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 are 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]

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 forfeiture[12] 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]

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[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 $1).

[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); CORBIN, *supra* note 1, § 946. 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 WILISTON ON CONTRACTS § 805 (3d ed. 1962); Granite Constr. Co. v. United States, 962 F.2d 998 (Fed. Cir. 1992), *cert. denied*, 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 & Ruth Brelaver, *Liquidated Damages in Federal Government Contracts*, 47 B.U.L. REV. 71 81–82 (1967); Robert S. Peekar, *Liquidated Damages in Federal Constructions 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. den.*, 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. Common Contract Disputes

Transportation projects are complex undertakings that often create conflicts and misunderstandings. Claims and disputes cannot always be avoided. Today's contract disputes may involve right-of-way, environmental issues, different site conditions, delays caused by change orders, interferences, extra work, stop orders, utility relocation, ambiguous contract provisions, changes in design and specifications, extra work, conflicts with other contractors, shop drawing and approval delays, permit conditions, and liquidated damages. Research by the construction industry has found that construction disputes arise from three major sources: project uncertainty, process problems, and people issues.[15]

4. 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.[16]

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.[17] 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.[18] The application of the "cost to remedy" rule will not apply where the cost would be so clearly unreasonable as to constitute "economic waste."[19] However, the doctrine of economic waste does not apply where the defects or omissions affect the integrity of the structure.[20] 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.[21] In the 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.[22] But some courts have denied the contractor any recovery.[23]

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.[24] A refusal by the owner to allow the contractor a reasonable opportunity to correct the defects is a breach and may waive the defects.[25]

The determination of damage of lost value of the work has often been difficult.

An important analysis of damages in the construction context is provided by *Commercial General Contractors, Inc. v. United States*.[26] In that case, the U.S. Army Corps of Engineers had contracted with Commercial General (CCI) to build portions of a flood control channel, which involved excavation, pouring of concrete, and backfill. After completion of the work, CCI filed several claims for extra compensation, and the government counterclaimed, asserting violation of the False Claims Act. Although this particular case involves false claim issues, it also provides an excellent discussion of the issues surrounding damage determinations.

The Federal Circuit court found that CCI had built the channel shorter than specified in the contract to avoid difficult work, and had knowingly submitted false

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[15] Former FHWA Federal-Aid Highway Program Manual of 1991, at 38. For additional background on this publication and its current equivalent, *see* Section 1 of this volume, at note 12 and accompanying text. *See also* FHWA Federal Policy Guide available at http://www.fhwa.dot.gov/legsregs/directives/fapgtoc.htm, last accessed July 22, 2012.

[16] 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).

[17] 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).

[18] Granite Constr. Co. v. United States, 962 F.2d 98 (Fed. Cir. 1992), *cert. den.*, 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).

[19] 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).

[20] *Id*.

[21] 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").

[22] 13 AM. JUR. 2D *Building and Construction Contracts* § 84; Annotation, 41 A.L.R. 4th 131.

[23] *See* cases collected in Annotation, 41 A.L.R. 4th at 139–42.

[24] Hartford Elec. Applicators of Thermalux, Inc. v. Alden, 363 A.2d 135 (Conn. 1975).

[25] Carter v. Kruger, 916 S.W.2d 932 (Tenn. Ct. App. 1995).

[26] 154 F.3d 1357 (Fed. Cir. 1998); cited and discussed in FALSE CLAIMS IN CONSTRUCTION CONTRACTS, FEDERAL, STATE AND LOCAL 74–75 (Charles M. Sink & Krista L. Pages eds., American Bar Association, 2007).

claims for the noncompliant work. The court further found that CCI had knowingly backfilled the channel with construction debris, contrary to the prohibition in the contract, and had improperly heated concrete test cylinders and knowingly submitted claims for work violating contract quality requirements.

The trial court indicated that if it was not possible for the injured party to prove the loss of value caused by the contractor's deficient performance, damages could be computed on an alternative basis. The CCI court indicated it was difficult to determine the loss of value because no competitive private-sector market exists for flood control channels that would establish commercial prices or values for such channels. The court focused instead on the cost to remedy the construction defects, determined that the damages for the improperly shortened channel should be measured by the full cost to repair the channel, and determined that damages for the improper use of debris backfill would be the full cost of removing the construction debris and rebuilding the affected sections of the channel.[27]

The Federal Circuit affirmed the trial court's findings on the majority of damages, but reversed the trial court's decision on damages for defective concrete testing, stating that

> an injured party is not entitled to recover the full replacement costs for any deviation from the exact terms of the contract, however minor. In the unusual case in which actual cost cannot be ascertained, the injured party may recover the replacement cost, but only, if that cost is not clearly disproportionate to the probable loss in value caused by the defects in question.[28]

The appellate court reversed the trial court's damage award on damages for defective concrete testing because the government was unable to show that the quality control violations affected the structural integrity of the channel, and the cost of tearing down and rebuilding the affected portions was clearly disproportionate to the probable loss in value caused by CCI's deficient work.

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.[29]

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 applied to the unit bid price, reducing the amount paid for the work.[30]

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.[31] 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.[32] In this regard, care should be taken in justifying and quantifying the liquidated damage provisions.[33]

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[27] *Id*. at 1372.

[28] *Id*. at 1373-75.

[29] Black Top Paving Co. v. Department of Transp., 466 A.2d 774 (Pa. Commw. 1983) (credit assessed for nonconforming work).

[30] 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.

[31] 593 N.E.2d 487 (Ohio Ct. Cl. 1990).

[32] State of Ala. Hwy. Dep't v. Milton Constr. Co., 586 So. 2d 872 (Ala. 1991).

[33] FINCH, *supra* note 30, at 1582, n.83.

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.[34]

Standard contract provisions in all New York State contracts provide for an administrative set off. The N.Y. provision provides:

> The State shall have all of its common law, equitable and statutory rights of set–off. These rights shall include, but not limited to, the State's option to withhold for the purposes of set-off, any monies due or that may become due to the Contractor under this Contract up to any amounts due and owing to the State under this Contract, any other Contract with any State department or agency, including any contract for a term commencing prior to the term of this Contract, plus any amount due and owing to the State for any other reason including, without limitation, tax delinquencies, or monetary penalties relative thereto. The State shall exercise its set-off rights in accordance with normal State practices, including, in case of set-off to an audit, the finalization of such audit to the appropriate State agency, its representatives, or the New York State Comptroller.[35]

Wisconsin DOT administratively exercises its common law rights to set off without specific contract authority. NCHRP Legal Research Digest 55, *Identification, Prevention, and Remedies for False Claims in Highway Improvement Contracting*, recommended consideration be given to modifying standard contract provisions to include express contractual authorization for recouping of costs of false claim investigative efforts through appropriate deduction from contract payments.

The right extends to setoffs between separate contracts that the owner has with the contractor.[36] The deduction may be made even though the debt owed by the contractor is unliquidated and arose from a separate transaction.[37] 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.[38] Deductions should be reasonably prompt so that the contractor's position with its subcontractors is not prejudiced.[39]

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.[40] "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."[41] The government, however, is entitled to setoff debts owed by the original contractor against contract proceeds claimed by the surety under its payment bond.[42]

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.[43] Whether a surety can enforce that right against a state agency holding retainage depends upon whether the state has waived sovereign immunity.[44]

5. 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 the engineer for state construction contracts,[45] and in

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[34] 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).

[35] Office of the New York State Attorney General, Schedule A, Required Clauses [for State contracts].

[36] 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).

[37] 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 (Md. 1947) and Eyer v. Richards & Conover Hardware Co., 55 P.2d 60 (Okla. 1936).

[38] Philco Constr. Co., DOTCAB 67-33, 68-2 BCA ¶ 7110 (1968).

[39] 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).

[40] 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).

[41] Morrison Assur. Co., *id*. at 632.

[42] United States v. Munsey Trust Co., 332 U.S. 234 (1947).

[43] Nat. Sur. Corp. v. United States, 118 F.3d 1542 (Fed. Cir. 1997).

[44] 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.

[45] 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).

the contracting officer for federal construction contracts.[46]

As a general rule, the Federal Government and state governments are not bound by the unauthorized acts of their representatives.[47] 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.[48]

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.[49] Ratification occurs when the ratifying contract official has knowledge of the unauthorized acceptance and expressly or impliedly approves the acceptance.[50] 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.[51]

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.[52] The contractor is entitled to perform in accordance with its interpretation of the contract, provided that its interpretation was reasonable.[53]

6. 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.[54] Only patent defects are waived; latent defects survive acceptance because they are unknown and therefore cannot be voluntarily waived.[55]

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.[56] 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.[57]

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.[58]

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 defect by accepting the work without reservation.[59] "Anti-waiver" clauses reveal the intent of the parties to

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[46] 48 C.F.R. 43.102(A).

[47] 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).

[48] Noel v. Cole, *id*.; Williams v. United States, *id*.

[49] Dan Rice Constr. Co. v. United States, 36 Fed. Cl. 1 (1996); Dolmatch Group Ltd. v. United States, 40 Fed Cl. 431 (1998).

[50] Aero-Arbe, Inc. v. United States, 39 Fed. Cl. 654 (1997); Williams v. United States, 127 F. Supp. 617 (Ct. Cl. 1995).

[51] 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).

[52] Canupp Trucking, Inc., Comp. Gen. Dec., B-261127 (1996).

[53] Constructors Metric, Inc. v. United States, 44 Fed. Cl. 513 (1999) (court rejected contractor's interpretation of specifications as unreasonable).

[54] 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).

[55] 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).

[56] 48 C.F.R. ch. 1, 52.246-12; Georgia DOT Standard Specification 107.20; Arkansas DOT Standard Specification 107.20.

[57] United States v. Lembke Constr. Co., 786 P.2d 1386 (9th Cir. 1986).

[58] Nebraska DOT Standard Specification 107.18; Washington DOT Standard Specification 1-07.27.

[59] V.P. Owen Constr. Co. v. Dunbar, 532 So. 2d 835 (La. App. 1988).

eliminate the binding effect of final acceptance of the work.[60]

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.[61] 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.[62] 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.[63]

7. 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.[64] 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 reasonable diligence, that it had a claim for which relief from a court could be sought.[65]

A statute of repose begins to run from a certain event specified in the statute.[66] 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.[67] Once the statutory time period has elapsed, the claim is extinguished and cannot be revived.[68] 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."[69]

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.[70] 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.[71] In short, time ran out before the owner had an opportunity to pursue relief for the defect.[72]

Whether a particular statute is a statute of limitations or a statute of repose is a question of statutory construction.[73] 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.[74]

> 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 specified 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.[75]

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[60] Metropolitan Sanitary Dist. of Greater Chicago v. Anthony Pontarelli & Sons, Inc., 288 N.E.2d 905, 915 (Ill. App. 1972).

[61] 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 16 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.

[62] Harris v. Williams, 679 So. 2d 990 (La. App. 1996).

[63] M.A. Mortenson & Co. v. United States, 29 Fed. Cl. 82 (1993).

