C. 2000).	Within 13 years after substantial completion of improvement. STAT. 28-3-202 (1980).
Vermont	STAT. ANN. 461 (1947).	Within 6 years after cause of action accrues. STAT. ANN. 511 (1959). <i>Univ. of Vermont v. W.R. Grace & Co.</i> 565 A.2d 1354 (Vt. 1989).
Virginia	Expiration of the period in statute of repose extinguishes cause of action, preventing state from maintaining suit. <i>Com. v. Owens-Corning Fiberglass Corp.</i> , 385 S.E.2d 865 (Va. 1989).	Not more than 5 years after performance of construction. CODE ANN. 8-01-250 (1977).
Washington	REV. CODE 4.16.310 (1988). The statute added the state to its coverage, overruling <i>Bellevue School Dist. No. 405 v. Braizer Const. Co.</i> , 691 P.2d 178 (Wash. 1984), which had applied <i>nullum tempus</i> .	Within 6 years after substantial completion of construction. REV. CODE 4.16.310 (1988). See <i>Gevaart v. Metro Constr. Inc.</i> , 760 P.2d 348, 350 (Wash. 1988), discussing how the 6-year period can be extended.
West Virginia	CODE 55-2-19 (1923). <i>Gibson v. Dept. of Highways</i> , 406 S.E.2d 440 (W. Va. 1991).	Within 10 years after acceptance of improvement. Code 55-2-6A (1983).
Wisconsin	STAT. 893.87 (1980). Action by state must be brought within 10 years after cause of action accrues.	Within 10 years from substantial completion. Limitation does not apply to defects resulting from fraud, concealment, or misrepresentation. CODE 893.89 (1994).

The Supreme Courts of Colorado, New Jersey, and South Carolina,⁸⁵ as noted in the table, held that the common law doctrine of *nullum tempus* was abrogated when sovereign immunity was waived. Those courts also said that it would be anomalous that a state, which is not protected from suit by sovereign immunity, should be entitled to benefit from *nullum tempus*.

The view that abrogating sovereign immunity also abrogates *nullum tempus* has been rejected by other courts. For example, in *Rowan Cty. Bd. of Educ. v. U.S. Gypsum Co.*, the North Carolina Supreme Court said:

Further, while USG correctly notes that this Court has expressed an intent to restrict rather than extend application of sovereign immunity (citation omitted), our treatment of that doctrine does not affect our view of *nullum tempus*, which serves a different purpose. While the two doctrines share a similar “philosophical origin and have a similar effect of creating a preference for the sovereign over the ordinary citizen,” (citation omitted) retrenchment on the one does not require retrenchment on the other. While limiting sovereign immunity diminishes the government’s escape of its misdeeds, the same concern for the rights of the public supports retention of *nullum tempus*, as that doctrine allows the government to pursue wrongdoers in vindication of public rights and the public purse.⁸⁶

7. Damage to Structures During Contract Performance

a. Liability for Damage

Generally, destruction of the subject matter of the contract excuses further performance, but only when performance becomes objectively impossible. To excuse performance, the impossibility must be produced by an unforeseen event that could not have been prevented or guarded against by the contractor. The fact that unforeseen events, beyond the contractor’s control, make performance more difficult or costly does not excuse performance. The contractor must either perform or respond in damages.⁸⁷ To protect itself against unforeseen events, the contractor could purchase builder’s risk insurance. The cost of insurance would typically be

passed on to the owner as part of the bid price.⁸⁸ To reduce bids and encourage competition, owners often include risk sharing clauses in their construction contracts. Such clauses allocate the risk for *force majeure* events.⁸⁹

Typically, these clauses excuse the contractor from responsibility for damages to the work caused by any of the events listed in the clause.⁹⁰ To avoid responsibility for damage to work, the contractor must show that the damage caused by one of the enumerated events in the clause was beyond the control of the contractor and did not result from the contractor’s negligence.⁹¹

b. Age and Condition of Structure as Factors in Determining Damages

Generally, public bridges and roads do not have a commercial market value, because ordinarily they are not bought and sold.⁹² Because they do not have a market value, the usual rules for determining damages to real property improvements do not apply.⁹³ If the damage to the structure can be repaired without affecting its integrity and safety, the measure of damages is the cost of repair.⁹⁴ If the structure is destroyed, the proper measure of damages is the replacement cost of a similar structure, consistent with current design standards.⁹⁵

The authorities disagree, however, as to whether the replacement cost of a structure should be adjusted to compensate for the age, condition, and utility of the structure. Under one view, the measure of damages for the loss of the structure is the reasonable cost of replacement by a similar structure, consistent with current design standards. The age, condition, and utility of

⁸⁸ The cost to procure and maintain insurance may be high where the project is located in an area subject to severe storms or earthquakes.

⁸⁹ *Force majeure* clauses allocate risk. Chase Precast Corp. v. John J. Paonessa Co., 566 N.E.2d 603 (Mass. 1991) (*force majeure* clauses allocate and excuse specific risks that might affect performance). For example, “acts of God, the public enemy or governmental authorities,” Kansas Standard Specification 107.16.

⁹⁰ Standard Specifications: Florida 7.14; Kansas 107.16; South Dakota 7.17; Washington 1-07.13; Donald B. Murphy Contractors v. State, 696 P.2d 1270 (Wash. App. 1985); Reece Constr. Co. v. State Highway Comm’n, 627 P.2d 361 (Kan. App. 1981).

⁹¹ Reece Constr. Co. v. State Highway Comm’n, *id.*; Appeal of Norla Gen. Contractors Corp., ASBCA No. 5695, 59-2 BCA (CCH 2474).

⁹² Shippen Township v. Portage Township, 575 A.2d 157 (Pa. Commw. 1990). Annotation: 31 A.L.R. 5th 171 (1995).

⁹³ Warrick County v. Waste Management of Evansville, 732 N.E.2d 1255 (Ind. App. 2000) (cost of repair or reduction in market value, whichever is lesser).

⁹⁴ United States v. State Road Dep’t of Fla., 189 F.2d 591 (5th Cir. 1951).

⁹⁵ Department of Transp. v. Estate of Crea, 483 A.2d 996 (Pa. Commw. 1977); Annotation 31 A.L.R. 5th 171 (1995).

⁸⁵ *Shootman v. Department of Transp.*, 926 P.2d 1200 (Colo. 1996); *N.J. Educ. Facilities Auth. v. Gruzen Partnership*, 592 A.2d 559 (N.J. 1991); *State ex rel. Condon v. City of Columbia*, 528 S.E.2d 408 (S. C. 2000).

⁸⁶ 418 S.E.2d 648, 657 (N.C. 1992). While the North Carolina Statute (1-30) applies to actions brought by the State in the same manner as actions brought by private parties, the Statute does not apply if the function that gives rise to the claim is governmental, because when the State acts in a governmental capacity it does not act in the same manner as a private party. See 71 N.C. L. REV. 879 (1993).

⁸⁷ *United States v. Spearin*, 248 U.S. 132 (U.S. Ct. Cl. 1918); *Kel Kim Corp. v. Central Market*, 519 N.E.1d 295 (N.Y. 1987); *Kans. Turnpike Auth. v. Abramson*, 275 F.2d 711 (10th Cir. 1960); *Sornsin Constr. Co. v. State*, 590 P.2d 125 (Mont. 1978); 13 AM. JUR. 2D *Building and Construction Contracts* § 64. See § 7.B.9, *supra*.

the bridge are inapplicable in calculating damages.⁹⁶ Under the other rule, damages are calculated by taking into consideration the structure's age, utility, and condition.⁹⁷ These factors are considered in addition to the replacement cost of the bridge.

In addition to damages for loss of the structure, a public agency may seek damages for design costs, engineering costs, and damages to the public for increased road user costs as a result of the structure being unavailable for use.⁹⁸ Liquidated damages for the delay in project completion may also be recoverable.⁹⁹ These factors are considered in addition to the replacement cost of the bridge.

The contractor may be liable for damage to other property on, or in the vicinity of, the work site, where the damages were a foreseeable consequence of the contractor's failure to protect the work.¹⁰⁰

8. Owner's Rights Against the Construction Bond Surety

a. Performance and Payment Bonds

All states have laws that require the contractor to obtain performance and payment bonds for public works construction contracts.¹⁰¹ Essentially, the bond is a tripartite agreement composed of the principal (the contractor), the obligor (the surety), and the obligee (the owner).¹⁰²

Performance and payment bonds are distinguished by the different obligations they impose. Under a performance bond, the surety is responsible when the contractor defaults on its contractual obligations affecting contract performance. As such, a performance bond

⁹⁶ *Tuscaloosa County v. Jim Thomas Forrestry Consultants, Inc.*, 613 So. 2d 322 (Ala. 1992); *Shippen Township v. Portage Township*, 575 A.2d 157 (Pa. Commw. 1990); *State Highway Comm'n v. Stadler*, 148 P.2d 296 (Kan. 1944); *Puget Power & Light Co. v. Strong*, 816 P.2d 716 (Wash. 1991).

⁹⁷ *Vlotho v. Hardin County*, 509 N.W.2d 350 (Iowa 1993); *Town of Fifield v. St. Farm Mut. Ins. Co.*, 394 N.W.2d 684 (Wis. 1984); *Warrick County v. Waste Management*, 732 N.E.2d 1255 (Ind. App. 2000).

⁹⁸ *See State Highway Dep't v. Milton Constr. Co.*, 586 So. 2d 872 (Ala. 1991) (liquidated damages provided full compensation for delay to ongoing work and as such the State could not recover road user costs).

⁹⁹ *Southeast Alaska Constr. Co. v. State*, 791 P.2d 339 (Alaska 1990).

¹⁰⁰ *DSCO, Inc. v. Warren*, 829 P.2d 438 (Colo. App. 1991); *Beaver Valley Power v. National Eng'g & Contracting*, 883 F.2d 1210, 1221 (3d Cir. 1989) (under Pennsylvania DOT Standard Specification 107.12, liability for damages inflicted by the contractor applied only to property within or adjacent to the project site, and not to noncontiguous lands damaged by the contractor; bridge contractor not liable to upstream dam owner for damages caused by cofferdams and high waters).

¹⁰¹ *See table in § 2.C, supra.*

¹⁰² *Federal Ins. Co. v. United States*, 29 Fed. Cl. 302 (1993); *Gates Constr. Inc. v. Talbot Partners*, 980 P.2d 407 (Cal. 1999).

protects the owner.¹⁰³ A payment bond guarantees payment to persons who furnish labor and materials to the general contractor for the public improvement. As such, a payment bond protects subcontractors, laborers, and materialmen.¹⁰⁴ This type of protection is necessary because such persons have no lien rights against public works when the contractor fails to pay them for their labor and materials.¹⁰⁵ A performance bond and a payment bond may be separate instruments,¹⁰⁶ or combined into one instrument.¹⁰⁷

b. Surety's Options When the Contractor Defaults

A performance bond renders the surety liable up to the penal sum of the bond when the contractor defaults.¹⁰⁸ However, a surety has several options when a contractor defaults. The contractor can let the owner complete the work and litigate the owner's claim for the cost of completing the contract in excess of the balance of the contract price, or the surety can tender the cost of completing the work, up to the penal sum of the bond, in exchange for a release discharging the surety from further liability.¹⁰⁹

Another option is to arrange for the completion of the work by another contractor, or by the original contractor, when the contractor's cash flow problems prevented it from further contract performance. But a new completion contractor hired by the surety must be licensed to perform the type of work necessary to complete the contract.¹¹⁰ Payments by the owner for the work can be made directly to the completion contractor if agreed to by the surety, or to the surety, who then pays the contractor.

c. Surety's Liability for Breach of the Construction Contract That Results in Latent Defects and Other Contractual Defaults

Typically, the construction contract between the owner and the contractor is incorporated by reference into the performance bond.¹¹¹ The performance bond and the construction contract are read together to de-

¹⁰³ *Morrison Assurance Co. v. United States*, 3 Ct. Cl. 626 (1983); *United States for Use and Benefit of James E. Simon Co. v. Ardelt-Horn Constr. Co.*, 446 F.2d 820 (8th Cir. 1971).

¹⁰⁴ *Morrison Assurance Co. v. United States, Id.*

¹⁰⁵ *J.S. Sweet Co. v. White County Bridge Comm'n*, 714 N.E.2d 219 (Ind. App. 1999).

¹⁰⁶ *Miller Act*, 40 U.S.C. *et. seq.*

¹⁰⁷ *See, e.g., WASH. REV. CODE § 39.08.010.*

¹⁰⁸ Normally, the surety's liability is limited to the penal sum of the bond. *American Home Assurance Co. v. Larkin General Hosp., Ltd.*, 593 So. 2d 195 (Fla. 1992); *United States v. Seaboard Sur. Co.*, 817 F.2d 956 (2d Cir. 1987); *Bd. of Supervisors of Stafford County v. Safeco Ins. Co.*, 310 S.E.2d 445 (Va. 1983).

¹⁰⁹ 21 CAL. W. L. REV. 128 (1984).

¹¹⁰ *General Ins. Co. of America v. St. Paul Fire & Marine Ins. Co.*, 38 Cal. App. 3d 760 (1974).

¹¹¹ *See table, § 2.C, supra.* *Hunters Pointe Partners v. U.S.F. & G. Co.*, 486 N.W.2d 136 (Mich. App. 1992).

termine the surety's liability for a breach of the construction contract by the contractor.¹¹² Generally, the surety's liability corresponds with that of its principal. Thus, if the principal (the contractor) can be held liable for breach of the construction contract, so may the surety.¹¹³ A surety may be liable to the owner for latent defects that result from a breach of the construction contract by the contractor.¹¹⁴

The surety's liability may extend to other contractual obligations that the contractor failed to perform. For example, in *Hartford Accident and Indemnity Co. v. Arizona Dept. of Transportation*,¹¹⁵ the court said that the performance bond guaranteed the full performance of the construction contract, which required the contractor to pay unemployment insurance taxes. The surety became liable for those taxes when the contractor failed to pay them. The surety may also be liable for liquidated damages for late completion of the project caused by the original contractor's default,¹¹⁶ although there is authority to the contrary.¹¹⁷

d. Limitations on the Surety's Liability Under Its Performance Bond

As observed earlier, the surety's liability under its performance bond is limited to the penal sum of the bond. This is the general rule,¹¹⁸ although the surety's liability may exceed the penal sum of the bond if it fails to act reasonably in dealing with the owner's claim.¹¹⁹ Whether a surety's refusal to pay the owner's claim amounts to bad faith is a question of fact.¹²⁰

¹¹² *Hunters Pointe Partners, id.*; *School Bd. of Pinellas County v. St. Paul Fire & Marine Ins. Co.*, 449 So. 2d 872 (Fla. App. 1984); *City of Gering v. Patricia G. Smith Co.*, 337 N.W.2d 747 (Neb. 1983).

¹¹³ *Ackron Contracting Co. v. Oakland County*, 310 N.W.2d 874 (Mich. App. 1983); *AgriGeneral Co. v. Lightner*, 711 N.E.2d 1037 (Ohio App. 1998).

¹¹⁴ See cases cited in note 112, *supra*.

¹¹⁵ 838 P.2d 1325 (Ariz. 1992); see also *Employment Sec. Comm'n v. C.R. Davis Contracting Co.*, 462 P.2d 608 (N.M. 1969), where a similar result was reached.

¹¹⁶ *Pacific Employers Ins. Co. v. City of Berkeley*, 204 Cal. Rptr. 387 (1984); *Grady v. Alfonso*, 315 So. 832 (La. App. 1975); Ken Sobol, *Owner Delay Damages Chargeable to Performance Bond Surety*, 21 CAL. W. L. REV. 128 (1984).

¹¹⁷ *American Home Assurance Co. v. Larkin Gen. Hosp.*, 593 So. 2d 195 (Fla. 1992).

¹¹⁸ *American Home Assurance Co. v. Larkin Gen. Hosp., id.*; *United States v. Seaboard Sur. Co.*, 817 F.2d 956 (2d Cir. 1987); *Dodge v. Fidelity and Deposit Co. of Md.*, 778 P.2d 1236 (Ariz. App. 1986); *Lawrence Tractor Co. v. Carlisle Ins. Co.*, 249 Cal. Rptr. 150 (1988).

¹¹⁹ *Loyal Order of Moose, Lodge 1392 v. International Fidelity Ins.*, 797 P.2d 622 (Ak. 1990) (surety has duty of good faith in dealing with owner's claim); *Discovery Bay Condominium v. United Pacific Ins. Co.*, 884 P.2d 1134 (Haw. 1994); *Continental Realty Corp v. Andrew J. Crevolin Co.*, 380 F. Supp. 246 (D. W. Va. 1974).

¹²⁰ *Loyal Order of Moose Lodge 1392, id.*

An owner's right to recover against the performance bond surety for latent defects may be affected by a time limit within which the owner must assert its cause of action. A time limit for asserting a cause of action against the performance bond surety may be imposed by a statute or by a provision in the bond. While many states have enacted statutes establishing the limits for bringing actions against contractors for latent defects,¹²¹ few have enacted similar laws dealing specifically with performance bond sureties,¹²² although most states have laws establishing a limitation period for actions against the payment bond.¹²³

In the absence of a special statute of limitations, a cause of action against the performance bond surety is governed by the general statute of limitations that applies to written contracts.¹²⁴ However, unless prohibited by statute,¹²⁵ the parties may agree to a time limitation (within which suit must be brought on the performance bond) that is shorter than the general statute of limitations applicable to written contracts.¹²⁶ Thus, parties are free to contract for any reasonable limitation period they choose, if it does not conflict with an express limitation in a public bond statute.

¹²¹ *Latent Defects in Government Contracts Law*, 27 PUB. CONT. L.J., No. 1 (1997); see Table A, *supra*, this section.

¹²² 16 FORUM L. REV. 1057 (1981). The following states have enacted statutes of limitation dealing with performance sureties: HAW. STAT. 657-8—within 2 years after cause of action accrues, but not more than 10 years after completion of improvement); LA. REV. STAT. 38:2189—5 years after completion of contract; see *State v. McInnis Bros. Constr.*, 701 So. 2d 937 (La. 1997); WIS. STAT. 779.14—1 year after completion of contract. A Virginia Statute (11-59) established a 5-year statute of limitations for an action on a performance bond. However this statute has been repealed. See Acts 2001, c. 844 (Oct. 1, 2001).

¹²³ New York (Stat. 137, McKinney's Finance Law; A.C. Legnetto Constr., Inc. v. Hartford Fire Ins. Co., 680 N.Y.S.2d 45 (A.D. 1998)—Statute of limitations – one year); Virginia (Stat. 11-60—1 year after completion of contract); Wyoming (Stat. 16-6-115—1 year after publication of notice of final contract payment). For other examples, see table of "Notice and Filing Requirements," appendix to NCHRP Legal Research Digest No. 37, D. W. Harp (Dec. 1999). This article appears as a supplement in VOL. 3, SELECTED STUDIES IN HIGHWAY LAW.

¹²⁴ 74 AM. JUR. 2D *Suretyship* § 119 (2001); *Regents of Univ. of Cal. v. Hartford Accident & Indem. Co.*, 581 P.2d 197 (Cal. 1978); *People v. Woodall*, 271 N.W.2d 298 (Mich. 1976); *Southwest Fla. Retirement Ctr., Inc. v. Fed. Ins. Co.*, 682 So. 2d 1130 (Fla. App. 1996); *AgriGeneral Co. v. Lightner*, 711 N.E.2d 1037 (Ohio App. 1998).

¹²⁵ For example, FLA. REV. STAT. 95-03 prohibits contract provisions that allow a shorter time than that provided in the applicable statute of limitations. See also HAW. REV. STAT. 657-8.

¹²⁶ *Timberline Elec. Supply Corp. v. Ins. Co. of N. America*, 421 N.Y.S.2d 987 (A.D. 1979); *General Ins. Co. of America v. Interstate Service Co.*, 701 A.2d 1213 (Md. App. 1997); *Alaska Energy Auth. v. Fairmount Inc. Co.*, 845 P.2d 420 (Alaska 1993); *Howard & Lewis Constr. Co. v. Lee*, 830 S.W.2d 60 (Tenn. App. 1991).

[W]e held that parties could not contract to shorten the one-year limitation period for payment bonds required by the public bond statute. However, in contrast to the provisions governing payment bonds, our public bond statute does not specify a limitation period for performance bonds. Therefore, parties entering into a public performance bond are free to contract for any reasonable limitation period they chose.¹²⁷ (citations omitted).

Thus, most cases involving claims against the performance bond are governed by the limitation period specified in the bond.¹²⁸ An owner's claim against the contractor for defective construction may be time barred by a statute of repose. Is the claim against the surety barred where the general statute of limitations applicable to a claim against the surety has not expired? There are two views.

Under one view, the owner may sue the surety on the performance bond even though the limitation period in a statute of repose has expired, barring the owner's claim against the contractor.¹²⁹ Under the opposing view, a cause of action that is time barred against the contractor is also time barred against the surety, even though the statute of limitation applicable to the surety has not expired. This view is based on the rule that a surety's liability corresponds with that of its principal, so if the principal cannot be held liable, neither should the surety.¹³⁰

e. Alteration of the Construction Contract

An alteration of the construction contract by the owner, without the surety's consent, discharges the surety to the extent that it is prejudiced by the alteration.¹³¹ This rule is obviated with respect to change orders when the bond contains a provision incorporating the construction contract by reference. By agreeing to the incorporation of the construction contract, the surety agrees in advance to changes made by the owner under the "changes" clause.¹³²

¹²⁷ *Town of Pineville v. Atkinson/Dyer/Watson*, 442 S.E.2d 73, 74 (N.C. App. 1994) (limitation period 2 years—reasonable); *Hunters Pointe & Partners, Inc. v. U.S.F.G., Co.*, 486 N.W.2d 136 (Mich. App. 1992). (Limitation 1 year—reasonable).

¹²⁸ *Armand v. Territorial Constr., Inc.*, 282 N.W.2d 365 (Mich. App. 1979); *Gen. State Auth. v. Sutter Corp.*, 403 A.2d 1022 (Penn. 1979).

¹²⁹ *Regents v. Hartford Accident & Ind. Co.*, 581 P.2d 197 (Cal. 1978) (surety has a cause of action against the contractor for indemnification); *President & Directors v. Madden*, 505 F. Supp. 557, 591 (D. Ct. Md. 1980); *See also Note, Running of Statute of Limitations in Favor of Principal Does Not Exonerate a Surety*, 67 CAL. L. R. 563 (1979).

¹³⁰ *Hudson County v. Terminal Constr. Corp.*, 381 A.2d 355 (N.J. 1977); 16 FORUM L. REV. 1057; *State v. Bi-States Constr. Co.*, 269 N.W.2d 455 (Iowa 1978).

¹³¹ Restatement of Security § 128B; *Continental Ins. Co. v. City of Virginia Beach*, 908 F. Supp. 341 (E.D. Va. 1995).

¹³² *Mergentime Corp. v. Washington Metro. Area Transit Auth.*, 775 F. Supp. 14 (D.D.C. 1991).

f. Disputes Over the Right to Contract Payments When the Contractor Defaults

i. *Disputes Between the Surety and the Bank.*—Occasionally, contractors borrow money from banks to finance their operations. Banks usually require the contractor to sign an agreement assigning future contract payments earned by the contractor to the bank to secure the loan.¹³³ In a similar fashion, sureties usually require contractors to sign a general indemnity agreement in favor of the surety.¹³⁴ A conflict may arise between the surety and the bank over the right to the contract proceeds when the contractor defaults. The positions of the surety and the bank in this type of dispute were summarized by the court in *Alaska State Bank v. General Insurance Company* as follows:

The bonding company argues that when a contractor defaults and a bonding company steps in to complete the job and pay laborers and materialmen, it is subrogated to the rights of the owner, the contractor, the laborers, and the materialmen. Since the owner could have used funds still in its hands to complete the job, there would have been no sums available for the contractor and, therefore, the contractor's secured creditor who stands in the contractor's shoes. Under this view the bonding company has first rights to the progress payment, although it may have been fully earned by the contractor's prior performance.

The bank argues that progress payments are contract rights and that the bonding company's subrogation theory merely purports to impose on them a hidden lien. The bank urges that both it and the bonding company had the power to take advantage of Article 9 of the Uniform Commercial Code and perfect their respective security interests. Under this view, the bank had prior rights since it utilized the U.C.C. while the bonding company did not.¹³⁵

....

The bank urges the court that this "classic dispute" between bank and bonding company should be resolved under the Uniform Commercial Code.

With respect to this type of dispute, the general rule is that the surety is entitled to the contract proceeds.¹³⁶ However, there is some authority that the surety's assignment of contract proceeds is subject to the filing requirements of the Uniform Commercial Code, giving the bank priority to contract proceeds when the surety does not comply with the Code's filing requirements.¹³⁷

But what if it's not clear as to whom the owner should pay? An owner caught in a dispute between the

¹³³ *Alaska State Bank v. Gen. Ins. Co. of America*, 579 P.2d 1362 (Ak. 1978).

¹³⁴ *Book Run Baptist Church v. Cumberland*, 983 S.W.2d 501 (Ky. 1998); *Nat. Shawmat Bank of Boston v. New Amsterdam Casualty Co.*, 411 F.2d 843 (1st Cir. 1969).

¹³⁵ 579 P.2d at 1364.

¹³⁶ *Id.*

¹³⁷ *Transamerica Ins. Co. v. Barnett Bank of Marion County*, 524 So. 2d 439 (Fla. App. 1988).

surety and the bank may have the option of filing an interpleader action. This type of action would allow the owner to seek a court order authorizing it to pay the contract proceeds into the registry of the court, discharging the owner from further liability as to whom it should pay and leaving it up to the surety and bank to litigate entitlement to the proceeds.¹³⁸

ii. Disputes Over Contract Proceeds Between the Owner and the Surety.—An owner's right to a setoff¹³⁹ against unpaid progress payments for its claims against a contractor that has defaulted is superior to the surety's subrogation claim under its payment bond.¹⁴⁰ However, the authorities differ on whether the owner's right is superior to the surety's subrogation rights under its performance bond.¹⁴¹ A surety who pays the subcontractor, materialmen, and labor claims has a right to the contract retainage that is superior to the owner's right of setoff.¹⁴² Whether the surety can enforce that right against a state agency may depend upon whether the state has waived sovereign immunity.¹⁴³

9. Owner's Rights Against Its Design Consultant

a. Contractual Liability

Design consultants are obligated to perform their contractual duties with the same degree of ordinary care and skill exercised by members of their profession. Failure to perform those duties is a breach of contract.¹⁴⁴

In addition to the evidence normally admissible in breach of contract actions, the evidence may establish the consultant's breach by showing that it was negligent in performing its contractual obligations.¹⁴⁵ Generally, negligence must be proved by expert testimony,¹⁴⁶

¹³⁸ *City of N.Y. v. Cross Bay Contracting Corp.*, 709 N.E.2d 459 (N.Y. 1999) (interpleader action to resolve competing claims to contract funds held by owner); *Trans America Ins. Co. v. Barnett Bank*, *id.*

¹³⁹ See § 7.A.3.D, "Administrative Setoff," *supra*.

¹⁴⁰ *United States v. Munson Trust Co.*, 332 U.S. 234 (1947).

¹⁴¹ Owner's right *superior*: *Standard Accident Ins. Co. v. United States*, 97 F. Supp. 829 (Ct. Cl. 1951). Owner's right *not superior*: *Universal Ins. Co. v. United States*, 382 F.2d 317 (5th Cir. 1967).

¹⁴² *Nat. Sur. Corp. v. United States*, 118 F. 3d 1542 (Fed. Cir. 1997) (by paying claimants, the surety is subrogated to the claimants' rights to the retainage).

¹⁴³ *Liberty Mutual Ins. Co. v. Sharp*, 874 S.W.2d 736 (Tex. App. 1994) (suit by surety against state agency challenging agency's setoff against retainage dismissed because of governmental immunity). See § 6.2.A. "Sovereign Immunity," *supra*.

¹⁴⁴ *Brushton-Moira Cent. School Dist. v. Alliance Wall Corp.*, 600 N.Y.S.2d 511 (N.Y. A.D. 1993); *Paxton v. Acameda County*, 259 P.2d 934 (Cal. 1953).

