BRADLEY ARANT ROSE & WHITE LLP **First Quarter 2006**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

Rhonda Caviedes Andreen
James F. Archibald, III
David H. Bashford (c)
Axel Bolvig, III
John D. Bond, III (c)
Christyne K. Brennan (d.c.)
Joel E. Brown
Stanley D. Bynum
Roy D. Campbell, III (j)
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Sabra Barnett Wireman

Are Government Officials Still Presumed To Act In Good Faith?

In *Tecom, Inc. v. U.S.,* Tecom, which had a contract administered by the Air Force to service and maintain vehicles at an Air Force Base complex, sought to recover additional compensation on behalf of its subcontractor. Tecom claimed that the Air Force breached certain implied duties that accompany contractual agreements.

Tecom argued that the Air Force breached the implied duties (a) of cooperation, (b) not to hinder or interfere with performance, and (c) of good faith and fair dealing. The Court first resolved to identify the appropriate standard of proof, including whether Tecom was required to prove by "clear and convincing evidence" that the Air Force had acted in bad faith. Mindful of the government's argument that its officials are legally *presumed* to act in good faith, the Court devoted more than a third of its 37-page decision to a detailed review of the "presumptions of regularity and good faith conduct," from their genesis in English law through numerous precedential decisions by United States courts dating from 1816 through the present day. The Court's examination included a review of the familiar standard in government contract law that "well-nigh irrefragable proof" is necessary to overcome the presumption that government officials act in good faith. After commenting that the jurisprudence in this area "has persisted in its elusiveness[,]" the Court, "following" the Federal Circuit's decision in *Am-Pro Protective Agency, Inc. v. U.S.* announced that the following guidelines governed its consideration of Tecom's claims:

(1) "[W]hen a government official is accused of fraud or quasi-criminal wrongdoing in the exercise of his official duties, there is a strong presumption of good faith conduct that must be rebutted by clear and convincing evidence."

(2) "When a government official acts under a duty to employ discretion, granted formally by law, regulation, or contract, and a lack of good faith is alleged that does not sink to the level of fraud or quasi-criminal wrongdoing, clear and convincing evidence is not needed to rebut the presumption. Instead, this may be inferred from a lack of substantial evidence [supporting the official's action], gross error, or the like."

(3) "[W]hen the government actions that are alleged are not formal, discretionary decisions, but instead the actions that might be taken by any party to a contract, the presumption of good faith has no application."

Turning to Tecom's claims, the Court noted that proof of fraud, quasi-criminal wrongdoing, "or even bad intent" historically is *not* required to establish breach of duty of good faith and fair dealing. The court stated that "[a]lthough this

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duty is stated in terms of 'good faith,' proof of bad intent does not appear to be required in order for a breach to be found." Accordingly, the presumption of good faith did *not* apply to Tecom's claims, and Tecom was required to prove breach only by the traditional "preponderance of the evidence" standard, not the higher standard of "clear and convincing evidence." Ultimately, the Court denied Tecom's motion and the government's cross-motion for summary judgment, finding a genuine factual dispute as to whether the government had breached its implied duties.

The *Tecom* decision, issued by the Court of Federal Claims, is *not* binding on any federal or state court, or even the Court of Federal Claims itself. It will be interesting to see whether trial courts in the future agree that the good faith presumption afforded government officials does not apply in ordinary breach cases. Further, it remains to be seen whether the U.S. Supreme Court or, more likely, the Federal Circuit – whose decisions *are* binding on the Court of Federal Claims – reacts to the *Tecom* Court's interpretation of *Am-Pro*, where the federal circuit affirmed the dismissal of the contractor's claims when the contractor failed to prove by "clear and convincing evidence" that the contracting officer breached his duty. Thus, unlike *Am-Pro, Tecom* held that the presumption of good faith is inapplicable to alleged breaches of the government's implied duty of good faith and fair dealing. With this possible split of authority, we will continue to closely watch any new developments!

More Condo Work on the Coast: "Condo Conversions"

For those of you who have done condominium work on the Gulf Coast, you already know it has been booming. There is plenty of repair and renovation work to be done to address the effects of back-to-back highly destructive hurricane seasons. In addition, there is much new construction. Adding to the mix of "traditional" condominium work, however, is a dramatic increase in condominium conversion projects.

In a condominium conversion, an existing complex is converted from its past use into the condominium form of ownership. Quite often, these conversions involve buildings in which space was previously available for rent such as an existing apartment building. Some news reports indicate that literally thousands of former apartment rental units were converted to condominiums in Florida last year. To protect the rights of those affected – primarily the existing residential tenants – the State of Florida has passed legislation known as the "Roth Act" which sets forth guidelines for performing a condo conversion.

If an owner/developer intends to perform a condo conversion in Florida, one of the first things which must be done pursuant to the Roth Act, is to provide notice of the intended conversion to all existing tenants. The Notice must first be drafted and submitted for approval to the Division of Florida Land Sales, Condominiums, and Mobile Homes. At a minimum, the notice must declare the intended conversion, identify the developer and inform the tenant of his rights to extend the lease or purchase a unit.

Under the Roth Act, tenants who have lived in the apartment unit to be converted continuously for at least the 180 days prior to the notice, have a right of first refusal to purchase the converted unit. Such a tenant must receive a written offer to purchase within 90 days after the notice of the intended conversion, which offer shall remain open for 45 days after receipt. Even afterwards, should the developer change the terms of purchase at any time, the offer must be made again to the former tenant under the revised terms. The renewed offer must remain open for another 10 days.

Primarily because condo conversions do not involve new construction, the requirements of the Roth Act place a high burden on developers to investigate and disclose the conditions of the existing building to any potential purchaser. For example, the date and type of the original construction, the prior uses of the building and whether any termite damage and/or infestation have been detected must be disclosed. In addition, various components and/or systems of the building must be described and detailed including the age, estimated remaining useful life, estimated current replacement cost and structural soundness. The disclosures must be certified by an architect or engineer. Furthermore, the developer must establish certain reserve accounts for deferred maintenance items or, alternatively, give warranties or post a surety bond with respect to the continued viability of certain systems.