[64] Corkill v. Knowles, 955 P.2d 438 (Wyo. 1998); Cheswold Volunteer Fire Co. v. Lambertson Constr. Co, 462 A.2d 416 (Del. Super. 1984).

[65] 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).

[66] 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).

[67] *See* table in subpart 60, *infra*, listing events that trigger the statutes.

[68] Com. v. Owens-Corning Fiberglass Corp., 385 S.E.2d 865 (Va. 1989).

[69] *Id*. at 867. *See* Monson v. Paramount Homes, Inc., 515 S.E.2d 445 (N.C. App. 1999).

[70] *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).

[71] Com. v. Owens-Corning Fiberglass Corp., 385 S.E.2d 865 (Va. 1989).

[72] Funk v. Wollin Silo & Equip., 435 N.W.2d 244 (Wis. 1989); Corkill v. Knowles, 955 P.2d 438 (Wyo. 1998).

[73] Smith v. Liberty Nursing Home, Inc., 522 S.E.2d 890 (Va. App. 2000).

[74] Corkill v. Knowles, 955 P.2d 438 (Wyo. 1988); Com. v. Owens-Corning Fiberglass, 385 S.E.2d 865 (Va. 1989).

[75] 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

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.[76] Second, the statutes denied open access to the courts,[77] without expressing a strong public necessity for the provision.[78] 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.[79]

Several states have reenacted their repose statutes, after the statutes were declared unconstitutional, specifically spelling out the public necessity for their creation.[80] 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) undue 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. [81]

The reenacted Florida and Utah statutes have been held constitutional.[82] These jurisdictions now follow the majority of state courts, which hold that statutes of repose are constitutional.[83] One study has revealed that the vast majority of claims brought for design defects were brought within 10 years after the improvement was completed.[84]

c. Nullum Tempus

Under the common law doctrine of *nullum tempus*,[85] a state and its agencies were exempt from statutes of limitations generally applicable in civil lawsuits between private parties.[86] Historically, the *nullum tempus*

(Fla. 1991); Craftsman Builder's Supply v. Butler Mfg., 974 P.2d 1194, 1202 (Utah 1999).

[76] 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.

[77] Thirty-eight states have open court provisions in their constitutions. Craftsman Builder's Supply v. Mutler Mgf., 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.

[78] *See* Overland Constr. Co. v. Sirmons, 369 So. 2d 572 (Fla. 1979).

[79] 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).

[80] FLA. STAT. 95.11(3)(c)(1980); WIS. STAT. ANN. 893.89 (1982); UTAH CODE ANN. § 78 – 12-25.5 (1996).

[81] 974 P.2d 1194, 1199 (Utah 1999).

[82] 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).

[83] 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).

[84] 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).

[85] *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).

[86] 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. &

doctrine was based upon sovereign power and prerogative.[87] 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."[88]

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.[89] A number of states, however, have taken a different tack by abrogating the *nullum tempus* doctrine, either statutorily or though 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.

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).

[87] People v. Asbestospray, 616 N.E.2d 652, 654 (Ill. App. 1993); United States v. Thompson, 98 U.S. 486, 489 (1878).

[88] 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).

[89] 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	*NULLUM TEMPUS* 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: *Shootman v. Dept. of Trans*., 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. *People v. Asbestospray Corp*., 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. *State ex rel Schneider v. McAfee*, 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. *See Louisville & N.R. Co. v. Siler*, 186 F. 176 (C.C.E.D. Ky. 1911).	Within 10 years from completion. REV. STAT. 413.120.
Massachusetts	GEN. L. 260.18 (1902). *See Com. v. Owens-Corning Fiberglass Corp*., 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). *See City of St. Paul v. Chicago M. & St. P. Ry. Co.*, 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: *N.J. Ed. Facilities Auth. v. Gruzen Partnership*, 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 State v. Cruz Constr. Co*., 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. *Rowan County Bd. of Educ. v. United States Gypsum Co*., 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: *State ex rel. Condon v. City of Columbia*, 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). *Univ. of Vermont v. W.R. Grace & Co.* 565 A.2d 1354 (Vt. 1989).
Virginia	Expiration of the period in statute of repose extinguishes cause of action, preventing state from maintaining suit. *Com. v. Owens-Corning Fiberglass Corp.,* 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 *Bellevue School Dist. No. 405 v. Braizer Const. Co*., 691 P.2d 178 (Wash. 1984), which had applied *nullum tempus*.	Within 6 years after substantial completion of construction. REV. CODE 4.16.310 (1988). See *Gevaart v. Metro Constr. Inc*., 760 P.2d 348, 350 (Wash. 1988), discussing how the 6-year period can be extended.
West Virginia	CODE 55-2-19 (1923). *Gibson v. Dept. of Highways*, 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,[90] 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.[91]

8. 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.[92] 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.[93] 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.[94]

Typically, these clauses excuse the contractor from responsibility for damages to the work caused by any of the events listed in the clause.[95] 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.[96]

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.[97] Because they do not have a market value, the usual rules for determining damages to real property improvements do not apply.[98] If the damage to the structure can be repaired without affecting its integrity and safety, the measure of damages is the cost of repair.[99] If the structure is destroyed, the proper

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[90] 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).

[91] 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).

[92] 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*.

[93] The cost to procure and maintain insurance may be high where the project is located in an area subject to severe storms or earthquakes.

[94] *Force majure* clauses allocate risk. Chase Precast Corp. v. John J. Paonessa Co., 566 N.E.2d 603 (Mass. 1991) (*force majure* 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.

[95] 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).

[96] Reece Constr. Co. v. State Highway Comm'n, *id*.; Appeal of Norla Gen. Contractors Corp., ASBCA No. 5695, 59-2 BCA (CCH 2474).

[97] Shippen Township v. Portage Township, 575 A.2d 157 (Pa. Commw. 1990). Annotation: 31 A.L.R. 5th 171 (1995).

[98] 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).

[99] United States v. State Road Dep't of Fla., 189 F.2d 591 (5th Cir. 1951).

measure of damages is the replacement cost of a similar structure, consistent with current design standards.[100]

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 the bridge are inapplicable in calculating damages.[101] Under the other rule, damages are calculated by taking into consideration the structure's age, utility, and condition.[102] 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.[103] Liquidated damages for the delay in project completion may also be recoverable.[104] 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.[105]

9. 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.[106]

Research has found little use of letters of credit to replace performance bonds. However, many design-build and PPP projects are now using letters of credit or 50 percent performance bonding, as discussed in Section 1 of this study.[107]

Essentially, the performance bond is a tripartite agreement composed of the principal (the contractor), the obligor (the surety), and the obligee (the owner).[108] The performance bond protects the owner when the contractor it has retained fails to perform in whole or in part.

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 protects the owner.[109] 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.[110] 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.[111] A performance bond and a payment bond may be separate instruments,[112] or combined into one instrument.[113]

All conditions precedent specified in a performance bond must be satisfied before the surety's obligation can mature. One of the most significant is the requirement that the owner provide clear notice of default prior to terminating the contractor's rights under the contract. A failure to provide notice would be fatal to asserting a claim under a performance bond.

The terms of the performance bond are of critical importance in the relationship between the surety, obligee (owner), and principal. Performance bond forms should be reviewed and updated by state DOTs or other owners to specify as clearly as possible the surety's options, obligations, and time periods for action. Ancient bond terminology such as "know ye all present…" should be eliminated to reflect the clear purpose of the performance bond: to secure performance and completion of the contract in event of a default. Many bonds forms currently in use omit the word "performance" from the standard form, which may prove problematic in the event of seeking to enforce substitute performance by the surety.

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[100] Department of Transp. v. Estate of Crea, 483 A.2d 996 (Pa. Commw. 1977); Annotation 31 A.L.R. 5th 171 (1995).

[101] 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).

[102] 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).

[103] *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).

[104] Southeast Alaska Constr. Co. v. State, 791 P.2d 339 (Alaska 1990).

[105] 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).

[106] *See* table in § 2.C, *supra*.

[107] *See, e.g.*, *infra* § 1(d), notes 514 through 517 and accompanying text, of this volume.

[108] Federal Ins. Co. v. United States, 29 Fed. Cl. 302 (1993); Gates Constr. Inc. v. Talbot Partners, 980 P.2d 407 (Cal. 1999).

[109] 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).

[110] Morrison Assurance Co. v. United States, *Id*.

[111] J.S. Sweet Co. v. White County Bridge Comm'n, 714 N.E.2d 219 (Ind. App. 1999).

[112] Miller Act, 40 U.S.C. *et seq*.

[113] *See, e.g.*, WASH. REV. CODE § 39.08.010.

NYSDOT bond forms provide that the surety, if requested by the State DOT, has the option to remedy the default, or take charge and fully perform and complete the work pursuant to the terms and conditions of the contract. The bond further provides that the procedure by which the surety undertakes to discharge its obligation shall be subject to advance written approval of the State DOT. The bond requires notice of the surety's election to remedy the default or perform and complete the contract within 45 days after receipt of notice from the State DOT.

The NYSDOT bond forms further provide that in the event the surety fails to exercise its options, then the State DOT shall give 10 days' notice to the surety and have the work completed pursuant to the provisions of Section 40 of the State's Highway Law. The bond also provides that the surety has the obligation to pay all damages that may result from failure to perform, and to complete the contract, including costs necessary to protect the traveling public, liquidated damages, engineering charges, and all repair and replacement costs necessary to correct construction errors.[114]

After a claim or demand is made on the surety, it has the obligation to make an independent investigation of the situation and determine how to proceed. There is an implied obligation of "good faith and fair dealing" between the surety and obligee.[115] The owner has the obligation to make available pertinent records that will assist the surety in its investigation. The surety should be given access to basic project records, including payment requisitions, retainages, liens, adjusted contract price amounts to date, contract balances, project schedules, time extensions, and other contract documents. The obligee should permit the surety or its expert consultants to visit the project site and discuss basic project information with engineering staff. Delays and denial of record requests often can delay the surety's investigation, and thus delay ultimate project completion.

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.[116]

Once the surety has completed its investigation, and has considered all the issues, it must decide whether or not to perform, and then communicate its decision to the owner. If the surety decides not to perform, it will prepare to defend its decision in the litigation that will inevitably result. If it decides to perform, it has numerous options.

One of the low-cost options for the surety is to finance the principal's (contractor's) completion of the project by paying its bills as they accrue, if the principal is still in operation and capable of performance. This is an attractive option to the surety if the majority of the work is already complete, if the owner has made no complaints about the quality of the principal's (contractor's) work, and if the surety believes that the default was caused by financial difficulties.[117]

Another option for the surety is a "takeover," driven by the surety's determination that the principal's completion of the contract is no longer possible or prudent. In the takeover, the surety agrees to complete the contract using a different completion contractor. Of most significance, once the surety agrees to take over the contract, its ultimately liability will not be limited to the penal sum of the bond. The surety seeks the owner's approval of a "takeover" agreement. The takeover agreement defines the surety's activities and current and future obligations. The surety will usually demand that provisions in the takeover agreement limit its liability to the penal sum, which is contrary to the general rule that once the surety undertakes to complete the work it is liable for all the cost of completion.[118] Public owners have been successful in not agreeing to this penal sum limit, or agreeing to a provision that preserves all parties' positions for future litigation.