¹⁴⁵ *Id.*

¹⁴⁶ *Garaman, Inc. v. Williams*, 912 P.2d 1121 (Wyo. 1996); Annotation, *Necessity of Expert Testimony to Show Malpractice of Architect*, 3 A.L.R. 4th 1023 (1981).

unless the act or omission is so obvious that lay persons can easily recognize the act or omission as negligent.¹⁴⁷

b. Betterment

Should the design consultant be liable for the cost of a construction feature that had to be added during construction because it was erroneously omitted from the contract plans? Under the "betterment" rule, the answer is generally "no." Usually, liability is limited to the difference between adding the construction feature by change order and what it should have cost if the construction feature had been included in the contract bid price.¹⁴⁸ The "betterment" rule puts the owner in the position it would have occupied had the error not occurred, and prevents the owner from obtaining a windfall.¹⁴⁹

c. Indemnification

Another theory of recovery against a design consultant is indemnity under an indemnification clause in the design agreement. The clause is triggered by the design consultant's negligence when it causes harm to third persons, resulting in damage claims against the project owner.¹⁵⁰ The owner's ability to recover may be limited, however, by an anti-indemnification statute, or by a limitation of liability clause in the design agreement.¹⁵¹

10. Indemnity and Insurance Requirements

a. Indemnity

Most owners employ indemnity provisions in their construction contracts.¹⁵² Such provisions protect the owner by requiring the contractor to indemnify the owner against all claims arising from the performance of the contract.¹⁵³ An example of a general indemnity clause is the standard provision used by the Maryland

¹⁴⁷ *Hull v. Engr. Constr. Co.*, 550 P.2d 692 (Wash. App. 1976); *Town of Breckenridge v. Golfence Inc.*, 851 P.2d 214 (Colo. App. 1992).

¹⁴⁸ *St. Joseph Hosp. v. Corbetta Constr. Co.*, 316 N.E.2d 51 (Ill. App. 1974); *Lochrane Engr., Inc. v. Willingham Real-growth Inv. Fund, Ltd.*, 552 So. 2d 228 (Fla. App. 1989).

¹⁴⁹ *Id.*

¹⁵⁰ Indemnification requirements are discussed in the next subpart of this section.

¹⁵¹ Those limitations affecting indemnification are also discussed in the next subpart.

¹⁵² The following are some examples of indemnity clauses used by state transportation agencies: Arkansas Standard Specifications 7.2.12A; Maine Standard Specification 1-07.15; Missouri Standard Specification 1-07.12; New Hampshire Standard Specification 1-07.14; Washington State Standard Specification 1-07.14; Wisconsin Standard Specification 1-07.12.

¹⁵³ *Smith v. Cassadago Valley Cent. Sch. Dist.*, 578 N.Y.S.2d 747 (N.Y. A.D. 1991).

State Department of Transportation in its construction contracts.¹⁵⁴

To the fullest extent permitted by law, contractor shall indemnify, defend and hold harmless the State, its officials and employees from all claims arising out of, or resulting from performance of the contract. Claim as used in this specification means any financial loss, claim, suit, action, damage, or expense, including but not limited to attorney's fees, bodily injury, death, sickness or disease or destruction of tangible property including loss of use resulting therefrom. The contractor's obligation to indemnify, defend and hold harmless includes any claim by contractor's agents, employees, representatives or any subcontractor or its employees.

An indemnity clause may require the indemnitor to indemnify the indemnitee against damages that are caused by the indemnitee's negligence. As a general rule, such clauses are enforceable where the clause clearly provides that the indemnitee is to be indemnified, notwithstanding the indemnitee's negligence.¹⁵⁵ Some states, however, have enacted anti-indemnification statutes, which prohibit the use of such clauses in construction contracts.¹⁵⁶ The following is an example of this type of statute:¹⁵⁷

A covenant, promise, agreement or understanding in, or in connection with or collateral to a contract or agreement relative to the construction, alteration, repair or maintenance of a building, structure, ...purporting to indemnify or hold harmless the promisee against liability for damage arising out of bodily injury to persons or damage to property contributed to, caused by or resulting from the negligence of the promisee, his agents or employees, or indemnitee, whether such negligence be in whole or in part, is against public policy and is void and unenforceable....

Another limitation on indemnification is a liability limitation clause in the contract. This type of clause imposes a ceiling on the indemnitor's liability. Typi-

cally, the clause will limit liability to a fixed dollar amount specified in the clause.¹⁵⁸

Generally, such clauses are enforceable.¹⁵⁹ However, their enforceability may be affected by an anti-indemnification clause. In *City of Dillingham v. CH2M Hill Northwest, Inc.*,¹⁶⁰ the court held that a limitation of liability clause in an engineering services agreement was invalid under the Alaska anti-indemnification statute,¹⁶¹ because the statute prevented the indemnitor from limiting its liability for its negligent acts.

In *Valhal Corp. v. Sullivan Associates*,¹⁶² the court distinguished indemnification and limitation of liability clauses. The court said that an indemnity clause immunizes a party from its own negligence and therefore is void under an anti-indemnification clause. A limitation of liability clause, however, is not invalid. The clause did not purport to immunize a party from its own negligence; it only capped the amount of the indemnitor's liability.

b. Insurance

Owners usually specify in the construction contract the types of insurance that the contractor must procure for the project. The most commonly required type is liability insurance, protecting the insured against liability for third-party claims that result from construction activities.¹⁶³ The contract may also require the contractor to obtain builder's risk insurance, protecting the insured against damage to the improvement during the course of construction.¹⁶⁴

¹⁵⁴ General Provision 7-13. The owner may also be entitled to common-law indemnification when the owner is exposed to liability due to the contractor's negligence or breach of contract. *Margolin v. N.Y. Life Ins. Co.*, 297 N.E.2d 80, 82 (N.Y. 1973). Inclusion of an indemnity provision in the construction contract does not alter the common law right to indemnity. *Hawthorne v. South Bronx Community Corp.*, 582 N.E.2d 586 (N.Y. 1991). But the common law duty to indemnify may be limited by the terms of the express indemnity clause. *Regional Steel Corp. v. Superior Court*, 32 Cal. Rptr. 2d 417 (Cal. App. 1994).

¹⁵⁵ *Cunningham v. Goettl Air Conditioning, Inc.*, 980 P.2d 489 (Ariz. 1999). See generally WILLIAM L. PROSSER, LAW OF TORTS § 46, at 249-54 (2d ed. 1955).

¹⁵⁶ For example, the following states have enacted anti-indemnification statutes: Alaska (STAT. 45.45.900); Arizona (REV. STAT. 34-226(A)); California (CIV. CODE § 1782); Georgia (CODE 20-50A); Illinois (REV. STAT. ch. 29, § 61); New York (GEN. OBLIG. LAW 5-322.1); Washington (REV. CODE § 4.24.115).

¹⁵⁷ N.Y. GEN. OBLIG. LAW § 5-322.1. See *Sheehan v. Fordham Univ.*, 687 N.Y.S.2d 22 (N.Y. A.D. 1999) (statute precluded contractual indemnification for indemnitee's negligence).

¹⁵⁸ *Valhal Corp. v. Sullivan Assocs.*, 44 F.3d 195 (3d Cir. 1995); *C&H Eng'rs P.C. v. Klargester, Inc.*, 692 N.Y.S.2d 269 (N.Y. A.D. 1999).

¹⁵⁹ *Valhal Corp v. Sullivan Assocs., id.*

¹⁶⁰ 873 P.2d 1271 (Ak. 1994).

¹⁶¹ A.S. § 45.45.900.

¹⁶² 44 F.3d 195 (3d Cir. 1995).

¹⁶³ D.W. HARP, INDEMNIFICATION AND INSURANCE REQUIREMENTS FOR DESIGN CONSULTANTS AND CONTRACTORS ON HIGHWAY PROJECTS (National Cooperative Highway Research Program Legal Research Digest No. 37, 1996.) Supplement to Vol. 3, SELECTED STUDIES IN HIGHWAY LAW. While state transportation agencies require these construction contractors to obtain liability insurance, not all of them require their design consultants to obtain professional errors and omissions (E&O) coverage. *Id.*

¹⁶⁴ Annotation, *Builder's Coverage Under Builder's Risk Insurance Policy*, 97 A.L.R. 3d 1270 (1980).

i. Liability Insurance.—The contract specifications typically specify the type or types of liability insurance that the contractor is required to procure and the limits of coverage. The two most common forms of such insurance are commercial general liability (CGL) insurance¹⁶⁵ and owners and contractors protective insurance, in which the owner is the insured.¹⁶⁶ Both forms of insurance are based on occurrence coverage.¹⁶⁷ Under occurrence coverage, a claim is covered if the event causing the damage or injury occurred during the period that the policy was in force.

[S]tandard comprehensive or commercial general liability [CGL] insurance policies provide that the insurer has a duty to indemnify the insured for those sums that the insured becomes legally obligated to pay as damages for a covered claim. Such a policy is triggered if the specified harm is caused by an included occurrence, so long as at least some such harm results within the policy period.¹⁶⁸

The specifications requiring insurance may require that the owner be named as an additional insured on the contractor's CGL policy.¹⁶⁹ The specification may also require that in addition to the agency, the agency's officers and employees must also be named as additional insureds.¹⁷⁰ The specifications typically specify the minimum limits of coverage for each occurrence, and in the aggregate for each year that the policy is in force.¹⁷¹ The limits for owners and contractors protective insurance are usually the same as the limits specified for CGL coverage.¹⁷² The specifications may require the contractor to obtain liability insurance on standard

¹⁶⁵ Arizona DOT Standard Specification 1-07.14 (2000); California DOT Standard Specification 7-1-12 B (1999); Colorado DOT Standard Specification 1-07.15 (1999); Florida DOT Standard Specification 7.13.2 (2000); Washington State DOT Standard Specification 1-07.18 (2000).

¹⁶⁶ Colorado (Standard Specification 1-07-15) and Washington (Standard Specification 1.07.18) are examples of state's requiring OCP coverage in addition to CGL coverage.

¹⁶⁷ The specifications listed in note 165, *supra*, are examples of specifications requiring liability insurance based on "occurrence" coverage.

¹⁶⁸ *Aerojet-General Corp. v. Transport Indem. Co.*, 948 P.2d 909 (Cal. 1997). A claim under a claims-made policy must be made before the policy expires or during an extended reporting period provided in the policy. A typical E&O policy is written on a claims-made basis rather than an occurrence basis.

¹⁶⁹ Colorado Standard Specification 1-07.15.

¹⁷⁰ California Standard Specification 7-1.12 B.

¹⁷¹ California: \$1 million each occurrence, \$2 million aggregate, \$5 million excess liability coverage for projects under \$25 million, \$15 million excess coverage for projects over \$25 million, Standard Specification 7-1.12 B (1999). Florida: bodily injury or death: \$1 million each occurrence, \$5 million aggregate; property damage: \$50,000 each occurrence, \$100,000 aggregate for all damages occurring during the policy period, Standard Specification 7.12.2 (2000). Colorado: \$600,000 each occurrence, \$2 million aggregate, Standard Specification 1-07.15 (2000); Washington: \$1 million each occurrence, \$2 million aggregate, Standard Specification 1-07.18 (2000).

¹⁷² Colorado (Specification 1-07.15) and Washington (Specification 1-07.18) are examples.

forms published by the Insurance Services Office (ISO), a national organization that provides services to the insurance industry.¹⁷³

Disputes between the insured and insurer over coverage may lead to litigation. Whether the policy covers a particular occurrence is a question of contract interpretation.¹⁷⁴ An insurance policy is treated in the same way as contracts are treated generally. The court's goal in interpreting the policy is to ascertain the intent of the parties. If that intent cannot be determined, and the policy is ambiguous, the policy will be construed against the insurer and in favor of coverage for the insured.¹⁷⁵

ii. Builder's Risk Insurance.—This form of insurance provides coverage for damage to the improvements during the course of construction.¹⁷⁶ Coverage may be limited by specific exclusions in the policy.¹⁷⁷ But an exclusion will not prevent coverage when it conflicts with other provisions of the policy granting coverage. "When provisions of an insurance policy conflict, they are to be construed against the insurer and in favor of the insured."¹⁷⁸

iii. Failure to Obtain Insurance.—The contractor's failure to obtain insurance, as required by the contract, is a breach, entitling the owner to damages.¹⁷⁹ A contractor cannot avoid a contractual insurance requirement by arguing that a specification requiring insurance should be construed as an indemnification clause and, therefore, unenforceable under an anti-indemnification statute. The specification is an insurance requirement, not an indemnification provision.¹⁸⁰

The owner's failure to obtain proof of liability insurance before notifying the contractor to proceed with the work does not waive the insurance requirement.¹⁸¹

¹⁷³ California (Specification 7-1.12 B) and Washington (Specification 1-07.18), for example, require the use of ISO Form G0001 or a form providing the same coverage.

¹⁷⁴ *Simon v. Shelter General Ins. Co.*, 842 P.2d 236 (Colo. 1992).

¹⁷⁵ *California Pacific Homes, Inc. v. Scottsdale Ins. Co.*, 70 Cal. Rptr. 4th 1187, 83 Cal. Rptr. 2d 328 (1999); *Simon v. Shelter Gen. Ins. Co.*, *id.*; 13 APPLEMAN, INSURANCE LAW AND PRACTICE, § 7401 (1976).

¹⁷⁶ Annotation, *Builder's Coverage Under Builder's Risk Insurance Policy*, 97 A.L.R. 3d 1270 (1980).

¹⁷⁷ *Safeco Ins. Co. of America v. Hirschmann*, 773 P.2d 413 (Wash. 1987); *Markman v. Hoefer*, 106 N.W.2d 59 (Iowa 1960).

¹⁷⁸ *Simon v. Shelter Gen. Ins. Co.*, 842 P.2d 236 (Colo. 1992).

¹⁷⁹ *Mass. Bay Transp. Auth. v. United States*, 129 F.3d 1226 (Fed. Cir. 1997); *PPG Indus. v. Continental Heller Corp.*, 603 P.2d 108 (Ariz. App. 1979); *Caputo v. Kimco Dev. Corp.*, 641 N.Y.S.2d 211 (N.Y. A.D. 1996).

¹⁸⁰ *Homes v. Watson-Forsberg Co.*, 488 N.W. 473 (Minn. 1992); *Jokich v. Union Oil Co. of Calif.*, 574 N.E.2d 214 (Ill. App. 1991).

¹⁸¹ *Batterman v. Consumers Illinois Water Co.*, 634 N.E.2d 1253 (Ill. App. 1994).

c. *Tendering the Claim*

When an owner receives a claim, several questions should be asked: Is the claim covered by insurance? Is the claim covered by an indemnification provision in the contract? If the answer to the first question is, “yes,” the claim should be tendered promptly to the insurer. If the answer to the second question is also, “yes,” the claim should be tendered promptly to the contractor.

Tender of the claim to the design consultant may raise special considerations. Should the owner sue the designer in the same action brought by the contractor against the owner? Pursuing the claim in one action avoids the cost of multiple litigation and may avoid inconsistent results by a court, jury, or arbitrator, although joining the designer in the same action brought by the contractor does not guarantee a consistent result. This can occur because different standards of liability may apply. The contractor will sue the owner for breach of contract or an equitable adjustment under a specific clause in the contract. The owner will usually sue the designer for indemnification based on the designer’s negligence.¹⁸²

In addition to avoiding multiple litigation, there is also another advantage in bringing the claim against the designer in the same action brought by the contractor against the owner. By bringing the claim in the same action, it allows the owner to point the finger at the designer, as the party ultimately responsible for the damage, and to a large extent “piggyback” the contractor’s case. A major disadvantage in pursuing all claims in the same action, however, is that it may force the designer to point the finger at the owner. The designer may claim that it recommended a time extension, a different design, or more soils investigation, but the owner refused. Another disadvantage is where the designer is also the construction manager, and the owner is an “absentee owner.” In those situations, only the construction manager, on the owner’s side, may have day-to-day knowledge about the project. The problem of whether recovery should be sought from design consultants for design errors occurred in a major rail link project in New York State.¹⁸³

Typically, however, many states use design and/or construction inspection consultants to complement their own staff. This may result in a blending of responsibilities, an unclear scope of responsibility, or the procurement of various engineering consulting services that do not require complete designs. Construction inspection services are similarly procured.

A problem occurred in connection with the Oak-Point Link Rail Project in New York State. A major rail link to New York City was to be placed on a viaduct in a nearby river. The government agency gave the consultant the

criteria on expected loads the viaduct would carry. The project was on a quick track, but the funds allocated were insufficient. The design consultant was told that the State would provide the soil samples, borings, and evaluations and was instructed to use as-built plans for existing structures in the immediate area to gain whatever information it deemed appropriate in connection with the design. The State instructed that the limited boring information and interpolations were to be used to determine where rock formations and other obstructions might reasonably be anticipated. As it turned out, the rock formations, in many instances, deviated from the information obtained from the plans. The State subsequently ordered additional site boring and worked closely with the consultants to identify a solution.

Because of the overlapping agency staff and consultant activity and the lack of clear engineering responsibility placed solely on the consultants, the agency officials were not able to decisively determine who was responsible for the errors and failures when the project was terminated. The State paid the contractor several million dollars for extra work and delay damages after determining that no recovery should be sought from the consultant because of the instructions from the agency staff and the fusion of engineering functions.¹⁸⁴

An owner may choose to defer action against the designer until the action against the owner is resolved. One method of accomplishing this is through the use of a “stand-still” agreement.¹⁸⁵ A stand-still agreement typically provides that the owner will not initiate any action against the designer that is related to the claim brought by the contractor during the effective period of the agreement.¹⁸⁶ The agreement usually provides that the parties agree to toll any applicable statutes of limitations that might otherwise be interposed.

Another potential limitation on the power of the owner to resolve its claims in one proceeding is where one prescribed dispute resolution method is litigation and the other is arbitration. This problem also exists where the contract or the design agreement does not authorize joinder of another party. All jurisdictions view arbitration as purely consensual. Thus, an owner cannot join the designer in an arbitration between the owner and the contractor unless the designer agrees.¹⁸⁷

¹⁸⁴ *Id.* at 7.

¹⁸⁵ The agreement reserves, until a later time, the owner’s rights against the designer and the designer’s defenses against the owner.

¹⁸⁶ The effective period of the agreement commences upon its execution and ends upon a final resolution of the contractor’s claim against the owner. This may occur upon a final judgment, arbitration award, or final settlement of all of the contractor’s claims for which the owner may seek indemnification from the designer.

¹⁸⁷ The consensual nature of arbitration is discussed in the next subsection.

¹⁸² An error in a plan or specification may be a breach of the construction contract, but the design consultant is not necessarily liable to the owner if the error was not caused by the designer’s negligence. See subpart 7.9.A., *supra*.

¹⁸³ HARP, *supra* note 123.

B. ALTERNATIVES TO LITIGATION—ADR

1. The Alternative Dispute Resolution Process

An early resolution of a construction dispute is usually in the best interests of both the owner and the contractor. The adage, “Agree for the law is costly,”¹⁸⁸ has particular significance in heavy construction, one of the country’s most adversarial and litigious industries.¹⁸⁹ A single dispute early in the project, if left unresolved, may escalate into a claim that ultimately leads to litigation.¹⁹⁰

Because most construction disputes involve money, they are often viewed in purely economic terms. Viewed as a business judgment, it is often better to settle and avoid the costs and risks of litigation. An owner may, however, choose litigation rather than settle to uphold some principle, or to establish a judicial precedent. In the absence of these kinds of consideration, owners often choose to settle rather than litigate the dispute. Over the past decade, the construction industry has developed a variety of nondispute resolution methods, which can be used to facilitate settlement. These methods, which include mediation, mini-trials, and Dispute Review Boards (DRBs), have proven to be useful.¹⁹¹ Their success has tended to overcome the general resistance to bringing a third-party facilitator into the negotiation process or to referring the dispute to a neutral third-party for a nonbinding, advisory decision.

There is no single form that nonbinding ADR methods must follow. The method may be predetermined by the contract,¹⁹² or one ADR method may be combined with another. Combining mediation and arbitration into one process is an example.¹⁹³ Since nonbinding ADR is voluntary, the parties may develop various hybrids to suit their needs.¹⁹⁴ When and how non-binding

ADR is used is up to the parties. But whatever method is agreed upon, it should represent a good faith effort by the parties to try and settle their dispute, and not used as a means of obtaining “free” discovery.

This subsection discusses the more commonly used methods of ADR such as mediation, mini-trials, and DRBs. Arbitration is also discussed as an alternative to litigation. The subsection concludes with an overview of the Partnering process as part of a dispute resolution system designed to minimize and even prevent claims.¹⁹⁵

2. Nonbinding ADR

a. Mediation

Mediation is a form of structured negotiations in which the parties seek to settle their disputes with the assistance of an impartial facilitator. It is an informal non-adversarial process. In mediation, decision-making authority rests with the parties. The role of the mediator is to assist the parties in identifying issues, evaluating each party’s respective positions,¹⁹⁶ and exploring settlement alternatives.¹⁹⁷

The mediation process may be contractually required as a condition precedent to engaging in litigation or arbitration. In the absence of a contract provision requiring mediation, the contract may encourage, but not compel mediation.¹⁹⁸

Mediation, as a form of structured negotiations, was often used when the parties—because of personality conflicts or hard feelings—were unable to resolve their disputes through face to face negotiations. Instead of attempting to negotiate directly with each other, the parties retained a neutral third person to conduct the negotiations, usually a skilled negotiator who had a construction law background. The process was usually quick, several days at most, and relatively inexpensive.¹⁹⁹ In the 1980s, mediation became popular as a way of resolving construction disputes. Studies have shown that mediation usually works. About 80 percent to 85 percent of the cases submitted to mediation settle.²⁰⁰ These successes have led to the adoption of standard contract provisions providing for mediation. For example, the Arizona Department of Transportation

¹⁸⁸ LEGAL BRIEFS 148 (McMillian – U.S.A. 1995).

¹⁸⁹ James P. Groton, *Alternative Dispute Resolution in the Construction Industry*, 52 DISP. RESOL. J. 48 (1997).

¹⁹⁰ *Id.*

¹⁹¹ *Id.* About 85 percent of those who mediate their disputes settle. See Douglas E. Knoll, *A Theory of Mediation*, 56 DISP. RESOL. J. 16, 18, 26 (2001); John D. Coffee, *Dispute Review Boards*, 43 ARB. J. 58 (1988).

¹⁹² The American Arbitration Association (AAA) Mediation Rules suggest that, as to disputes, the construction contract should require mediation before resorting to litigation or arbitration. The Associated General Contractors of America (AGC) form 600, article 14.3, makes mediation optional. The sample DRB contract provision makes submittal of the dispute to the DRB a condition precedent to litigation; see Paragraph C.1 of Appendix A, p. 276, AMERICAN ARBITRATION ASSOCIATION, *ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES* (Kendall/Hunt Publishing Co. 1994) (hereinafter “Practical Guide”).

¹⁹³ See AMERICAN ARBITRATION ASSOCIATION, *supra* note 192, at 217-23.

¹⁹⁴ For one large construction claim, the parties agreed to combine mediation with a mini-trial format (I-90 floating

bridge refurbishment project). The Oregon DOT used voluntary mediation to resolve a \$4 million claim. (FHWA Report, TS-84-2098 (1993)).

¹⁹⁵ Steven Pinnell, *Partnering and the Management of Construction Disputes*, 54 DISP. RESOL. J. 16 (1999).

¹⁹⁶ As discussed latter, these discussions are conducted in the private sessions.

¹⁹⁷ Beth Paulsen and Franker Sander, *Alternative Dispute Resolutions, An ADR Primer*, ABA Standing Committee on Dispute Resolution (1987).

¹⁹⁸ See Practical Guide, *supra* note 192.

¹⁹⁹ Usually the mediator’s fee is shared equally by the parties.

²⁰⁰ AMERICAN ARBITRATION ASSOCIATION, *supra* note 192, at 72.

has a standard specification that provides that the contractor may request the engineer to arrange for a mutually acceptable mediator, with the cost for the mediator's services to be shared equally by the state and the contractor.²⁰¹

i. The Mediation Process.—The mediation process is simple and straightforward. The parties agree on a mediator or a process for selecting a mediator through an association such as the American Arbitration Association. The parties sign a mediation agreement, which they draft or which is furnished to them by the mediator, and then they mediate.²⁰²

Typically, the mediation process begins with a joint session between the parties presided over by the mediator. The mediator may share any preliminary thoughts he or she may have with the parties and outline the procedure that will be followed. Following the mediator's remarks, the parties have an opportunity to make opening statements in which each party presents its case to the mediator. The parties then split up and go to separate rooms for the private sessions, or caucuses.²⁰³

In the private sessions, the mediator meets privately with each party. The mediator seeks to elicit compromises from a party that may lead to settlement. The critical ground rule, in these sessions, is that the discussions are confidential and cannot be revealed to the opposing party unless the party making the statement authorizes its disclosure. The mediator engages in what is commonly called "shuttle-negotiations," going back and forth between the parties communicating offers of settlement that a party has authorized. This process continues until a settlement is reached, or it becomes apparent the negotiations have reached an impasse and further mediation would be a waste of time and money.²⁰⁴

ii. Selecting the Mediator.—The selection of a skilled and forceful negotiator is essential. The mediator is not just a messenger communicating offers made by the parties. An experienced mediator may play the role of a devil's advocate, often questioning and even challenging a party position to show that its position is not as strong as the party may believe, or to show that the opposing party's position also has merit.²⁰⁵

How do you find a skilled mediator? One way is to ask other attorneys and owners who have engaged in mediation for recommendations. Other sources for recommendations are construction expert witnesses who have been involved in major construction litigation. Often, such experts will attend a mediation and develop a perspective on who to select and who to avoid. The American Arbitration Association and similar dispute resolution organizations are other sources for recommendations.²⁰⁶

iii. The Opening Statement.—There are two opportunities during mediation of persuading the opponent to settle. The first is the opening statement in the joint session. The second is the information provided to the mediator during the private sessions, which the mediator can use to persuade the opponent to settle.

The opening statement by each party should be persuasive and a thorough presentation of that party's position. The real purpose of the opening statement is to persuade the opposing party that your case is strong and that you are likely to prevail if the claim is litigated or arbitrated. The opening statement should not be designed solely to educate the mediator. This can be done, as necessary, in the private session. "The opening statement in mediation should not be directed toward the mediator, rather it should be directed toward the opposing party."²⁰⁷

The opening statement is usually made by counsel, and may be augmented with presentations by key project personnel and expert witnesses, as appropriate.²⁰⁸ The presentation should be well organized, accurate, and thorough. It should be supported by pertinent documents, such as CPM schedules, correspondence, change orders, photographs, diary entries, and inspection reports. The use of PowerPoint slides and overhead projector transparencies should be considered. Blown-

²⁰¹ Standard Specification 105.21 (2000); see also PRACTICAL GUIDE, *supra* note 192.

²⁰² The mediation agreement is discussed in more detail later.

²⁰³ Peter J. Comodeca, *Ready, Set, Mediate*, 56 DISP. RESOL. J. 32 (Dec. 2001-Jan. 2002).

²⁰⁴ *Id.*; see also Timothy S. Fisher, CONSTR. MEDIATION, 49 DISP. RESOL. J. 8, (1994); and Note, *Protecting Confidentiality in Mediation*, 98 HARV. L. REV. 441 (1984); Wayne D. Brazil, *Protecting the Confidentiality of Settlement Negotiations*, 39 HASTINGS L.J. 955 (1988); *Preparing for Mediation and Negotiation*, 37 PRAC. LAW. 66 (1991); Ross R. Hart, *Improving Your Chance of Success During Construction Mediation*, 47 ARB. J. 14 (Dec. 1992).

²⁰⁵ *Getting the Mediation Process Started*, GROTON, *supra* note 192. For a discussion of various mediator styles and theories of mediation, see Douglas E. Knoll, *A Theory of Mediation*, 56 DISP. RESOL. J. No. 2, at 78 (2001).

²⁰⁶ Timothy S. Fisher, *Construction Mediation*, 49 DISP. RESOL. J. No. 1, at 12 (1994); *A Theory of Mediation, id.*; *How Do You Select A Mediator?*, ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES, *supra* note 192, at 82-83,

²⁰⁷ Comodeca, *supra* note 203, at 38.