The dramatic increase in popularity of the condo conversion project should continue to add to the backlog of potential work for contractors on the Florida coast. However, owners, developers, designers and contractors who are involved in the process should be aware of the Roth Act and make sure they have fully complied with its provisions before proceeding with a condo conversion.

For A Forum Selection Clause to be Effective, Careful Consideration Must Be Given to its Wording

In *American Soda, LLP v. U.S. Wastewater Group*, the Tenth Circuit Court of Appeals (the federal court supervising trial courts in Colorado, Kansas, New Mexico, Oklahoma, Utah, and Wyoming) recently held that the forum selection clause in a contract was binding on the parties to the contract, and that the courts of the state specified in the clause were the exclusive forum for the adjudication of disputes arising out of the contract. The holding was based on the specific wording of the forum selection clause at issue, and the decision warrants careful analysis because the difference of just a few words might have resulted in a contrary outcome.

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The case involved a breach of contract action. In the contract between the parties, there was a forum selection clause that read:

> *Both Contractor and Company hereby submit to the jurisdiction of the Courts of the State of Colorado and agree that the Courts of the State of Colorado/Arbitrator shall be the exclusive forum for the resolution of any disputes related to or arising out of this Term Agreement.*

The plaintiff filed suit in state court. The defendant thereafter removed the action to a federal court. The federal court on a motion by the plaintiff, sent the case back to state court, holding that the language present in the forum selection clause "unequivocally and exclusively designated any court of the State of Colorado for the resolution of disputes arising out of the contract," and did not allow for the case to be adjudicated in federal court.

On appeal, the defendant argued that the federal court's order remanding the case to state court was erroneous. The defendant based its argument on two points: (1) that the language of the forum clause specifying "Courts of the State of Colorado" could include the federal court sitting in Colorado; and (2) that the forum selection clause was permissive rather than mandatory. The federal court of appeals rejected both of the defendant's arguments.

In regards to the first argument, the appellate court agreed with the federal court's holding that "the federal court located in Colorado is not a court of the State of Colorado but rather a court of the United States of America." In so holding, the court also relied on a Fifth Circuit Court of Appeals (the federal court supervising courts in Texas, Mississippi, and Louisiana) decision interpreting a similar provision. The provision at issue in that case referred to the "Courts of Texas," whereby the Fifth District court interpreted that phrase as referring exclusively to Texas state courts.

On the defendant's second argument, that the forum selection clause was permissive rather than mandatory, the court noted that there were only two situations in which it would interpret a forum selection clause to be mandatory: (1) "when venue is specified and the designation is accompanied by mandatory or obligatory language; and (2) when a jurisdiction is specified and the clause contains language indicating the parties' intent to make venue exclusive, which applied to the clause agreed upon by the parties in this case.

There are two important lessons to be taken from this decision. First, when evaluating a forum selection clause in a contract, examine whether the language speaks of submitting to the jurisdiction of the courts "of" a state or "in" a state. If the clause refers to the parties' submitting to the jurisdiction to the courts "of" a certain state, it will likely be interpreted as referring specifically to state level courts. Consequently, a party would likely be unable to have the action adjudicated in the federal court system, if the opposing party prefers to be heard in the state court. Secondly, a forum selection clause will likely be construed as mandatory if (1) a specific venue is specified (such as a particular county or tribunal) and the specification is accompanied by mandatory or obligatory language; or (2) only a jurisdiction is specified (example- "the courts of the state of Colorado") and there is some additional language indicating the parties' intent to make venue exclusive.

The drafting of a forum selection clause must be done with caution and attention to detail. Careful selection of the language used can result in an opposing party being bound to the drafter's chosen forum. Alternatively, ambiguous or indefinite language can render the clause ineffective for its desired purpose.

Subcontractor Attempts to 'Get Around' a Pay-if-Paid Clause—Gets Slapped With Punitive Damages

In *Environmental Energy Partners, Inc. v. Siemens Building Technologies, Inc.,* EEP served as general contractor on an energy management project for a hospital ("the hospital"). EEP subcontracted with Siemens for Siemens to perform the last phase of the work on the project. The subcontract between EEP and Siemens contained a provision stating: "No payment due [Siemens] unless [EEP] receives payment [from the hospital]."

Siemens fell behind on the project, and the Missouri court noted that it was the only subcontractor that failed to complete its part of the project on time. The court also noted that, "[t]hroughout the project, Siemens failed to provide the documentation required, including backup detail that would support invoices submitted." As a result of this and other deficiencies in Siemens's performance, the hospital elected to withhold the final payment to EEP until Siemens completed its work.

Siemens filed suit against the hospital and EEP. Before trial, EEP learned that the hospital and Siemens had entered into a settlement agreement, whereby the hospital agreed to pay Siemens the sum of $148,475, which was the amount the hospital had been withholding from EEP under its contract with EEP. The settlement agreement also contained a provision whereby Siemens and the hospital agreed to keep the terms and conditions of the agreement confidential.

The trial court rendered judgment in favor of EEP and against Siemens, and the trial court also awarded EEP punitive damages. The Missouri Court of Appeals upheld the trial court's award of punitive damages. The court noted that Siemens failed to complete its work on schedule, ceased communicating with EEP during the course of the project, and failed to provide necessary information to EEP. The court also noted that Siemens negotiated an agreement with the

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hospital that resulted in Siemens receiving funds that, by contract, were owed EEP, and that Siemens kept this agreement confidential. Ultimately the Missouri Court of Appeals held that "Siemens' conduct imposed unwarranted obligations and harm upon EEP that went beyond concrete damages compensatory awards could address. Punitive damages were appropriate in these circumstances to deter such conduct in future business affairs and for purposes of retribution."

It is impossible to know whether another jurisdiction would uphold an award of punitive damages under the same or similar facts. However, the case serves as a warning that subcontractors should not attempt to get around "pay-if-paid" or "pay-when-paid" clauses by secretly seeking payment directly from an owner, because courts may not look favorably on this type of conduct.