Government attorneys, especially those in agencies which do a high volume of construction business, are in a unique and powerful position in negotiating takeover agreements with surety companies. If negotiations are unsuccessful, and litigation ensues, this could place the surety in jeopardy for existing and future relationships, by placing at risk the surety's ability to continue providing performance bonds acceptable to the agency on future projects.

In *Fidelity & Deposit Co. of Md. v. Bristol Steel & Iron Works, Inc.*,[119] for example, the state highway department defaulted the contractor for his refusal to make repairs on a bridge reconstruction project. The surety denied liability and the highway department disqualified the surety from bonding future state contracts. Subsequently the surety settled with the state and sought indemnification against the principal contractor. The court determined that the surety acted with utmost good faith in protecting the interest of the contractor.[120] In summary, government attorneys should exercise their discretion carefully and responsibly in protecting the public interest.

Terms of the takeover agreement should be closely reviewed by attorneys for the state DOT or other owner prior to execution to determine whether they alter the terms of the basic contract. Public owners are not re-

[114] NYSDOT Standard Specifications, § 103.00.

[115] DUNCAN L. CLORE, BOND DEFAULT MANUAL 31 (2d ed., American Bar Association).

[116] 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).

[117] CLORE, *supra* note 115, at 115.

[118] *Id.* at 179.

[119] Fidelity & Deposit Co. of Md. v. Bristol Steel & Iron Works, Inc., 722 F.2d 1160 (4th Cir. 1983).

[120] CLORE, *supra* note 115, at 237.

quired even to enter into a takeover agreement, especially if the terms of the contract and performance bond provisions are clear and unambiguous. The surety will seek waivers of liquidated damages, assurances that it will receive all future contract payments, and an amended contract completion date. These provisions should be given careful review so as not to affect the holders of previously filed liens, and other parties who may have rights to contract balances. Public owners often extend contract completion dates and reserve liquidated damage assessments to promote job progress towards the new completion date.

Another option available to the surety is to tender a sum of money to the obligee in full and final settlement of all claims. In some cases, this amount could be less than the penal sum of the bond. The tender ends the surety's obligation quickly and at a fixed cost.

An additional option for the surety is to fulfill its performance obligations by obtaining bids from other contractors to complete the work, and having the low bidder (new contractor) enter into a new contract with the obligee, with a new performance bond to complete the work, and/or paying the obligee its damages and/or the additional cost to complete with this new contractor. The surety would also obtain a full or partial release from the obligee. This would limit the surety's losses, and shift the risk of completion to a new completion contractor. This method is not in wide use by public entities, which fear the loss of federal participation in project costs because the new contractor may not have been chosen through federally mandated bidding requirements. A new completion contractor hired by the surety, however, must be licensed to perform the type of work necessary to complete the contract. 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. This procedure may also require serious negotiation over responsibility for defective work and latent defects, but has proven to be successful in non-federally funded projects.

In addition, 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.

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.

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.[121] The performance bond and the construction contract are read together to determine the surety's liability for a breach of the construction contract by the contractor.[122] 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.[123] A surety may be liable to the owner for latent defects that result from a breach of the construction contract by the contractor.[124]

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*,[125] 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,[126] although there is authority to the contrary.[127]

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,[128] 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.[129] Whether a surety's refusal to pay the owner's claim

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[121] *See* table, § 2.C, *supra*. Hunters Pointe Partners v. U.S.F. & G. Co., 486 N.W.2d 136 (Mich. App. 1992).

[122] 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).

[123] 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).

[124] *See* 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).

[125] 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.

[126] Pacific Employers Ins. Co. v. City of Berkely, 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).

[127] American Home Assurance Co. v. Larkin Gen. Hosp., 593 So. 2d 195 (Fla. 1992).

[128] 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).

[129] 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).

amounts to bad faith is a question of fact.[130] As noted earlier, the surety's liability may extend beyond the penal sum once it undertakes to complete the project or finance its completion using the principal.[131]

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,[132] few have enacted similar laws dealing specifically with performance bond sureties,[133] although most states have laws establishing a limitation period for actions against the payment bond.[134]

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.[135] However, unless prohibited by statute,[136] 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.[137] 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.

> [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.[138] (citations omitted).

Thus, most cases involving claims against the performance bond are governed by the limitation period specified in the bond.[139] 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 statue of repose has expired, barring the owner's claim against the contractor.[140] 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.[141]

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.[142]

After default termination, and during completion by the surety, public owners should refrain from making improvements to the existing contract work without additional compensation. If such improvements are

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[130] Loyal Order of Moose Lodge 1392, *id*.

[131] CLORE, *supra* note 115, at 116.

[132] *Latent Defects in Government Contracts Law*, 27 PUB. CONT. L.J., No. 1 (1997); *see* Table A, *supra*, this section.

[133] 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).

[134] 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—1 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 (1999). This article appears as a supplement in VOL. 3, SELECTED STUDIES IN HIGHWAY LAW.

[135] 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).

[136] 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.

[137] 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).

[138] 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).

[139] 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).

[140] 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 Statue of Limitations in Favor of Principal Does Not Exonerate a Surety*, 67 CAL. L. R. 563 (1979).

[141] 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).

[142] Restatement of Security § 128B; Continental Ins. Co. v. City of Virginia Beach, 908 F. Supp. 341 (E.D. Va. 1995).

made, a separate accounting should be kept, so as to avoid increasing improperly the surety's obligations under the performance bond on the original construction contract.

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.[143]

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.[144] In a similar fashion, sureties usually require contractors to sign a general indemnity agreement in favor of the surety.[145] 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.[146]
>
> ....
>
> 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.[147] 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.[148]

But what if it's not clear as to whom the owner should pay? An owner caught in a dispute between the 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.[149]

ii. Disputes Over Contract Proceeds Between the Owner and the Surety.—An owner's right to a setoff[150] 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.[151] However, the authorities differ on whether the owner's right is superior to the surety's subrogation rights under its performance bond.[152] 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.[153] Whether the surety can enforce that right against a state agency may depend upon whether the state has waived sovereign immunity.[154]

10. 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.

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[143] Mergentime Corp. v. Washington Metro. Area Transit Auth., 775 F. Supp. 14 (D.D.C. 1991).

[144] Alaska State Bank v. Gen. Ins. Co. of America, 579 P.2d 1362 (Ak. 1978).

[145] 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).

[146] 579 P.2d at 1364.

[147] *Id*.

[148] Transamerica Ins. Co. v. Barnett Bank of Marion County, 524 So. 2d 439 (Fla. App. 1988).

[149] 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*.

[150] *See* § 7.A.3.D, "Administrative Setoff," *supra*.

[151] United States v. Munson Trust Co., 332 U.S. 234 (1947).

[152] 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).

[153] 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).

[154] 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*.

Failure to perform those duties is a breach of contract.[155]

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.[156] Generally, negligence must be proved by expert testimony,[157] unless the act or omission is so obvious that lay persons can easily recognize the act or omission as negligent.[158]

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.[159] 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.[160]

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.[161] 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.[162]

11. Indemnity and Insurance Requirements

a. Indemnity

Most owners employ indemnity provisions in their construction contracts.[163] Such provisions protect the owner by requiring the contractor to indemnify the owner against all claims arising from the performance of the contract.[164] An example of a general indemnity clause is the standard provision used by the Maryland State Department of Transportation in its construction contracts.[165]

> 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.[166] Some states, however, have enacted anti-indemnification statutes, which prohibit the use of such clauses in construction contracts.[167] The following is an example of this type of statute:[168]

> A covenant, promise, agreement or understanding in, or in connection with or collateral to a contract or agreement

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[155] 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).

[156] *Id*.

[157] 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).

[158] Hull v. Engr. Constr. Co., 550 P.2d 692 (Wash. App. 1976); Town of Breckenridge v. Golforce Inc., 851 P.2d 214 (Colo. App. 1992).

[159] St. Joseph Hosp. v. Corbetta Constr. Co., 316 N.E.2d 51 (Ill. App. 1974); Lochrane Engr., Inc. v. Willingham Realgrowth Inv. Fund, Ltd., 552 So. 2d 228 (Fla. App. 1989).

[160] *Id*.

[161] Indemnification requirements are discussed in the next subpart of this section.

[162] Those limitations affecting indemnification are also discussed in the next subpart.

[163] 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.

[164] Smith v. Cassadago Valley Cent. Sch. Dist., 578 N.Y.S.2d 747 (N.Y. A.D. 1991).

[165] 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).

[166] 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).

[167] 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).

[168] 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).

> 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. Typically, the clause will limit liability to a fixed dollar amount specified in the clause.[169]

Generally, such clauses are enforceable.[170] However, their enforceability may be affected by an anti-indemnification clause. In *City of Dillingham v. CH2M Hill Northwest, Inc*.,[171] the court held that a limitation of liability clause in an engineering services agreement was invalid under the Alaska anti-indemnification statute,[172] because the statute prevented the indemnitor from limiting its liability for its negligent acts.

In *Valhal Corp. v. Sullivan Associates*,[173] 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.

Standard insurance provisions require that the insurance be in place continually and without lapse from beginning of work until contract final acceptance, and cover all the operations under the contract, whether performed by the contractor or any subcontractors. Transportation agencies usually obtain and rely on the certificate of insurance furnished by the insurance carrier's authorized agent, although they may obtain full copies of the insurance policy.

New York State has experienced many disputes with insurance carriers disclaiming coverage in connection with tort claims litigation arising from work site construction accidents or work zone vehicular accidents. NYSDOT requires that insurance companies be authorized to do business in the State by the New York State Department of Financial Services (the agency resulting from the merger of the former State Insurance Department and State Banking Department), and have an A.M. Best Company rating of (A-) or better approved by that Department.[174] Nonauthorized carriers may submit documentation required by the Insurance Department regulations and may be permitted at the discretion of NYSDOT.

NYSDOT's Standard Specifications require that satisfactory evidence of such policies shall be delivered to NYSDOT prior to the commencement of work, provide for certificates of insurance in a form satisfactory to the Commissioner of Transportation, and authorize immediate issuance of stop-work orders in the event of any lapse in insurance coverage. NYSDOT does not accept the use of the commonly used "Accord" certificate of insurance form, but requires the use of its own certificate form, signed by authorized representative of the insurance carrier. NYSDOT also specifies the policy form must be written on an occurrence basis, but will accept a form written on a claims-made basis if certain conditions are met. The NYSDOT insurance certificate requires disclosure of any deductible, self-insured retention, or any exclusions in the policy that materially change the contract coverage.

c. Self-Insured Retention

Contractors, in order to save on premiums, may obtain policies that have deductibles or self-insured retention provisions. Permitting contractors to have deductibles or self-insured retention has created some obstacles and difficulties for claimants seeking claim adjustments. NYSDOT has developed a system that permits contractors to adopt a self-insured retention program. NYSDOT provisions require prior approval of the program. Such programs are limited to $100,000 or the amount of the bid deposit, whichever is less. New York requires that security for such programs be deposited to assure payment of both the self-insured limit and the cost of adjusting claims. The contractor is solely responsible for all claims, expenses, and loss payments within any permitted self-insured retention or permitted deductible program. If the contractor's self-insured program exceeds the amount of the bid deposit, it is required to submit an irrevocable letter of credit or collateral to guarantee its obligation. If NYSDOT determines that the contractor is not paying the deductible or self-insured retention on any of its policies, it may withhold payments.[175]

The most commonly required type is liability insurance, protecting the insured against liability for third-party claims that result from construction activities.[176]

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[169] 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).