²⁰⁸ See *The Value of an Expert in Today's ADR Forum*, ch. 21, ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES, *supra* note 192, at 302; Eric R. Galton, *Experts Can Facilitate a Mediation*, 50 DISP. RESOL. J. No. 4, at 64 (1994).

up charts to depict key information and summarized arguments can be effective.²⁰⁹

Concerns about “free discovery” and educating the opposing party should not affect the thoroughness of the opening statement. First, if the claim doesn’t settle and is tried or arbitrated, it is likely that the information will be obtained through discovery. Second, and more important, is the need to persuade the opposing party that it is in its interest to settle more on your terms than to stick with its initial position.

The opening statement should not be hostile or overbearing in tone. Instead, it should be civil and business like, focusing on the key points of the dispute. This type of presentation will help set the stage for the mediator in persuading the opposing party of the risks it faces if the case is tried, and the practical advantages it gains in settling the claim.

iv. Case Evaluation.—A party should make its own evaluation of the case and determine a reasonable settlement range, rather than relying on the mediator to establish a settlement range. However, a party’s settlement position should not be overly rigid. A party should be willing to reevaluate its settlement position based on new information that could significantly affect the outcome of the case if it were litigated. In this regard, it is important to know the case and its strengths and weaknesses to properly evaluate the new information.²¹⁰

If the new information cannot be evaluated properly without further investigation, then it may be better to adjourn the mediation until the information can be verified. Usually, this is a better course of action than being overly influenced by new information and settling too high if you are the defendant, or too low if you are the claimant.²¹¹

v. Candor with the Mediator.—Information provided to the mediator is confidential and cannot be used in subsequent proceedings, if the mediation fails.²¹² Also, anything said to the mediator in the private session cannot be revealed to the opposing party, unless the party making the statement authorizes disclosure.²¹³ Since communications with the mediator are protected, a

party should be frank and cooperative in the private sessions and provide the mediator with an honest assessment of the claim. Creating this type of atmosphere will promote the negotiations and serve as a “reality check” to test the soundness of a party’s position.

vi. The Mediation Agreement and Confidentiality.—The parties should enter into a mediation agreement establishing the ground rules for the mediation. The agreement should identify the dispute that will be mediated and the name of the mediator. The agreement should address certain “housekeeping” matters such as the mediator’s fee and expenses, how they will be shared by the parties, and when and where the mediation will be held.

The agreement may address the submission of position papers by the parties to the mediator, any limitations on their length, and whether the papers will be exchanged between the parties or submitted solely to the mediator in confidence. Usually the parties will exchange position papers. This is consistent with the notion that an important feature of mediation is for the parties to persuade each other of the merits of their respective positions.²¹⁴

It is not necessary to outline in the agreement how the mediation will be conducted. Usually, this will be covered by the mediator in the joint session. The agreement should contain a clause granting immunity to the mediator from any liability for the mediator’s participation in the mediation. The agreement should identify who will attend the mediation and identify the parties’ representatives who have full settlement authority.

Perhaps the most important provision of a mediation agreement is the one dealing with the confidentiality of the proceedings.²¹⁵ A public agency should consider including a clause in the agreement that allows the agency to disclose the terms of any settlement involving public funds or public issues. In *Register Div. of Freedom Newspapers, Inc. v. County of Orange*,²¹⁶ the court held that documents relating to the settlement of a claim with public funds constitute public records that are subject to disclosure under the California Public

²⁰⁹ *Preparing to Mediate*, ch. 8, ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES, *supra* note 192, at 97.

²¹⁰ Fisher, *supra* note 204.

²¹¹ See GROTON, *supra* note 192, at 105–6. The authors suggest that postponing the mediation to investigate new issues is counterproductive. Instead, the party should keep the process moving by doing a quick investigation during a break or between sessions. As a practical matter, a party’s choice to proceed or adjourn will be determined by the impact that the information has on the case, its reliability, and the time needed to verify its accuracy.

²¹² John W. Hinchley, *Construction Industry: Building the Case for Mediation*, 47 ARB. J. No. 2 (1992); Some states have enacted statutes that make mediation proceedings confidential. Some examples: TEX. CIV. PROC. & REM. CODE ANN. § 154.53(c); NEB. STAT. 25-2914;

²¹³ GROTON, *supra* note 192, at 106.

²¹⁴ See GROTON, *supra* note 192, at 129 for an example of a basic mediation agreement.

²¹⁵ See 38 PRAC. LAW. No. 2, at 32–33 (1992) for an example of a confidentiality clause for a mediation agreement. See also the confidentiality provision in the mediation agreement referenced in note 214 *supra*.

²¹⁶ 205 Cal. Rptr. 92, 158 Cal. App. 893 (1984).

Records Act.²¹⁷ Other jurisdictions have reached a similar result.²¹⁸

vii. Other Guidelines.—•A party should have one spokesman. Other party representatives should not speak unless called upon to do so by the spokesman. This guideline applies to both the joint and private sessions.

- After sufficient discovery is conducted to fill in any significant gaps in the case, the parties should consider a moratorium on discovery. This saves the cost of discovery and allows the parties to concentrate on preparing for the mediation, instead of being distracted by ongoing discovery, particularly depositions. This guideline applies where a lawsuit has been filed or a demand for arbitration has been made.

- When mediation is voluntary (not mandated by the contract), the owner should not agree to mediation until the owner is satisfied that it has sufficient information concerning the claim to be able to evaluate settlement positions during the mediation process.

- Once a settlement is reached, the principal terms of the settlement should be put in writing and signed by the parties. Counsel should prepare an outline of the important settlement terms in advance and bring them to the mediation.

viii. Advantages and Disadvantages.—Mediation has certain advantages in addition to creating an opportunity for the parties to engage in meaningful negotiations that may resolve their dispute. Mediation allows the parties to “test the waters” by having the mediator explore settlement possibilities with the opposing party. It allows the negotiations to be conducted by a skilled and impartial negotiator. The obvious drawback is the expense invested in the process, and to some extent “free discovery.” In addition, a settlement may be too high or too low, because a party was overly influenced by the mediator to settle. However, the better a party understands the case, the better it will be able to evaluate the case and make an informed decision on whether to settle or proceed to litigation or arbitration.

²¹⁷ Cal. Pub. Disclosure Act, CAL. GOV. CODE, § 6520, *et seq.* Examples of other states that have similar public disclosure or “sunshine” laws are: Florida, FLA. STAT. ANN. § 119.01 (West), *et seq.*; Georgia, GA. CODE. ANN. 50-18-170, *et seq.*; Maryland, MD. STATE GOV’T CODE 10-011; Missouri, MO. STAT. 610-011, *et seq.*; New York, N.Y. PUB. OFF. LAW § 84 (McKinney); Michigan, MICH. STAT. 15.231, *et seq.*; Ohio, OHIO STAT. 149.43; South Carolina, S.C. CODE 30-4-10, *et seq.*; Washington, WASH. REV. CODE 42.17.010, *et seq.*

²¹⁸ Daily Gazette Co. v. Withrow, 350 S.E.2d 738 (W. Va. 1986); Miami Herald Pub. Co. v. Collazo, 329 So. 2d 333 (Fla. App. 1976); Kingsley v. Berea Bd. of Ed., 653 N.E.2d 653 (Ohio App. 1990); Dutton v. Guste, 395 So. 2d 683 (La. 1981); Anchorage Sch. Dist. v. Anchorage Daily News, 779 P.2d 1191 (Ak. 1989); Yakima Newspapers v. City of Yakima, 890 P.2d 544 (Wash. App. 1995). Annotation, *What Are Records of Agency Which Must be Made Available Under State Freedom of Information Act*, 27 A.L.R. 4th 680 (“Settlement agreements and contracts”) § 16, at 723–725 (1984).

ix. Authority To Mediate.—Do public agencies need statutory authority to engage in mediation? Generally, the power to contract, and to sue and be sued, carries with it the implied power to settle disputes arising out of the contract.²¹⁹ This should include mediation since it is simply a form of structured negotiations.

x. Mandatory Mediation.—Should mediation be contractually required as a condition precedent to arbitration or litigation, or should mediation be purely voluntary? Those who favor mandatory mediation argue that even if the mediation fails, the mediation process forces the parties to test their positions before a neutral mediator, which may lead to a settlement.²²⁰ There are those, however, who believe that mediation should be voluntary.²²¹ If a party is not willing to compromise its position, it is unlikely that the claim can be settled. Why should a party who is unwilling to compromise be required to go through a process that, as a practical matter, will be meaningless? In rebuttal, some argue that mediation should be required by the contract because it creates an opportunity for settlement, and that is sufficient reason to require mediation as a condition of the contract.²²² But there is an old proverb that “you can lead a horse to water, but can’t make it drink.” The same is often true for a party who is unwilling to negotiate or compromise its position. The party can be forced to attend the mediation—to satisfy the condition precedent so that it can bring suit or demand arbitration—but it cannot be forced to negotiate.

²¹⁹ E.E. Tripp Excavating Contractor, Inc. v. Jackson County, 230 N.W.2d 556 (Mich. App. 1975). (Power to contract carries with it the power to adjust disputes in the manner deemed most expeditious by the public agency, unless the manner it chooses is prohibited by statute). M.S. Kelliher Co. v. Town of Wakefield, 195 N.E.2d 330 (Mass. 1964) (town had authority to agree to arbitration as a means of resolving contractual dispute rather than by litigation).

²²⁰ Hinchley, *supra* note 212, at 40.

²²¹ For example, the AGC favors making mediation optional. *See* note 192 *supra*.

²²² The AAA recommends mandatory mediation in its Mediation Rules, note 192 *supra*.

b. The Mini-Trial

i. The Mini-Trial Process.—A mini-trial is a form of structured negotiations in which each party makes a summary or abbreviated presentation of its position to a panel composed of the parties' principals, who have authority to settle the claim. The parties' positions may be presented by witnesses, usually in narrative form. Cross-examination is limited, or not permitted, as determined by the parties. The hearing is confidential; nothing said can be used by the parties in subsequent proceedings. The hearing is adversarial; each party presents its best case. However, the presentations nevertheless should be civil in tone. After the mini-trial is concluded, the principals will try to negotiate a settlement. The process may be facilitated by a neutral who, serving as the moderator, keeps the process on track and running smoothly. The facilitator can also serve as a mediator when the principals try to negotiate a settlement of the claim.²²³

ii. History.—The U.S. Army Corps of Engineers has led the way among federal agencies in the use of mini-trials. The use of mini-trials as a voluntary method of resolving contract disputes received further encouragement with the enactment of the Disputes Resolution Act.²²⁴ The mini-trial process has been used successfully to settle large construction claims.²²⁵

iii. Mini-Trial Agreement.—The mini-trial agreement should set the ground rules on how the mini-trial will be conducted and contain a clause making the proceedings confidential. The agreement should identify the principals who will hear the presentations and the neutral who will serve as the facilitator. The agreement should contain a schedule of the proceedings and how the time for the presentations will be allocated between the parties. It should also address the immunity of the facilitator and the sharing of his or her fees by the parties.²²⁶

iv. Advantages and Disadvantages.—The primary advantage of the mini-trial is that it provides an opportunity for the parties to explore the strengths and weaknesses of their respective positions in a structured, confidential setting designed for settlement purposes. Its disadvantages are the time and expense invested in the process. Also, a mini-trial is not suitable if the outcome of the dispute turns mainly on the application of some legal precedent or legal principal.²²⁷

c. Dispute Review Boards

i. Purpose.—A Dispute Review Board (DRB) is a non-binding ADR method that is established by the owner and the contractor to decide construction disputes that arise during the course of the project.²²⁸ The function of a DRB is to provide recommendations as to how a dispute should be resolved. The owner and the contractor can then use the recommendation in their settlement negotiations.²²⁹ However, unlike other forms of non-binding ADR, the recommendations are not confidential.²³⁰ Moreover, the DRB Specifications provide that, "...the written recommendations, including any minority reports will be admissible as evidence in any subsequent litigation."²³¹ Generally, a DRB serves as an ad hoc method of resolving disputes; disputes that if not resolved could fester and eventually lead to litigation or arbitration.

²²³ Lester Edleman & Frank Carr, *The Mini-Trial: An Alternative Dispute Resolution Procedure*, 42 ARB. J., No. 1, at 7 (1987); GROTON, *supra* note 192, at 233–43.

²²⁴ 5 U.S.C. § 581, *et seq.*

²²⁵ See the discussion of cases in which mini-trials were used successfully in Douglas H. Yarn, *Mini-Trial*, in ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES 233–34. Several states have had success in using mini-trials to resolve construction claims. For example, the Pennsylvania Department of Transportation achieved settlement of a major construction claim on the Schoylkill Expressway (\$38.4 million claim settled for \$7.5 million), *State Laws and Regulations Governing Settlement of Highway Construction Contract Claims and Claim Disputes* (No. FHWA-TS-84-209 (1993)).

²²⁶ See PUB. CONT. L.J. No. 3 71–75 (1995) for a sample mini-trial agreement.

²²⁷ See Yarn, *supra* note 225, at 234–36.

²²⁸ A sample DRB specification is shown in Appendix A to Chapter 20, *Dispute Review Boards*, GROTON, *supra* note 192, at 274–80. A sample DRB three-party agreement is shown in Appendix B, at 281–94. A sample DRB guideline is shown in Appendix C, at 295–97.

²²⁹ John D. Coffee, *Dispute Review Boards*, 43 ARB. J. No. 4, at 58 (1988); *Avoiding and Resolving Disputes During Construction*, The Technical Committee on Contracting Practices of the Underground Technology Research Council (1991).

²³⁰ *Supra* note 198.

²³¹ See sample specification, Section B11 at p. 276, Appendix A, note 228 *supra*, and American Society of Civil Engineers Model Specification at 338–44.

ii. *DRB Membership.*—The composition of a DRB is specified in the contract documents. Typically, a DRB is composed of three members:²³² one member selected by the owner and approved by the contractor, one member selected by the contractor and approved by the owner, and a third member selected by the other two board members who also must be approved by the owner and the contractor. The member usually serves as the chairperson.²³³ The contract specifications also require that all DRB members must be experienced with the type of construction involved in the project.²³⁴ The specification may provide that in the event of an impasse in the selection of a third member, either the owner or contractor or both may appeal to a designated court, requesting the court to select a third member from a list or lists submitted to the court by the owner and/or the contractor.²³⁵ Replacement members are to be appointed in the same manner as the original members were appointed.²³⁶ After the DRB members are selected, the owner, the contractor, and the DRB members must sign a three-party agreement, which governs the operations of the DRB.²³⁷

iii. *DRB Operations.*—The function of the DRB is spelled out in the contract. The DRB is an advisory body assisting the parties in the resolution of contract disputes.²³⁸ The DRB provides written recommendations to the owner and the contractor. These recommendations, while advisory and nonbinding, are admissible as evidence in subsequent litigation or arbitration proceedings.²³⁹

²³² A DRB could consist of one member to reduce costs, or as many as five members, as was done on the English Channel Tunnel Project. It is important to have an odd number of members to ensure a majority decision and avoid a tie, which could happen with an even numbered panel if there was a split decision.

²³³ Sample DRB specification, Section E, “DRB Members,” Appendix A, *supra* note 228, at 277.

²³⁴ *Id.* The goal in selecting the third member is to complement the experience of the other two members. “Dispute Review Board Three Party Agreement,” Section II.A, Appendix B, *supra* note 228, at 282.

²³⁵ *Id.*

²³⁶ *Id.*; Appendix B, Section F, at 283.

²³⁷ Appendix B, *supra* note 228.

²³⁸ Appendix A, Section D, *supra* note 228.

²³⁹ Appendix A, Section B.11, *supra* note 228. There is not unanimity as to whether the DRB’s recommendations should be admissible in evidence in subsequent dispute resolution proceedings. Daniel D. McMillan, *An Owner’s Guide to Avoiding the Pitfalls of Dispute Review Boards on Transportation Related Projects*, 27 *TRANSP. L.J.* 181, at 198–99 (Spring 2000) (Discussing why owners should consider deleting the provision concerning admissibility of DRB recommendations). The majority view, that the recommendation should be admissible, is based on the premise that the parties are more inclined to accept the DRB’s recommendation when the contract provides that the recommendation will be admissible in any subsequent litigation or arbitration. “Alternative Dispute Resolution in the Construction Industry,” *supra* note 189, at 53.

Generally, the DRB procedure is similar to arbitration, although the DRB’s recommendations are advisory and not binding. The party that has the dispute goes first, followed by the other party. Each party is permitted to rebut what the other has said until all aspects of the dispute are thoroughly covered. Each party may call witnesses. Presentations are made narratively, and the witnesses may use exhibits to support or to illustrate their testimony. There is no cross-examination by the opposing party, but the DRB members may ask questions. A refusal by a party to provide information requested by the DRB may be considered by it in making its findings and recommendations.²⁴⁰

After the hearing is concluded, the DRB meets in private to discuss and decide the dispute. Its findings and recommendations are then submitted as a written report, including a minority report, if a member dissents, to both parties. Either party may request the DRB to reconsider its recommendation based on new evidence.²⁴¹

If a party refuses to attend a DRB hearing, the party requesting the hearing may seek a court order to compel the recalcitrant party’s attendance.²⁴²

iv. *Ethical Considerations.*—Because the DRB’s recommendations are not binding and may be rejected by the owner or the contractor, it is essential that both parties have confidence in the DRB process and in each of its members.²⁴³ If either party loses confidence in the DRB, a party is unlikely to give weight to an unfavorable recommendation, making the DRB process ineffective.²⁴⁴

²⁴⁰ Appendix C, “Dispute Review DRB Guidelines,” *supra* note 228, at 295.

²⁴¹ *Id.*

²⁴² “An Owner’s Guide to Avoiding the Pitfalls of Dispute Review Boards on Transportation Related Projects,” *supra* note 239, at 200. The article also discusses the pros and cons of proceeding with a DRB hearing in the absence of one of the parties.

²⁴³ The requirement in the contract that each party must approve the other’s member, and the third member selected by the two members, is designed to establish neutrality and make the DRB function as an objective, impartial, and independent body. See *CONSTRUCTION DISPUTE REVIEW BOARD MANUAL* 27–30, 40 (McGraw Hill 1995).

²⁴⁴ *L.A. County Metro. Transp. Auth. v. Shea-Kiewit-Kenny*, 59 Cal. App. 4th 676, 69 Cal. Rptr. 2d 431 (1997) (DRB specification only allowed a DRB member to be terminated for cause. Owner terminated its member for cause when the member told the owner, during the second day of the hearing, that it should settle because it was going to lose. The court found that the owner had cause to terminate its member). Ex parte communications between DRB members and the owner or contractor are prohibited. The DRB members are specifically forbidden to give consulting advice to either party. *CONSTRUCTION DISPUTE REVIEW BOARD MANUAL*, *supra* note 243.

v. *History and Popularity of the DRB Concept*.—The DRB concept has gained popularity since its first reported use by the Colorado Department of Transportation for the construction of the Eisenhower Tunnel in 1975.²⁴⁵ Based on its success in Colorado,²⁴⁶ the use of DRBs was recommended by the Underground Technology Research Council.²⁴⁷ The concept spread and DRBs have been used numerous times on major, heavy construction projects, including the construction of the Central Artery/Tunnel in Boston.²⁴⁸

DRBs owe their popularity to the fact that the DRB's recommendations have generally been accepted by the contracting parties.²⁴⁹ While the DRB concept is popular, it should not be viewed as a panacea for all construction disputes, particularly large, complex claims²⁵⁰ or claims that involve purely legal issues.²⁵¹ DRBs are well suited for the resolution of technical construction issues that invariably crop up during the course of the work. The fact remains, however, that the DRB concept has proven to be a useful tool in resolving construction disputes. Moreover, the establishment of a DRB tells potential bidders that the owner believes in trying to resolve disputes by engaging neutrals, who are experts in construction, to assist the parties in resolving their disputes. This could result in lower bids by reducing contingent amounts included in bids for anticipated legal costs in litigating construction claims.²⁵²

d. Hybrid ADR

While mediation and mini-trials are the more common ADR methods, the parties are free to create other ways of resolving their contract disputes. Mediation combined with arbitration (Med-ARB) is an example.²⁵³ Under this hybrid, the parties mediate the dispute and if the dispute is not resolved, it is referred to arbitra-

tion for a binding resolution. The person who served as the mediator may or may not serve as the arbitration.²⁵⁴

Mediation can be combined with a mini-trial format in which presentations are made by witnesses to the mediator in a joint session. The mediator can use the information obtained during the mini-trial to provide each party, in the private sessions, with a confidential assessment of the claim and the probable outcome if the parties proceed to litigation or arbitration.²⁵⁵ A variation of this method is fact-based mediation. In this method, the mediator, after making a thorough investigation of the claim, issues a detailed, confidential report to each party stating a recommended settlement figure and the factual basis for the recommendation. The parties can then use the report for further negotiations.²⁵⁶

In short, there is no single format that ADR must follow. Since ADR is consensual, the parties are free to create any process that suits their needs in resolving construction disputes.²⁵⁷

3. Arbitration of Construction Claims

a. Overview

Arbitration has become the most widely used method of resolving construction disputes between private contracting parties.²⁵⁸ Most states have enacted arbitration statutes modeled after the Uniform Arbitration Act adopted by the National Conference of Commissioners on Uniform State Laws.²⁵⁹ The Federal Arbitration Act (FAA) authorizes enforcement of arbitration agreements that affect Interstate commerce.²⁶⁰ However, arbitration is not authorized for dispute resolution when

²⁵⁴ *Id.* Serving as both the mediator and arbitrator could affect the parties' willingness to make compromises and be candid with the mediator.

²⁵⁵ *Supra* note 194.

²⁵⁶ ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES, *supra* note 192, "Considering Fact-Based Mediation," at 96.

²⁵⁷ While research has not disclosed any laws that mandate a particular form of non-binding ADR that state transportation agencies must follow, a few states require arbitration as the sole remedy for the final resolution of a public works contract dispute, if the parties cannot settle the dispute through negotiations. *See generally* table in Section 6.3.B.

²⁵⁸ ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES, *supra* note 192, at 71.

²⁵⁹ *See, e.g.*: CONN. GEN. STAT. 52-412; GA. CODE ANN. 9-9-9; HAW. REV. STAT. 658-76; TEX. ANN. CIV. STAT. art. 224; UTAH CODE ANN. 78-31A; Washington, WASH. REV. CODE ch. 7.04.

²⁶⁰ 9 U.S.C. § 2. The meaning of "interstate commerce" as used in the Act is broadly construed. *In re Gardner Zemke Co.*, 978 S.W.2d 624 (Tex. App. 1998); *St. Lawrence Explosives Corp. v. Worthy Bros. Pipeline Co.*, 916 F. Supp. 187 (N.D.N.Y. 1996); *see also Indemnity Ins. Co. of N.A. v. ABA Power*, 925 F. Supp. 705 (S.D.N.Y. 1996) (preemption of state law when the arbitration agreement specified that state law will apply).

²⁴⁵ Keith W. Hunter & Jim Hoening, *Dispute Resolution and Avoidance Techniques in the Construction Industry*, 47 ARB. J. No. 3, at 16, 17 (1992).

²⁴⁶ *Id.* See also Coffee, *supra* note 229.

²⁴⁷ *Avoiding and Resolving Disputes During Construction*, *supra* note 229.

²⁴⁸ CONSTRUCTION DISPUTE REVIEW BOARD MANUAL, *supra* note 24343.

²⁴⁹ Groton, *supra* note 189.

²⁵⁰ Very large, complex claims may require analysis by construction experts, extensive discovery, and a financial audit. The DRB process may not be the best way to resolve large, end-of-project, omnibus claims.

²⁵¹ Ordinarily, lawyers are not permitted to serve as DRB members for fear that it might make the process too adversarial. *See* Kathleen N. J. Harmon, *The Role of Attorneys and Dispute Review Boards*, ADR CURRENTS (March-May 2002) (published by the American Arbitration Association).

²⁵² ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES, *supra* note 192, at 272.

²⁵³ *Id.* Ch. 16, "Med-ARB," at 217.

the Federal Government is one of the disputing parties. Contract disputes involving the Federal Government are resolved in accordance with the procedures specified in the Contract Disputes Act.²⁶¹

Arbitration is generally favored by the courts as an expeditious means of resolving contract disputes.²⁶² This was not true under the common law. The common law viewed arbitration as an improper attempt to deprive or oust the courts of jurisdiction to hear contract disputes.²⁶³ This view is now generally obsolete. With the enactment of statutes providing for judicial enforcement of arbitration agreements and a change in judicial attitude, arbitration agreements are entitled to be enforced on the same terms as any other contractual undertaking.²⁶⁴

b. The Arbitration Process

Litigation and arbitration are governed by rules. Litigation is conducted in accordance with the civil rules of procedure and the rules of evidence in effect in the jurisdiction where the case is filed. Arbitration, although less formal, is governed by the rules specified in the arbitration clause, normally the Construction Industry Arbitration Rules of the American Arbitration Association.²⁶⁵ These rules, which were revised in 1996, create three classes of claims: (1) fast track (claims less than \$50,000); (2) regular track (claims \$50,000 to \$1 million); and (3) large, complex case track (claims over \$1 million). The new rules are designed to speed up and streamline the arbitration process.

While arbitration is not as formal as a trial, it would be a mistake to approach arbitration as some sort of “fact-finding” process, where each party tells its story and then leaves it up to the arbitrator or arbitrators to sort out the truth and reach a fair result. It would also be a mistake to regard arbitration as a Solomonic process in which the arbitrators invariably “split the baby.” Instead, one should prepare for arbitration much like one would prepare for a trial. The key to successful arbitration, like successful litigation, is sound and thorough preparation.²⁶⁶ In an arbitration proceeding, direct and cross-examination usually follow a question-and-

answer format.²⁶⁷ The presentation to the panel, which is usually made by counsel, should be organized, interesting, and credible. The use of models, photographs, videos, and other demonstrative exhibits to illustrate the testimony help accomplish this goal. Affidavits should be used to establish routine facts that the opposing party is unwilling to stipulate to. Another technique is to use affidavits for direct testimony, leaving live testimony for cross-examination.²⁶⁸ Although the rules of evidence do not apply in arbitration, objections to questions that are unfair or improper should be made. Objections should also be made to testimony that is clearly out-of-bounds.²⁶⁹

The use of summaries should be considered as a method of presenting voluminous information. The party offering a summary should give the opposing party the opportunity to review the underlying data on which the summary is based in advance of the hearing. Documents that will be used as exhibits should be pre-numbered and, if possible, stipulated to in advance of the hearing. Bulky documents, such as the contract plans and specifications, should be available in the hearing room. Less bulky documents that have been agreed to, such as correspondence, change orders, excerpts from reports, diary entries, memoranda, and inspection reports should be placed in notebooks in numerical order, according to how they are pre-numbered, for use by the arbitrators, the witnesses, and counsel. Each arbitrator should have his or her own notebook for use during the hearing.

Briefs should be submitted after the evidentiary hearing is closed.²⁷⁰ Documents referred to in the brief should be identified by their number in the notebook. Arbitrators should not be forced to sift through a mass of documents in the notebooks to find some document referred to in the brief just by its description or title. Legal authority should be used wisely. Citing case after case is usually ineffective. It is better to cite a case that

²⁶¹ 41 U.S.C. 601, *et seq.* See 16 PUB. CONT. L.J. 66; 50 YALE L.J. 458.

²⁶² *Maross Constr., Inc. v. Central N.Y. Regional Transp. Auth.*, 488 N.E.2d 67 (N.Y. 1985).

²⁶³ *Id.*; *L.H. Lacy Co. v. City of Lubbock*, 559 S.W.2d 348 (Tex. 1977).

²⁶⁴ *Hetrick v. Friedman*, 602 N.W.2d 603, 610 (Mich. App. 1999).

²⁶⁵ *The General Conditions of the Contract for Construction*, American Architect Institute (AIA) Document A201, incorporates the Construction Industry Arbitration Rules of the AASAZ. The following state transportation agencies that employ arbitration use the AAA rules: Arizona, Connecticut, Delaware, Oregon, and Washington. See table Section 6.B.3.