"But You Knew What Was Going On!"

In the recent case of *D.W.H. Painting Company, Inc. v. D.W. Ward Construction Company*, the Court of Appeals of North Carolina reaffirmed the potentially harsh rule that general knowledge expressed at weekly progress meetings concerning the existence of ongoing injury – whether losses, extra costs or delay – may not be sufficient notice to preserve a contractor's right to bring a later claim for recovery. The opinion, however, left open the possibility of significant exceptions that might save an injured contractor's claim.

D.W. Ward, a prime contractor on a multi-prime public project in North Carolina, sought recovery from other prime contractors for damages to the work of D.W. Ward's painting subcontractor, allegedly caused by those other prime contractors pursuant to North Carolina law, allowing for prime contractors on a public construction project to be held directly liable for damages incurred by the other prime contractors despite lack of contractual privity.

According to the evidence at trial, the damage at issue was discovered by D.W. Ward's subcontractor in March 2001. Between April and June 2001, the damage was repaired, and the subcontractor invoiced D.W. Ward for the additional work. In August 2001, at D.W. Ward's request and insistence, the State's project designer sent letters to the other prime contractors informing them of the damage and requesting contribution for payment of the subcontractor's invoices for the repair work. The trial court found that D.W. Ward failed to provide "timely and effective notice" of the damage at issue pursuant to the interpretation of certain standard-form language in all prime contractors' contracts with the State: The right to seek damages is conditioned upon the provision of "timely and effective notice" adequate to "enable the contractor allegedly responsible for [the] damage an opportunity to inspect the damage and to reach a prompt and equitable settlement or resolution with the prime contractor whose work was damaged."

In part, D.W. Ward contended that the other prime contractors had received sufficient notice of their responsibility for the damages at issue through discussions at several weekly progress meetings. In addressing D.W. Ward's contention, the Court of Appeals restated the rule on State construction projects in North Carolina that "notice provided in weekly project meeting is sufficient only where an aggrieved contractor gives 'written or verbal notice of potential claims [or] … notice that it is suffering economic harm.'" According to the Court of Appeals, non-specific statements and discussions at weekly project meetings regarding damages generally on the project are not sufficient notice to preserve a prime contractor's subsequent right to seek recovery. Hence, had the contractor timely given non-written, but specific, notice of its "suffering economic harm" and intention to assert "potential claims" for economic damages, the Court of Appeals might have deemed the notice "sufficient" and allowed the action to proceed.

The advisable action for any contractor incurring loss, extra costs or delay on a construction project is to comply with contractual notice requirements. Although seeking to avoid conflict, confrontation or criticism, especially early in a project, by remaining ambiguous about the cause or existence of injury is natural, subsequently pointing to equivocal and/or vague statements made during meetings on the project may not convince an adjudicator to grant relief from the harsh bar of recovery for notice failure. However, if an injured contractor gives specific and unequivocal notice, whether orally or in writing, of its "suffering economic harm" and its intention to assert "potential claims" for economic damages, courts (including those in North Carolina) may allow the contractor to bring a subsequent action asserting such claims, despite technical non-compliance with contractual notice requirements.

Contracting "Around" the FAA

Despite the convenience and (sometimes) cost-savings of arbitration, many clients continue to be frustrated by the lack of judicial review available of arbitral awards, particularly those that give no rationale at all for their conclusions. Federal courts have been loathe to grant any relief, commonly declaring that they have neither the time nor the inclination to revisit the merits of arbitrated cases. Against this backdrop, a recent First Circuit U. S. Court of Appeals (the federal court supervising trial courts in Maine, Massachusetts, New Hampshire, Puerto Rico, and Rhode Island) case considered whether and how parties may contract for a different standard of judicial review of an arbitration award.

The ordinary standard of review for an arbitral award under the Federal Arbitration Act ("FAA") is limited to circumstances of fraud, evidence of partiality or bias, exceeding of an arbitrator's powers, or manifest disregard of the law. The last ground, while seeming to provide some

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hope for parties when there is a legal error, has largely proved fruitless. Because arbitration is a creature of contract, parties may try to contract for a different standard of review if they choose, and the First Circuit agreed with this choice. However, the party complaining about the arbitral award claimed that a simple choice of law clause that made the parties subject to Puerto Rican law was sufficient to displace the FAA's limited standard of review. The First Circuit disagreed, noting the conflict between the federal policy of favoring arbitrability and contracting parties' ability to write their own agreements, and held that "the mere inclusion of a generic choice of law clause within the arbitration agreement is not sufficient to require the application of state law concerning the scope of review, since there is a strong federal policy requiring limited review." The court summarized its holding as follows: "We hold that the judicial review provisions of the FAA can be displaced only by explicit contractual language evidencing the parties' clear intent to subject the arbitration award to a different standard of review."

Readers may be familiar with other "clear statement" tests enunciated by the United States Supreme Court and other courts, which do not settle disputes but simply spawn further disputes about how "clear" the "clear statement" made has to be. For that reason, this decision is likely to settle very little on the underlying important question of whether arbitrators' legal errors are reviewable. Arbitration in the construction industry was originally adopted to obtain speedy, efficient decisions from knowledgeable arbitrators. If that is the goal for you and your company – and it is a goal increasingly difficult to achieve in the current arbitration environment – then broad judicial review may be seen as inimical to that goal. If, on the other hand, you believe that judicial review provides a "safe harbor" from a miscarriage of justice, and if you believe that broad judicial review is an even safer harbor, then you and your legal advisor should study the implications of *Puerto Rico Telephone Co., Inc. v. U.S. Phone Man. Co.* (the case under review) to craft language that would broaden the narrow judicial review provided for under the FAA or under most state statutes. Our advice is that parties drafting their arbitration agreements give careful consideration to whether they desire a reasoned award from an arbitrator and whether it is sensible to contract for full review of legal errors, perhaps maintaining a bar against the review of factual disputes.