[170] Vahal Corp v. Sullivan Assocs., *id.*

[171] 873 P.2d 1271 (Alaska 1994).

[172] ALASKA STAT. § 45.45.900.

[173] 44 F.3d 195 (3d Cir. 1995).

[174] NYSDOT Standard Specifications 107.06.

[175] *Id*.

[176] 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 con-

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.[177]

Additional insurance requirements include subcontractor liability insurance, workers' compensation, builders' risk of damage to structures or buildings, railroad protective liability, professional liability for errors and omissions, and commercial auto liability insurance.

d. 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) insurance[178] and owners and contractors protective insurance, in which the owner is the insured.[179] Both forms of insurance are based on occurrence coverage.[180] 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.[181]

The specifications requiring insurance may require that the owner be named as an additional insured on the contractor's CGL policy.[182] The specification may also require that in addition to the agency, the agency's officers and employees must also be named as additional insureds. [183] The insurance limit ranges from $1 million to $5 million depending upon the size of the project. 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.[184] The limits for owners and contractors protective insurance are usually the same as the limits specified for CGL coverage.[185] The specifications may require the contractor to obtain liability insurance on standard forms published by the Insurance Services Office (ISO), a national organization that provides services to the insurance industry.[186]

NYSDOT's Standard Specifications require specific ISO forms for coverage for commercial general liability, products completed operations, and blanket Pollution Liability. In addition, the coverage must also include Explosion Collapse and Underground Hazard coverage for contracts that involve excavation, underground work, and/or the use of blasting equipment.

In addition to the basic CGL policy, N.Y. requires a separate dedicated Special Protective and Highway Liability Policy for the State of New York, using a separate ISO form with separate liability amounts to cover liability for the State of N.Y. for any damages the insured may be held liable for. Such protective liability coverage for the owner must expressly and specifically include all of its individual officers and employees as well as the owner as an organization. This can be of considerable importance if a claimant sues the owner's officers and employees individually and seeks to recover from their personal assets.

In the absence of such express and specific requirements, individual engineers, inspectors, or others employed by the owner can be sued individually in their personal rather than official capacity, placing their personal assets at risk without insurance to cover them. In New York, a construction worker suffered permanent disabling injuries in a construction work zone vehicular accident. He then discovered that the construction contractor had failed to pay its insurance premiums and did not have either liability or Workers Compensation coverage in effect. His lawyers sued to commence federal diversity jurisdiction tort litigation against individual NYSDOT officers and employees, as well as seeking to pursue state claims litigation against the

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tractors to obtain liability insurance, not all of them require their design consultants to obtain professional errors and omissions (E&O) coverage. *Id*.

[177] Annotation, *Builder's Coverage Under Builder's Risk Insurance Policy*, 97 A.L.R. 3d 1270 (1980).

[178] 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).

[179] Colorado (Standard Specification 1-07-15) and Washington (Standard Specification 1.07.18) are examples of states requiring OCP coverage in addition to CGL coverage.

[180] The specifications listed in note 178, *supra*, are examples of specifications requiring liability insurance based on "occurrence" coverage.

[181] 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.

[182] Colorado Standard Specification 1-07.15.

[183] California Standard Specification 7-1.12 B.

[184] 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).

[185] Colorado (Specification 1-07.15) and Washington (Specification 1-07.18) are examples.

[186] 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.

owner.[187]

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.[188] 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.[189]

e. Builder's Risk Insurance

This form of insurance provides coverage for damage to the improvements during the course of construction.[190] Coverage may be limited by specific exclusions in the policy.[191] 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."[192]

f. Use of Industry "Accord" Form or Other Forms

Many state transportation agencies rely on the standard insurance industry "Accord" form. The form states: "This certificate is issued as a matter of information only and confers no rights upon the certificate holder….This certificate of insurance does not constitute a contract between the issuing insurer(s), authorized representative or producer and the certificate holder." The form specifically states it is information only, and cannot be relied upon as proof of insurance. In the event of litigation arising from an occurrence on a project for which an Accord form certificate has been used, the insurance carrier will typically limit coverage to the specific terms and limitations set forth in its policy as opposed to the certificate. The policy typically authorizes cancellation of coverage without notice in the event of nonpayment of premiums, and provides for large deductibles. The policy is also typically limited to coverage of the contractor alone, and fails to include coverage of the owner or the owner's individual officers or employees. Even if someone has filled in the Accord form with recitations of no cancellation of coverage without prior notice to the owner, and with coverage of the owner and the owner's individual officers and employees as well as the contractor, the insurance carrier will typically disclaim being bound by such recitations even if the Accord certificate has been issued by the carrier's authorized agent, pointing to the form language that "This certificate is issued as a matter of information only and confers no rights upon the certificate holder."

NYSDOT does not permit the use of the Accord form, and requires a certificate of insurance satisfactory to NYSDOT to be filled out by the insurance carrier's authorized representative or producer, although this has met with resistance from the insurance industry and complaints to the New York State Department of Financial Services (the agency resulting from the merger of the former State Insurance Department and State Banking Department). The form is required to be submitted before the contractor will be allowed to commence any work under the contract. The form requires that it be acknowledged before a notary public, requires disclosure of additional insureds and named insureds, and expressly references the inclusion of all required

[187] The manner in which lack of express language requiring protective liability coverage of the owner's individual officers and employees can result in litigation against such officers and employees is illustrated by Mohammed v. Farney et al., one of multiple cases arising from a NYSDOT highway project.

The cases resulted from a highway work zone vehicular incident, in which an uninsured motorist inflicted permanent disabling injuries upon a construction worker and then fled. When the State notified the contractor's insurance carrier, the carrier disclaimed any responsibility, asserting that it had cancelled all insurance coverage without notifying the owner (the State) as required by the insurance certificate, because the prime contractor had failed to pay its insurance premiums.

This allowed the disabled worker to pursue civil litigation, because the insurance carrier refused to honor the contractor's Workers' Compensation coverage. Rather than merely suing the State in its Court of Claims, the attorneys for the disabled construction worker, who resided in an adjacent state, also filed roughly $20 million in federal diversity jurisdiction tort actions against the contractor, the contractor's personnel, and individual NYSDOT engineers and inspectors. The insurance carrier then additionally disclaimed any responsibility to defend or indemnify any individual state personnel, pointing to the absence of any express and detailed language in the insurance certificate requiring it to do so, as opposed to language requiring protective liability coverage for the State as an entity.

This situation was demoralizing for the state DOT engineers and inspectors who were sued as individuals. This was true even though legal defense and indemnification of the individual state personnel involved was eventually arranged, and the litigation against the State was ultimately settled (for somewhat less than $1 million), resulting in withdrawal of the federal litigation against the individual State DOT employees. This litigation also had a considerable disruptive effect upon the continued performance and completion of the project, which involved a major urban arterial expressway.

[188] Simon v. Shelter General Ins. Co., 842 P.2d 236 (Colo. 1992).

[189] 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).

[190] Annotation, *Builder's Coverage Under Builder's Risk Insurance Policy*, 97 A.L.R. 3d 1270 (1980).

[191] Safeco Ins. Co. of America v. Hirschmann, 773 P.2d 413 (Wash. 1987); Markman v. Hoefer, 106 N.W.2d 59 (Iowa 1960).

[192] Simon v. Shelter Gen. Ins. Co, 842 P.2d 236 (Colo. 1992).

endorsements.[193]

g. Pollution Exclusions

Many insurance policies have pollution exclusion provisions that delete or restrict coverage for environmental hazards, which may include asbestos removal, oil removal and other hazardous waste, and improper disposal of contaminated construction and demolition debris. The owner's attorneys should examine the insurance certificate or policy for such exclusions. If such coverages are needed, the state DOT or other owner should request the removal of such exclusions from the policy. Many public owners are unaware that pollution exclusions may be part of the contractor-furnished insurance policies. If the owner is aware that pollution hazards are likely to exist on the project (e.g., the known presence of asbestos in a building undergoing demolition), it should specifically require the contractor to obtain the Contractor Pollution Liability policy. Relying on the standard policy, which may contain such pollution exclusions, can only lead to coverage issues. If the policies contain such pollution exclusions, they must be noted on the certificate of insurance.

h. Owner Controlled Insurance Programs

Some state transportation agencies, motivated to find ways to reduce costs and control construction budgets, have turned towards the use of Owner Controlled Insurance Programs, especially for "mega projects."

Owner Controlled Insurance Programs (OCIP) or "wrap-up" insurance can be an effective way to improve safety and reduce the costs of insurance for large projects. The essential idea is to have one party, either the owner or the contractor, procure, maintain, and control the insurance coverage and services for all the parties.[194] Basic features of an OCIP are: 1) the owner purchases the insurance coverage to cover all contractors and subcontractors; 2) there is an integrated owner-contractor managed safety program; and 3) claims are centrally processed. OCIPs are able to achieve savings through the use of lower bulk insurance rates, improved safety management, and reductions in disputes between contractors as to who is liable for the loss.[195]

The advantages of the program are derived from the economies in purchasing coverage for all parties.[196] The coverage protects all parties for claims arising under worker's compensation, general liability, and excess or umbrella liability, but does not include coverage for performance bond claims. OCIPs can provide improved insurance coverage, enhanced contract and claims management, and possibly enhanced achievement of DBE goals. Owner's contract management is simplified since the owner will not have to track many policies with differing terms, conditions, effective dates, and limits. OCIPs also may promote safety by coordinating an effective safety program for the entire project. OCIPs on projects involving complex, high-risk construction, and in excess of $100 million in construction costs, represent significant opportunities for project cost savings.

Wrap-up insurance, which includes OCIPs and Contractor Controlled Insurance Policies (CCIPs), may also provide savings and improve claim management and loss control. If an OCIP is used, the transportation agency is responsible for procurement of an insurance broker and the creation of the OCIP program. The OCIP program will include all the general and professional liability and other insurance for the project. All contractors and subcontractors would be contractually required to participate in the program, and to delete insurance costs from their overhead. If a CCIP is used for a design-build project, the design–builder is required to provide an insurance program that covers the design-builder and its subcontractors. The design-builder would be responsible for administration of the CCIP and insuring that all subcontractors do not include insurance costs in their overhead.