²⁶⁶ “How to Win at Arbitration,” ch. 12, ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES, *supra* note 192, at 157–75.

²⁶⁷ *Id.* See also “The Expert in ADR,” *Id.*, at 303–05, suggesting a narrative form of expert testimony where it is necessary to explain technical issues to the panel. However, the panel’s expertise should be kept in mind by the attorney and the expert in presenting expert testimony. Construction arbitration panels are usually knowledgeable about construction issues, project delays, and damages. See also James J. Meyers, *10 Techniques for Managing Arbitration Hearings*, 51 DISP. RESOL. J., No. 1., at 28 (Jan.–March 1996). The author discourages the use of expert witnesses except where an issue cannot be resolved without them, at p. 29.

²⁶⁸ *10 Techniques for Managing Arbitration Hearings, Id.*, at 28.

²⁶⁹ “Handling Objections,” ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES, *supra* note 192, at 170–71.

²⁷⁰ In addition to a post-hearing brief, a pre-hearing brief containing a short, concise statement of the party’s position is also helpful, and should be given to the arbitrators in advance of the hearing. The pre-hearing brief can be amplified by a brief opening statement, *Id.*, at 162–64 (“Opening Briefs and Statements”), 173 (“Closing Statements”), 174.

is a precedent than cite a string of cases from other jurisdictions. Copies of cases that are cited should be attached as an appendix to the brief. Important language in the case should be highlighted. The brief should explain why the law applies, how its application dictates the result that the party is seeking, and why that result is fair and furthers public policy.²⁷¹ The brief should be written in clear, plain English; the use of legalese should be avoided. The brief should be accurate, persuasive, and supported by references to the record. In this sense, what persuades judges should also persuade arbitrators, although arbitrators, unlike judges, are not bound by legal precedent. In short, a good post-hearing brief should serve as a map that the arbitrators can use in reaching their decision.

Arbitration may be waived by failing to demand it within the time required by the contract,²⁷² by commencing litigation,²⁷³ or by failing to plead the agreement to arbitrate as an affirmative defense in an answer to a complaint in a lawsuit.²⁷⁴ Also, arbitration may be time-barred when the demand for arbitration is filed after the statute of limitations has expired.²⁷⁵

Generally, an arbitrator's decision on questions of fact or law is conclusive,²⁷⁶ and can only be modified or vacated in accordance with the grounds specified in the state's arbitration act.²⁷⁷ An arbitrator's decision may collaterally estop another party in a subsequent proceeding²⁷⁸ or bar a later claim based on *res judicata*.²⁷⁹

²⁷¹ See, e.g., *Foster Wheeler Enviresponse v. Franklin County Convention Facilities*, 678 N.E.2d 519, 528 (Ohio 1997) (purpose and public policy served by a contract provision requiring written authorization by the owner for alterations in a construction contract).

²⁷² *Capitol Place I Ass'n L.P. v. George Hyman Constr. Co.*, 673 A.2d 194 (D.C. 1996). See 25 A.L.R. 3d 1171 (1969).

²⁷³ *Modren Piping, Inc. v. Blackhawk Auto Sprinklers, Inc.*, 581 N.W.2d 616 (Iowa 1998).

²⁷⁴ *S&R Co. of Kingston v. Latona Trucking, Inc.*, 159 F.3d 80 (2d Cir. 1998).

²⁷⁵ *Zufari v. Arch. Plus*, 914 S.W.2d 756 (Ark. 1996). See 94 A.L.R. 3d 533 (1979); see also *Har-Mar, Inc. v. Thorsen and Thorshov, Inc.*, 218 N.W.2d 751 (Minn. 1974) (arbitration not barred by statute of limitations).

²⁷⁶ *Garrison Assocs. v. Crawford Constr.*, 918 S.W.2d 195 (Ark. App. 1996).

²⁷⁷ *Stockdale Enters. v. Ahl*, 905 P.2d 156 (Mont. 1995). Reasons for vacation of an award are narrow, and include fraud, undisclosed bias, ultra vires determinations that were not arbitrable, or misconduct on the part of the arbitrators. The court's review of an arbitration proceeding is limited to whether or not the statutory grounds for vacation exist. *Mike's Painting, Inc. v. Carter Welsh, Inc.*, 975 P.2d 532 (Wash. App. 1999); *Bennett v. Builders II, Inc.*, 516 S.E. 808 (Ga. App. 1999).

²⁷⁸ *QDR Consultants & Dev. Corp. v. Colonial Ins. Co.*, 675 N.Y.S.2d 117 (N.Y. App. 1998) (determination that the general contractor was liable to the subcontractor collaterally estopped the subcontractor's action against the general contractor's surety).

²⁷⁹ *TLT Constr. Corp. v. A. Anthony Tappe and Assocs., Inc.*, 716 N.E.2d 1044 (Mass. App. 1999) (arbitration decisions

A question may arise as to whether a dispute is subject to arbitration.²⁸⁰ Normally, this is a question for judicial determination.²⁸¹ But if arbitrability is debatable, the clause generally will be construed in favor of arbitration.²⁸² This view is consistent with that public policy favoring arbitration.

A party to an arbitration agreement cannot vitiate the arbitration hearing by refusing to attend. The arbitration may proceed in the absence of a party who, after notice of the hearing, fails to be present or fails to obtain a continuance from the arbitrator.²⁸³

in favor of city barred contractor's claim against city's retained architect who was in privity with city); see "Res Judicata and Collateral Estoppel," ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES, *supra* note 192, at 193–98.

²⁸⁰ *Department of Public Works v. Ecap Constr. Co.*, 737 A.2d 398 (Conn. 1999). While the state could be compelled to arbitrate whether it breached a settlement agreement of that claim, the state statute providing for arbitration only made claims directly involving the work arbitrable.

²⁸¹ *Id.*

²⁸² In *United Steel Workers of America v. Warrior & Gulf Nav. Co.*, 363 U.S. 574, 585 (U.S. Ala. 1960), the court said that only the "most forceful evidence of an intention to exclude a dispute from arbitration" will be sufficient to find against arbitrability. Accord: *Munsey v. Walla Walla College*, 906 P.2d 988 (Wash. App. 1995); *Jenkins v. Percival*, 962 P.2d 796 (Utah 1998).

²⁸³ AAA Rule 29; *E.E. Tripp Ex. Con., Inc. v. City of Jackson*, 230 N.W.2d 556 (Mich. App. 1975). *Contra*, see *Pinnacle Constr. Co. v. Osborne*, 460 S.E.2d 880 (Ga. App. 1995) (invalidating arbitration agreement in an effort to oust courts of jurisdiction—following early common law rule, which is now rejected by most courts); see *Maross Constr. Co. v. Cent. Regional Trans. Auth.*, *supra* note 262, and *Hetrick v. Freidman*, *supra* note 264.

c. State Transportation Agencies and Arbitration

i. Authority To Arbitrate.—Some state transportation agencies include arbitration clauses in their contracts. In Delaware²⁸⁴ and North Dakota,²⁸⁵ arbitration is the exclusive method for resolving contract disputes. In California, arbitration is required by statute, although the State and the contractor may agree, in writing, to waive arbitration and litigate the claim.²⁸⁶ In Connecticut, the contractor has the option of electing either arbitration or litigation.²⁸⁷ A few states use a mix of arbitration and litigation.²⁸⁸

In the absence of express legislation authorizing arbitration as a means of resolving contract disputes, may a state contracting agency agree to arbitrate? Generally, the answer to this question is yes. A number of jurisdictions have held that the express statutory authority to contract, and to sue or be sued, waives sovereign immunity and includes, by implication, the implied power to agree to arbitration as a means of resolving contract disputes. For example, in *Dormitory Authority v. Span Electric Corp.*,²⁸⁹ the New York Court of Appeals said: "... we hold that the state itself is not insulated against the operation of an arbitration clause because the power to contract implies the power to assent to the settlement of disputes by means of arbitration."

Other jurisdictions have followed the view expressed by the New Court of Appeals in cases where public agencies have attempted to avoid arbitration by contending that they lacked statutory authority to include arbitration clauses in their contracts.²⁹⁰

Statutes that expressly authorize state contracting agencies to arbitrate contract disputes may be strictly construed. Only disputes of the kind specified in the statute are subject to arbitration. If there is a serious question as to whether the dispute is arbitrable, the statute will be construed against arbitration and in favor of the state's interpretation that the claim is not subject to arbitration under the statute. In *Department of Public Works v. Ecap Const. Co.*,²⁹¹ the Connecticut Supreme Court held that the public works arbitration statute did not apply to a claim that the state had breached a settlement agreement. The statute only applied to actual construction disputes. It would not be construed to cover a claim that an agreement settling a construction dispute had been breached by the State.

ii. Advantages and Disadvantages.—Contract disputes that remain unresolved often develop into a claim leading to litigation or arbitration. The forum selected to resolve the claim usually depends upon the final dispute resolution method specified in the contract or by a statute.²⁹² Which forum is better for an owner—arbitration or litigation? Those who favor arbitration agree that arbitration is quicker, cheaper, and more efficient than litigation. Those who favor litigation argue that litigation has better safeguards because of the rules of evidence, the application of legal precedent, and broader appeal rights. There doesn't seem to be any absolute answer as to which forum is better. Each has its own advantages and disadvantages, as depicted in the following table.²⁹³

²⁸⁴ 10 Del. C. § 5723 (1999) *et seq.*

²⁸⁵ N.D.C.C. 24-02-31.

²⁸⁶ State Contract Act, pt. 2, Public Contract Code, Article 7.2, § 10240.10, "Waiver of Arbitration."

²⁸⁷ C.G.S.A. § 4-61 (1998).

²⁸⁸ Arizona: STAT. 12-1518; Missouri: STAT. 485-350; see *Murray v. Highway Trans. Comm'n*, 37 S.W.3d 228 (Mo. 2001), (arbitration of negligence case); Mississippi: STAT. 435-350; New Mexico: STAT. 12-8A-3; Oregon: STAT. 20-330 (acknowledging Dep't of Transportation's authority to include arbitration clauses in its contracts); Rhode Island: R.I. GEN. LAWS, § 37-16-1, *et seq.*; Washington: WASH. REV. CODE 39.04.240 (recognizing state agency's authority to use arbitration clauses in its construction contracts).

²⁸⁹ 218 N.E.2d 693, 696 (N.Y. 1966).

²⁹⁰ *Watkins v. Department of Highways of Com. of Ky.*, 290 S.W.2d 28 (Ky. 1956); *Pytko v. State*, 255 A.2d 640 (Conn. Super. 1969); *City of Hartford v. American Arb. Ass'n*, 391 A.2d 137 (Conn. Super. 1978); *Charles E. Brohawn Bros. v. Bd. of Trustees of Chesapeake College*, 304 A.2d 819 (Md. 1973); *State by Spannaus v. McGuire Architects-Planners, Inc.*, 245 N.W.2d 218 (Minn. 1976); *Paid Prescriptions v. State Dep't of Health & Rehabilitative Services*, 350 So. 2d 100 (Fla. App. 1977); *Holm-Sutherland Co. v. Town of Shelby*, 982 P.2d 1053 (Mont. 1999); *E.E. Tripp Ex Con, Inc. v. City of Jackson*, 230 N.W.2d 556 (Mich. App. 1975); Annotation, 20 A.L.R. 3d 569 (1968); *City of Atlanta v. Brinderson Corp.*, 799 F.2d 1541 (11th Cir. Ga. 1986); 4 AM. JUR. 2D *Alternative Dispute Resolution* § 106 (1995).

²⁹¹ *Supra* note 280. Statutes that waive sovereign immunity are strictly construed. This rule applies to statutes that authorize arbitration as a means of resolving public contract disputes.

²⁹² For example, the California State Contract Act specifies arbitration as the required dispute resolution method unless the state and the contractor agree to litigation, *supra* note 287.

²⁹³ See generally Judge Marjorie O. Rendell, *ADR vs. Litigation*, 55 DISP. RESOL. J., No. 1, at 69 (Feb. 2000); John A. Harding, Jr., *Dealing With Mandatory ADR*, 39 TRIAL LAW. GUIDE 38 (1995); 4 AM. JUR. 2D *Alternative Dispute Resolution* §§ 8 and 11 (1995).

TABLE B**Arbitration and Litigation Comparisons by Features**

Feature	Arbitration	Litigation
Discovery	Restrictive	Liberal
Motion Practice	Little if any.	Civil rules allow pre-trial motions to dismiss claims and limit evidence.
Evidence	Rules of evidence do not govern admissibility.	Rules of evidence apply.
Basis for decision	Leans toward fairness—Not bound by legal precedent, favors a party who has the “equities.”	Governed by legal precedent, although jury may be influenced by what it believes to be fair.
Complex engineering and technical issues	Arbitrators usually selected for their knowledge and technical expertise.	Decisionmaker—judge or jury—usually lacks technical expertise.
Scheduling	More flexible and easier to schedule hearings, although this is not always true when three arbitrators are involved.	Less flexible and harder to schedule hearings because of court congestion.
Expense and time required for hearing	Generally less expensive, and more expeditious; however, the cost and time to resolve large, complex omnibus claims involving a three-member arbitration panel may be more expensive and time consuming than a courtroom trial.	Generally takes longer and is more expensive than arbitration.
Appeal from adverse decision	Limited—grounds for vacation of award are usually governed by statute. ²⁹⁴	Broader appeal rights based on substantial evidence and conformity to legal precedent.

²⁹⁴ The California State Contract Act provides that a court must vacate the arbitration award if it is not supported by substantial evidence, or it is not decided in accordance with state law. Public Contract Code, art. 7.2, § 10240.12.

Generally, arbitration has been the forum of choice for resolving smaller claims. Several states have implemented this view. Arizona requires mandatory arbitration for claims not exceeding \$200,000.²⁹⁵ Oregon requires mandatory arbitration for claims under \$25,000.²⁹⁶ Washington requires mandatory arbitration for claims not exceeding \$250,000.²⁹⁷ Each state specifies that the arbitration hearing will be conducted in accordance with the Construction Industry Arbitration Rules promulgated by the American Arbitration Association.²⁹⁸

d. Consolidation of Arbitration Proceedings

Ordinarily, courts will not compel consolidation of separate arbitration proceedings where the arbitration agreements do not contain provisions permitting consolidation.²⁹⁹ The rule is based on the rationale that arbitration is consensual and thus parties cannot be compelled to arbitrate matters that they did not agree to arbitrate.³⁰⁰ However, when a party signs a contract containing an arbitration clause, it waives its right to litigate disputes covered by the clause and it can be compelled to submit those disputes to arbitration.³⁰¹

Owners who favor arbitration, and would like the flexibility of being able to join the contractor and the owner's design engineer in a single arbitration proceeding, should provide for joinder and consolidation in both the construction contract and the design contract.³⁰² The California public works arbitration statute authorizes such joinder of "any supplier, subcontractor, design professional, surety or other person who has so agreed and if the joinder is necessary to prevent a substantial risk of the party otherwise being subjected to inconsistent obligations or decisions."³⁰³ A "flow-down"

clause in a subcontract may incorporate an arbitration clause in the prime contract.³⁰⁴ The arbitration clause will not be incorporated in the subcontract, however, unless it is clear that the subcontractor intended to submit to arbitration.³⁰⁵

4. Partnering

Partnering is a nonbinding process initiated at the outset of the construction project. The process involves a workshop attended by the owner and the contractor. The workshop may be conducted by a professional facilitator who guides the discussions. The workshop is designed to accomplish several goals: First, it encourages the parties to recognize that it is in their interest to resolve problems as they arise rather than let them fester and grow into bigger problems. Partnering encourages the parties to trust each other and try to resolve their disputes through negotiations, rather than by litigation.

The partnering process was developed by the U.S. Army Corps of Engineers in the 1980s for a major construction project on the Columbia River. The purpose of partnering has been described as follows:

Partnering is the creation of an owner-contractor relationship that promotes achievement of mutually beneficial goals. It involves an agreement in principle to share the risks involved in completing the project, and to establish and promote a nurturing partnership environment. Partnering is not a contractual agreement, however, nor does it create any legally enforceable rights or duties. Rather, Partnering seeks to create a new cooperative attitude in completing government contracts. To create this attitude, each party must seek to understand the goals, objectives, and needs of the other—their "win: situations—and seek ways that these objectives can overlap."³⁰⁶

Although partnering is a method of avoiding disputes rather than resolving them, it is still regarded as part of a dispute management system.³⁰⁷ The partnering process has been used by a number of state transportation agencies.³⁰⁸ The partnering workshop usually concludes with the parties signing a memorandum or part-

²⁹⁵ Stand. Spec. 105.22 (2000).

²⁹⁶ Stand. Spec. 00199.40 (1996).

²⁹⁷ Stand. Spec. 1-09.13 (3) (2000).

²⁹⁸ The "fast track" rules apply to claims that do not exceed \$50,000. The "regular track" rules apply to claims over \$50,000, but less than \$1 million. The rules are available from the AAA Customer Service Dept., 140 W. 51st., N.Y., N.Y. 10020-1203; Telephone: (212) 484-4000; Fax: (212) 765-4874; email: usadrsrv@arb.com.

²⁹⁹ *Hyundai American, Inc. v. Meissner & Wurst GmbH & Co.*, 26 F. Supp. 2d 1217 (N.D. Cal. 1998); *Hartford Accident and Indem. Co. v. Swiss Reinsurance America Corp.*, 87 F. Supp. 2d 300 (S.D.N.Y. 2000).

³⁰⁰ *AJM Packing Corp. v. Crossland Constr. Co.*, 962 S.W.2d 906 (Mo. App. 1998); *Diensen v. Joe Keim Builders, Inc.*, 505 N.E.2d 1325 (Ill. App. 1987); *City and County of Denver v. Dist. Ct.*, 939 P.2d 1353 (Colo. 1997).

³⁰¹ *Maross Constr. v. Cent. Regional Trans.*, *supra* note 262; *3A Indus. v. Turner Constr. Co.*, 869 P.2d 65 (Wash. App. 1993).

³⁰² See § 7.10.c., *supra*, discussing considerations regarding the joinder of the owner's architect/engineer in the litigation between the owner and the contractor.

³⁰³ California State Contract Act, Public Contract Code, art. 7.2, § 10240.9.

³⁰⁴ *3A Indus. v. Turner Constr. Co.*, 869 P.2d 65 (Wash. App. 1993).

³⁰⁵ *Gen. Railway Signal Corp. v. L.K. Comstock & Co.*, 678 N.Y.S.2d 208 (N.Y.A.D. 1998).

³⁰⁶ U.S. Army Corps of Engineers, *Partnering* (Pamphlet – 91-ADR-P-4).

³⁰⁷ Steven Pinnell, *Partnering and the Management of Construction Disputes*, 54 DISP. RESOL. J. No. 1, at 16 (Feb. 1999); James H. Kill, *The Benefits of Partnering*, 54 DISP. RESOL. J., No. 1, at 29 (Feb. 1999). (This article discusses the use of partnering by the Puerto Rico Dept of Transportation in fashioning an ADR system for the *Tren Urbano* project, a regional rail transit system in San Juan.)

³⁰⁸ The following states have used partnering: Alaska, Arizona, California, Idaho, Kansas, Minnesota, Montana, North Carolina, North Dakota, New Mexico, Oregon, Texas, Utah, Washington, Wisconsin, and Wyoming. Source: Resolutions International, email: Norman Anderson@msn.com.

nering agreement.³⁰⁹ The agreement provides that the contractor and the owner, with a positive commitment to honesty and integrity, agree that:

- a. Each will function within the laws and statutes applicable to their duties and responsibilities;
- b. Each will assist in the other's performance;
- c. Each will avoid hindering the other's performance;
- d. Each will proceed to fulfill its obligations diligently; and
- e. Each will cooperate in the common endeavor of the contract.³¹⁰

Partnering is not a quick fix for adversarial attitudes and antagonistic relationships that may exist between owners and contractors. Yet it can be a positive step toward improving communications between the parties and establishing a non-adversarial process aimed at resolving problems as they occur, rather than letting them fester and become worse.

5. Conclusion

The high cost of litigation and arbitration for large, complex claims has caused owners and contractors to explore alternative means of resolving their disputes, other than through litigation or arbitration. Innovative owners and contractors have developed variations in traditional ADR techniques, such as hybrid mediation specifically tailored to meet the parties' needs. In the private sector, the trend has been toward greater use of the ADR process to resolve construction disputes. Many public contracting agencies have joined this trend.

As ADR becomes even more sophisticated, it is likely this trend will increase and more public contracting agencies will take advantage of the opportunities that ADR offers.

³⁰⁹ A partnering agreement does not change the terms of the contract, or alter the legal relationship of the parties to the contract, Arizona Standard Specification 104.01 (2000).

³¹⁰ Arizona Standard Specification 104.01. The Specification provides that cost of the workshop will be shared equally by the owner and the contractor. The Arizona DOT partnering specification (104.01) is quoted at p. 52, in 52 DISP. RESOL. J. No. 3 (1997), *supra* note 189.

APPENDIX A

**PUBLICATION REQUIREMENTS FOR INVITATIONS TO BID ON TRANSPORTATION
CONSTRUCTION CONTRACTS**

STATE & CITATION	NEWSPAPER NOTICE	OTHER REQUIREMENTS
ALA. CODE § 39-2-2	Publication once each week for 3 consecutive weeks in newspapers of general circulation in counties where project will be located.	
ALASKA STAT. § 36.30.130 2 ALASKA ADMIN. CODE § 12.130	May include newspaper publication “calculated to reach prospective bidders.”	Must be published in Alaska Administrative Journal for 21 days prior to bid opening and on online public notice system. May include posting in public place where work is to be performed or materials furnished.
ARIZ. REV. STAT. § 28-6923	Once a week for not less than 2 consecutive weeks in weekly newspaper of general circulation in state, or twice in daily newspaper, not less than 6 nor more than 10 days apart.	
ARK. CODE § 19-11-229	Must advertise not less than 5 nor more than 30 days prior to bid opening by publishing at least once in at least one newspaper of general circulation in the state or posting by electronic media.	
CAL. PUB. CONT. CODE § 10140	Publication once a week for 2 consecutive weeks, unless longer period deemed necessary by department, in newspaper of general circulation in county where project is located.	Publication for 2 consecutive weeks in construction trade journal of general circulation in San Francisco or Los Angeles for projects in those vicinities.
COLO. REV. STAT. 24-92-103(3), 24-92-104.5, 43-1-105(4)	Advertisement 14 days prior to for bid opening, may be published in newspaper of general circulation.	May include online publication, including Internet.
CONN. GEN. STAT. § 4a-57 Conn. DOT Construction Contract Bidding and Award Manual	Notice in at least two publications, one of which must be major daily newspaper published in the state, at least 5 days before bid submission.	Must be posted on Internet. Notice to contractors’ subscriber list and advertisement in trade journals, per Manual sections VII.A and IIV.B.
29 DEL. CODE § 6962(b)	Publication at least once a week for 2 consecutive weeks in newspaper circulated in each county in state.	May include mailing to registry of prospective bidders.
D.C. CODE § 2-303.03	Public notice for 30 days, publication in newspaper of general circulation and in appropriate trade publications with provision for shorter notice of not less than 7 days.	Shall maintain Internet site that provides vendors with notice of opportunities to bid as well as notice of awards.

STATE & CITATION	NEWSPAPER NOTICE	OTHER REQUIREMENTS
FLA. STAT. § 337.11	For contracts under \$250,000, publication in newspaper of general circulation in county where proposed work is located, once a week for at least 2 consecutive weeks, with first publication no less than 14 days prior to deadline for submission of bids.	For contracts greater than \$250,000, bid solicitation notice to prequalified contractors 2 weeks before bids to be received.
GA. CODE ANN. 32-2-65	Advertise for at least 2 weeks, in newspapers “as will ensure adequate publicity,” with one ad at least 2 weeks prior to bid opening and another 1 week after first notice.	May advertise in other publications in addition to or instead of newspaper, so long as there is adequate publicity.
HAW. REV. STAT. § 103D-302(c)	Advertise in a reasonable time before bid opening pursuant to regulations adopted by procurement policy board.	
IDAHO CODE § 40-902	Advertisement in at least two consecutive weekly issues in a weekly newspaper, or five issues in a daily newspaper, each having a general circulation in the county where the work is to be done.	
ILL. COMP. STAT. § 30500/20-10		Publication in Illinois Procurement Bulletin at least 14 days before the date set for bid opening.
IND. CODE § 8-23-9-1	Notice required.	
IOWA CODE § 313.10	Must advertise if over \$1,000 contract.	
KAN. STAT. § 68-408	Publication once per week for 2 consecutive weeks in Kansas Register.	Other notice as the Secretary deems necessary and proper.
KY. REV. STAT. § 176.070, § 424.130(1)(b)	Publication at least once by legal notice not more than 21 days nor less than 7 days prior to bid opening, in qualified newspaper.	May be published two or more times.
LA. REV. STAT. § 48:252	Publication in official journal of the state once a week for 3 weeks, first ad at least 21 days prior to bid opening.	Must also be published on electronic bidding system that is accessible to general public.
23 ME. REV. STAT. § 753	Publication in two or more public newspapers printed wholly or in part in the state, and in one newspaper printed wholly or in part in the county where the work is located if there is a newspaper in the county.	
MD. STATE FIN. & PROC. CODE § 13-103(c)	Must give reasonable notice for 10 days prior to bid opening; published in state Contract Weekly; may publish in newspapers.	Must publish in Contract Weekly Online; may publish in periodicals or trade journals.
MASS. GEN. L. ch. 81, § 8	Publish in two or more newspapers published in each county in which the highway lies, and in three or more	

STATE & CITATION	NEWSPAPER NOTICE	OTHER REQUIREMENTS
	daily newspapers published in Boston.	
MINN. STAT. § 161.32	Publication in newspaper of general circulation once each week for 3 weeks.	May be published on Internet.
MISS. CODE § 65-1-85	Publication once per week for 2 successive weeks in newspaper of general state circulation published in Jackson, no less than 14 days nor more than 60 days prior to bid opening.	May also be published in metropolitan newspaper or trade publication.
MO. REV. STAT. § 227.100.1	Advertisement published in county where work is to be done.	
MONT. CODE § 18-2-301	Advertisement published weekly for 3 consecutive weeks, in newspaper of seat of government and in newspaper in county where work is performed.	
NEB. REV. STAT. § 39-1348	Not less than 20 days prior to opening bids, advertise once a week for 3 consecutive weeks in the official county newspaper designated by county board in county where work will be done, and in such additional newspapers as may appear necessary to department.	
NEV. REV. STAT. § 408.327	Once a week for 2 consecutive weeks in newspaper of general circulation in county where major part of work will be done; also, once a week for 2 consecutive weeks in one or more daily newspapers of general circulation in State; first publication not less than 15 days before bid opening.	
N.H. REV. STAT. § 237:14	Once a week for 2 consecutive weeks in newspaper of general circulation in state, first advertisement not less than 14 days prior to bid opening.	
N.J. STAT. § 27:7-29	Once a week for 3 weeks prior to bid opening in each of two newspapers printed in county or counties where project is located, and in one newspaper published in Trenton.	May publish notice in one or more American engineering periodicals.
N.M. STAT. §§ 13-1-104; 67-3-43	Published at least once, not less than 10 days prior to bid opening, in newspaper of general circulation where agency central office is located.	Agency may adopt other procedures, including publications in trade journals.
N.Y. HIGH. LAW § 38	Once a week for 2 successive weeks in newspaper published in county where	May also publish in trade journals.