Owner Faces Double Payment Where Construction Management Firm Failed to Forward Payments to Subcontractors

Is it possible for an owner to be held liable to subcontractors who performed work on its job when the owner has already paid its construction manager (who kept the money and filed for bankruptcy)? The Mississippi Supreme Court addressed this issue in the recent case of *Aladdin Construction Co. v. John Hancock Life Insurance Co.*, and held an owner could be held liable (twice) under certain circumstances. The owner in the case, John Hancock Life Insurance Company, entered into an agreement with McMo, Inc. to provide project management services (e.g., solicit and analyze bids, negotiate agreements, route payments to the subcontractors, generally oversee the construction process) in the construction of a shopping mall. McMo entered into contracts with the subcontractors, to which the owner was not a named party, but failed to forward the owner's payments to the subcontractors. When McMo filed for bankruptcy, the unpaid subcontractors looked to the owner for payment.

The owner argued that McMo was acting as a general contractor, not its agent, and, pursuant to Mississippi law, the subcontractors' failure to file a stop-payment notice barred their recovery. The court defined "general contractor" as "the party to the building contract who is charged with the total construction and who enters into sub-contracts for such work as electrical, plumbing and the like." It also noted that courts have defined "construction manager" as an owner's agent who hires in his principal's name. The court stated that the actions or agreements of the parties, and ultimately their intent, are determinative. The evidence showed that it was possible McMo acted as the owner's agent despite the owner not being a party to the contracts with the subcontractors and the construction management contract not stating McMo was acting as the owner's agent. Such evidence included the fact that 1) the owner controlled the manner of payment to the plaintiffs, per the contract between owner and McMo; 2) the owner's complaint filed against McMo in Florida stated the owner "entrusted" the payments to McMo, which were made out to McMo, much like an escrow agreement; 3) the payments to McMo for services performed were separated from payments to the plaintiffs; and 4) McMo sought no profit from the construction itself, unlike a general contractor who seeks to make a profit from the actual construction.

Even if the subcontractors did not prove McMo was the owner's agent, however, the court stated the subcontractors could recover for breach of contract if they proved they were third-party beneficiaries to the contract. A non-party to a contract (in this case, the subcontractors) may enforce a contractual provision if the parties to the contract made such a provision for the primary benefit of the non-party. The evidence showed that provisions within McMo's agreement with the owner directly named the subcontractors and set forth the owner's obligation to pay the subcontractors through McMo.

Therefore, if the subcontractors could prove at trial that McMo acted as the owner's agent *or* that they were third-party beneficiaries to the construction management contract, the owner's payments to McMo did not satisfy its debt to the

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subcontractors, and the subcontractors could recover payment directly from the owner.

Owners who enter into construction management agreements should be mindful of the implications of this decision. An owner may pay twice if a court finds the construction manager acted as the owner's agent, and the manager fails to forward the payments to the subcontractors. Courts analyzing whether an agency relationship exists look to both words and actions. Thus, owners who wish to avoid such a situation should draft their construction management contracts in a way that makes clear the intention that the construction managers are not acting as the owners' agents and not maintaining control over the payment process as the owner did in this case.

Bradley Arant Lawyer Activities:

November 4, 2005: Doug Patin participated as a panelist in a session on "Ethical Issues Arising in the Construction Industry" at the 26th Annual Seminar on Construction and Public Contract Law in Charlottesville, Virginia.

November 4, 2005: Axel Bolvig presented a seminar on the topic "How to Assure You Get Paid" to the Associated Builders & Contractors, Inc., Alabama Chapter.

November 7-10, 2005: Arlan Lewis attended the Construction Users Roundtable's 2005 National Conference of Construction Owners in Naples, Florida.

November 9, 2005: Doug Patin presented a session on "Contractor Default Claims" at the IRMI Construction Risk Conference in Las Vegas, Nevada.

December 4, 2005: Doug Patin, Mike Koplan, and Bob Symon presented a seminar on "Risk Management" for project managers in Arlington, Virginia.

December 8-9, 2005: Wally Sears chaired a session on "Construction Management: Can Anyone Really Manage Construction?" at the "Contractor and Construction Manager Issues" Superconference in San Francisco. **John Bond, Colin Stockton, and Sabra Wiremen** also attended the Superconference.

December 15, 2005: David Pugh presented a seminar on "Building Codes" in Mobile, Alabama.

January 17, 2006: Mabry Rogers presented an in-house seminar for a client regarding FAR compliance.

January 25, 2006: David Pugh presented a seminar on "Building Codes" in Birmingham, Alabama.

January 26, 2006: Rhonda Andreen, Stanley Bynum, Donna Crowe, Eric Frechtel, Arlan Lewis, and David Owen attended the ABA Forum on the Construction Industry's Midwinter Meeting, "Expecting the Unexpected: Anticipating and Managing Key Risks to Successful Projects," in New York City.

January 27, 2006: Stanley Bynum, Donna Crowe, Eric Frechtel, and Arlan Lewis attended the ABA/TIPS Fidelity and Surety 2006 Annual Midwinter Meeting in New York City.

February 26, 2006: Nick Gaede will preside as President of the annual meeting of the American College of Construction Lawyers, on Sanibel Island, Florida.

March 16, 2006: Jim Archibald, Patrick Darby, Arlan Lewis, David Pugh, and Sabra Wireman will present a seminar on "Construction Insurance, Bonding and Liens in Alabama," in Birmingham, Alabama.

2006: Axel Bolvig will serve as a member of the 2006 General-Subcontractor Committee of Associated Builders & Contractors, Inc., Alabama Chapter.

2006: Joel Brown and Rob Campbell will serve as members of the 2006 Legislative Committee of Associated Builders & Contractors, Inc., Alabama Chapter. **Joel Brown** also will continue to serve as a member of the Education Committee of the ABC Alabama Chapter.

2006: Rob Campbell will serve as member of the Legislative Committee and **Joel Brown** will serve as a member of the Small Business Committee of the Business Council of Alabama.

NOTE: WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY CONTACT ANY ATTORNEY LISTED ON PAGE 7 OF THIS NEWSLETTER.