OCIPs have been used on the Boston Central Artery Tunnel Projects ("Big Dig"), and on many of the larger projects for Caltrans, with much success. Caltrans has adopted a Rolling Owner Controlled Insurance Program (ROCIP) and issued a ROCIP program insurance manual for all contractors and subcontractors (with certain exceptions) who provide direct labor on the project site. The ROCIP provides general liability, completed operations coverage, excess liability, and worker's compensation for enrolled contractors. The ROCIP does not cover professional liability or other types of insurance required by the contractor or contract provisions. Caltrans pays the ROCIP premiums, and the contractor is required to submit cost documentation that supports the costs for insurance from the bid for the work. Caltrans has the right to audit the contractor's records to confirm that the costs of general liability insurance, excess liability insurance, and worker's compensation are not included in the original bid. The provisions further provide that failure of the contractor to comply with the ROCIP provisions shall entitle the department to suspend performance by the contractor or terminate the contract for cause. The provisions require the contractor to develop a Site Specific Safety Program, and to allocate a full time Safety Quality Control Manager for duration of the contract. Provisions for documentation, safety conditions, fall protection, and tool box safety meetings are also included.[197]

[193] NYSDOT Standard Specifications 107.06 A 3.

[194] James Evans, Owner-Controlled Insurance Programs: A Public Sector Perspective, ASSE Proceedings, June 1, 2011.

[195] Dwight A. Horne, Action: Owner Controlled Insurance Policy, Oct. 7, 2002, FHWA memorandum setting forth FHWA policy on OCIP, http://www.fhwa.dot.gov/programadmin/contracts/100702.cfm, last accessed on July 26, 2012.

[196] Evans, *supra* note 194.

[197] CalTrans Standard Specifications 5-1.13, Rolling Owner Controlled Insurance Program (ROCIP).

i. Failure to Obtain Insurance

The contractor's failure to obtain insurance, as required by the contract, is a breach, entitling the owner to damages.[198] 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.[199]

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.[200]

In N.Y., if it comes to the attention of NYSDOT that the required insurance is not in place, or that adequate proof of insurance has not been provided, the department may immediately issue a stop-work order suspending the work, withhold contract payments, or treat such failure as a breach of contract or default and terminate the contract.[201]

j. 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.[202]

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.[203]

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

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[198] 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).

[199] Homes v. Watson-Forsberg Co., 488 N.W. 473 (Minn. 1992); Jokich v. Union Oil Co. of Cal., 574 N.E.2d 214 (Ill. App. 1991).

[200] Batterman v. Consumers Illinois Water Co., 634 N.E.2d 1253 (Ill. App. 1994).

[201] NYSDOT Standard Specifications 107.06 A.

[202] 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*.

[203] DARRELL W. HARP, INDEMNIFICATION AND INSURANCE REQUIREMENTS FOR DESIGN CONSULTANTS AND CONTRACTORS ON HIGHWAY PROJECTS (NCHRP Legal Research Digest 37, Transportation Research Board, 1997).

consultant because of the instructions from the agency staff and the fusion of engineering functions.[204]

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.[205] 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.[206] 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.[207]

k. Recovery Against Design Professionals

The best protection state transportation agencies can have against liability to third parties for consultant liability for design errors and omissions is to provide contract provisions that assign responsibility to the consultant and contractor. At the federal level, 48 C.F.R. § 36.608 provides:

> Architect-engineer contractor shall be responsible for the professional quality, technical accuracy, and coordination of all services required under their contract. A firm may be liable for government costs resulting from errors or deficiencies in design furnished under this contract. Therefore when a modification to a construction contract is required because of an error or deficiency in the services provided under the architect–engineer contract, the contracting officer (with the advice of technical personnel and legal counsel) shall consider the extent the architect-engineer contractor may be reasonably liable.

Many state transportation agencies and the Army Corps of Engineers have adopted provisions in their design contract that provide that the designer is responsible for the professional quality, technical accuracy, and coordination of all design drawings, specifications, and other services. The standard provisions further provide that neither approval nor acceptance of, nor payment for, the services shall operate as a waiver of any rights, and the designer shall remain liable under applicable law for all damages.[208] Adopting similar requirements, together with requiring consultants to provide professional liability coverage for their errors and omissions, and requiring indemnification provisions, can serve to limit or avoid potential liability problems.[209] In any such situation, the consultant should be put on notice pursuant to the standard contract indemnification provisions. It is critically important that the transportation agency not pay the consultant to correct its design errors and omissions.[210] Clear identification of consultants' services and responsibilities will serve to protect the public agency if it expects to hold the consultant liable for its failures, errors, and omissions. In addition, federal regulations require state transportation agencies to set up a procedure for the review of design errors, omissions, or deficiencies.

Special attention should be paid to the blending of responsibilities between state and consultant personnel. This is especially true where the state DOT supplements its staff with consultant inspectors, as exemplified by the Oak Point Link Rail Project in New York State previously discussed.

Some recent cases shed light on how precedents on the liability of design professionals are evolving. Since most such cases are resolved through settlement without litigation to a final court decision, the majority of court decisions identified by our research involved rulings on motions rather than final decisions on the merits.

In a 2005 decision, *Lyndon Prop. Ins. Co. v. Duke Levy & Assoc. LLC*, the U.S. Court of Appeals for the Fifth Circuit reversed a decision that had granted summary judgment to an engineering firm in a case filed by a surety, alleging that the company was negligent in carrying out its inspection duties on a public construction project, and remanded the suit for further proceedings on the surety's negligence claim.[211] The surety had issued a performance bond for a contractor agreement to build a sewage treatment system for a water and sewer district. The engineering firm was hired to inspect the contractor's work, and to make recommendations on whether payments should be made to the contractor. The contract was terminated, and some of the work had to be redone. The surety paid for the project's completion. On appeal, the Fifth Circuit held that the surety could pursue an equitable subrogation claim, and that the fact that the sewer district did not ultimately suffer a loss, due to the surety's payment for completion of the project, was inconsequential. The

[204] *Id*. at 7.

[205] The agreement reserves, until a later time, the owner's rights against the designer and the designer's defenses against the owner.

[206] 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.

[207] The consensual nature of arbitration is discussed in the next subsection.

[208] Article 25 of NYSDOT Standard Design Agreement.

[209] HARP, *supra* note 203, at 7.

[210] Address of Eric Kerness, NYSDOT, Maintaining Control of Design Liability in Government Contracting, TRB 39th Annual Workshop on Transportation Law, July 2000.

[211] 475 F.3d 268; 2007 U.S. App. LEXIS 93 (5th Cir. 2007).

Fifth Circuit also held that an exculpatory clause in the company's contract was not sufficiently clear to act as a limitation of liability under Mississippi law, and that the sewer district could not bargain away the engineering firm's potential duty to the surety. Further, the Fifth Circuit ruled that the language of the engineering firm's contract showed that the firm had a duty to inspect the contractor's work before recommending payment, and noted that the surety had presented an expert's report articulating how the engineering firm had failed to use ordinary professional skills and diligence in doing so.

In a 2009 ruling, *Sewell et al. v. Barge, Waggoner, Sumner & Cannon, Inc., et al.*, a magistrate judge of the U.S. District Court for the Northern District of Alabama grappled with design liability issues arising from a highway accident.[212] The case involved catastrophic and permanent personal injuries incurred in a vehicular collision, which resulted from allegedly unsafe design of a highway intersection and traffic control devices. On cross motions for summary judgment, the magistrate judge recommended denial of plaintiff's motion for partial summary judgment because there were unresolved issues of material fact regarding liability that required determination by a jury; the judge also recommended that a motion for summary judgment by an engineering design firm be denied on the same basis, and recommended dismissal of a derivative claim filed by a relative, on statute of limitation grounds. Evidence in the case indicated that two vehicles could legally be in the intersection at the same time, creating a risk of collisions. The magistrate judge noted that the Manual of Uniform Traffic Control Devices (MUTCD) established standards for the design of intersections. The highway interchange involved in the case was not constructed exactly as designed, without the knowledge of the design firm. There was a factual dispute as to whether the design met MUTCD standards. Plaintiff's expert witness testified that the design did not meet applicable standards, was unsafe as designed, and was even more unsafe as built. The magistrate noted that the designer was not responsible for the timing of the traffic control devices once they were installed, and that timing of the four-way red light was insufficient to clear the intersection before lights turned green. The magistrate considered untenable the design firm's claim that it was absolved of liability merely because a design change was instituted without its knowledge during the construction phase of the project. The fact that the design had been changed in some manner did not, standing alone, automatically relieve the design firm of liability.

In a 2011 decision, *Matter of Fort Totten Metrorail Cases, lead case Jenkins v. Washington Metropolitan Area Transit Authority, et al.*, the U.S. District Court for the District of Columbia addressed design liability issues arising from a major crash on the Washington Metro system during 2009.[213] One of the defendants, Alstom, a firm that had been involved in construction of the Metro system both as a designer and as a manufacturer, moved for dismissal. The court held that a statute of repose barred design claims arising more than 10 years after manufacture. The court also ruled, however, that the statute of repose did not bar claims for manufacturing defects that were not discovered until years later.

In another 2011 decision, *Drew County, Arkansas v. Joh Pas Murray Co.*, the U.S. District Court for the Eastern District of Arkansas had to deal with design liability issues arising from a situation considerably complicated by confusion over the legal standards and procedures governing procurement of design and construction services for a hospital project.[214] A municipal hospital's managers entered into negotiations with an out-of-state contractor under some confusion over whether the contractor, not licensed in the state as an engineering firm and initially not licensed in the state as a contractor either, would be acting as a design-builder or as a construction manager at risk. The hospital's board authorized the project, and the contractor began the planning phase of the project before any contract was signed. The hospital broke off dealing with the firm after the hospital's attorney concluded that design-build projects were not authorized by state law. The hospital then turned the planning work product that had been delivered to date over to a licensed architectural firm. The contractor then sued for the value of the planning work that had been performed to date. The court found that while the firm might have violated state law against practicing engineering without a license, the state law prohibiting that did not preclude recovery for services performed on the basis of express or implied contract. The court denied the hospital's motion for summary judgment, granted the contractor's motion for partial summary judgment precluding some of the hospital's defenses, and ordered further proceedings.

In a 2010 decision, *SEPTA v. AECOM USA, Inc.,* the U.S. District Court for the Eastern District of Pennsylvania dealt with design liability issues arising from an urban rail project.[215] The owner had hired an A/E firm to design a rail reconstruction project. The A/E firm hired subconsultants. After problems developed, the owner sued the A/E firm for failure to perform. The A/E firm brought a third-party complaint against its subconsultants. The subconsultants then cross-claimed against each other. The court denied one subconsultant's motion to dismiss, granted a motion to dismiss cross-claims for indemnification, but denied a motion to dismiss cross-claims seeking contribution.

[212] Sewell et al. v. Barge, Waggoner, Sumner & Cannon, Inc., et al., 2009 U.S. Dist. LEXIS 85233 (U.S. Dist. Ct. ND Alabama, magistrate judge, 2009).

[213] 793 F. Supp. 2d 133 (U.S. Dist. Ct. D.C. 2011).