STATE & CITATION	NEWSPAPER NOTICE	OTHER REQUIREMENTS
	work will be done; and in other newspapers as commissioner designates. If county has no newspaper, publication in paper of adjoining county designated similarly.	
19A N.C. ADMIN. CODE § 02D.0803	Advertised in three widely circulated newspapers in the state prior to bid opening.	Invitations to bid mailed to prospective bidders, material suppliers, and other interested parties on day of publication.
N.D. CENT. CODE § 24-02-19	Once in official newspaper of county where project located, prior to bid opening.	Publication in other daily newspaper of general circulation where project is located; trade journals; written solicitations to those on bidders' list.
OHIO REV. CODE § 5525.01	Publication for 2 consecutive weeks in newspaper of general circulation published in county where project is all or partially located; or, if none, newspaper having general circulation in adjacent county.	May advertise in other publications director considers advisable.
61 OKLA. STAT. § 104	Publication in two consecutive weekly issues of newspaper of general circulation published in county where work will be done, with first notice not less than 20 days prior to bid opening.	May be published in trade journals.
OR. REV. STAT. § 279.025	Publication at least once in at least one newspaper of general circulation in area of project.	If estimated cost of contract exceeds \$125,000, notice must be published in at least one trade journal of statewide circulation. May also use electronic publication.
62 PA. CONS. STAT. § 512	Must give adequate notice, which may include notice in newspaper of general circulation.	May also use notice by electronic publication available to general public; notice in trade publications; notice to mailing list; or notice to prequalified contractors' list.
R.I. GEN. LAWS §§ 24-8-12; 37-2-18	Once in a newspaper of statewide circulation 5 days before date for receiving bids.	
S.C. CODE § 57-5-1620	Publication for 2 weeks in one or more daily newspapers in the State.	May advertise for longer time and in other publications.

STATE & CITATION	NEWSPAPER NOTICE	OTHER REQUIREMENTS
S.D. CODIFIED LAWS § 31-5-10	Advertising required; department may adopt rules governing advertising.	
TENN. CODE § 54-5-114	Publication for 2 weeks prior to bid opening in newspaper published in county where work will be performed and in one widely circulated daily newspaper in that area of state. If no paper published in county, publication in newspaper in adjacent county.	
TEX. TRANSP. CODE §§ 223.002, 223.003	Once a week for at least 2 weeks before contract award in newspaper published in county where work to be done and two other newspapers designated by highway department, for projects over \$300,000. For those under that amount, published in two successive issues of newspaper in county where project is located.	Notice may be mailed to those contractors who have requested to be on mailing list.
UTAH CODE ANN. § 63-56-20	Public notice must be given a reasonable time prior to bid opening; may be published in a newspaper of general circulation; newspaper of local circulation in the area pertinent to the procurement; industry media; or government publication designed for giving public notice.	
UTAH ADMIN. CODE § 33-3-104		
VT. STAT. 19 § 10 Code of Vt. Rules § 14-010-010	Contracts must be advertised.	
VA. CODE §§ 2.2-4301, 33.1-185	All construction contracts must be advertised at least 10 days prior to letting contract, by publication in newspaper of general circulation.	Posting on Internet procurement Web site designated by the Department of General Services is required. May be posted in designated public place.
WASH. REV. CODE § 47.28.050	Once a week for 2 consecutive weeks preceding date for receiving bids in at least one trade journal of general circulation in State, or if project is less than \$50,000, in one newspaper of general circulation in county where major part of work will be done.	

STATE & CITATION	NEWSPAPER NOTICE	OTHER REQUIREMENTS
W. VA. CODE § 17-4-19	At least once in at least one daily newspaper published in Charleston.	May publish in such other journals and magazines as deemed advisable by commissioner.
WIS. STAT. ANN. § 84.06(2)(a)		Advertisement in manner determined by department.
WYO. STAT. § 24-2-108	Public notice required by statute; department policy is to advertise weekly for 3 weeks prior to bid opening.	Department will mail invitations for bids to bidders requesting to be on mailing list.
Wyoming DOT Construction Manual, § 8.01		

APPENDIX B

SECURITY REQUIRED FOR BIDS ON HIGHWAY CONSTRUCTION CONTRACTS

STATE & CITATION	AMOUNT OF SECURITY	FORM OF SECURITY	TERMS FOR RETURN OF SECURITY
ALA. CODE § 23-1-2; 39-2-4, 39-2-5	Not less than 5 percent of awarding authorities estimate or of bid amount, but not more than \$10,000.	Cashier's check or bid bond.	All except those of three lowest bids returned immediately after determination of low bidder; others returned after contract and contractor bond executed.
ALASKA STAT. § 36.30.120	At least 5 percent of bid.	Bond or other form acceptable to commissioner.	
ARIZ. REV. STAT. § 34-201	Ten percent of bid amount.	Certified check, cashier's check, or surety bond.	Returned to those whose proposals are not accepted, and to successful bidder upon execution of contract and surety bond.
ARK. CODE § 19-11-235	Bid security may be required by regulations.		
CAL. PUB. CONT. CODE §§ 10167, 10184	At least 10 percent of bid amount.	Cash, cashier's check, certified check, or bid bond.	Returned within 10 days after award; second and third low bidders' security may be retained until a contract is executed.
Colo. Code of Regulations 2-CCR-601-10-4.64	Amount specified in bid invitation.	Cashiers check, certified check, or bid bond.	Proposal guarantees for three lowest bids, held until award, then two unsuccessful bidders' security returned immediately; successful bidder's is held until execution of contract and bond.
CONN. GEN. STAT. § 13a-95 (1998)	One third of contract price, or annual bid bond in amount of one-third of amount of all current bids by that bidder; or amount set by commissioner and stated in invitation for bids.	Surety bond.	Returned to unsuccessful bidders within 3 calendar days after award of contract. If award not made within 10 days after bid opening, bonds of all but three lowest bidders are returned.
Conn. Standard Specifications, §§ 1.02.07, 1.03.03			

STATE & CITATION	AMOUNT OF SECURITY	FORM OF SECURITY	TERMS FOR RETURN OF SECURITY
29 DEL. CODE § 6962(d)(8)	Equal to or greater than 10 percent of bid amount.	Surety bond.	Returned to unsuccessful bidders upon award or rejection of all bids; returned to successful bidder upon contract execution.
D.C. CODE §§ 2-305.01, 2-305.02	Required for all contracts over \$100,000 (subject to revision by regulations), at least 5 percent of bid.	Surety bond, cash or equivalent, or other form acceptable to director.	Surety authorized to do business in district.
FLA. STAT. § 337.17	On contracts over \$150,000, not to exceed 10 percent of preliminary estimate of project cost.	Certified check, cashier's check, bank draft, money order, or surety bond.	
GA. CODE ANN. § 32-2-68	Amount deemed necessary "to insure that the successful bidder will execute the contract on which he bid."	Certified check, "or other acceptable security."	Returned to unsuccessful bidders upon determination of lowest reliable bidder.
HAW. REV. STAT. § 103D-323 (2002)	At least 5 percent of amount of bid as established by policy board.	Cash or surety bond, or form of security specified by rules.	Irrevocable for period specified in invitation for bids.
IDAHO CODE § 40-902(2); 40-908	Five percent of the bid amount.	Cashier's check, certified check, or surety bond.	Returned to unsuccessful bidders when contract is awarded.
44 ILL. ADMIN. CODE § 660.160(d)	Amount stated in invitation for bids.	Certified check, cashier's check, or surety bond.	
IND. CODE § 8-23-9-9	Five percent of bid price.	Surety bond.	
Iowa Stan. Specs. §§ 1102.11, 1103.03, 1103.05	Form and amount of bid guaranty as prescribed in notice to bidders.	Certified check, bank draft, cashier's check, bid bond, surety bond.	Returned to unsuccessful bidders after approval for award has been made. Successful bidder's guaranty returned when contract bond approved.
KAN. GEN. STAT. §§ 60-1111, 68-410, 68-521			

STATE & CITATION	AMOUNT OF SECURITY	FORM OF SECURITY	TERMS FOR RETURN OF SECURITY
KY. REV. STAT. § 176.080 (2002)	Amount set by department, guaranteeing that contractor will execute contract.	Certified check or surety bond.	
LA. REV. STAT. 48:253	Five percent of official bid amount.	Certified check, cashiers check, money order, company check, or surety bond.	Returned not later than 60 days after receipt of bids.
23 ME. REV. STAT. § 753	Amount specified in bid invitation, determined by department to be sufficient to guarantee that bidder will execute contract if awarded.	Surety bond.	
MD. STATE FIN. & PROC. CODE § 13-207	At least 5 percent of bid.	Surety bond, cash, or other form of security allowed by regulation.	None required if expected price is \$100,000 or less.
MASS. L. ch. 30, § 39M	Five percent of value of bid.	Surety bond, cash, certified check, cashiers check, or treasurer's check.	
Minn. Stan. Specs. §§ 1208, 1304	Amount specified in bid invitation.	Certified check, surety bond.	Returned to unsuccessful bidders "immediately" following opening and checking of proposals, except for two lowest bidders, whose bonds are retained until contract is executed.
MISS. CODE § 65-1-85 Stan. Specs. § 103.04	Not less than 5 percent of bid amount.	Cashier's check, certified check, or surety bond.	Bid bonds not returned, but checks will be returned following bid opening except for two lowest bidders, which will be returned 10 days after award.
MO. REV. STAT. § 227.100.2	Five percent of amount of bid.	Certified check, cashier's check, or surety bond.	Returned to successful bidder upon execution of contract and bond, and to unsuccessful bidders under terms of proposal.

STATE & CITATION	AMOUNT OF SECURITY	FORM OF SECURITY	TERMS FOR RETURN OF SECURITY
MONT. CODE ANN. § 18-1-202	Not less than 10 percent of bid amount.	Cash; cashier's check, certified check, bank money order or bank draft drawn and issued by bank insured by FDIC; bid bond, guaranty bond, or surety bond.	Returned after bid opening.
Neb. Stan. Specs. § 102.14	At least 5 percent of bid amount.	Surety bond.	
NEV. REV. STAT. § 408.337	At least 5 percent of bid amount.	Cash, certified check, or surety bond.	Returned to unsuccessful bidders within 10 days after award. Guaranties of second and third lowest bids may be held until after contract is executed.
N.H. Stan. Specs. § 102.09, 103.04	Character and amount specified in bid invitation.	Surety bond or certified check.	Returned to unsuccessful bidders within 7 days after bids are opened, except two lowest bidders' guaranties, which are returned after contract award.
N.J. STAT. ANN. §§ 27-7-31, 27-7-33	Amount to be determined by commissioner, not to exceed 50 percent of bid.	Surety bond.	Returned to unsuccessful bidders within 3 days after bids received, except two lowest bidders.
N.M. STAT. § 13-1-146 18 N.M.A.C. §§ 27.2.8.11, 27.2.9.5	At least 5 percent of bid amount.	Surety bond or cash equivalent, cashiers check, certified check, postal money order, or bank money order.	Checks returned to all but two lowest bidders; lower of two returned after award; lowest bidder's check returned after contract execution. Bonds returned upon request.
N.Y. HIGH. LAW § 38	Amount fixed by Commissioner and set out in advertisement.	Certified check, cashier's check, or surety bond.	Returned to unsuccessful bidders following bid opening, except two lowest bidders whose security is retained until contract bond is filed.
N.C. Stan. Specs. §§ 102-11, 103-6	At least 5 percent of bid amount.	Surety bond, certified check, or cashier's check.	All bid bonds retained until bonds are executed by successful bidder, after which they are destroyed. Checks, other than those of three lowest bidders, returned within 10 days after bid opening. Checks of three lowest bidders returned when contractor bonds furnished by suc-

STATE & CITATION	AMOUNT OF SECURITY	FORM OF SECURITY	TERMS FOR RETURN OF SECURITY
N.D. CENT. CODE § 24-02-20 (1970) Std. Specs. § 102.09, 103.04	Five percent of bid amount if check is used; 10 percent if bond is used.	Certified check or cashier's check on solvent bank, or surety bond.	successful bidder. Bonds and checks returned upon bid opening except for lowest three bidders; lowest bidder's security returned after execution of contract, other two after determination made for award.
OHIO REV. CODE § 5525.01	Five percent of bid amount up to \$50,000 if by check, or 10 percent of bid amount, if by bid bond.	Certified check, cashier's check, or surety bond.	Returned to unsuccessful bidders "forthwith" following contract award, and to successful bidder after bidder has executed contract and provided contractor bonds.
61 OKLA. STAT. § 107	Five percent of bid amount for contracts over \$25,000.	Certified check, cashier's check, surety bond, or irrevocable letter of credit.	Unsuccessful bidders' security returned according to terms of bid solicitation; successful bidder's security returned upon execution of contract and bonds.
OR. REV. STAT. §§ 279.027, 279.031	Not more than 10 percent of bid amount.	Certified check, cashier's check, surety bond, or irrevocable letter of credit.	Returned to unsuccessful bidders when bids have been opened and contract has been awarded; returned to successful bidder upon execution of contract and bond.
62 PA. CONS. STAT. § 533(1) Pa. Stan. Specs. §§ 102.08, 103.04	Not less than 5 percent of proposal price.	Certified check, cashier's check, but preferably surety bond.	Returned to unsuccessful bidders within 3 days after bid opening, except for that of low bidder, which is returned upon contract execution.
R.I. GEN. LAWS § 37-2-40; Stan. Specs. § 102.06, 103.04	Not less than 5 percent of bid amount, as designated in notice to contractors.	Cash or surety bond for contracts over \$50,000.	All returned at time of bid opening except two lowest bidders. Unsuccessful bidders' bonds returned 10 days after award and lowest two after contract and bond executed.
S.C. Stan. Specs. §§ 102.10, 103.04	Five percent of submitted bid.	Surety bond.	All retained until contract is executed, then are destroyed unless bidder has requested that it be returned.
S.D. CODIFIED LAWS §§ 5-18-6, 5-18-7	Five percent if by check issued by state or national bank; 10 percent of bid amount for bond.	Surety bond; cashier's check or certified check.	Returned to unsuccessful bidders "immediately"; and to successful bidder upon execution of contract and bond. Must be returned

STATE & CITATION	AMOUNT OF SECURITY	FORM OF SECURITY	TERMS FOR RETURN OF SECURITY
TENN. CODE §§ 54-5-115, Stan. Specs. §§ 1.02.05, 1.03.02	“Proper bond” or proposal guaranty must accompany bid.		within 30 days after bid opening. Returned to unsuccessful bidders upon opening, except for those likely to be considered for award, which are returned upon execution of contract and bond.
TEX. STAT. §§ 223.014, 223.015	Amount indicated in bid invitation.	Cashier’s check, money order, bid bond, trust account, or other form satisfactory to department. Department may establish escrow accounts for prepayment of bid guarantees and use of credit cards for electronic fund transfer.	
UTAH CODE § 63-56-37	At least five percent of bid amount.	Surety bond, cash, or form acceptable to state.	Lowest two bidders’ security retained until contract and bond executed. Others returned to unsuccessful bidders “as soon as possible.”
Code of Vt. Rules § 14-010-010 (2003)	Must be for amount and of character indicated in bid invitation.		
Va. Stan. Specs. §§ 102.07, 103.04	Five percent of bid amount.	Surety bond, with exact wording as department form.	Returned to unsuccessful bidders immediately after opening and checking bids, except two lowest bidders, whose security is returned within 5 days after execution of contract and bonds.
WASH. REV. CODE § 47.28.090 Wash. Stan. Specs. §§ 1-02.7, 1-03.6	Five percent of bid amount.	Certified check, cashier’s check, surety bond, or cash.	Bonds or guaranties accompanying proposals not eligible for further consideration returned after bid opening; others returned after contract execution.
W. VA. CODE § 17-4-19(e) Stan. Specs. §§ 102.8, 103.4	Amount specified in bid invitation, but not less than \$500, nor more than 5 percent of bid, specified in advertisement.	Certified check, cashier’s check, or surety bond.	Returned to unsuccessful bidders immediately following opening and checking of bids, except security of two lowest bidders; second lowest returned within 10 days after award, and successful bidder’s security returned after execution of contract and bond.
Wis. Stan. Specs. §§ 102.7, 103.4	Amount specified in bid invitation.	Certified check, bank draft, cashier’s check, postal money order.	Returned to unsuccessful bidders immediately following bid opening, except

STATE & CITATION	AMOUNT OF SECURITY	FORM OF SECURITY	TERMS FOR RETURN OF SECURITY
Wyo. Stan. Specs. §§ 102.08, 103.04	Amount specified in bid invitation.	Certified check, cashier's check, or bank money order.	<p>security of second lowest bidder is returned after check of bids. Security of low bidder returned after execution of contract.</p> <p>Negotiable securities returned to unsuccessful bidders immediately following bid opening, except security of second lowest bidder is returned after check of bids. Security of low bidder returned after execution of contract. Bid bonds returned upon request.</p>

APPENDIX C

REQUIREMENTS FOR COMPETITIVE BIDDING AND CRITERIA FOR AWARD OF HIGHWAY CONSTRUCTION CONTRACTS

STATE & CITATION	CLASSES OF CONTRACTS	CRITERIA FOR AWARD	AUTHORITY TO REJECT ALL BIDS
ALA. CODE § 39-2-2; 39-2-6	Public works contracts exceeding \$50,000.	Lowest responsible and responsive bidder, unless awarding authority finds bid unreasonable or it is not in awarding authority's interest to accept any of the bids.	If all bids are unreasonable and it is not in awarding authority's interest to accept any, bids may be rejected and work done by force account by awarding authority.
ALASKA STAT. §§ 19.10.170; 36.30.170(a) 2 AAC 12.860 – 870	All highway construction with estimated cost exceeding \$100,000. For construction costing less than \$100,000, department may perform work directly; however, for work over \$5,000, commissioner must make written findings that state forces will be less expensive than contracting.	Lowest responsible and responsive bidder whose bid conforms in all material respects to the requirements and criteria set out in the invitation to bid.	May reject all bids only with the prior written approval of the DOT & Public Facilities Commissioner, if found to be in best interests of state or for other reasons listed in agency regulations.
ARIZ. REV. STAT. §§ 34-221; 34-201; 41-563	For fiscal year 1994-95, work over \$150,000; thereafter, adjusted annually by the annual percentage change in the GDP price deflator.	Lowest responsible bidder whose proposal is satisfactory.	All bids may be rejected for any reason the contracting agent determines.
ARK. CODE 27-67-206	All new construction, and all other construction costing \$10,000 or more; except for discretionary authority to contract with railroads for signals and safety devices at grade crossings, or grade crossing elimination. All materials purchased for road work.	Lowest responsible bidder.	Commission has right to reject any or all bids.

STATE & CITATION	CLASSES OF CONTRACTS	CRITERIA FOR AWARD	AUTHORITY TO REJECT ALL BIDS
CAL. PUB. CONT. CODE §§ 10180; 10185	As of 1993, all work over \$100,000, which amount is adjusted every 2 years by California construction index.	Lowest responsible bidder.	May reject all bids if found to be not for best interest of the State to accept them; must state reasons for rejecting bids.
COLO. REV. STAT. §§ 24-92-103; 24-92-105	All construction contracts.	Low responsible bidder whose bid meets the requirements and criteria set forth in the invitation for bids.	All bids may be rejected when in best interest of state; reasons must be stated in contract file.
CONN. GEN. LAWS ANN. § 13a-95	Construction, alteration, improvement, reconstruction, relocation, widening, or change of grade of State highways or bridges.	Lowest bidder deemed responsible.	Commissioner may reject any and all bids for cause.
17 DEL. CODE § 151; 29 DEL. CODE § 6923	Contracts exceeding amount set by Contracting and Purchasing Advisory Council, unless Secretary of Transportation and Budget Commission determine it to be in best interests of state to enter into contract without bidding.	Lowest responsive and responsible bidder whose bid conforms in all material respects to the requirements and criteria set forth in the invitation to bid.	May reject all bids if it is advantageous to the state.
D.C. CODE § 2-303.03; 2-303.21; 2-303.07	Construction contracts over \$100,000.	Responsible and responsive bidder whose bid is most advantageous to District, considering price and other factors.	May reject all bids if in best interest of District.
FLA. STAT. § 337.11	All construction contracts exceeding \$250,000.	Lowest responsible bidder, or in the instance of a time-plus-money contract, the lowest evaluated responsible bidder.	May reject all bids and readvertise project, or perform work.
GA. CODE §§ 32-2-61; 32-2-64; 32-2-69	Any construction or maintenance contract over \$50,000.	Lowest reliable bid.	May reject any and all such bids, and readvertise, perform work directly, or abandon project.
HAW. REV. STAT. §§ 103D-301, 103D-302	All construction contracts.	Lowest responsible and responsive bidder whose bid meets the requirements and criteria set forth in the invitation.	

STATE & CITATION	CLASSES OF CONTRACTS	CRITERIA FOR AWARD	AUTHORITY TO REJECT ALL BIDS
IDAHO CODE §§ 40-906, 40-912	Contracts exceeding \$25,000.	tation for bids. Lowest responsible bidder.	May reject any or all bids.
30 ILL. COMP. STAT. 500/20-5, 500/30-15; 500/20-20; 500/20-40	All construction contracts over \$30,000, to be adjusted for inflation.	Lowest responsible and responsive bidder whose bid meets the requirements and criteria set forth in the invitation for bids.	All bids may be rejected when in best interest of State, in accordance with administrative rules.
IND. CODE §§ 8-23-9-2; 8-23-9-3; 8-23-9-4	All contracts for construction.	Lowest and best bidder, provided not more than 5 percent over engineer's estimate and in best interests of state.	May reject all and all bids for cause.
IOWA CODE ANN. §§ 313.10; 314.1	Construction contracts over \$1,000.	Bid price to be considered with financial responsibility, experience, equipment, and performance in similar work.	May reject any or all bids, and relet job by negotiated contract or day labor, provided cost does not exceed lowest bid received.
KAN. STAT. § 68-410	All State contracts for highway construction, improvement, reconstruction, and maintenance of State highway system involving more than \$1,000.	Lowest responsible bidder.	
KY. REV. STAT. §§ 176.080, 180.060	Construction and maintenance on State highways, bridges, and bridge approaches.	Lowest and best bidder.	May reject any or all bids if in best interest of State, and readvertise.
LA. REV. STAT. §§ 48:205; 48:255	Construction contracts over \$25,000.	Lowest responsible bidder.	May reject any and all bids if no satisfactory bids are received.

STATE & CITATION	CLASSES OF CONTRACTS	CRITERIA FOR AWARD	AUTHORITY TO REJECT ALL BIDS
23 ME. REV. STAT. § 753	Construction of state highways.	Lowest responsible bidder.	May reject any and all bids if there is deemed to be good cause.
MD. STATE FIN. & PROC. CODE § 13-206, 13-103	All State highway construction.	Lowest responsible bidder, or lowest evaluated bid price if that process is noted in invitation for bids.	May reject all bids if in best interest of state.
MASS. LAWS ch. 30, § 39M; ch. 81, § 8	Construction, alteration, reconstruction, or repair in excess of \$10,000.	Lowest eligible responsible bidder.	Invitation for bids reserves right to reject all bids.
MICH. COMP. LAWS § 247.661c	All highways, streets, and bridges whose cost exceeds \$100,000, unless department affirmatively finds that another method is in public interest.		
MINN. STAT. § 161.32	May use state forces or contract.	Lowest responsible bidder, considering conformity with specifications, delivery terms, and other conditions imposed in bid notice; may also use life-cycle costing.	May reject any and all bids. If no satisfactory bids received, commissioner may readvertise or perform work directly.
MISS. CODE §§ 65-1-85	All contracts for construction, reconstruction, or other public work, and purchase of materials and supplies exceeding \$10,000.	Lowest responsible bidder.	Director, with approval of Transportation Commission, may reject any and all bids.
MO. REV. STAT. § 227.100.1	All construction contracts.	Lowest responsible bidder.	Commission may reject all bids and do work under own supervision.
MONT. REV. CODE § 18-2-301; 18-1-102	Construction for \$75,000 or more.	Lowest responsible bidder.	If no responsible bids received after two attempts, may reject and contract in manner that is cost-effective to the state.
NEB. REV. STAT. § 39-1349	Contracts for construction, reconstruction, improvement, maintenance, and repair of State roads and bridges.	Lowest responsible bidder.	May reject any or all bids, and cause work to be done as directed by department.
NEV. REV. STAT. §§ 408.317; 408.323; 408.343	All construction, improvement, and maintenance on State highway system, except where director can justify that limited work can be	Lowest responsible bidder who has qualified and submitted bid in accordance with statute.	May reject any and all bids if, in the department's opinion, such bids are unbalanced, incomplete, irregular, or

STATE & CITATION	CLASSES OF CONTRACTS	CRITERIA FOR AWARD	AUTHORITY TO REJECT ALL BIDS
	done more economically or in other satisfactory manner by other means.		for other good cause.
N.H. REV. STAT. §§ 228:4; 228:4-a	All major State highway projects over \$25,000, except normal maintenance and improvements.	Lowest responsible bidder.	Right reserved to reject all bids or negotiate with lowest responsible bidder.
N.J. STAT. §§ 27:7-29, 27:7-30	Construction contracts for State highway system.	Lowest responsible bidder.	May reject any and all bids.
N.M. STAT. § 67-3-43	All construction, reconstruction, and maintenance on State highway system, except work performed directly by State Highway Department.	Lowest responsible bidder.	May reject any and all bids if such bids are unbalanced, or for other good cause.
N.Y. HIGH. LAW § 38	Contracts for construction or improvement of state highways.	Lowest responsible bidder as will best promote the public interest.	May reject any and all bids and readvertise if State's best interest will be promoted thereby.
N.C. GEN. STAT. § 136-28.1	Contracts for highway construction or repair exceeding \$1.2 million. Contracts under that amount require three informal bids, without advertising.	Lowest responsible bidder.	Right is reserved to reject all bids.
N.D. CENT. CODE §§ 24-02-17, 18; 24-02-23	Construction or improvements exceeding \$20,000.	Responsible bidder submitting the lowest and best bid.	May reject all bids.
OHIO REV. CODE §§ 5517.02, 5525.01, 5525.10	State highway construction, improvement, and repair; bridge, culvert, and traffic signal projects over \$20,000;	Lowest competent and responsible bidder.	May reject any and all bids. No contract may be awarded that exceeds the estimate by

STATE & CITATION	CLASSES OF CONTRACTS	CRITERIA FOR AWARD	AUTHORITY TO REJECT ALL BIDS
	maintenance over \$10,000 per mile of highway.		more than 5 percent.
61 OKLA. STAT. §§ 102, 103, 111, 119	All construction work on State highway system.	Lowest responsible bidder.	Agency may reject all bids and readvertise if in best interest of state.
OR. REV. STAT. §§ 279.015, 279.029, 279.035	All public contracts, except those declared exempt by Public Contract Review Board as (1) not likely to substantially diminish competition, (2) result in saving to contracting agency; or (3) if prompt action needed to deal with emergency.	Lowest responsible bidder.	May reject any or all bids for cause, and readvertise. If all bids exceed estimate, may negotiate with lowest responsible bidder to bring project within cost estimate.
62 PA. CONS. STAT. §§ 102; 512(g)	All work done by contract.	Lowest responsible bidder.	May reject any and all bids.
R.I. GEN. LAWS § 24-8-12; §§ 37-2-18, 37-2-22	All highway construction or improvements over \$10,000.	Lowest responsible and responsive bidder.	Right reserved to reject all bids.
S.C. CODE § 57-5-1620	Contracts for construction work on State highways involving \$10,000 or more.	Lowest qualified bidder.	
S.D. CODIFIED LAWS § 31-5-10	Contracts of State Highway Commission for highway improvements on trunk highway system.	Lowest competent and responsible bidder, unless bid is deemed unreasonable.	
TENN. CODE §§ 54-5-116, 54-5-118	Contracts of State Department of Transportation relating to highways.	Best and most advantageous offer. Lowest bid to be accepted.	Any and all bids may be rejected at commissioner's discretion.
TEX. TRANSP. CODE §§ 6674i, 6674h	Contracts of highway department relating to State highway system over \$25,000.	Lowest bidder.	May reject any and all bids.