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James F. Archibald, III .... (205) 521-8520 .... jarchibald@bradleyarant.com
David H. Bashford .... (704) 338-6001 .... dbashford@bradleyarant.com
Axel Bolvig, III .... (205) 521-8337 .... abolvig@bradleyarant.com
John D. Bond, III .... (704) 338-6007 .... jbond@bradleyarant.com
Joel E. Brown .... (205) 521-8416 .... jbrown@bradleyarant.com
Christyne K. Brennan (Washington, D.C.) .... (202) 719-8207 .... cbrennan@bradleyarant.com
Stanley D. Bynum .... (205) 521-8000 .... sbynum@bradleyarant.com
Roy D. Campbell, III (Jackson) .... (601) 948-9934 .... rdcampbell@bradleyarant.com
Rhonda R. Caviedes Andreen .... (205) 521-8683 .... rcaviedes@bradleyarant.com
Donna M. Crowe (Washington, D.C.) .... (202) 719-8212 .... dcrowe@bradleyarant.com
Chris Danley (Washington, D.C.) .... (202) 719-8230 .... cdanley@bradleyarant.com
J. Patrick Darby .... (205) 521-8332 .... pdarby@bradleyarant.com
Julie S. Elmer .... (205) 521-8431 .... jelmer@bradleyarant.com
Eric A. Frechtel (Washington, D.C.) .... (202) 719-8249 .... efrechtel@bradleyarant.com
A. H. Gaede, Jr. .... (205) 521-8323 .... ngaede@bradleyarant.com
John W. Hargrove .... (205) 521-8343 .... jhargrove@bradleyarant.com
Jonathan B. Head .... (205) 521-8054 .... jhead@bradleyarant.com
Gary C. Huckaby (Huntsville) .... (256) 517-5140 .... ghuckaby@bradleyarant.com
David G. Hymer .... (205) 521-8289 .... dhymer@bradleyarant.com
Danielle Daigle Ireland (Jackson) .... (601) 948-9942 .... direland@bradleyarant.com
Michael W. Knapp (Charlotte) .... (704) 338-6004 .... mknapp@bradleyarant.com
Jeffrey D. Komarow (Washington, D.C.) .... (202) 719-8211 .... jkomarow@bradleyarant.com
Michael S. Koplan (Washington, D.C.) .... (202) 719-8251 .... mkoplan@bradleyarant.com
Arlan D. Lewis .... (205) 521-8131 .... alewis@bradleyarant.com
Michael D. McKibben .... (205) 521-8421 .... mmckibben@bradleyarant.com
James William Manuel (Jackson) .... (601) 948-9936 .... wmanuel@bradleyarant.com
Mitchell S. Mudano .... (205) 521-8544 .... mmudano@bradleyarant.com
Andrew J. Noble, III .... (205) 521-8342 .... anoble@bradleyarant.com
David W. Owen .... (205) 521-8333 .... dowen@bradleyarant.com
Douglas L. Patin (Washington, D.C.) .... (202) 719-8241 .... dpatin@bradleyarant.com
Jeffrey A. Peters .... (205) 521-8583 .... jpeters@bradleyarant.com
J. David Pugh .... (205) 521-8314 .... dpugh@bradleyarant.com
E. Mabry Rogers .... (205) 521-8225 .... mrogers@bradleyarant.com
Katherine L. Ruff (Washington, D.C.) .... (202) 719-8208 .... kruff@bradleyarant.com
Walter J. Sears III .... (205) 521-8202 .... wsears@bradleyarant.com
J. R. Steele (Washington, D.C.) .... (202) 719-8222 .... jsteele@bradleyarant.com
H. Harold Stephens (Huntsville) .... (256) 517-5130 .... hstephens@bradleyarant.com
Colin R. Stockton (Charlotte) .... (205) 338-6005 .... cstockton@bradleyarant.com
Robert J. Symon (Washington, D.C.) .... (202) 719-8294 .... rsymon@bradleyarant.com
Sabra Barnett Wireman .... (205) 521-8549 .... swireman@bradleyarant.com

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Julie S. Elmer
Eric A. Frechtel (d.c.)
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Courts' Review of Arbitration Awards For Manifest Disregard of the Law Varies

A spate of recent cases shows that the ability to obtain meaningful review of an arbitration award for manifest disregard of the law may depend disproportionately on the location of the arbitration and the federal circuit in which the award will be enforced. The Seventh Circuit Court of Appeals (supervising trial courts in Indiana, Illinois, and Wisconsin) and the Eleventh Circuit Court of Appeals (supervising trial courts in Alabama, Florida, and Georgia) have taken very aggressive positions in opposition to any substantive review of arbitration awards unless an arbitrator unequivocally announces the intention to disregard the law. The Fourth Circuit Court of Appeals (supervising trial courts in North Carolina, South Carolina, Virginia, and West Virginia) and the Fifth Circuit Court of Appeals (supervising trial courts in Louisiana, Mississippi, and Texas), however, scrutinize contract cases much more closely and have recently set aside arbitration awards for arbitrators' failure to follow clear contractual mandates. There appears to be a sufficient split in the federal circuits to indicate the need for clarification by the U.S. Supreme Court.

Manifest disregard of the law is not one of the enumerated grounds for vacating an arbitration award in the Federal Arbitration Act. The U.S. Supreme Court created the doctrine of manifest disregard of the law over forty years ago without explicitly marking out its boundaries, leading to considerable litigation over the details. Since there are other grounds for vacating an award for procedural irregularity, manifest disregard unquestionably has at its core a substantive component, *i.e.*, some review of the merits of the case. This idea is very troublesome to some judges, in light of the federal policies favoring arbitration and the limited judicial review of arbitration awards. The doctrine immediately raises questions in construction cases about whether a contract itself is the law to be disregarded.