[214] 2011 U.S. Dist. LEXIS 43947 (U.S. Dist. Ct. E.D. Ark. 2011).

[215] 2010 U.S. Dist. LEXIS 123097 (E.D. Pa., Nov. 19, 2010).

A number of other cases concerning the liability of design professionals have been decided since the 2005 update to the current volume, which will be summarized only briefly here, but may possibly prove relevant in certain situations.

In the 2009 case of *Auto-Owners Insurance Co. v. Ace Electrical Service, Inc., et al.*, the U.S. District Court for the Middle District of Florida dealt with a dispute involving a surety bond loss that resulted from the failure of a design for electrical work on a municipal project to meet code.[216]

In the 2008 case of *Holbrook v. Woodham et al.*, the U.S. District Court for the Western District of Pennsylvania dealt with design liability and other issues arising in a wrongful death case involving a construction accident on an airport runway extension and repaving project.[217]

In yet another 2008 case, *Quinn Construction, Inc. v. Skanska U.S.A. Building, Inc., et al.,* the U.S. District Court for the Eastern District of Pennsylvania addressed design liability issues arising from a university construction project.[218] In that case, a concrete subcontractor on the project sued the contractor and an architectural firm, alleging that continuous design changes, incomplete drawings, and failure to provide timely review of shop drawings caused the subcontractor to incur significant additional labor costs on the project. The contractor cross-claimed against the architectural firm for any liability to the subcontractor. The court denied a motion to dismiss that had been based on a state procedural requirement for the filing of a certificate of merit in support of any claim of failure to meet professional standards. The court reasoned that the subcontractor's negligent misrepresentation claim involved an ordinary standard of negligence, rather than more serious allegations of failure to meet professional standards.

In a 2007 case, *Southern New Jersey Rail Group, LLC at ano. v. Lumbermens Mutual Casualty Co.*, a magistrate judge of the U.S. District Court (Southern District of New York) dealt with design liability issues raised on cross-motions for summary judgment.[219] The case involved construction of a light rail transit line. The plaintiff sought to invoke a Construction, Engineering and Design Professional Liability Insurance Policy issued by the defendant. The magistrate recommended granting summary judgment to the defendant, dismissing the plaintiff's claim for design liability coverage under the policy, because plaintiff did not timely tender its claims under the policy to the defendant.

[216] 648 F. Supp. 2d 1371; 2009 U.S. Dist. LEXIS 75367 (U.S. Dist. Ct. Middle Dist. Fla. 2009).

[217] 2008 U.S. Dist. LEXIS 76268 (U.S. Dist. Ct. W.D. Pa. 2008).

[218] 2008 U.S. Dist. LEXIS 45980 (U.S. Dist. Ct. E.D. Pa. 2008).

[219] 2007 U.S. Dist. LEXIS 58510 (U.S. Dist. Ct. S.D.N.Y. 2007).

B. ALTERNATIVES TO LITIGATION—ALTERNATIVE DISPUTE RESOLUTION

1. The Alternative Dispute Resolution Process

The most popular form of alternative dispute resolution (ADR) is negotiation, which occurs when the parties resolve the issue themselves at the project level. Transportation agencies commonly use this method in many of the ADRs that will be discussed in this section.

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,"[220] has particular significance in heavy construction, one of the country's most adversarial and litigious industries.[221] A single dispute early in the project, if left unresolved, may escalate into a claim that ultimately leads to litigation.[222]

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,[223] and if used proactively can minimize and prevent claims. 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.

ADR may enhance the quality of negotiation, acceptably minimize operational delays, and yield long-term savings in time and money.[224] ADR can improve the flow of information among the parties, which can in turn lead to a creative and superior outcome while maintaining the parties' control of the outcome. ADR helps to preserve existing relationships and avoid project disruption, while promoting long-term trust and understanding. The ADR process provide the parties with an opportunity to gain a clearer understanding of their own cases, the other parties' positions, and the underlying issues, which can lead to more efficient

[220] LEGAL BRIEFS 148 (McMillian–U.S.A. 1995).

[221] James P. Groton, *Alternative Dispute Resolution in the Construction Industry*, 52 DISP. RESOL. J. 48 (1997).

[222] *Id*.

[223] *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).

[224] CHARLES POU, JR., CURRENT PRACTICES IN THE USE OF ALTERNATE DISPUTE RESOLUTION (Legal Research Digest 50, Transportation Research Board, 2008).

hearings and resolutions. A neutral perspective on issues can provide a fresh perspective on positions and strategy, which can lead to a successful resolution.

There is no single form that nonbinding ADR methods must follow. The method may be predetermined by the contract,[225] or one ADR method may be combined with another. Combining mediation and arbitration into one process is an example.[226] Since nonbinding ADR is voluntary, the parties may develop various hybrids to suit their needs.[227] When and how nonbinding 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 be 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.[228]

Federal Participation

FHWA will determine federal aid eligibility on a case by case basis on any contract claim arbitration or mediation proceeding, administrative board determination, court judgment, negotiated settlement, or other contract claim settlement. Federal funds will participate to the extent that the claim is supported by the facts and has a basis in state contract law.[229]

FHWA will not participate in attorney fees or anticipated profits. FHWA will, however, participate in interest if it is allowed by state law or specification and not the result of delays caused by dilatory action of the State or contractor, and if the interest rate does not exceed the rate provided by state law or specifications.[230]

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 nonadversarial 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,[231] and exploring settlement alternatives.[232] The mediator provides assistance in resolving the dispute by narrowing and clarifying issues, but does not decide the dispute.[233]

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.[234]

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.[235] 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.[236] These successes have led to the adoption of standard contract provisions providing for mediation. For example, the Arizona DOT 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. [237] The Ohio DOT actively uses DRBs, and provides for mediation as an additional method of dispute resolution.

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[225] 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 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* para. C.1 of App. A, at 276, AMERICAN ARBITRATION ASSOCIATION, ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES (Kendall/Hunt Publishing Co., 1994) (hereinafter "Practical Guide").

[226] *See* AMERICAN ARBITRATION ASSOCIATION, *supra* note 192, at 217–23.

[227] 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)).

[228] Steven Pinnell, *Partnering and the Management of Construction Disputes*, 54 DISP. RESOL. J. 16 (1999).

[229] FHWA, CONTRACT ADMINISTRATION CORE CURRICULUM PARTICIPANT'S MANUAL AND REFERENCE GUIDE 37 (2006); *see* http://fhwa.dot.gov/programadmin/contracts/coretoc.cfm.

[230] *Id.* at 38.

[231] As discussed later, these discussions are conducted in the private sessions.

[232] Beth Paulsen & Franker Sander, *Alternative Dispute Resolutions, An ADR Primer*, ABA Standing Committee on Dispute Resolution (1987).

[233] FHWA Report, *supra* note 227, at 39.

[234] *See* Practical Guide, *supra* note 192.

[235] Usually the mediator's fee is shared equally by the parties.

[236] AMERICAN ARBITRATION ASSOCIATION, *supra* note 192, at 72.

[237] Standard Specification 105.21 (2000); *see also* PRACTICAL GUIDE, *supra* note 225.

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.[238]

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.[239]

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.[240]

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.[241]

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 whom to select and whom to avoid. The American Arbitration Association and similar dispute resolution organizations are other sources for recommendations.[242]

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."[243]

The opening statement is usually made by counsel, and may be augmented with presentations by key project personnel and expert witnesses, as appropriate.[244] 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-up charts to depict key information and summarized arguments can be effective.[245]

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.

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[238] The mediation agreement is discussed in more detail later.

[239] Peter J. Comodeca, *Ready, Set, Mediate*, 56 DISP. RESOL. J. 32 (Dec. 2001–Jan. 2002).

[240] *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).

[241] *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).

[242] 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 225, at 82–83,

[243] Comodeca, *supra* note 239, at 38.

[244] *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).

[245] *Preparing to Mediate*, ch. 8, ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES, *supra* note 225, at 97.

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.[246]

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.[247]

v. Candor with the Mediator.—Information provided to the mediator is confidential and cannot be used in subsequent proceedings, if the mediation fails.[248] 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.[249] 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.[250]

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.[251] 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*,[252] 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 Records Act.[253] Other jurisdictions have reached a similar result.[254]

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[246] Fisher, *supra* note 242.

[247] *See* GROTON, *supra* note 221, 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.

[248] 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.

[249] GROTON, *supra* note 221, at 106.

[250] *See* GROTON, *supra* note 221, at 129 for an example of a basic mediation agreement.

[251] *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 250 *supra*.

[252] 205 Cal. Rptr. 92, 158 Cal. App. 893 (1984).

[253] Cal. Pub. Disclosure Act, CAL. GOV'T 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*.

[254] 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).

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. It is critical that the attorneys have the presence of, or access to, the real decision makers of each of the parties, so that issues can be efficiently resolved and negotiations promptly concluded.

• 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.

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.[255] 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.[256] There are those, however, who believe that mediation should be voluntary.[257] 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.[258] 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.

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 principles 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.[259]

ii. History.—Mini-trials have been widely used for 2 decades in the private sector and in some federal agencies.[260] 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.[261] The mini-trial process has been used successfully to

[255] 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).

[256] Hinchley, *supra* note 248, at 40.

[257] For example, the AGC favors making mediation optional. *See* note 225 *supra*.

[258] The AAA recommends mandatory mediation in its Mediation Rules, note 225 *supra*.

[259] Lester Edleman & Frank Carr, *The Mini-Trial: An Alternative Dispute Resolution Procedure*, 42 ARB. J., No. 1, at 7 (1987); GROTON, *supra* note 221, at 233–43.

[260] POU, *supra* note 224, at 17.

[261] 5 U.S.C. § 581*, et seq*.

settle large construction claims.[262] Mini-trials have, however, not been in wide use in transportation agencies. As an exception, a mini-trial was used by PennDOT to settle a construction dispute on the Schuylkill Expressway Project. The parties were represented by participants who had authority to settle, including FHWA participants who had authority to approve the settlement.

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.[263]

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.[264]

c. Dispute Review Boards

i. Purpose.—A Dispute Review Board (DRB) is a nonbinding ADR method that is established by the owner and the contractor to decide construction disputes that arise during the course of the project.[265] It involves a board of impartial professionals formed at the beginning of the project to follow construction progress, encourage dispute avoidance, and assist in the resolution of disputes for the duration of the project.[266] DRBs serve an important role in dispute avoidance. If a dispute occurs, 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.[267] However, unlike other forms of nonbinding ADR, the recommendations, depending on contract specifications and provisions, may not be confidential.[268] Moreover, the DRB Specifications may provide that "…the written recommendations, including any minority reports will be admissible as evidence in any subsequent litigation."[269] 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.