STATE & CITATION	CLASSES OF CONTRACTS	CRITERIA FOR AWARD	AUTHORITY TO REJECT ALL BIDS
UTAH CODE §§ 72-6-107; 72-6-109; 63-56-20	Contracts of State Department of Transportation for construction or improvement of State highways involving cost exceeding \$125,000.	Lowest responsible bidder.	Any or all bids may be rejected.
19 VT. STAT. § 4 Code of Vt. Rules § 14-010-010 Stan. Specs. §§ 102.8, 102.13, 103.01, 103.02	Agency of Transportation authorized to contract on such terms as it deems to be for best interest of State for construction, repair, and maintenance of State highways, and for use of machinery and equipment for road work, etc. However, highway or bridge contracts exceeding \$50,000 must be advertised for bids.	Lowest qualified bidder.	May reject bids if found to be on altered form, irregular, incomplete, conditional, or if bid is obviously unbalanced.
VA. CODE §§ 33.1-185; 2.2-4319; 2.2-4303	All contracts let by Commonwealth Transportation Board for construction or other necessary work; agency may use competitive negotiation at its option.	Lowest responsive and responsible bidder.	
WASH. REV. CODE §§ 47.28.090, 47.28.100	Contracts for construction on State highway system.	Lowest responsible bidder.	May reject lowest bid for good cause, and may reject all bids if in best interest of state.
W. VA. CODE § 17-4-19 Stan. Specs. § 103.2	Contracts of State Highway Department for road work, materials, and supplies exceeding \$3,000.	Lowest responsible bidder.	May reject all bids, and perform work directly.
WIS. STAT. § 84.06 Stan. Specs. 103.1, 103.2	All contracts for construction, reconstruction, and rehabilitation of highways.	Lowest competent and responsible bidder.	All bids may be rejected if lowest bid exceeds estimated reasonable value of work, or if bids not in public interest.
WYO. STAT. § 24-2-108	Contracts for highway improvements exceeding \$100,000.	Lowest responsible qualified bidder.	Transportation Commission may reject any or all bids, and readvertise.

APPENDIX D

SUMMARY OF STATE LAWS RELATING TO LICENSING CONTRACTORS

STATE	LICENSING AGENCY	SCOPE OF REQUIREMENT	EXAM	CRITERIA	CLASSIFICATIONS	PERIOD	CAUSES OF REVOCATION
ALASKA STAT. § 08.18.011- 171	Department of Community and Economic Development	Person who under- takes or offers to per- form or submits a bid to construct, alter, re- pair, move, or demol- ish a building, high- way, road, railroad, or any type of fixed struc- ture.	No	Surety bond and proof of insurance.	General Specialty Mechanical Residential Electrical		Failure to comply with in- surance and bond require- ment.
ARIZ. REV. STAT. § 32- 1101 to 32- 1169	Registrar of Contractors	Person who for com- pensation undertakes or offers to construct, alter, repair, add to, subtract from, im- prove, move, wreck, or demolish any building, highway, road, rail- road, excavation or other structure, proj- ect, development, or improvement.	May be re- quired.	1. Good standing with corporation com- mission. 2. Compliance with rules regarding workers' compensa- tion. 3. Submission of bond and fee. 4. Financial resources. 5. Good character and reputation.	General commer- cial building General dual li- censed General engi- neering General residen- tial Specialty commer- cial Specialty dual licensed Specialty residen- tial	2 years	1. Abandonment of contract. 2. Disregard of plans and specs. 3. Disregard of registrar's rules. 4. Disregard of rules re- garding social security, workers' compensation, or unemployment compensa- tion. 5. Failure to pay taxes. 6. Misrepresentation of ma- terial fact in obtaining li- cense. 7. Fraudulent act that re- sults in substantial injury to another. 8. Conviction of felony. 9. Failure to complete a proj- ect for the price stated/ 10. Aiding or abetting an unlicensed person to evade licensing law.

<p>ARK. CODE §§ 17-25-101 <i>et seq</i>; 17-25-301 <i>et seq</i>.</p>	<p>Contractors' Licensing Board</p>	<p>Person who for compensation, contracts to construct, erect, alter, or repair any building, highway, sewer, utility, grading, or any other improvement or structure on public or private property for lease, rent, resale, public access, where project is over \$20,000.</p>	<p>Yes</p>	<ol style="list-style-type: none"> 1. Experience. 2. Ability. 3. Character. 4. Manner of performance of previous contracts. 5. Financial condition. 6. Equipment. 7. Any fact tending to show ability and willingness to conserve public health and safety. 8. Default in complying with licensing laws or any other state laws. 	<p>1 year</p>	<ol style="list-style-type: none"> 11. Failure to pay bills for labor and materials when due and when able to pay, in excess of \$750. 12. Failure to comply with labor or safety codes. 13. False or deceptive advertising 14. Knowingly contracting beyond classification 15. Contracting while license suspended. <ol style="list-style-type: none"> 1. Fraud or deceit in obtaining a license. 2. Aiding or abetting any contractor or person to violate the provisions of this chapter. 3. Gross negligence. 4. Incompetence. 5. Misconduct in the conduct of the contractor's business. 	
<p>CAL. BUS. & PROF. CODE § 7000-7145.5</p>	<p>Contractors' State License Board Department of</p>	<p>All contractors, or anyone who for compensation undertakes, offers to undertake, or</p>	<p>Yes</p>	<p>Knowledge and experience in the classification applied for, and such general knowl-</p>	<p>General engineering General building</p>	<p>2 years</p>	<ol style="list-style-type: none"> 1. Abandonment of work without legal excuse 2. Diversion of funds.

5	Consumer Affairs	purports to have capacity to construct, alter, repair, add to, subtract from, improve, move, or demolish any building, highway, road, railroad, or other structure, project, development, or improvement.	edge of the building, safety, health, and lien laws of the state and of the administrative principles of the contracting business necessary for the safety and protection of the public; knowledge of pertinent state laws and the contracting business and trade.	Specialty building	<ol style="list-style-type: none"> 3. Fraud, gross negligence, or disregard of specifications or accepted trade standards. 4. Willful violation of building laws or rules of construction, labor, or safety. 5. Failure to carry workers' compensation insurance. 6. Failure to keep records. 7. Misrepresentation in obtaining license. 8. Aiding or entering into contract with unlicensed contractor. 9. Commission of crime related to duties as contractor. 10. Failure to complete work at specified price. 11. Aiding evasion of license law. 12. Failure to cooperate in investigation by Registrar. 13. Failure to pay bills.
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<p>CONN. GEN. STAT. §§ 20-341gg; ch. 393</p> <p>Conn. Regs. §§ 20:341gg-1 through 7</p>	<p>Department of Consumer Protection</p>	<p>Person doing construction, structural repair, structural alteration, dismantling or demolition of a structure or addition that exceeds statutory threshold limits.</p>	<p>No</p>	<ol style="list-style-type: none"> 1. Credit references. 2. References re work. 3. General liability insurance. 4. Certificate of good standing from Secretary of State if incorporated. 	<p>Major contractors</p>	<ol style="list-style-type: none"> 1. Conviction of a felony. 2. Gross incompetence. 3. Malpractice or unethical conduct. 4. Knowingly makes false, misleading, or deceptive representations regarding work. 5. Violation of regulations adopted under this chapter. 6. False statement in obtaining license. 7. Performing work beyond scope of license. 8. Employ unlicensed contractor. 	
<p>HAW. REV. STAT. §§ 444-1 to 444-36</p>	<p>Contractors Licensing Board</p>	<p>Person who undertakes to improve any realty or construct, alter, repair, add to, subtract from, improve, move, or demolish any building, highway, road, railroad, excavation, or other structure, project, development, or improvement, including specialty contractors and subcontractors.</p>	<p>May be required</p>	<ol style="list-style-type: none"> 1. Workers compensation insurance. 2. Liability insurance. 3. Bond. 	<p>General engineering General building Specialty</p>	<p>2 years</p>	<ol style="list-style-type: none"> 1. Dishonest, fraudulent, or deceitful acts. 2. Unfair or deceptive practice. 3. Abandonment of project without legal excuse. 4. Diversion of funds. 5. Willful disregard of plans and specifications. 6. Willful violation of law. 7. Failure to keep records. 8. Misrepresentation of material fact in obtaining license. 9. Failure to complete project for agreed price.

<p>IDAHO CODE §§ 54-1901 to 54-1924</p>	<p>Public Works Contractors License Board</p>	<p>Person who under- takes any construction, repair, or reconstruc- tion of any public work under contract with the state of Idaho or any agency or public or quasi public corpora- tion.</p>	<p>Yes</p>	<p>Such degree of experi- ence, and such general knowledge of the building, safety, health, and lien laws of the state, and of the rudimentary adminis- trative principles of the contracting busi- ness, as may be deemed necessary by the board for the safety and protection of the public; good character, shown by past performance of work and reputation for honesty and integ- rity; has never been refused a license or had a license revoked.</p>	<p>Six classes based on amount of work licensee may bid on: Class AAA—more than \$3 million AA—up to \$3 mil- lion A—up to \$1 mil- lion B—up to \$500,000 C—up to \$100,000</p>	<p>12 calen- dar months</p>	<ol style="list-style-type: none"> 10. Failure to pay bills. 11. Failure to carry workers compensation insurance. 12. Failure to complete with diligence. <ol style="list-style-type: none"> 1. Abandonment of project without legal excuse. 2. Diversion of funds or property received. 3. Willful disregard of plans or specifications. 4. Willful disregard of valid building laws, or safety, labor, or compensation insurance laws. 5. Material misrepresentation in obtaining a license. 6. Aiding or abetting an unlicensed person to evade provisions of this chapter. 7. Material failure to comply with this chapter. 8. Knowingly entering into contract with unlicensed contractor on public works project. 9. Willful failure without legal excuse to finish project with reasonable diligence, causing material injury to another. 10. Willful failure to pay for materials or services.
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IOWA CODE § 91C	Labor Commissioner, Division of Labor Services	Person who engages in business of construction as defined in IOWA ADMIN. CODE § 345-3.82(96).	No	Application and payment of fee; evidence of workers' compensation insurance; surety bond required for payment of taxes if out-of-state contractor for contracts in excess of \$5,000.	2 years	<p>11. Change in financial circumstances impairing financial responsibility.</p> <p>1. Violation of requirement that contractor be registered.</p> <p>2. Violation of requirement that registration information be substantially complete and accurate.</p> <p>3. Failure to file bond with the division of labor services (if out of state contractor).</p>
LA. REV. STAT. §§ 37:2150–37:2164	State Licensing Board for Contractors	Person who undertakes to or submits a bid to construct or supervise construction, alteration, repair, improvement, movement, demolition, or furnishing labor, for any building, highway, road, railroad, utility, grading, excavation, pipeline, housing, development, or other commercial construction of \$50,000 or more.	Yes, but may be waived	<p>1. Financial statement showing net worth of at least \$10,000.</p> <p>2. Examination, unless waived.</p>	1 year	<p>1. Dishonest or fraudulent act causing substantial damage to another.</p> <p>2. Willful misrepresentation of material fact in obtaining license.</p> <p>3. Willful failure to comply with this Chapter.</p> <p>4. Entering into contract with unlicensed contractor.</p> <p>5. Permitting contractor's license to be used by unlicensed person.</p> <p>6. Failure to maintain a qualifying party to represent the licensee.</p> <p>7. Insolvency or involuntary</p> <p>1. Building.</p> <p>2. Highway, street, and bridge.</p> <p>3. Heavy construction.</p> <p>4. Municipal and public works.</p> <p>5. Electrical.</p> <p>6. Mechanical.</p> <p>7. Plumbing.</p> <p>8. Hazardous materials.</p> <p>9. Specialty.</p> <p>10. Residential.</p>

<p>MISS. CODE § 31-3-1 to 31-3-23</p>	<p>State Board of Contractors</p>	<p>Person contracting or undertaking as prime contractor, subcontractor of any tier to do erection, building, con- struction, reconstruction, repair, maintenance, or related work on any public or private project.</p>	<p>Yes</p>	<ol style="list-style-type: none"> 1. Experience and ability. 2. Character. 3. Performance of previous contracts. 4. Financial condition. 5. Equipment. 6. Personnel. 7. Work completed and work on hand. 8. Default in complying with law. 9. Results of objective, standardized examinations. 	<p>1 year</p>	<p>cessation of business.</p> <ol style="list-style-type: none"> 8. Failure to continue to fulfill requirements for original licensure. 9. Problems relating to ability to engage in business of contracting, as demonstrated by prior experience. 10. Disqualification or debarment by any public entity. <p>Finding of nonresponsibility.</p>
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NEV. REV. STAT. §§ 624.040 – 624.361	State Contractors' Board	Person who for compensation undertakes or submits a bid to construct, alter, repair, add to, subtract from, improve, move, wreck, or demolish any building, highway, road, railroad, excavation, or other structure, project, development, or improvement.	Yes	<ol style="list-style-type: none"> 1. Financial responsibility; experience; knowledge of building, safety, health, and state lien laws; and qualifications of the applicant. 2. Proof of industrial insurance. 3. Good character. 4. Surety bond. 	General engineering General building Specialty	1 year	<ol style="list-style-type: none"> 1. Abandonment of project. 2. Disregard of plans or specifications. 3. Diversion of funds. 4. Failure to maintain records. 5. Failure to maintain bond. 6. Failure to establish financial responsibility. 7. Misuse of license or evasion of law. 8. Acting beyond scope of license. 9. Contracting with unlicensed person. 10. Fraudulent or deceptive act; criminal conviction.
N.C. GEN. STAT. § 87-1 to 15.1	State Licensing Board for General Contractors	Person who for compensation bids upon or constructs or manages construction of any building, highway, public utilities, grading or any improvement or structure costing \$30,000 or more.	Yes	<ol style="list-style-type: none"> 1. Good character. 2. Competency and ability. 3. Integrity. 4. Financial responsibility. 5. Has not committed act that would be grounds for suspension or revocation of license. 6. Has not committed act of dishonesty, fraud, or deceit. 7. Has never been refused a license as a general contractor nor had such 	Building Residential Highway Public Utilities Specialty	1 year	<ol style="list-style-type: none"> 1. Fraud or deceit in obtaining a license. 2. Gross negligence. 3. Incompetency. 4. Misconduct. 5. Willful violation of any provision of this Article.

license revoked in any state.

8. Has not been convicted of felony involving moral turpitude, relating to building or contracting, or involving embezzlement or misappropriation of funds or property.

N.D. CENT. CODE 43-07	Secretary of State	Person who constructs, repairs, alters, dismantles, or demolishes any highways, roads, streets, buildings, airports, dams, drainage or irrigation facilities, utilities, and all other structures, projects, developments, or improvements over \$2,000.	No	<ol style="list-style-type: none"> 1. Experience and qualifications, under oath. 2. Liability insurance. 3. Workers' compensation insurance. 	<p>Class A—no dollar limit.</p> <p>Class B—up to \$250,000.</p> <p>Class C—up to \$120,000.</p> <p>Class D—up to \$50,000.</p>	1 year	<ol style="list-style-type: none"> 1. Abandonment of contract without legal excuse. 2. Diversion of funds or property. 3. Committing any fraudulent act in which another is injured. 4. False statement in application for license.
S.C. CODE §§ 40-11-5 to 40-11-430	Contractor's Licensing Board	General or mechanical contracting work, the cost of which is greater than \$5,000.	Yes	<ol style="list-style-type: none"> 1. Financial condition and bank reference. 2. Qualifying party who is full time employee and certified in classification. 	<p>General</p> <p>Mechanical groups setting contract limits are based on contractor's net worth.</p>	2 years	<ol style="list-style-type: none"> 1. Negligence or incompetence. 2. Abandonment of a contract without legal excuse. 3. Fraud or deceit in obtaining a license or certification. 4. Violation of licensing laws. 5. Conviction of forgery, embezzlement, or similar crime.

<p>TENN. CODE §§ 62-6-101 to 62-6-132</p>	<p>State Board for Licensing Contractors</p>	<p>Person who under- takes to or submits bid to construct or super- vise construction, al- teration, repair, im- provement, movement, demolition, or fur- nishing labor to install material or equipment for any building, highway, railroad, sewer, grading, exca- vation, pipeline, public utility structure, housing, or improve- ment; \$25,000 or more.</p>	<p>Written and/or oral</p>	<ol style="list-style-type: none"> 1. Letter of reference from past client, employer, or codes administration official. 2. Financial statement. 3. Affidavit that applicant is not performing construction work and has not offered to perform work exceeding \$25,000. 	<ol style="list-style-type: none"> 1. Commercial 2. Industrial 3. Heavy 4. Highway 5. Municipal & Utility 6. Mechanical 7. Electrical 8. Environmental 9. Residential 	<p>2 years</p>	<ol style="list-style-type: none"> 6. Conviction of crime involving moral turpitude in connection with contract. 7. False, misleading, or deceptive advertising. 8. Failure to obtain a building permit. 9. Failure to maintain net worth requirements. 10. Contracting outside classification. <ol style="list-style-type: none"> 1. Gross negligence. 2. Incompetence. 3. Fraud, dishonest dealing, and/or misconduct in contracting. 4. Failure to observe the terms and conditions of license.
<p>UTAH CODE § 58-55-101 to 58-55- 604</p>	<p>Construction Services Commission</p>	<p>Any person who for compensation other than wages as an em- ployee undertakes any work in the construc- tion, plumbing, or elec- trical trade.</p>	<p>Yes</p>	<ol style="list-style-type: none"> 1. Financial responsibility. 2. Knowledge and experience in the construction industry and knowledge of the principles of contracting 	<ol style="list-style-type: none"> 1. General building. 2. General engineering. 3. Electrical. 4. Plumbing. 	<p>2 years</p>	<ol style="list-style-type: none"> 1. Unlawful or unprofessional conduct.

				business reasonably necessary for protection of the public.	5. Residential. 6. Specialty.		
VA. CODE §§ 54.1-1100 to 54.1-1117 18 VA. ADMIN CODE 50.22	Board for Contractors	Person that for compensation undertakes to bid upon contracts for performing, managing, or superintending the construction, removal, repair, or improvement of any building or structure.	Oral or written	1. Past performance record. 2. Compliance with contracting and business laws. 3. Financial information.	Class A—single projects of \$70,000 or more, or total in one year or \$500,000 or more. Class B—single projects \$7,500 but less than \$10,000, or total in one year between \$150,000 and \$500,000. Class C—projects over \$1,000 but less than \$7,500, or total in one year under \$150,000.	2 years	Violation of statutes or regulations governing licensed contractors.
WASH. REV. CODE §§ 18.27.010-340	Department of Labor and Industries	Person who as independent business undertakes to or submits a bid to construct, alter, repair, add to, subtract from, improve, move, wreck or demolish, for another, any building, highway, road, railroad, excavation or other structure, project, development, or improvement.	No	1. Workers' compensation insurance. 2. Insurance or financial responsibility. 3. Surety bond.	General Specialty	2 years	1. Unsatisfied final judgment for work within scope of this chapter. 2. Not maintaining valid unified business identifier number for department of revenue. 3. Loss of insurance. 4. Loss of surety bond.

APPENDIX E

SUMMARY OF STATE LAWS AND REGULATIONS RELATING TO QUALIFICATION OF BIDDERS

STATE	CERTIFYING AGENCY	DOCUMENTS SUBMITTED WITH APPLICATIONS	EXEMPTION FROM CERTIFICATION	CRITERIA FOR CERTIFICATION
ALA. CODE § 23-1-56	Department of Transportation	Statement under oath on forms prescribed by Department. Financial statements certified by CPA. Inventory of equipment. Lists of previous projects and sureties from previous 3 years.		<ol style="list-style-type: none"> 1. Sufficient net worth. 2. Competent and responsible. 3. Compliance with workers' compensation laws.
2 ALASKA ADMIN CODE § 12.500 Alaska Standard Specification § 102-1.01	Department of Transportation and Public Facilities	Contractors questionnaire. Contractor registration and license (for state funded projects). Bidder registration form.		<ol style="list-style-type: none"> 1. Satisfactory record of performance. 2. Legally qualified to contract in state. 3. Availability of necessary financing, equipment, personnel, facilities, expertise, and business and technical organization.
ARIZ. ADMIN. CODE 17-3-201 through 204	Contractor Prequalification Board (appointed by State Highway Engineer)	Application and financial statement compiled by independent CPA or public accountant registered and licensed by any state.		<ol style="list-style-type: none"> 1. Key personnel and their work experience. 2. Organizational structure. 3. History of past or current projects and contracts. 4. Company affiliations. 5. Equipment owned or controlled. 6. Any applicable licenses. 7. Type of work requested. 8. Individuals authorized to act on behalf of the contractor. 9. Any prequalification or bidding disputes with a government agency. 10. Financial condition.
ARK. CODE § 19-11-235	State Highway Commission	Financial statement and experience record on ques-	Contractor's license under ARK.	<ol style="list-style-type: none"> 1. Evidence contractor has been regularly engaged

STATE	CERTIFYING AGENCY	DOCUMENTS SUBMITTED WITH APPLICATIONS	EXEMPTION FROM CERTIFICATION	CRITERIA FOR CERTIFICATION
Ark. Standard Specifications § 102-01		questionnaire forms specified by Commission, certified by certified or registered public accountant.	STAT. § 17-22-101 not required for contracts of less than \$20,000, but must still pre-qualify.	<ul style="list-style-type: none"> in type of work being bid and length of time. 2. Evidence of necessary capital, machinery, material, and expert workers.
CAL. PUB. CONTRACT CODE §§ 10160-10165	Department of Transportation	Standard questionnaire and Financial statement.	Prequalification is at option of department, but if required for one bidder must be required for all bidders on a given project.	<ul style="list-style-type: none"> 1. Financial responsibility. 2. Experience. 3. Any previous disqualification or debarment. 4. Safety record.
COLO. REV. STAT. § 24-92-107 2 COLO. CODE. Reg. 601-10	Department of Transportation	Application and supporting information, including financial statement.		<ul style="list-style-type: none"> 1. Financial responsibility. 2. Equipment. 3. Experience of organization and personnel. 4. Whether previously debarred in any jurisdiction. 5. Past record on DOT contracts.
CONN. GEN. STAT. § 13a-95 Conn. DOT Construction Contract Bidding and Award Manual	Department of Transportation	Contractor's prequalification statement and financial statement attested by CPA.		<ul style="list-style-type: none"> 1. Financial condition and resources. 2. Plant and equipment. 3. Organization. 4. Prior experience. 5. Financial interest in any other construction business. 6. Statement describing circumstances of any violation, nonresponsibility determination, or debarment.
29 DEL. CODE § 6962(c)	Department of Transportation	Contractor questionnaire and any supplemental information requested. Audited financial statement.		<ul style="list-style-type: none"> 1. Experience. 2. Performance reviews on previous contracts. 3. Civil judgments and criminal history, sus-

STATE	CERTIFYING AGENCY	DOCUMENTS SUBMITTED WITH APPLICATIONS	EXEMPTION FROM CERTIFICATION	CRITERIA FOR CERTIFICATION
				<p>pension or debarment, bankruptcy, or license revocation.</p> <p>4. Organization.</p> <p>5. Financial ability.</p>
<p>D.C. CODE § 2-303.04, 2-308.04</p> <p>Code of D.C. Regs. § 2200.4</p> <p>Standard Specifications § 102.01</p>	<p>Chief Procurement Officer, Office of Contracting and Procurement</p>		<p>Bidders who have not done comparable work for the District within the past 5 years may be required to prequalify at contracting officer's discretion; also prequalification approval in another State may be considered as alternative to filing D.C. qualification forms.</p>	<p>1. Adequate financial resources.</p> <p>2. Ability to comply with schedule, taking all other commitments into account.</p> <p>3. Satisfactory performance record.</p> <p>4. Satisfactory record of integrity and business ethics.</p> <p>5. Organization.</p> <p>6. Experience.</p> <p>7. Accounting and operational controls.</p> <p>8. Technical skills.</p> <p>9. Compliance with district licensing and tax regulations.</p> <p>10. Necessary equipment and facilities.</p> <p>11. Other qualifications necessary to receive award.</p>
<p>FLA. STAT. § 337.14</p> <p>FLA. ADMIN. CODE § 14-22</p>	<p>Department of Transportation</p>	<p>Application, audited financial statement.</p>	<p>Prequalification not required to bid on contracts under \$250,000.</p>	<p>1. Financial responsibility.</p> <p>2. Equipment.</p> <p>3. Organizational personnel.</p> <p>4. Satisfactory work performance record.</p>
<p>GA. CODE § 32-2-66</p> <p>Ga. Admin. Rules ch. 672-5</p>	<p>Department of Transportation</p>	<p>Application and questionnaire.</p> <p>Financial statement.</p> <p>List of equipment</p> <p>Letters of reference from</p>	<p>Required only for individual contracts in excess of \$500,000 or total contracts in excess of \$2 million.</p>	<p>1. Financial responsibility.</p> <p>2. Major plant and equipment.</p> <p>3. Organization and personnel.</p>

STATE	CERTIFYING AGENCY	DOCUMENTS SUBMITTED WITH APPLICATIONS	EXEMPTION FROM CERTIFICATION	CRITERIA FOR CERTIFICATION
		three other public agencies if no work done for DOT in previous 5 years.		4. Experience over past 3 years.
HAW. REV. STAT. § 103D-310	Procurement Policy Board	Financial statement and Standard Questionnaire.		1. Financial ability. 2. Resources. 3. Skills, capability. 4. Business integrity.
Standard Specifications § 102.01				
IDAHO CODE §§ 54-1910	Public Works Contractors License Board	Sworn application. Financial statement, which may include letter from bonding company. Oral or written examination, or both, required.	1. Officers of court acting in scope of office. 2. Public utilities. 3. Work on federal land. 4. Irrigation or drainage ditches. 5. Licensed architects or engineers. 6. Construction costing \$10,000 or less. 7. Governmental entity. 8. Installation of finished products, not fixtures. 9. Personal property. 10. Solid waste disposal sites.	1. Experience and general knowledge of building safety, health and lien laws, and basic administrative principles of contracting business. 2. Good character. 3. Contractor has not previously been refused a license.
Standard Specifications §§ 102.11, 107.03				
44 ILL. ADMIN. CODE § 650	Department of Transportation	Completed application; Statement of Experience, Equipment, and Financial Condition.	Department has authority to waive prequalification for specialized contracts.	1. Financial resources. 2. Performance. 3. Experience. 4. Equipment. 5. Capacity to perform.
IND. CODE § 8-23-10-1 through 8-23-10-8	Department of Transportation	Application. Financial statement, if for contract over \$1 million, must be audited.	Subcontracts of less than \$100,000.	1. Financial resources are adequate. 2. Competent and responsible.

STATE	CERTIFYING AGENCY	DOCUMENTS SUBMITTED WITH APPLICATIONS	EXEMPTION FROM CERTIFICATION	CRITERIA FOR CERTIFICATION
		Commission may investigate any aspect of application or statement.		
IOWA CODE § 314.1	Department of Transportation	Application form supplied by department.		<ol style="list-style-type: none"> 1. Financial Responsibility. 2. Equipment. 3. Experience.
KAN. STAT. § 75-37,104 KSDOT Contractor's Pre-qualification and Experience Questionnaire	Department of Transportation, in cooperation with Director of Purchases	Application, including financial statement.		<ol style="list-style-type: none"> 1. Financial rating. 2. Amount of required equipment. 3. Experience of organization and key personnel.
KY. REV. STAT. §§ 176-130, 176-140, 176-150 603 KY. ADMIN. RULES 2:015	Department of Highways	Application, including financial statement.		<ol style="list-style-type: none"> 1. Financial status. 2. Experience and organization. 3. Adequacy of plant and equipment. 4. Business ability. 5. Previous record.
LA. REV. STAT. §§ 37:2151 through 37:2163 Standard Specifications §§ 102.01, 102.02	State Licensing Board for Contractors	Financial statement prepared by auditor. References.	<ol style="list-style-type: none"> 1. Contracts for less than \$50,000. 2. Work on land owned by federal government. 3. Licensed engineers and architects. 4. Supervising work on own property. 5. Public utilities. 	<ol style="list-style-type: none"> 1. Financial responsibility. 2. Experience. 3. Equipment. 4. Organization and personnel.
23 ME. REV. STAT. §§ 13-753; 13-4206 MDOT Contractor Pre-	Department of Transportation	Financial statement and experience record.	<p>Contracts under \$150,000.</p> <p>Contractor previously prequalified and has completed two projects in</p>	<ol style="list-style-type: none"> 1. Sufficient experience. 2. Past record and personnel. 3. Record on safety, environmental, and civil

STATE	CERTIFYING AGENCY	DOCUMENTS SUBMITTED WITH APPLICATIONS	EXEMPTION FROM CERTIFICATION	CRITERIA FOR CERTIFICATION
qualification Form			last prequalification period. May be waived by commissioner.	rights. 4. Financial responsibility. 5. Previous denials or pre-qualification. 6. Claims history.
Maryland	State Highway Administration	Does not prequalify contractors.		
MASS. LAWS c. 29 § 8B 720 CODE MASS. Reg. 5.00	Commissioner of Highways	Application. Financial statement.	Contracts of less than \$50,000.	1. Financial responsibility. 2. Bonding capacity. 3. Experience. 4. Equipment. 5. Size and completion dates of other jobs. 6. Past performance on similar jobs.
MICH. ADMIN. CODE §§ 247.1 through 247.53	Department of State Highways and Transportation	Application Financial statement		1. Past performance on work of similar nature. 2. Financial resources. 3. Construction equipment and facilities. 4. Experience and key personnel.
Minn. Standard Specifications §§ 1201, 1213	Department of Transportation	Prequalification not required for bid submission; however, a written statement may be required prior to consideration of a bid or award showing experience of bidder and amount of capital and equipment available.		
MISS. CODE §§ 31-3-15; 31-3-21 Rules and Regulations of State Board of Contractors (2002)	State Board of Contractors	Application on form provided by Board, to be submitted with payment of special privilege tax. Financial statement signed by CPA. Certificate of general liability insurance.	Contracts of \$50,000 or less.	1. Experience, ability, and character. 2. Manner of previous performance. 3. Equipment. 4. Personnel. 5. Work completed and work on hand. 6. Apparent ability to satisfactorily perform work currently under contract. 7. Written or oral examination results.