The following cases provide a glimpse of how confused and confusing the jurisprudence on this issue is in the various federal circuits. *Patten v. Signator Ins. Agency* (4th Cir. March 13, 2006) (reversing the district court's decision to affirm an arbitration award because the arbitrator's award did not "draw its essence" from the parties' contract); *CUNA Mut. Ins. Soc'y v. Int'l Union 39* (7th Cir. March 16, 2006) (awarding sanctions for challenging award; stating challenge can succeed "only when the arbitrator must have based his award on some body of thought, or feeling, or policy, or law that is outside the contract."); *B.L. Harbert International, LLC v. Hercules Steel Company* (11th Cir. Feb. 28, 2006) (affirming award and establishing rule requiring express arbitrator statement regarding intent to disregard law; rule existed in previous concurring opinion only); *Cytyc Corp. v. Deka*

Inside:

www.bradleyarant.com

Birmingham Office
One Federal Place
1819 5th Avenue North
Birmingham, AL 35203
(205) 521-8000

Huntsville Office
200 Clinton Ave. West
Suite 900
Huntsville, AL 35801
(256) 517-5100

Montgomery Office
Alabama Center for Commerce
401 Adams Avenue, Ste. 780
Montgomery, AL 36104
(334) 956-7700

Washington, D.C. Office
1133 Connecticut Avenue, N.W.
Twelfth Floor
Washington, D.C. 20036
(202) 393-7150

Jackson Office
188 East Capitol Street
One Jackson Place
Suite 450
Jackson, MS 39215
(601) 948-8000

Charlotte Office
Bank of America Corp. Ctr.
100 N. Tryon St.
Suite 2690
Charlotte, NC 28202
(704) 332-8842

Prods., LP (1st Cir. March 01, 2006) (affirming award, but writing that if "the panel neglected to offer any interpretation of the text" of the contract or its interpretation were "unfounded in reason and fact," vacation would be an appropriate remedy); *Spero Elec. Corp. v. Int'l Bhd. of Elec. Workers* (6th Cir. February 28, 2006) (award vacated when it conflicted with the written collective bargaining agreement).

With the proliferation of arbitration clauses in commercial and consumer contracts, it is not surprising that this issue is being litigated frequently. Parties should know before they enter into an arbitration agreement whether their federal circuit allows substantive review or not, in order to ensure finality or the possibility of review, as desired.

Owners Beware: Allowing Contractor to Continue Without Setting New Deadline Waives Completion Deadline and Liquidated Damages Are Lost

In *RDP Royal Palm Hotel, L.P. v. Clark Construction*, the U.S. Court of Appeals for the Eleventh Circuit (supervising trial courts in Alabama, Florida, and Georgia) ruled that an owner waived the completion date by allowing construction to continue and not setting a new date. The end result was the loss of the owner's right to assess liquidated damages.

The case arose out of a multi-million dollar construction project. The owner entered into a Guaranteed Maximum Price ("GMP") contract with the general contractor for the construction of a resort hotel in Miami Beach. The contract allowed 518 calendar days for substantial completion and the owner had a right to liquidated damages if the project was late. The contract also allowed for change orders, where the GMP and substantial completion deadline would be adjusted accordingly.

Throughout the course of the project, the contractor encountered numerous problems. For example, the contractor found a buried sea wall and contaminated soil. The owner also decided that the existing hotel, which was to be renovated, was too deteriorated and had to be demolished and completely reconstructed. Needless to say, as a result, the owner issued hundreds of change orders. The contractor requested numerous time extensions and increases to the GMP. However, despite the owner's assurances, the parties never resolved the time and money issues.

The substantial completion deadline came and went. Construction continued. The owner issued more change orders and the contractor continued to work based on those changes. The owner accepted the contractor's continued performance and made payments. The owner did not set a new deadline. Eventually, when the owner stopped making payments, the contractor ceased its work. The owner hired another contractor to complete the project.

The owner and contractor sued each other. The owner asserted that the contractor caused a two year delay to the completion date. The owner sought liquidated damages. However, the trial court found that the owner waived the completion deadline by accepting the contractor's continued performance. The court ruled that in the absence of a new deadline, the owner was not entitled to recover liquidated damages.

The federal appeals court affirmed the ruling that rejected the owner's argument. The court opined: "[The owner] allowed the substantial completion date … to pass without setting a new deadline and continued issuing change orders … requiring [the contractor] to perform additional work. [The owner's] conduct … constituted waiver of the 'time is of the essence' provision in the contract. In addition, [the owner] failed to set a new substantial completion date, thus it failed to reserve its right to enforce the liquidated damages provision …."

The lesson learned: an owner cannot rely on a completion date and later cry "foul" when the date is not met, if it supported continued performance and actually issued changes after the expiration of the date. More importantly, in order to preserve the right to liquidated damages, an owner is encouraged to reset the completion date if it allows the contractor to continue working.

Supreme Court of Alabama Holds That an Exclusive Venue Clause and Arbitration Clause Did Not Conflict

In a case involving a dispute over specially-fabricated pressure vessels, the Supreme Court of Alabama has held that a clause reading "the venue for any litigation hereunder or related hereto shall be in Mobile County, Alabama, and hereby consents to the jurisdiction of the courts located therein" did not prevent arbitration.

As is common in the manufacturing context, the fabricator provided a proposal on the condition that it became part of the ultimate agreement between the parties. The buyer made the fabricator's proposal a contract document and attached it to the contract between the parties. The proposal incorporated a set of terms and conditions by reference containing a broad-form arbitration clause, but there was a dispute between the parties regarding whether the terms and conditions were physically attached to the proposal.

The Supreme Court of Alabama first recited the law regarding incorporation by reference, noting that no "magic words" are required for incorporation. The court rejected the buyer's position that the proposal was included only in order to provide the scope of the work to be done because contract language to that effect, which is common, was not included. The court then reached what was the real crux of the dispute between the parties, *i.e.*, whether the exclusive venue clause for "any litigation" was repugnant to or mutually exclusive with an arbitration clause. The court followed the precedent of the Fifth Circuit Court of Appeals (supervising trial courts in Louisiana, Mississippi, and Texas) and held that when the arbitration clause and venue clause were read in *pari materia,* as they must be, there was no conflict in the provisions. Interpreted correctly, the provisions mean the venue "for any litigation hereunder *that is not arbitrated under the broad- form clause* shall be in Mobile County, Alabama."