DRBs are commonly used on large, complex projects. The DRB process has been found to be successful in preventing disputes, and also in achieving early resolution when disputes occur, as it involves trusted expert neutrals who have the confidence of the parties, and whose objective decisions can administer a "dose of reality." [270]

History of DRBs

In 1975, the underground industry held the first DRB in connection with the second bore of the Eisenhower Tunnel on I-70 in Colorado. The DRB heard three disputes and was overwhelmingly successful, and all parties were pleased with the results. Other successful DRBs followed, and over the following 3 decades DRB usage spread rapidly throughout North America and the world. In 2010, DRBs were used in over 2,200 projects worth $150 billion in construction value.

The DRB issues a recommendation based upon an analysis of the provisions of the contract documents, applicable law, and the facts and circumstances of the dispute. It is not mediation or arbitration, and requires training to become familiar with the unique role and obligations of a DRB member.

DRBs at DOTs, Models of State Practice

Transportation agencies have used DRBs on numerous large bridge, tunnel, and highway projects with remarkable success. The Dispute Resolution Board Foundation (DRBF), a nonprofit corporation that promotes DRB usage, reports that 98 percent of DRB projects were completed without litigation or arbitration. The DRBF-published guide specifications and standard three party agreements are a useful resource. DRBs are in active use for DOTs in Alaska, California, Delaware, Florida, Hawaii, Idaho, New York, Ohio, Maine,

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[262] *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)).

[263] *See* PUB. CONT. L.J. No. 3 71–75 (1995) for a sample mini-trial agreement.

[264] *See* Yarn, *supra* note 262, at 234–36.

[265] A sample DRB specification is shown in App. A to ch. 20, *Dispute Review Boards*, GROTON, *supra* note 221, at 274–80. A sample DRB three-party agreement is shown in App. B, at 281–94. A sample DRB guideline is shown in App. C, at 295–97.

[266] DRBF Administrative & Practice Workshop, Seattle, Washington, Sep. 2011.

[267] 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).

[268] *Supra* note 198.

[269] *See* sample specification, § B11, at 276, App. A, note 265 *supra*, and American Society of Civil Engineers Model Specification at 338–44.

[270] POU, *supra* note 224, at 16.

Maryland, Massachusetts, Nevada, Oregon, Virginia, Washington, West Virginia, and Wisconsin. Caltrans uses DRBs for all contracts over $10 million, and has adopted either three-member or single-member DRBs for most of its construction program. Florida uses DRBs for all contracts over $10 million, and uses regional DRBs for most of the other construction projects, which has resulted in drastic reductions in claim litigation. Ohio uses DRBs for all projects over $25 million. One of the nation's highest profile projects, the Central Artery Tunnel Project ("Big Dig") in Boston, used DRBs on 24,000 issues with 500 meetings of the DRB, and only 31 issues were raised to formal hearings.[271]

DRBs also have been, and are, in active use in many transit projects for WMATA, New York City Metropolitan Transit Authority, and Miami International Airport.

DRBF's best practices provide:

1. DRB members are neutral and subject to the approval of both parties.
2. DRB members sign a three-party agreement obliging them to serve both parties equally.
3. DRB fees and expenses are shared equally by the parties.
4. The DRB is organized when work begins, before there are any disputes.
5. The DRB keeps abreast of job developments by reviewing relevant documentation, and by making regular visits to the site.
6. Either party can refer a dispute to the DRB.
7. If a dispute is referred to a DRB, an informal and comprehensive hearing is convened promptly.
8. The written recommendation of the DRB is nonbinding, although admissible in later litigation.

ii. Selection and Disclosure.—The composition of a DRB is specified in the contract documents. Typically, a DRB is composed of three members:[272] 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.[273] The contract specifications also require that all DRB members must be experienced with the type of construction involved in the project.[274] Essential elements of the DRB process are that the DRB members must be experienced and technically qualified, must be impartial and have no conflict of interest, and must be trained in the DRB process. Many transportation agencies insist that prospective board members be trained in DRB operations and practices, and often offer DRBF training for the attorneys, engineers, contractors, and consultants involved in a project. Replacement members are to be appointed in the same manner as the original members were appointed.[275] 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.[276]

iii. DRB Operations.—The function of the DRB is spelled out in the contract, and in the operating procedures adopted by all the parties. After the DRB is formed and all parties sign the three-party agreements, DRB operating procedures are reviewed and signed by all parties. The DRB is an advisory body assisting the parties in the resolution of contract disputes,[277] and may issue formal recommendations after formal submissions and a hearing, or informal oral advisory opinions after brief informal presentations. 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.[278] Generally, lawyers do not make the presentations, but are available to address legal issues if both parties agree. The Ohio DRB model, however, prefers lawyers to serve as DRB chairs. The DRB's recommendation, if not accepted by all parties, is usually used as the basis of future negotiations, which contributes to DRBs' 98 percent success rate.

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

[271] *Id.* at 16.

[272] 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.

[273] Sample DRB specification, § E, DRB Members, App. A, *supra* note 265, at 277.

[274] *Id*. The goal in selecting the third member is to complement the experience of the other two members. Dispute Review Board Three Party Agreement, § II.A, App. B, *supra* note 265, at 282.

[275] *Id*.; App.B, § F, at 283.

[276] App. B, *supra* note 265.

[277] App. A, § D, *supra* note 265.

[278] App. A, § B.11, *supra* note 265. 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 221, at 53.

their testimony. There is no cross-examination by the opposing party, and the formal rules of evidence do not apply, 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.[279]

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.[280] Although DRB reports are admissible in future proceedings, three-party DRB agreements generally provide that DRB members cannot be called to testify, nor can DRB members' notes be admissible.

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.[281]

iv. Canon of Ethics.—

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.[282] If either party loses confidence in the DRB, a party is unlikely to give weight to an unfavorable recommendation, making the DRB process ineffective.[283]

DRBF members subscribe to five Canon of Ethics, which provide that:

1. DRB members shall disclose any interest or relationship that could possibly be viewed as affecting impartiality or create the appearance of partiality or bias. This obligation is a continuing obligation throughout the life of the contract.

2. Board members shall be above reproach; there shall be no *ex parte* communication except as provided in operating procedures.

3. Board members should not disclose confidential information.

4. Board members should conduct meetings and hearings in an expeditious, diligent, orderly, and impartial manner.

5. A DRB shall consider all claims and disputes referred to it. Reports shall be based solely on the provisions of the contract documents and facts of the dispute.

v. History and Popularity of the DRB Concept.—DRBs owe their popularity to the fact that the DRB's recommendations have generally been accepted by the contracting parties.[284] While the DRB concept is popular, it is not a panacea for all construction disputes. DRBs are well suited for the resolution of 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.[285]

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.[286] Under this hybrid, the parties mediate the dispute and if the dispute is not resolved, it is referred to arbitration for a binding resolution. The person who served as the mediator may or may not serve as the arbitrator.[287]

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.[288] 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

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[279] App. C, Dispute Review DRB Guidelines, *supra* note 265, at 295.

[280] *Id*.

[281] "An Owner's Guide to Avoiding the Pitfalls of Dispute Review Boards on Transportation Related Projects," *supra* note 278, at 200. The article also discusses the pros and cons of proceeding with a DRB hearing in the absence of one of the parties.

[282] 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).

[283] 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 282.

[284] Groton, *supra* note 221.

[285] ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES, *supra* note 225, at 272.

[286] *Id*. ch. 16, Med-ARB, at 217.

[287] *Id*. Serving as both the mediator and arbitrator could affect the parties' willingness to make compromises and be candid with the mediator.

[288] *Supra* note 227.

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.[289]

Some transportation agencies use a hybrid ADR process. In South Dakota, an in-house expert outside adjuster (similar to an engineering neutral) who is selected by the agency and reports to the agency recommends appropriate resolutions to the Secretary of Transportation. In South Dakota, 10 cases annually utilize this process to assist the agency and the contractor to reach a negotiated result.[290] In Vermont, the Agency of Transportation Board provides appellate review of contract claims.[291]

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.[292]

3. Arbitration of Construction Claims

a. Overview

Arbitration has become the most widely used method of resolving construction disputes between private contracting parties.[293] Most states have enacted arbitration statutes modeled after the Uniform Arbitration Act adopted by the National Conference of Commissioners on Uniform State Laws.[294] The Federal Arbitration Act (FAA) authorizes enforcement of arbitration agreements that affect interstate commerce.[295] However, arbitration is not authorized for dispute resolution when 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.[296]

Arbitration is generally favored by the courts as an expeditious means of resolving contract disputes.[297] 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.[298] 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.[299]

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.[300] 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).
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.[301] In an arbitration proceeding, direct and cross-examination usually follow a question-and-answer format.[302]

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[289] ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES, *supra* note 225, "Considering Fact-Based Mediation," at 96.

[290] POU, *supra* note 224, at 16.

[291] *Id.*

[292] While research has not disclosed any laws that mandate a particular form of nonbinding 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 § 6.3.B.

[293] ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES, *supra* note 225, at 71.

[294] *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; WASH. REV. CODE ch. 7.04.

[295] 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).

[296] 41 U.S.C. 601, *et seq*. *See* 16 PUB. CONT. L.J. 66; 50 YALE L.J. 458.

[297] Maross Constr., Inc. v. Central N.Y. Regional Transp. Auth., 488 N.E.2d 67 (N.Y. 1985).

[298] *Id*.; L.H. Lacy Co. v. City of Lubbock, 559 S.W.2d 348 (Tex. 1977).

[299] Hetrick v. Friedman, 602 N.W.2d 603, 610 (Mich. App. 1999).

[300] *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 § 6.B.3.

[301] "How to Win at Arbitration," ch. 12, ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES, *supra* note 225, at 157–75.

[302] *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 ex-

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.[303] 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.[304]

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.[305] 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 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.[306] 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,[307] by commencing litigation,[308] or by failing to plead the agreement to arbitrate as an affirmative defense in an answer to a complaint in a lawsuit.[309] Also, arbitration may be time-barred when the demand for arbitration is filed after the statute of limitations has expired.[310]

Generally, an arbitrator's decision on questions of fact or law is conclusive,[311] and can only be modified or vacated in accordance with the grounds specified in the state's arbitration act.[312] An arbitrator's decision may collaterally estop another party in a subsequent proceeding[313] or bar a later claim based on *res judicata*.[314]

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pert 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 29.

[303] *10 Techniques for Managing Arbitration Hearings*, *id.* at 28.

[304] Handling Objections, ADR, A PRACTICAL GUIDE TO RESOLVE CONSTRUCTION DISPUTES, *supra* note 225, at 170–71.

[305] 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.

[306] *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).

[307] 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).

[308] Modren Piping, Inc. v. Blackhawk Auto Sprinklers, Inc., 581 N.W.2d 616 (Iowa 1998).

[309] S&R Co. of Kingston v. Latona Trucking, Inc., 159 F.3d 80 (2d Cir. 1998).

[310] 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).

[311] Garrison Assocs. v. Crawford Constr., 918 S.W.2d 195 (Ark. App. 1996).

[312] 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).

[313] 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).

[314] TLT Constr. Corp. v. A. Anthony Tappe and Assocs., Inc., 716 N.E.2d 1044 (Mass. App. 1999) (arbitration decisions 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 225, at 193–98.