STATE	CERTIFYING AGENCY	DOCUMENTS SUBMITTED WITH APPLICATIONS	EXEMPTION FROM CERTIFICATION	CRITERIA FOR CERTIFICATION
				8. Financial condition. 9. Any previous default under contractor licensing laws.
MO. REV. STAT. §§ 227.100, 227.105 7 MO. CODE REGS. §§ 10-15.010, 10-18.010	Department of Transportation	Audit report from bonding company.	Contracts under \$2 million. Contractors who have performed work for department within preceding 5 years.	1. Experience of contractor and key personnel. 2. Ability to complete work satisfactorily and on time. 3. Type of work contractor qualified to perform. 4. Designation of resident agent. 5. Value of works in progress. 6. Equipment available. 7. Insurance coverage. 8. Audit from bonding company.
MONT. ADMIN. R. § 18.3.201	Department of Transportation	Does not require prequalification; requires only registration with Department of Labor. Responsibility determined at time of bidding.		1. Financial resources adequate. 2. Adequate equipment, material, personnel, and facility. 3. Satisfactory record of integrity. 4. Legally qualified to contract with Commission. 5. Satisfactory record of performance.
NEB. REV. STAT. §§ 39-1351, 39-1352 Standard Specifications § 102.01	Department of Roads	Statement under oath showing qualifications. Financial statement certified by CPA. Letter of credit acceptable in lieu of financial statement for contracts under \$250,000.	Contracts of less than \$2,500; emergency contracts.	1. Financial resources. 2. Equipment. 3. Experience. 4. Performance record.
NEV. REV. STAT. § 408.333	Department of Transportation	Financial statement, questionnaire verified under oath.		Financial ability and experience in performing public works of similar nature.
N.H. CODE ADMIN. R. Tra-	Department of Transportation	Questionnaire and financial statement meeting stan-		1. Financial resources.

STATE	CERTIFYING AGENCY	DOCUMENTS SUBMITTED WITH APPLICATIONS	EXEMPTION FROM CERTIFICATION	CRITERIA FOR CERTIFICATION
401		Standard set out in rule; need not be certified for projects under \$500,000.		<ol style="list-style-type: none"> 2. Experience. 3. Record of completed projects, whether any defaults.
N.J. STAT. ANN. §§ 27:7-35.2 through 27:7-35.12 Department Regulations § 16:44-1	Department of Transportation	<p>Questionnaire with statement under oath.</p> <p>Certified financial statement.</p>		<ol style="list-style-type: none"> 1. Financial ability. 2. Adequacy of plant, equipment, and organization. 3. Record of prior performance.
N.M. STAT. 13-1-134 18 N.M. ADMIN. CODE § 27.5.3 through 27.5.15	Highway and Transportation Department	Questionnaire under oath.		<ol style="list-style-type: none"> 1. Financial resources. 2. Production or service facilities. 3. Personnel. 4. Service reputation. 5. Experience. 6. Must be licensed in New Mexico.
N.Y. Standard Specifications § 103-01	No qualification is required prior to bid opening. If requested by the Department of Transportation, the bidder must present evidence of ownership, corporate structure, ability, and financial standing, and a statement as to equipment.			
N.C. STANDARD SPECIFICATIONS § 102-2	Department of Transportation	Experience questionnaire and additional material requested by Department.		<ol style="list-style-type: none"> 1. Sufficient ability and experience. 2. History of successful and timely performance. 3. Financial ability to furnish bonds. 4. Sufficient equipment. 5. Available experienced personnel. 6. List of related completed work. 7. Identity of ownership. 8. Financial ability to complete work. 9. Safety Index Rating form.
N.D. CENT. CODE § 43-07-06	Department of Transportation	Financial statement, record of experience and equipment.	Not required for landscaping, rest areas, or electrical or	<ol style="list-style-type: none"> 1. Financial responsibility. 2. Organization. 3. Plant and equipment.

STATE	CERTIFYING AGENCY	DOCUMENTS SUBMITTED WITH APPLICATIONS	EXEMPTION FROM CERTIFICATION	CRITERIA FOR CERTIFICATION
Standard Specifications § 102.01			other specialty work.	4. Previous experience.
OHIO REV. CODE §§ 5525.02 through 5525.09 OHIO ADMIN. CODE §§ 5501:-2-3-1 through 10	Department of Transportation	Application form supplied by department. Certificate of compliance with affirmative action programs.	Not required for environmental remediation or specialty work for which no classes are established.	1. Net current assets or working capital to indicate ability to execute contract and meet obligations. 2. Equipment. 3. Past performance. 4. Experience. 5. Personnel and organization.
61 OKLA. STAT. § 118 OKLA. ADMIN. CODE § 730:25-3-1	Transportation Commission and Transportation Authority	Audited financial statement, certified by CPA. Experience questionnaire.	Department may waive requirement when in best interest of state and increase competition, and for work such as environmental or landscaping or other work that does not involve highway construction.	1. Financial resources. 2. Technical expertise.
OR. REV. STAT. §§ 279.029, 279.039 through 279.047	Department of Transportation	Financial statement, record of experience, and equipment.	Contracts under \$50,000.	1. Financial ability. 2. Sufficient equipment, material, personnel, and expertise. 3. Satisfactory record of performance. 4. Satisfactory record of integrity. 5. Legal ability to contract.
67 Pa. C.S. § 532; 67 PA. CODE §§ 467.1 through 467.12; Standard Specifications § 102.01(a)	Department of Transportation	Statement under oath on form supplied by department, including financial statement, contractor's organization and experience statement, and affirmative action statement.	Demolition contracts estimated at less than \$25,000; "miscellaneous work" determined to be not within purview of the law may be excluded by	1. Financial capacity. 2. Adequacy of plant and equipment. 3. Prior and current experience. 4. Organization and personnel. 5. Record of work done in

STATE	CERTIFYING AGENCY	DOCUMENTS SUBMITTED WITH APPLICATIONS	EXEMPTION FROM CERTIFICATION	CRITERIA FOR CERTIFICATION
			Deputy Secretary for Highway Administration, and so stated in bid advertisement.	past 5 years, and any liens, stop-work orders, or claims in last 5 years. 6. Whether ever failed to complete work, ever denied prequalification, or disqualified, or convicted of crime.
R.I. GEN. LAWS § 37-2-26 Standard Specifications § 102.01	Department of Transportation	List of equipment. Names of supervisory personnel and their qualifications. Financial statement and financial references. Certificate of nondiscrimination.		1. Financial resources. 2. Experience. 3. Equipment.
S.C. CODE § 11-35-1825 S.C. CODE of REG. 63-300 through 63-303	Department of Transportation	Sworn statement on form supplied by Department.		1. Prior performance. 2. Recent past references on performance. 3. Financial stability. 4. Experience on similar projects.
S.D. CODIFIED LAWS § 31-5-10 S.D. ADMIN. R. § 70:07:02. Standard Specifications § 2.1	Department of Transportation	Prequalification application with statement under oath, and financial information, which may be audited financial statement or certificate of surety from bonding firm.	Not required on contracts less than \$100,000.	1. Equipment. 2. Organization. 3. Prior experience. 4. Financial resources. 5. Any pending debarment proceedings.
TENN. CODE § 54-5-117 Standard Specifications § 102.01	Department of Transportation	Form supplied by department with statement under oath.		1. Financial responsibility. 2. Experience. 3. Organization and equipment. 4. Work currently underway.
43 TEX. ADMIN. CODE § 9.12	Department of Transportation	Questionnaire. CPA-audited financial statement if for project over \$300,000; may be unaudited if under that amount.		1. Financial condition. 2. Equipment. 3. Experience.

STATE	CERTIFYING AGENCY	DOCUMENTS SUBMITTED WITH APPLICATIONS	EXEMPTION FROM CERTIFICATION	CRITERIA FOR CERTIFICATION
		Certificate of Eligibility for federal aid projects.		
UTAH CODE § 63-56-20 Standard Specifications § 102.1	Department of Transportation	Application. Financial statement certified by CPA.	Contracts of less than \$500,000.	1. Financial resources and liabilities. 2. Equipment. 3. Past record. 4. Personnel.
19 VT. STAT. §§ 10, 1503 Code of Vt. Rules § 14-010-010 VDOT Contractor's Experience Questionnaire	Agency of Transportation	Experience questionnaire. Financial statement certified by CPA.		1. Financial ability. 2. Adequacy of plant and equipment. 3. Organization. 4. Prior experience.
VA. CODE § 33.1-12 Standard Specifications §§ 102.01, 102.8 24 Va. A. C. § 30-130-10 (DOT Rules Governing Pre-qualification and Certification)	Department of Transportation	Application. Financial statement. Workers' compensation certificates of insurance. Report of work underway.	Not required for specialty items.	1. Financial ability. 2. Organization. 3. Experience. 4. Equipment. 5. Work underway.
WASH. REV. CODE § 47.28.070 WASH. ADMIN. CODE 468-16-010 through 150	Department of Transportation	Standard questionnaire with statement under oath and financial statement. Limited prequalification questionnaire for projects under \$80,000.		1. Adequacy of financial resources. 2. Necessary experience. 3. Organization and technical competence. 4. Ability to meet performance schedule. 5. Satisfactory record of per-

STATE	CERTIFYING AGENCY	DOCUMENTS SUBMITTED WITH APPLICATIONS	EXEMPTION FROM CERTIFICATION	CRITERIA FOR CERTIFICATION
				formance.
				6. Integrity and skill on part of employees.
Standard Specifications § 1-02.1				
W. VA. CODE, 17-4-19	Division of Highways	Financial statement; record of experience and equipment.		1. Financial resources available.
W. Va. Code of State Rules § 157-3-4				2. Equipment, property, and other assets.
Stan. Specs. § 102.1				3. Organization and personnel.
WVDOT Pre-qualification Form (Contract Form SC 421)				4. Record of work accomplished.
				5. Past experience.
WIS. STAT. §§ 66.0901, 84.06	Department of Transportation	Application on form supplied by department.		1. Financial ability.
Standard Specifications § 102.11				2. Adequacy of plant and equipment.
				3. Organization.
				4. Prior experience.
WYO. STAT. § 24-2-108	Department of Transportation	Financial statement; record of experience.	Contracts of less than \$100,000.	1. Financial ability.
Transportation Rules and Regulations, ch. 6				2. Adequacy of plant and equipment.
				3. Organization.
				4. Past experience.
				5. "Other pertinent or material facts as may be desirable in the judgment of the Highway Superintendent."

APPENDIX F

STATE LAWS RELATING TO SUSPENSION AND DEBARMENT

STATE AND CITATION	APPLICATION DEADLINE	PERIOD OF CERTIFICATION	BASIS FOR SUSPENSION, DISQUALIFICATION, OR DEBARMENT
<p>ALA. CODE § 23-1-56</p> <p>Standard Specifications § 102.02</p> <p>ALDOT Pre-qualification Questionnaire</p>	14 days prior to bid opening.	1 year	<ol style="list-style-type: none"> 1. Lack of competency, plant, equipment, or machinery. 2. Uncompleted work that might hinder performance. 3. Failure to pay all bills for labor and materials on other jobs. 4. Failure to comply with prequalification regulations. 5. Default or unsatisfactory work on prior contracts. 6. Disqualification by FHWA. 7. DBE violations. 8. Collusion. 9. Failure to reimburse state for overpayment or forfeited proposal guarantee. 10. Affiliated with contractor who has been suspended or debarred. 11. Making false or fraudulent statements in application or in administrative or judicial proceeding.
<p>ALASKA STAT. §§ 36.30.635-685</p> <p>2 ALASKA ADMIN. CODE §§ 12.620-670</p>	Must submit forms if requested.	Bidder registration form must be submitted annually.	<p>Disqualification:</p> <ol style="list-style-type: none"> 1. Evidence of bid rigging or collusion. 2. Fraud or dishonesty in performance of previous contracts. 3. More than one proposal submitted. 4. Unsatisfactory performance on previous contract. 5. Failure to pay or settle all bills due on previous contract. 6. Uncompleted work that might hinder current contract. 7. Failure to reimburse state for money owed on previous contract. 8. Default under previous contract. 9. Failure to comply with any department qualification requirements. <p>Debarment / Suspension</p> <ol style="list-style-type: none"> 1. Conviction of criminal offense in obtaining or performing a public contract. 2. Conviction of offense such as embezzlement or bribery that indicates lack of business integrity. 3. Serious violation of contract terms such as knowing failure to complete on time or unsatisfactory performance. 4. Violation of ethical standards.
<p>Alaska Standard Specification §§ 102-1.01, 102-1.12</p>			

STATE AND CITATION	APPLICATION DEADLINE	PERIOD OF CERTIFICATION	BASIS FOR SUSPENSION, DISQUALIFICATION, OR DEBARMENT
ARIZ. ADMIN. CODE 17-3-201 through 204	15 days prior to bid opening.	15 months	<p>5. Violation of public contract laws.</p> <ol style="list-style-type: none"> 1. Contractor falsifies documents. 2. Failure to enter into contract awarded by department. 3. Default on previous contract with any public agency. 4. Unsatisfactory work performance record with department. 5. Failure to notify department within 30 days of any change in ownership, corporate officers, bankruptcy, receivership, or judgment adverse to contractor.
ADOT Application for Contractor Pre-qualification			
ARK. CODE §§ 19-11-235, 19-11-245	5 business days prior to time that rating is made.	1 year plus grace period of 4 months	<p>Disqualification:</p> <ol style="list-style-type: none"> 1. Failure to comply with prequalification requirements. 2. Lack of competency or plant and equipment. 3. Uncompleted work that might hinder performance. 4. Failure to satisfactorily settle all bills on previous jobs. 5. Serious misconduct that affects contractor's ability to perform future work. 6. Suspension or debarment in effect. 7. Failure to reimburse state for money owed on previous contract. 8. Previous failure to execute contract or provide bonds. 9. Unsatisfactory performance on previous contract. 10. Liquidated damages currently being assessed under current contract. 11. Default under previous contracts.
Ark. Standard Specifications § 102-01			
CAL. PUB. CONT. CODE §§ 10160-10166; 10285-10285.5	Application must be submitted at least 5 days prior to bid opening; must have been prequalified for at least 1 day prior to bid opening.		<ol style="list-style-type: none"> 1. Inadequate safety record. 2. Conviction of contractor or principal of fraud, bribery, collusion, conspiracy, or violation of antitrust laws.
COLO. REV. STAT. § 24-92-107	10 days prior to bid opening.	1 year	<ol style="list-style-type: none"> 1. Contractor declared in default on any contract. 2. Making false or deceptive statements on prequalification application or any other information provided to DOT. 3. Failure to report significant decreases in capabilities or limitations on performing work. 4. Lack of integrity in contract-related matters. 5. No longer meets criteria for prequalification.
2 Colo. Code. Reg. 601-10			

STATE AND CITATION	APPLICATION DEADLINE	PERIOD OF CERTIFICATION	BASIS FOR SUSPENSION, DISQUALIFICATION, OR DEBARMENT
Conn. DOT Construction Contract Bidding and Award Manual	30 days prior to requesting bid proposal form. May get proposal form without being prequalified, but must be prequalified in order to have bid considered.	16 months from end of contractor's previous fiscal year. Must reapply at least 30 days prior to expiration.	<ol style="list-style-type: none"> 1. Unsatisfactory record of compliance with state and federal laws. 2. Unethical conduct or criminal conduct. 3. Suspended or debarred by another agency. 4. Lacks necessary skills, equipment, organization, experience, or employees to timely complete project in accordance with contract. 5. Unsatisfactory record of performance on previous projects. 6. Lack of financial resources. 7. Lack of experienced management. 8. Making false representations to or about department. 9. Reason to doubt that contractor will fulfill all contract and legal requirements; that it has necessary financial, managerial, and other resources; that it will exhibit integrity, honesty, cooperativeness, professionalism, and skill in performing contract.
29 DEL. CODE § 6962(c), (d)(14)		1 year	<p>Disqualification</p> <ol style="list-style-type: none"> 1. Inadequate expertise, labor, or experience. 2. Failure to provide supplemental information requested. <p>Suspension/Debarment</p> <ol style="list-style-type: none"> 1. Failure to supply adequate labor. 2. Inadequate financial resources. 3. Poor performance.
D.C. CODE § 2-302.04, 2-308.04		1 year	<ol style="list-style-type: none"> 1. Conviction of criminal offense relating to obtaining or performing public contract. 2. Conviction for fraud or other crime indicating lack of business integrity. 3. Conviction of antitrust violation. 4. False assertion of DBE status. 5. Any other cause affecting responsibility.
Standard Specifications § 102.01			
FLA. STAT. § 337.16 FLA. ADMIN. CODE § 14-22	Department is allowed 30 days to process application.	Must reapply annually; qualification expires 16 months after date of last audited financial statement.	<ol style="list-style-type: none"> 1. Contractor delinquent on previously awarded contract. 2. Making false or deceptive statements in prequalification application, bid proposal, certificate or payment, or of judicial proceeding. 3. Insolvency or bankruptcy.

STATE AND CITATION	APPLICATION DEADLINE	PERIOD OF CERTIFICATION	BASIS FOR SUSPENSION, DISQUALIFICATION, OR DEBARMENT
			<ol style="list-style-type: none"> 4. Failure to comply with contract requirements. 5. Submission of more than one bid on the same project by contractor affiliates. 6. Wrongfully employing or offering compensation or otherwise wrongfully attempting to influence department employee. 7. Failure to register motor vehicles operated in the state.
<p>GA. CODE § 32-2-66</p> <p>Ga. Admin. Rules §§ 672-5.04, 672-5.16</p>	10 days prior to bid opening.	Must be obtained annually; may be required to be updated.	<ol style="list-style-type: none"> 1. Work not being prosecuted diligently. 2. Refusal to execute contract and forfeiture of bid bond. 3. Contractor's actions have lessened competition or damaged integrity of bidding process. 4. Conviction of crimes involving restraint of trade.
<p>HAW. REV. STAT. § 103D-310</p>	Must file notice of intent to submit offer at least 10 days prior to bid opening; Department may then require completion of Prequalification Questionnaire.		<ol style="list-style-type: none"> 1. Bidder not fully qualified and able to perform intended work. 2. Unreasonable failure to promptly provide information regarding inquiry on responsibility.
<p>IDAHO CODE §§ 54-1910, 54-1914</p> <p>Standard Specifications §§ 102.11, 107.03</p>	Must be licensed by Public Works Contractor License Board prior to submitting bid.	12 months	<ol style="list-style-type: none"> 1. Abandonment of construction project without legal excuse. 2. Diversion of funds or property received for construction project. 3. Willful disregard of plans and specifications. 4. Willful disregard of building, safety, labor, or compensation insurance laws. 5. Misrepresentation of material fact in obtaining license. 6. Aiding or abetting unlicensed person with intent to evade contractor licensing law. 7. Willful or deliberate failure to complete project. 8. Willful or deliberate failure to pay for labor or materials. 9. Change in financial circumstances that may impair financial responsibility.
44 ILL. ADMIN.	21 days prior to bid opening.		<ol style="list-style-type: none"> 1. Lack of business integrity or honesty, such as bribery.

STATE AND CITATION	APPLICATION DEADLINE	PERIOD OF CERTIFICATION	BASIS FOR SUSPENSION, DISQUALIFICATION, OR DEBARMENT
CODE §§ 660.520			<ol style="list-style-type: none"> 2. Material false statement in application for prequalification or affidavit. 3. Material violation of rule or procurement procedure. 4. Material false statement with respect to quality of cost of work done or procurement procedures. 5. Doing business with suspended contractor. 6. Debarment or suspension by another state agency or agency of other state.
IND. CODE § 8-23-10 105 IND. ADMIN. CODE §§ 11-1-1 through 11-2-12	Department has 30 days to act on application.	1 year	<ol style="list-style-type: none"> 1. Making false statement to department with respect to net worth in any other document filed with department.
IOWA CODE § 314.1 Standard Specifications §§ 1102.01, 1102.03	At least 5 calendar days prior to bid opening.	16 calendar months	<ol style="list-style-type: none"> 1. Failure to repair or replace work found not in conformity with contract documents. 2. Failure to carry out work in acceptable manner or in reasonable time. 3. Failure to perform required work with own organization, or assigning work without approval. 4. Forfeiture of proposal guaranty and failure to enter into awarded contract. 5. Failure to comply with EEO and affirmative action requirements. 6. Failure to pay subcontractor progress payments and retainage. 7. Safety concerns. 8. Contractor default. 9. Material change in financial condition.
KAN. STAT. § 75-37, 104 Kan. Admin. Rules § 36-31-2 through 36-31-5	At least 7 days prior to bid opening.	1 year	<ol style="list-style-type: none"> 1. Conviction or admission of fraud or criminal offense in connection with obtaining or performing contract; anti-trust violation; embezzlement, theft, forgery, falsification of documents, making false statements, obstruction of justice; wage and hour laws; or violation of laws indicating lack of business integrity. 2. Violation of contract terms, including failure to perform in accordance with specifications, or record of unsatisfactory performance.

STATE AND CITATION	APPLICATION DEADLINE	PERIOD OF CERTIFICATION	BASIS FOR SUSPENSION, DISQUALIFICATION, OR DEBARMENT
KSDOT Contractor's Pre-qualification and Experience Questionnaire	Department has 30 days to act on application unless bid opening is within 30 days; in that case department must act in 15 days.	Certificate expires 120 days after end of applicant's fiscal year. Contractor expected to re-apply no later than 90 days after end of fiscal year.	<ol style="list-style-type: none"> 1. Failure to perform satisfactorily. 2. Failure to adhere to laws and regulations.
KY. REV. STAT. §§ 176.130, 176.140, 176.150 603 KAR § 2:015	Department has 30 days to act on application unless bid opening is within 30 days; in that case department must act in 15 days.	Certificate expires 120 days after end of applicant's fiscal year. Contractor expected to re-apply no later than 90 days after end of fiscal year.	<ol style="list-style-type: none"> 1. Failure to perform satisfactorily. 2. Failure to adhere to laws and regulations.
LA. REV. STAT. §§ 37:2156 through 37:2158 Standard Specifications §§ 102.01, 102.02	Must have license from State Licensing Board for Contractors in order to submit bid over \$50,000.	License expires on December 31 of year in which it was issued.	<ol style="list-style-type: none"> 1. Dishonest or fraudulent act determined by a court to have caused substantial damage to another. 2. Willful misrepresentation of material fact in applying for license. 3. Willful failure to comply with licensing rules. 4. Entering into contract with unlicensed contractor. 5. Permitting contractor license to be used by unlicensed person. 6. Failure to maintain registered agent. 7. Failure to fulfill licensing requirements. 8. Insolvency or involuntary cessation of business. 9. Problems relating to ability to engage in business of contracting. 10. Debarment by any other agency.
Code of Md. Regs. § 21-08.02 through 21.08.03			<ol style="list-style-type: none"> 1. Bribery, attempted bribery, or conspiracy to bribe. 2. Conviction for fraud, embezzlement, theft, forgery, destruction or falsification of records. 3. Antitrust or RICO conviction.
17 Maine Admin. Rules § 102	At least 10 days prior to bid opening.	3 years	<ol style="list-style-type: none"> 1. Conviction of a bidding crime. 2. Conviction of any crime indicating lack of moral or business integrity. 3. Debarment by any state or federal agency. 4. Making false or deceptive statements on any documents submitted to department.
MDOT Contractor Pre-qualification Form			<ol style="list-style-type: none"> 4. Making false or deceptive statements on any documents submitted to department.

STATE AND CITATION	APPLICATION DEADLINE	PERIOD OF CERTIFICATION	BASIS FOR SUSPENSION, DISQUALIFICATION, OR DEBARMENT
MASS. LAWS ch. 29, § 8B 720 MASS. REGS. CODE 5.00		1 year	<ol style="list-style-type: none"> 1. Conviction of willfully making false or fraudulent statement in application. 2. Collusion.
MICH. ADMIN. CODE §§ 247.1 through 247.53	At least 15 days prior to bid opening.	Expires 15 ½ months after end of fiscal year. Must reapply annually.	<ol style="list-style-type: none"> 1. Submission of false statements. 2. Failure to comply with rules and with requirements of prequalification. 3. Factors that affect responsibility or ability to perform work.
Minn. Standard Specifications §§ 1201, 1213			<ol style="list-style-type: none"> 1. Debarment by federal agency under 49 C.F.R. pt. 29. 2. Submission of more than one proposal on a project. 3. Evidence of collusion.
MISS. CODE §§ 31-3-15; 31-3-21 Rules and Regulations of State Board of Contractors (2002)	Must have certificate of responsibility issued by State Board of Contractors prior to submission of bid. Board has 30 days to act on application.	1 year	<ol style="list-style-type: none"> 1. Finding of nonresponsibility by board. 2. Submission of bid outside of classification.
MO. REV. STAT. §§ 227.100, 105 7 MO. CODE REGS. §§ 10-15.010, 10-18.010	At least 7 days prior to bid opening.	1 year, unless the contractor does work for the Department during that year, in which case it may file standard contractor questionnaire.	<ol style="list-style-type: none"> 1. Submission of more than one proposal for same project. 2. Collusion. 3. Conviction or civil judgment for fraud, criminal offense in attempting to obtain bid, antitrust, embezzlement, theft, bribery, perjury, assault, false statements or claims, obstruction of justice. 4. Violation of terms of public contract so serious as to affect the integrity of the project. 5. Debarment by a local, state, or federal agency.
MONT. ADMIN. R. §§ 18.3.101-106			<ol style="list-style-type: none"> 1. Conviction of fraud or criminal offense in obtaining or performing a contract; antitrust violation; crime such as embezzlement, theft, or obstruction of justice; conspiracy or collusion; or any crime indicating lack of business integrity. 2. Filing false or fraudulent claim. 3. Violation of contract terms such as willful failure to comply with specifications; history of failure to perform or unsatisfactory performance. 4. Failure to reimburse department for money owed under previous contract.