The court reiterated its rejection of the position that arbitration clauses must be called out in any special fashion or physically appended to the contract, when other contractual provisions are not similarly singled out.

This case is instructive for contract drafters. It teaches that the mere insertion of "exclusive venue" contract language does

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not preclude arbitration. Parties should always demand to see any contractual terms and conditions that may affect their agreement before signing it, so both parties share an understanding of what they have agreed to.

State of Florida Court of Appeal Rules Punitive Damages Available in Arbitration

If a fraud claim falls within the scope of an arbitration clause, then punitive damages will be available in arbitration for that claim unless the parties have agreed otherwise according to a recent ruling by the Florida Second District Court of Appeal. The ruling was issued in *Morton v. Polivchak* which involved a contract for sale of real estate in 2002.

The buyer in that transaction obtained a property disclosure statement from the seller which stated that the seller was unaware of any drainage problems on the property. The contract documents contained an arbitration provision. After the closing, the buyer alleged that there were in fact drainage problems and filed a demand for arbitration pursuant to the American Arbitration Association rules. In that proceeding, the buyer alleged fraud and sought punitive damages.

The arbitration panel ruled that it had no power to award punitive damages. In response, the buyer filed suit in circuit court alleging fraud and seeking punitive damages. The seller filed a motion to compel arbitration and essentially seeking an order which would send the matter back to arbitration. The trial court dismissed the matter stating that it did not have the authority to intervene in a pending arbitration.

On appeal, the appellate court reversed. It did so on the basis that, under both Florida and federal precedent, the courts must determine the arbitrability of an issue unless the parties "clearly and unmistakably" agreed that arbitrability would be decided in arbitration. There was no such provision in the subject contract. Furthermore, there was no waiver by the buyer on the issue of arbitrability simply because he sought arbitration. Therefore, the circuit court was required to rule on the arbitrability of punitive damages as requested by the buyer.

Then, turning to the issue of punitive damages itself, the court ruled that if a fraud claim was available in the dispute in arbitration - that is, if it was not barred by the agreement between the parties – then the normal remedies available for the claim should be available in that arbitration. Thus, if the fraud claim could be brought in this case, than the punitive damages claim should not be rejected. The case was remanded to the circuit court to decide those issues.

Notably, the *Morton* court rejected the argument that prior Florida decisions prohibited punitive damages in arbitration. The court examined those opinions and determined that there were no fraud or other claims that would have supported punitive damages in those cases, and that was the reason punitives were not available earlier and not simply because those matters were in arbitration.

The lesson here is a drafting one. If a party wishes to avoid punitive damages in arbitration, it must carefully insert that language into the contract documents. Indeed, if it desires to avoid a trip to the courthouse at all, it further must require language in the contract which clearly states that the arbitrator will have the power to determine arbitrability as well. Of course, if the arbitration cannot hear punitive claims, such a clause may invite arbitration and litigation, concurrently.

Townhouse Mold Case Presents Lessons in Careful Contract Drafting and Responsibility For Storage of Materials

In *Stanley Martin Cos., Inc. v. Universal Forest Products Shoffner LLC*, a builder sued a supplier to recover damages for mold contamination in trusses used to build a 24 unit townhouse complex known as Quince Orchard Park Development in Gaithersburg, Maryland. The builder, Stanley Martin Companies ("SMC"), sued Universal Forest Products Shoffner LLC ("Shoffner"), the truss supplier, alleging breach of contract, negligence, contractual indemnification, common-law indemnification, and contribution. The U. S. District Court of Maryland granted in part and denied in part Shoffner's Motion for Summary Judgment and SMC's Motion to Strike Inadmissible Evidence.

SMC is a D.C.-area builder and Shoffner is a manufacturer and distributor of wood products. Shoffner supplied wood trusses for the townhouses. Late in construction, after some owners had taken occupancy, an owner told SMC that she had mold on the trusses in her basement. Soon, other owners reported similar mold contamination in their basements.

SMC hired Mantech Environmental ("Mantech") to investigate and take air and surface samples. Meanwhile, some owners complained to the City of Gaithersburg, which in turn hired Patuxent Environmental Group, Inc. ("Patuxent") to investigate the claims. Patuxent reported that the trusses likely "played a substantial role" in the mold growth. Guidelines were established for decontamination of the units. Each owner consented to the implementation of the remediation protocols, and the remediation process began.

While remediation was ongoing, 14 of the 24 owners filed suit against both SMC and Shoffner, seeking $150 million in damages. SMC and Shoffner temporarily tabled their disputes and agreed to a "Tolling Agreement" suspending all applicable limitations periods, yet reserving for each party the right to sue beyond the statutory time limit.

Remediation was completed in late 2003. With their homes free of mold, the 14 owners who filed suit settled their claims for nuisance value. Though the lawsuit was settled for a nominal amount, remediation cost approximately $2 million. SMC then filed suit against Shoffner, seeking recovery of remediation costs. After extensive discovery, Shoffner filed a Motion for Summary Judgment. SMC filed a Motion to Strike much of Shoffner's evidence as inadmissible.

Shoffner argued that SMC was barred from recovery because of: (1) its failure to timely demand arbitration; (2) its failure to reject the goods in a timely manner and failure to provide Shoffner with timely notice of any alleged breach; and (3) its waiver, through its conduct, of contractual provisions having to do with delivery and storage of the trusses.

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The contract contained an arbitration agreement dictating that the arbitration demand be made in writing within a reasonable time. Shoffner argued that SMC waited more than one year after the trusses were brought to the site without initiating arbitration; therefore, all claims should be deemed waived. The court held that the failure to demand arbitration did not amount to a waiver of all judicial remedies. Moreover, under the applicable law, the arbitration clause in question appeared to have been intended to apply only to disputes that arose during construction, not afterwards. Accordingly this portion of Shoffner's Motion for Summary Judgment was denied.