A question may arise as to whether a dispute is subject to arbitration.[315] Normally, this is a question for judicial determination.[316] But if arbitrability is debatable, the clause generally will be construed in favor of arbitration.[317] 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.[318]

c. State Transportation Agencies and Arbitration

i. Authority to Arbitrate.—Some state transportation agencies include arbitration clauses in their contracts. In Delaware[319] and North Dakota,[320] 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.[321] In Connecticut, the contractor has the option of electing either arbitration or litigation.[322] A few states use a mix of arbitration and litigation.[323]

In California, the California Public Works Contract Arbitration Program established an arbitration program of public work construction. The program, codified in 1981, provides "a fair and equitable resolution" of disputes between public agencies and contractors, in an attempt to reduce court congestion. Caseload in recent years has approached 20 to 25 cases.[324] Caltrans's strong adoption of the DRB process has no doubt reduced the arbitration caseload.

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.*,[325] 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.[326]

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.*,[327] 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

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[315] 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.

[316] *Id.*

[317] 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).

[318] 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 297, and Hetrick v. Freidman, *supra* note 299.

[319] 10 Del. C. § 5723 (1999) *et seq*.

[320] N.D.C.C. 24-02-31.

[321] State Contract Act, pt. 2, Public Contract Code, Article 7.2, § 10240.10, Waiver of Arbitration.

[322] C.G.S.A. § 4-61 (1998).

[323] 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).

[324] POU, *supra* note 224, at 18.

[325] 218 N.E.2d 693, 696 (N.Y. 1966).

[326] 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).

[327] *Supra* note 315. Statutes that waive sovereign immunity are strictly construed. This rule applies to statutes that authorize arbitration as a means of resolving public contract disputes.

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.[328] 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 "DRBs on ADR Continuum" chart, and in Table B, on the following pages.[329]

[328] 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.

[329] *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).

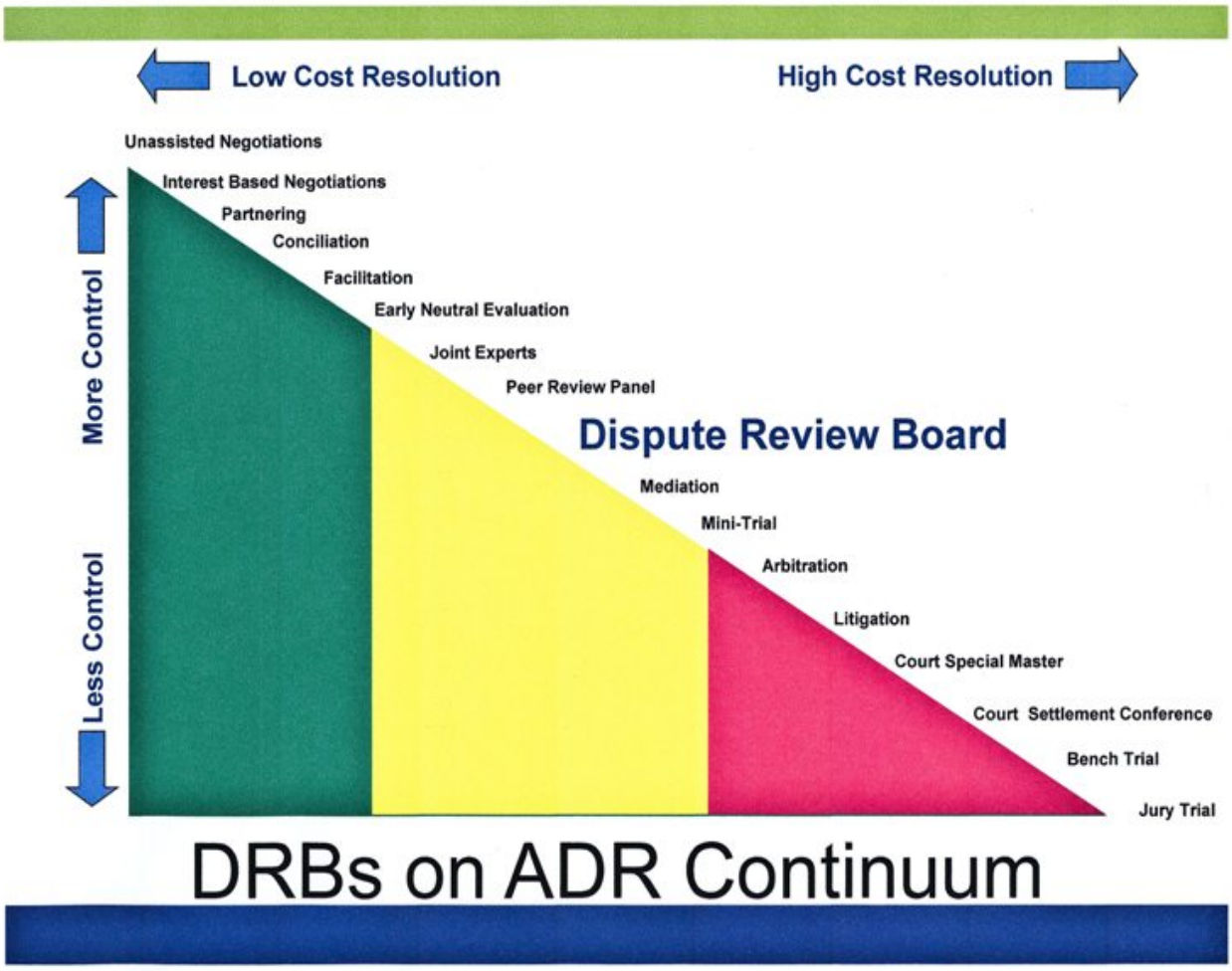
Low Cost Resolution
High Cost Resolution
More Control
Less Control
Unassisted Negotiations
Interest Based Negotiations
Partnering
Conciliation
Facilitation
Early Neutral Evaluation
Joint Experts
Peer Review Panel
Dispute Review Board
Mediation
Mini-Trial
Arbitration
Litigation
Court Special Master
Court Settlement Conference
Bench Trial
Jury Trial
DRBs on ADR Continuum

Table B. Arbitration, Litigation, and DRB Comparisons by Features.

Feature	Arbitration	Litigation	DRBs
Discovery	Restrictive	Liberal	None
Motion practice	Little if any.	Civil rules allow pre-trial motions to dismiss claims and limit evidence.	None
Evidence	Rules of evidence do not govern admissibility.	Rules of evidence apply.	Rules of evidence do not govern.
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.	Based on facts, circumstances, and applicable law.
Complex engineering and technical issues	Arbitrators usually selected for their knowledge and technical expertise.	Decisionmaker—judge or jury—usually lacks technical expertise.	Three-person DRB.
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.	Flexible.
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.	Inexpensive.
Appeal from adverse decision	Limited—grounds for vacation of award are usually governed by statute.[330]	Broader appeal rights based on substantial evidence and conformity to legal precedent.	Limited only as to new material.

[330] 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.[331] Oregon requires mandatory arbitration for claims under $25,000.[332] Washington requires mandatory arbitration for claims not exceeding $250,000.[333] Each state specifies that the arbitration hearing will be conducted in accordance with the Construction Industry Arbitration Rules promulgated by the American Arbitration Association.[334]

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.[335] 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.[336] 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.[337]

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.[338] 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."[339] A "flow-down" clause in a subcontract may incorporate an arbitration clause in the prime contract.[340] The arbitration clause will not be incorporated in the subcontract, however, unless it is clear that the subcontractor intended to submit to arbitration.[341]

4. Partnering and Use of Facilitation in Construction Administration

Partnering is not an ADR method, but is a change in the attitude and relationship between the contractor and owner.

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 cost of partnering sessions is typically shared equally by the owner and contractor, and federal funds may be used to reimburse owners for their shares of the costs.[342]

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."[343]

In partnering, key managers meet early in a workshop to establish a working relationship, identify common objectives, and agree on what is needed to achieve objectives and solve problems. The partnering facilitator ensures that all issues are brought up, including the dispute resolution process to be used. Follow-up meet-

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[331] Stand. Spec. 105.22 (2000).

[332] Stand. Spec. 00199.40 (1996).

[333] Stand. Spec. 1-09.13 (3) (2000).

[334] 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.

[335] 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).

[336] AJM Packing Corp. v. Crossland Constr. Co., 962 S.W.2d 906 (Mo. App. 1998); Diersen 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).

[337] Maross Constr. v. Cent. Regional Trans., *supra* note 297; 3A Indus. v. Turner Constr. Co., 869 P.2d 65 (Wash. App. 1993).

[338] *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.

[339] California State Contract Act, Public Contract Code, art. 7.2, § 10240.9.

[340] 3A Indus. v. Turner Constr. Co., 869 P.2d 65 (Wash. App. 1993).

[341] Gen. Railway Signal Corp. v. L.K. Comstock & Co., 678 N.Y.S.2d 208 (N.Y.A.D. 1998).

[342] FHWA, CONTRACT ADMINISTRATION CORE CURRICULUM PARTICIPANT'S MANUAL 160, available online at http://www.fhwa.dot.gov/programadmin/contracts/cacc.pdf, last accessed July 22, 2012.

[343] U.S. Army Corps of Engineers, *Partnering* (Pamphlet – 91-ADR-P-4).

ings are held at regular intervals to evaluate goals, objectives, and concerns. Partnering has been adopted by 46 transportation agencies, and is believed to reduce contract disputes. Arizona DOT estimates partnering has resulted in an annual cost savings of $5 million.[344]

Several transportation agencies, including Arizona, California, and Texas, have developed partnering field manuals and training activities.

Although partnering is a method of avoiding disputes rather than resolving them, it is still regarded as part of a dispute management system.[345] The partnering process has been used by a number of state transportation agencies.[346] The partnering workshop usually concludes with the parties signing a memorandum or partnering agreement.[347] The agreement provides that the contractor and the owner, with a positive commitment to honesty and integrity, agree that:

1. Each will function within the laws and statutes applicable to their duties and responsibilities.
2. Each will assist in the other's performance.
3. Each will avoid hindering the other's performance.
4. Each will proceed to fulfill its obligations diligently.
5. Each will cooperate in the common endeavor of the contract.[348]

New innovations in partnering involve "Alignment Partnering," in which facilitators align the parties' interests to improve communication and promote "project first thinking."

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 nonadversarial 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. The most valuable ADR techniques are those that prevent or resolve disputes as early as possible through the efforts of individuals directly involved at the project level. 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.

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[344] POU, *supra* note 224, at 15.

[345] Steven Pinnell, *Partnering and the Management of Construction Disputes*, 54 DISP. RESOL. J. No. 1, at 16 (1999); James H. Kill, *The Benefits of Partnering*, 54 DISP. RESOL. J., No. 1, at 29 (1999). (This article discusses the use of partnering by the Puerto Rico Dep't of Transportation in fashioning an ADR system for the *Tren Urbano* project, a regional rail transit system in San Juan.)

[346] 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.

[347] 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).

[348] 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 in 52 DISP. RESOL. J. No. 3 (1997), at 52, *supra* note 221.