STATE AND CITATION	APPLICATION DEADLINE	PERIOD OF CERTIFICATION	BASIS FOR SUSPENSION, DISQUALIFICATION, OR DEBARMENT
			5. Willful violation of applicable statute or regulation. 6. Serious or repeated violation of wage requirements. 7. DBE violation. 8. Doing business with debarred or suspended contractor. 9. Nonpayment of taxes.
NEB. REV. STAT. §§ 39-1351, 39-1352 Standard Specifications §§ 102.01, 102.18	Not later than 10 days prior to bid opening.	15 months after date of financial statement.	Disqualification: 1. Submission of more than one proposal for a project. 2. Collusion among bidders. 3. Bid obviously or materially unbalanced, signature is missing from affidavit, or bid not accompanied by bid bond. Debarment: 1. Indictment or conviction of bidding crime. 2. Conviction of offense involving lack of moral or ethical integrity. 3. Debarment by another state or federal agency. 4. Materially false statements on bid proposal.
NEV. REV. STAT. § 408.333	Must allow enough time prior to bid opening for processing of application.		May be disqualified if responses to questionnaire are insufficient.
N.H. ADMIN. R. Part Tra-401	At least 8 days prior to bid opening.	Must be renewed annually. Expires 1 year and 3 months from date of financial statement.	1. Materially false, deceptive, or fraudulent statements on application or on bid proposal form. 2. Conviction for antitrust violations. 3. Debarment by other state or federal agency. 4. Factors that materially affect contractor's ability to perform, including poor performance history.
N.J. STAT. ANN. §§ 27:7-35.2 through 27:7-35.12 Department Regulations § 16:44-1	At least 15 days prior to bid opening; classification effective 15 days after receipt of application.	18 months	Making false, deceptive, or fraudulent statement in application for prequalification, or in hearing relating to prequalification.
N.M. STAT. 13-1-134 18 N.M. ADMIN. CODE §§ 27.5.3	Not less than 7 days prior to bid opening.	1 year	1. False, deceptive, or misleading statements in application. 2. Conviction for bidding crime, embezzlement, theft, forgery, bribery, falsification or destruction of records, or

STATE AND CITATION	APPLICATION DEADLINE	PERIOD OF CERTIFICATION	BASIS FOR SUSPENSION, DISQUALIFICATION, OR DEBARMENT
through 27.5.15; 28.4.3 through 28.4.10			<ul style="list-style-type: none"> receiving stolen property. 3. Conviction of antitrust violation arising out of submission of bid proposal. 4. Willful failure to perform contract, or history of failure to perform. 5. Willful violation of state procurement code.
N.C. Standard Specifications §§ 102-2, 102-16	At least 2 weeks prior to opening of bids.	2 years	<ul style="list-style-type: none"> 1. Unsatisfactory safety record. 2. Unsatisfactory progress on work or being declared in default. 3. Uncompleted contracts that might hinder additional work. 4. Failure to comply with prequalification requirements. 5. Submission of more than one bid for a project. 6. Evidence of collusion, or failure to submit non-collusion affidavit. 7. Failure to comply with written order of state engineer. 8. Failure to comply with DBE requirements. 9. Failure to comply with subletting and assignment requirements. 10. Failure to return overpayments. 11. Failure to maintain safety index. 12. Recruitment of department employees. 13. Department has not received amount due under forfeited bid bond or on performance bond.
N.D. CENT. CODE § 43-07-06	At least 7 days prior to bid opening.	1 year	<ul style="list-style-type: none"> 1. More than one proposal submitted for a project. 2. Collusion among bidders.
Standard Specifications §§ 102.01, 102.13			
OHIO REV. CODE §§ 5525.02 through 5525.09	Department has 30 days to process application.	1 year	<ul style="list-style-type: none"> 1. Contractor in default on any department project. 2. Debarment or suspension by other state or federal agency. 3. Conviction of crimes involving fraud.
OHIO ADMIN. CODE §§ 5501:2-3-1 through 10			<ul style="list-style-type: none"> 4. Bankruptcy. 5. Submission of false or misleading statements in connection with prequalification or contract. 6. Collusion with other bidders. 7. Violation of DBE requirements.

STATE AND CITATION	APPLICATION DEADLINE	PERIOD OF CERTIFICATION	BASIS FOR SUSPENSION, DISQUALIFICATION, OR DEBARMENT
			<ul style="list-style-type: none"> 8. Failure to pay prevailing wages. 9. Poor contractor evaluations.
<p>61 OKLA. STAT. § 118</p> <p>OKLA. ADMIN. CODE §§ 730:25-3-1, 730:25-3-5</p>	14 days prior to bid opening.	1 year after initial prequalification, then 2 years from acceptance of contractor's last project.	<ul style="list-style-type: none"> 1. Conviction of bidding crime or other crime involving lack of moral or ethical integrity. 2. Unsatisfactory performance of contract. 3. Disqualification or debarment by another state or federal agency. 4. Failure or refusal to comply with terms or obligations of contract.
<p>OR. REV. STAT. §§ 279.037 through 279.047</p> <p>OR. ADMIN. R. 731-005-0025, 734-010-0130</p>	10 days prior to bid opening.	1 year	<ul style="list-style-type: none"> 1. Conviction of crime related to bidding or performance of public contract. 2. Conviction of offense involving lack of moral integrity, such as bribery or embezzlement. 3. Conviction under antitrust statutes. 4. Failure to perform contract or unsatisfactory performance. 5. Failure to have workers' compensation and unemployment compensation insurance.
67 PA. CODE § 457.13 through 457.17	At least 10 working days prior to bid opening.	30 months from date of contractor's balance sheet.	<ul style="list-style-type: none"> 1. Commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, or receiving stolen property. 2. Commission of fraud in obtaining public contract. 3. Violation of antitrust statutes. 4. Violation of campaign contribution laws. 5. Violation of environmental laws. 6. Violation of labor laws, including prevailing wage. 7. Violation of workers' compensation act. 8. Violation of anti-discrimination laws. 9. Suspension or debarment by another state or federal agency. 10. Three or more instances when contractor has been found ineligible to bid. 11. Unsatisfactory performance of contract, including being declared in default; untimely performance; making false statements.
R.I. GEN. LAWS § 37-2-26			<ul style="list-style-type: none"> 1. Submission of more than one bid on a project. 2. Collusion among bidders or violation of antitrust laws. 3. Making false statements on prequalification materials. 4. Failure to comply with prequalification requirements. 5. Debarment by another state or federal agency.
Standard Specifications §§ 102.01, 102.12			

STATE AND CITATION	APPLICATION DEADLINE	PERIOD OF CERTIFICATION	BASIS FOR SUSPENSION, DISQUALIFICATION, OR DEBARMENT
Rules and Regulations of R.I. Department of Transportation Regarding Contractor and Subcontractor Debarment, Suspension, and Sanctions			<ol style="list-style-type: none"> 6. Failure to provide contract bond. 7. Lack of competency or inadequacy of equipment. 8. Uncompleted work that might hinder additional work. 9. Failure to pay all bills due for labor or materials. 10. Default or unsatisfactory performance on previous contract. 11. Failure to reimburse state for money owed under previous contract. 12. Failure to comply with post-qualification regulations imposed by state. 13. Conviction or admission of bid-related crime. 14. Crime involving lack of moral or ethical integrity. 15. Failure to comply with state or federal regulations.
S.C. CODE § 11-35-1825	7 days prior to bid opening.	1 year	<ol style="list-style-type: none"> 1. Unsatisfactory work. 2. Conviction of any crime indicating lack of business integrity. 3. Civil judgment or administrative decision, or any act or omission, indicating lack of business integrity. 4. Willful violation of contract provision. 5. Persistent failure to perform contract, or incompetent performance. 6. Knowingly allowing suspended or disqualified person to act as subcontractor. 7. Failure to cooperate in department or law enforcement investigation.
S.C. CODE REGS. §§ 63-300 through 63-306			<ol style="list-style-type: none"> 3. Civil judgment or administrative decision, or any act or omission, indicating lack of business integrity. 4. Willful violation of contract provision. 5. Persistent failure to perform contract, or incompetent performance. 6. Knowingly allowing suspended or disqualified person to act as subcontractor. 7. Failure to cooperate in department or law enforcement investigation.
S.D. LAWS § 31-5-10	14 days prior to bid opening.	18 months from date of contractor's balance sheet.	<ol style="list-style-type: none"> 1. Lack of competency or inadequate machinery. 2. Uncompleted work that department believes will hinder additional work. 3. Failure to pay or settle legal obligations due. 4. Failure to comply with prequalification regulations. 5. Default on previous contract. 6. Unsatisfactory performance, including noncompliance with specifications or failure to complete on time. 7. Failure to provide adequate safety measures. 8. Questionable moral integrity. 9. Failure to reimburse state for money due. 10. Conviction for contract crime. 11. Conviction of antitrust violation.
S.D. ADMIN. CODE §§ 70:07:02, 70:07:04.01 through 70:07:04.19 Standard Specifications §§ 2.1, 2.3			<ol style="list-style-type: none"> 3. Failure to pay or settle legal obligations due. 4. Failure to comply with prequalification regulations. 5. Default on previous contract. 6. Unsatisfactory performance, including noncompliance with specifications or failure to complete on time. 7. Failure to provide adequate safety measures. 8. Questionable moral integrity. 9. Failure to reimburse state for money due. 10. Conviction for contract crime. 11. Conviction of antitrust violation.

STATE AND CITATION	APPLICATION DEADLINE	PERIOD OF CERTIFICATION	BASIS FOR SUSPENSION, DISQUALIFICATION, OR DEBARMENT
TENN. CODE § 54-5-117	Noon on day prior to bid letting.	1 year plus 3-month grace period for renewal.	<ol style="list-style-type: none"> 1. Default on existing contract. 2. Work on existing contract is behind schedule.
Standard Specifications § 102.01			
43 TEX. ADMIN. CODE §§ 9.12, 9.100-110	10 days prior to bid opening.	1 year plus 90-day grace period.	<ol style="list-style-type: none"> 1. Debarment by federal agency. 2. Conviction of or admission of bidding crime. 3. Conviction of offense indicating lack of moral or ethical integrity, such as bribery. 4. Failure to execute contract or honor bid guaranty. 5. Default on highway improvement contract.
UTAH CODE § 63-56-20	Agency is allowed 10 working days to process application.	Must prequalify annually.	<p>Disqualification:</p> <ol style="list-style-type: none"> 1. More than one proposal submitted for one project. 2. Evidence of collusion among bidders. <p>Disbarment:</p> <ol style="list-style-type: none"> 1. Conviction, public admission, or guilty plea to contract-related crime. 2. Submission of false, deceptive, or fraudulent information in prequalification, bidding, or contract performance. 3. Anti-trust violation. 4. Lack of integrity in performing public projects. 5. Debarment of contractor or affiliate by another agency. 6. Collusion regarding DBE compliance. 7. Default on previous contract. 8. Unsatisfactory performance, including failure to complete on time, noncompliance, need for substantial corrective work, failure to provide adequate safety measures and traffic control. 9. Questionable moral integrity. 10. Failure to reimburse state for money owed under previous contract.
Standard Specifications §§ 1.1; 1.15; 1.17-1.20			
19 VT. STAT. § 1503 Code of Vt. Rules §§ 14-010-010, 14-	Request must be submitted by 5 working days prior to bid opening.	1 year; certificate will expire 3 months after end of contractor's fiscal year.	<p>Disqualification:</p> <ol style="list-style-type: none"> 1. Work exceeds prequalification rating. 2. Unsatisfactory performance on past contracts. 3. Unsatisfactory performance or progress on current con-

STATE AND CITATION	APPLICATION DEADLINE	PERIOD OF CERTIFICATION	BASIS FOR SUSPENSION, DISQUALIFICATION, OR DEBARMENT
010-004 VDOT Contractor's Experience Questionnaire			tracts. 4. Uncompleted work might hinder performance of new work. Suspension and Debarment: 1. Fraud or criminal offense in obtaining public contract. 2. Criminal offense indicating lack of business integrity. 3. Violation of law in performance of state contract. 4. Violation of settlement agreement under prequalification rules. 5. Making false statement to influence state. 6. Violation of conflict of interest laws. 7. Outstanding criminal indictment. 8. Willful or serious failure to perform contract. 9. Disqualification by federal agency or other state.
VA. CODE § 33.1-12 Standard Specifications §§ 102.01, 102.8 DOT Rules Governing Prequalification and Certification DOT Board Policy for Debarment and/or Suspension of Contractors	30 calendar days prior to submission of bid.	12 months	Disqualification: 1. Project behind schedule. 2. Poor workmanship, until defective work corrected. 3. Submission of more than one bid on a project. 4. Incompetence or inadequacy of plant or equipment. 5. Unsatisfactory workmanship or progress on past projects for the department or other agencies. 6. Uncompleted work for the department that might hinder new job. 7. Failure to pay all bills for labor, materials, and equipment. 8. Failure to comply with prequalification regulations. 9. Failure to cooperate with department representatives. 10. Default on a contract. Enjoined from bidding: 1. Failure to meet DBE requirements. Debarment: 1. Proof of involvement in bidding crime. 2. Conviction of offense involving lack of moral or ethical integrity. 3. Debarment by another state or federal agency. 4. Flagrant violations of OSHA regulations.

STATE AND CITATION	APPLICATION DEADLINE	PERIOD OF CERTIFICATION	BASIS FOR SUSPENSION, DISQUALIFICATION, OR DEBARMENT
WASH. REV. CODE § 47.28.070	15 days prior to bid opening.	1 year	<p>Disqualification:</p> <ol style="list-style-type: none"> 1. More than one bid submitted for project. 2. Evidence of collusion with other bidders. 3. Record of unsatisfactory performance. 4. Uncompleted work that might hinder performance. 5. Failure to pay or settle outstanding bills. 6. Failed to complete previous contract. 7. Conviction of bidding crime. 8. Not registered to do business in Washington. <p>Suspension:</p> <ol style="list-style-type: none"> 1. Incompetence detrimental to timely completion or safety. 2. Inadequate performance. 3. Infractions of regulations or specifications. 4. Finding of noncompliance and refusal to take corrective action. 5. Uncompleted work that may hinder completion of new work. 6. Failure to comply with DBE requirements. <p>Revocation:</p> <ol style="list-style-type: none"> 1. Conviction or admission of antitrust laws. 2. Knowingly concealing deficiency in prior contract performance. 3. Falsification of information relating to prequalification or contract performance or destruction of records. 4. Debarment by a federal or state agency. 5. Willful disregard for applicable law. 6. Default on previous contract within 3 years. 7. Bankruptcy. 8. Breach of contract. 9. Having been suspended two or more times in 2-year period.
WASH. ADMIN. CODE §§ 468-16-180, 468-16-190			
Standard Specifications §§ 1-02.1, 1-02.14			
W. VA. CODE, §§ 17-4-19; 5A-3-33d	15 days prior to bid opening.		<p>Disqualification:</p> <ol style="list-style-type: none"> 1. More than one proposal submitted by bidder. 2. Collusion with another bidder. <p>Suspension/Debarment:</p> <ol style="list-style-type: none"> 1. Conviction of offense involving fraud or offense regarding
W. Va. Code of State Rules §§			

STATE AND CITATION	APPLICATION DEADLINE	PERIOD OF CERTIFICATION	BASIS FOR SUSPENSION, DISQUALIFICATION, OR DEBARMENT
157-3-4, 157-3-13 Standard Specs. for Roads & Bridges § 102.1			<ul style="list-style-type: none"> obtaining public contract. 2. Conviction of antitrust violation. 3. Conviction of an offense involving embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, or receiving stolen property in connection with the performance of a contract. 4. Conviction of offense that indicates lack of business integrity or honesty. 5. Default on obligations owed state, such as state tax and revenue laws, unemployment compensation, and workers' compensation. 6. Contractor not in good standing with licensing board. 7. Willful failure to perform public contract or violation of standards of law or of generally accepted practices of the trade, amounting to intentionally deficient or grossly negligent performance. 8. Use of substandard materials or defects in construction amounting to gross negligence. 9. Willful misconduct demonstrating wanton indifference to interest of public.
WIS. STAT. §§ 66.0901, 84.06 Standard Specifications §§ 102.11, 102.12 Policy on Pre-qualification of Bidders	5 days prior to bid opening.	Renewed annually; expire 1 year and 4 months after date of financial statement.	<ul style="list-style-type: none"> 1. Submission of falsified statement. 2. Conviction of violation of federal or state law. 3. Collusion or restraint of trade.
WYO. STAT. § 24-08 Transportation Rules and Regulations, ch. 6	2 weeks before bid letting if not previously prequalified; 2 days before if previously prequalified.	15 months, commencing on date of applicant's fiscal year end.	<ul style="list-style-type: none"> 1. Default on contract. 2. False, deceptive, or fraudulent statement on questionnaire. 3. Disqualification, suspension, or debarment by another government agency. 4. Attempt to influence department through gifts or gratuities, or by hiring agency employees. 5. Inability to meet WYDOT requirements for specifications and contracts.

APPENDIX G

STATE LAWS RELATING TO SCOPE AND COVERAGE OF CONTRACTOR BONDS

STATE & CITATION	SCOPE OF BOND OBLIGATION	AMOUNT OF COVERAGE	SPECIAL REQUIREMENTS
ALA. CODE § 39-1-1	<p>Performance Bond: faithful performance of contract.</p> <p>Payment Bond: labor, materials, or supplies for or in the prosecution of the work provided in the contract.</p> <p>Exemption: contracts under \$50,000.</p>	<p>100 percent of contract price.</p> <p>50 percent of contract price.</p>	<p>Payment bond must provide for payment of reasonable attorney fees for successful claimant on bond.</p>
ALASKA STAT. § 36.25.010	<p>Performance Bond: perform and complete all obligations and work under the contract.</p>	<p>50 percent of amount of contract less than \$1 million; 40 percent of amount of contract over \$1 million; over \$5 million, bond amount is \$2.5 million.</p>	<p>Corporate surety must be authorized to do business in state, or at least two individual sureties.</p>
Standard Specs. § 103-1.04	<p>Payment Bond; payment of all claims for labor performed and materials and supplies furnished.</p> <p>Applies to contracts over \$100,000.</p>	<p>Amount of performance bond shall be amount of payment bond.</p>	
ARIZ. STAT. §§ 34-221, 34-222	<p>Performance Bond: faithful performance of the contract in accordance with plans, specifications, and conditions, solely for protection of agency.</p>	<p>100 percent of contract amount for each payment and performance bond.</p>	<p>Surety must have authority to transact business in the State. Bond must provide for payment of attorney fees for prevailing party.</p>
Standard Specs. § 103.07	<p>Payment Bond: for payment of labor, materials, and supplies furnished to contractor or subcontractors.</p>		
ARK. CODE § 27-67-206	<p>Performance Bond: faithful performance of the contract.</p>	<p>Statute requires at least 25 percent of contract price. Standard Specs require 100 percent of contract amount for performance bond, and 80 percent of contract amount for payment bond.</p>	
Standard Specs. § 103.05	<p>Payment Bond: In form acceptable to department.</p>		
CAL. PUB. CONT. CODE §§ 10221-10225	<p>Performance bond: Guarantee faithful performance of contract.</p> <p>Payment Bond: For payment of claims of laborers mechanics or materialmen employed under the contract.</p>	<p>At least 50 percent of contract price for each bond.</p>	

STATE & CITATION	SCOPE OF BOND OBLIGATION	AMOUNT OF COVERAGE	SPECIAL REQUIREMENTS
<p>COLO. REV. STAT. §§ 38-26-106; 24-105-202</p>	<p>Performance bond: Satisfactory to the state.</p> <p>Payment Bond: Payment for any labor, materials, team hire, sustenance, provisions, provender, or other supplies used or consumed by the contractor or his or her subcontractor in performance of the work contracted to be done, or supplier or laborers, rental machinery, tools, or equipment.</p> <p>Exceptions: Contracts under \$50,000.</p>	<p>50 percent of contract amount.</p>	<p>Certified or cashier's check or bank money order may be accepted in lieu of surety bond.</p>
<p>CONN. GEN. STAT. § 49-41</p> <p>Stand. Specs § 1.03.04</p>	<p>Performance Bond: Agency may require.</p> <p>Payment bond: For the protection of persons supplying labor or material in the prosecution of the work.</p> <p>Exceptions: Contracts under \$50,000 do not require payment bond; contracts under \$25,000 do not require performance bond.</p>	<p>Full amount of the contract.</p>	
<p>29 DEL. CODE § 6927</p> <p>Standard Specifications § 103.05</p>	<p>Performance Bond: Compliance and performance by the successful bidder of each and every term and condition of the contract and the proposal, plans and specifications thereof; payment in full to every person furnishing materiel or performing labor in the performance of the contract, of all sums of money due the person for such labor and material.</p> <p>Exceptions: Bond may be waived for contract under threshold amount set by Contracting and Purchasing Council, or may be waived at discretion of State.</p>	<p>100 percent of contract price.</p>	<p>Bond must also indemnify and save harmless the State and the agency from all costs, damages, and expenses growing out of or by reason of the successful bidder's failure to comply and perform the work and complete the contract.</p>
<p>D.C. CODE §§ 2-305.01; 2-305.03; 2-305.04</p>	<p>Performance Bond: To ensure the protection of the District government.</p> <p>Payment Bond: For the protection of all businesses supplying labor and materials, including lessors of equipment to the extent of the fair rental value of the equipment, to the contractor or a subcontractor in the performance of the work provided for by the contract.</p> <p>Exceptions: Contracts under \$100,000.</p>	<p>Amount deemed adequate by the director; payment bond not less than 50 percent of contract price.</p>	<p>Surety must be authorized to do business in District.</p> <p>In lieu of bond, may provide cash or other satisfactory security.</p>
<p>FLA. STAT. § 337.18</p>	<p>Payment and Performance Bond: prompt, faithful, and efficient performance of the contract according to plans and specifications and within the time period specified, and for the prompt payment of all persons furnishing labor, material, equipment, and supplies</p>	<p>Amount of contract.</p>	<p>Department may require alternate security if bond is waived; surety must be registered to do business in state.</p>

STATE & CITATION	SCOPE OF BOND OBLIGATION	AMOUNT OF COVERAGE	SPECIAL REQUIREMENTS
	<p>therefore.</p> <p>Exceptions: Department may waive requirement for contracts of \$150,000 or less.</p>		
GA. CODE §§ 32-2-70; 13-10-40; 13-10-60.	<p>Performance Bond: Required for construction contracts over \$100,000, with discretion to require for contracts less than \$100,000.</p> <p>Payment Bond: For the use and protection of all subcontractors and all persons supplying labor, materials, machinery, and equipment in the prosecution of the work provided for in the contract.</p>	Amount of contract.	State may accept a cashier's check, certified check, or cash.
HAW. REV. STAT. § 103D-324	<p>Exemptions: Contracts under \$50,000.</p> <p>Performance Bond: Faithfully perform, and fully complete the contract in strict accordance with its terms.</p> <p>Payment Bond: For every person who furnishes labor or material to the contractor for the work provided in the contract.</p> <p>Exceptions: contracts \$25,000 or less.</p>	100 percent of contract price.	May be a single payment and performance bond that satisfies requirements for each.
IDAHO CODE § 54-1926	<p>Performance Bond: Faithful performance of the contract in accordance with its plans, specifications, and conditions. Bonds shall be solely for protection of contracting agency.</p>	Not less than 85 percent of contract amount.	Government obligations may be given in lieu of surety bond if they meet statutory criteria in IDAHO CODE § 54-1901.
Stand. Specs. § 103.04	<p>Payment Bond: Solely for protection of persons supplying labor or materials, or renting, leasing, or otherwise supplying equipment to the contractor or subcontractor in prosecution of the work provided for in the contract.</p>		
30 ILL. COMP. STAT. § 550/1	<p>Performance and Payment Bond: For the completion of the contract, for the payment of material used in such work, and for all labor performed in such work, whether by subcontractor or otherwise.</p>	Amount fixed by agency.	Sureties selected by contractor, but subject to right of reasonable approval or disapproval of agency.
Stand. Specs. § 103.04	<p>Exceptions: Contracts \$5,000 or less.</p>		
IND. CODE §§ 8-23-9-8; 8-23-9-9	<p>Performance Bond: Faithful performance of the work, in accordance with the profile, plans, and specifications set forth in the proposal; payment by the contractor and by all subcontractors for</p>	Amount not less than contract price.	Commissioner has right to approve surety.
Stan. Specs § 101.32			

STATE & CITATION	SCOPE OF BOND OBLIGATION	AMOUNT OF COVERAGE	SPECIAL REQUIREMENTS
	<p>all labor performed or materials furnished or other services rendered in the construction.</p> <p>Exceptions: Commissioner may waive bond requirements for contracts under \$100,000.</p>		
IOWA CODE §§ 573.2-573.5	<p>Contract Bond: Faithful performance of the contract and for fulfillment of other requirements as provided by law. Payment requirements include payment of all claims for labor and materials not otherwise covered by retainage.</p> <p>Exceptions: Contracts under \$25,000; may be required for contracts under that amount.</p>	Not less than 75 percent of the amount of the contract unless contract provided that no payments are due until completion, in which case only 25 percent of the contract amount must be covered by the bond. Standard specifications require 100 percent of contract price.	<p>Bonding company must be authorized to do business in the state.</p> <p>In lieu of surety bond, the contractor may deposit cash, certified check, or bonds issued by federal, state, or local agencies.</p>
Stan. Specs. § 1103.05			
KAN. STAT. §§ 68-410, 68-704	<p>Contractor Bond: Faithfully perform such contract in every respect, and pay all indebtedness incurred for supplies, materials, or labor furnished, used or consumed in connection with or in or about the construction of the project for which the contract has been let, including gasoline, lubricating oils, fuel oils, greases, coal, and similar items used or consumed and used directly in carrying out the provisions of the contract.</p> <p>Exceptions: Contracts \$1,000 or less.</p>	Amount not less than contract price.	Surety must be authorized to do business in state and approved by the secretary.
Stan. Specs. § 103.05			
KY. REV. STAT. § 45A.190	<p>Performance Bond: Satisfactory to state.</p> <p>Payment Bond:</p>	100 percent of contract price.	
Stan. Spec. § 103.05	<p>For the protection of all persons supplying labor and material to the contractor or subcontractors.</p> <p>Exceptions: Contracts under \$25,000.</p>		
LA. REV. STAT. §§ 38:2216; 39:2241, 48:255	<p>Performance Bond: For faithful performance of contractor's duties.</p> <p>Payment Bond: For payment to claimants as defined in § 38:2242.</p> <p>Exceptions: No payment bond required for contracts under \$25,000. No performance bond if under \$50,000. On contracts of \$200,000 or less, qualified small businesses required to furnish only half of required bond amount.</p>	Not less than 50 percent of contract amount.	

STATE & CITATION	SCOPE OF BOND OBLIGATION	AMOUNT OF COVERAGE	SPECIAL REQUIREMENTS
14 ME. REV. STAT. § 871	Performance Bond: Faithful performance of the contract in accordance with the plans, specifications, and conditions thereof.	100 percent of contract amount.	
Standard Specs § 103.05	<p>Payment Bond: Solely for the protection of claimants supplying labor or materials to the contractor or the contractor's subcontractor in the prosecution of the work provided for in the contract, including rental equipment.</p> <p>Exceptions: Contracts under \$100,000.</p>		
<p>MD. CODE STATE FIN. & PROC. §§ 13-216; 17-101</p> <p>MD. REGS. CODE §§ 21.07.02.01; 21.06.07.03</p>	<p>Performance Bond: Performance of contract.</p> <p>Payment Bond: Payment for labor and materials, including leased equipment, under a contract for construction.</p> <p>Exceptions: Contracts under \$100,000.</p>	100 percent of contract amount.	Bond amounts may be reduced if state decides that self-insuring for part of risk is in best interest of state.
<p>MASS. LAWS ch. 149, § 29</p> <p>Stan. Specs § 3.04</p>	<p>Performance Bond: Performance of the contract.</p> <p>Payment Bond: Payment by contractor or subcontractor for labor performed or furnished and material used or employed in the work, including lumber not yet incorporated into or wholly consumed, specially fabricated material, transportation costs, equipment rental charges, and sums due under collective bargaining agreements regarding labor performed under the contract.</p> <p>Exceptions: Contracts under \$5,000.</p>	Not less than one half of total contract price.	
MICH. COMP. LAWS §§ 129.201, 129.202, 129.203	<p>Performance Bond: Faithful performance of the contract in accordance with the plans, specifications, and terms thereof.</p> <p>Payment Bond: Claimants, as defined in statute, supplying labor or materials to the principal contractor or subcontractors in the prosecution of the work.</p> <p>Exceptions: Contracts under \$50,000.</p>	Sufficient security, but not less than 25 percent of contract amount.	
MINN. STAT. § 574.26	<p>Performance Bond: For the use and benefit of the public body to complete the contract according to its terms, and conditioned on saving the public body harmless from all costs and charges that may accrue on account of completing the specified work.</p> <p>Payment Bond: for the use and benefit of all persons furnishing labor and materials engaged under, or to perform the</p>	DOT may set amount at between 75 and 100 percent of contract amount.	

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