Shoffner also argued that SMC failed to timely reject the trusses or to timely notify Shoffner of its alleged breach. Shoffner argued that SMC should have noticed the alleged defect upon delivery or within the next several weeks. SMC said it had no knowledge of the defect at delivery because the mold was not visible, no owners had complained, and construction of the majority of units had not begun. Because SMC only gained its understanding of the nature and extent of the problem after the investigations conducted by Patuxent, and because thereafter it timely notified Shoffner that the trusses likely "played a substantial role" in the mold growth, the court also denied this portion of Shoffner's Motion for Summary Judgment.

Shoffner also contended that it could not be held in breach of the provision requiring it to "protect all materials by placing them in secured areas, covering them with polyurethane (supplied by the General Contractor), and elevating them off ground or basement floor," because under Maryland law, SMC waived this term by its conduct. Maryland law clearly provides that parties may waive contract terms by their conduct. Upon delivery of the trusses to the construction site, SMC's site construction manager assumed responsibility for placement and storage of the trusses. Thus, there was no way for Shoffner to maintain responsibility and control over the trusses or assure their protection from the elements. The court granted Shoffner's motion as to this count.

This case highlights two important issues facing construction contractors. First, it is of the utmost importance that the arbitration clause be carefully worded to have the desired force and effect. Second, it is important to make all construction personnel aware of the requirements for storage and care of materials delivered to the construction site. The issues can be addressed through properly worded contract clauses and an understanding of the responsibilities bestowed in the contract.

Small Case Reaches Large Decision in "Pay When Paid" Debate

Saad Construction Company ("Saad") entered into a contract under which Saad was to serve as general contractor for the construction of a middle school for the owner ("Owner"). Hartford Accident and Indemnity Company ("Hartford") was Saad's surety on the job, and Saad entered into a subcontract ("the Subcontract") with Cochran Plastering ("Cochran") for Cochran to perform work on the job as Saad's subcontractor.

The Subcontract provided that Saad would make periodic progress payments, subject to five percent retainage. The Subcontract also provided that "[f]inal payment shall then be made to [Cochran] within fifteen (15) days following [Saad's] receipt of payment from [the Owner]." Upon receiving each payment, Cochran signed a certification, certifying that "payments, less applicable retention, have been made through the period covered by previous payments received from [Saad]." After construction of the school, Cochran submitted a final invoice for $12,849.27; this amount did not include any retainage. Although Saad had not paid the $12,849.27—and, thus, Cochran had not been paid in full—Cochran nonetheless executed a full release, indicating that it had been paid in full. After executing the release, Cochran requested payment of the $12,849.27 from Saad, but Saad required that Cochran first provide lien-waiver and tax documents before the payment could be made. Accordingly, a Cochran representative went to deliver the documents to Saad. However, the Cochran representative ended up in a physical altercation with Saad's president. The Cochran representative did not leave the required documents, but he submitted them a few weeks later. Saad still did not pay the $12,849.27, and Cochran sued Hartford to recover $22,191.19—which included the payment due, plus retainage—plus interest and attorney fees.

Saad intervened in the suit and filed a third-party claim alleging assault and trespass against Cochran, and Cochran filed a claim alleging assault against Saad. While the complaint was pending, Saad sent Cochran a check in the amount of $12,849.27. Cochran negotiated the check but sent a letter to Saad indicating that it was not waiving or releasing any claims against Saad. The trial court tried the defenses of release and accord and satisfaction, and found in favor of Cochran. The trial court awarded Cochran $9,341.92 in retainage and $1,709.08 in interest, plus attorneys' fees in the amount of $21,577.50, and costs. Hartford appealed, and the Alabama Court of Civil Appeals affirmed.

The court dealt specifically with the "pay when paid" issues as follows:

Hartford argued that the Owner's payment to Saad was a condition precedent to Saad's payment to Cochran. In making this argument, Hartford relied on the provision of the Subcontract stating that final payment shall be made to Cochran "within fifteen (15) days following [Saad's] receipt of payment from [the Owner]." The court examined the Subcontract, and found "[w]hen read in its entirety … the 'final payment' provision of the [Subcontract] does not support the interpretation advanced by Hartford." Saad received a progress payment from the Owner that covered the work that Cochran completed, but Saad made no payment to Cochran. The court also cited *Federal Insurance Co. v. Kruger, Inc.*, noting that the court in *Kruger* determined that a similar clause was merely a timing mechanism for final payment. Further, the court reiterated the precept that a surety cannot assert a pay-when-paid clause contained in a contract between a contractor and a subcontractor, as a defense to its liability under a payment bond. Thus, the court rejected Hartford's condition precedent argument.

In other holdings, the court's results were as follows:

1) Hartford also argued that Cochran's claims were released via the release executed by Cochran prior to final payment. The Court examined the release and noted that Saad was supposed to pay $12,849.27 and that the release was

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contingent upon this payment. In addition, because the release did not specify a time for payment, the Court concluded that the release was ambiguous. The Court also noted that Saad did not make the payment until nearly a year after the release was signed, despite the fact that industry practice only allowed Saad 30 days to pay. The Court ultimately stated that "[t]he evidence supports a conclusion that the [release] was not supported by consideration;" therefore, the Court held that the trial court did not err in refusing to enforce the terms of the release.

2) The Court next considered Hartford's defense of accord and satisfaction. Hartford contended that Cochran's cashing of the check amounted to an accord and satisfaction. The Court outlined the elements of accord and satisfaction as: 1) proper subject matter; 2) competent parties; 3) assent or meeting of the minds; and 4) consideration. The Court then noted that there was no indication on the check sent to Cochran that it was intended to be in full satisfaction of the debt owed. Thus, the Court held that the trial court did not err in holding that there was no accord and satisfaction.

3) Finally, the Court addressed Hartford's challenge to the attorney's fee awarded by the trial court. The Court noted that, under Alabama law, a party suing a surety may seek a reasonable attorney's fee. Hartford argued that the figure awarded was excessive, but the Court disagreed. The Court noted that Cochran's attorney submitted an affidavit and detailed description of the fees incurred, and held that the trial court did not abuse its discretion in awarding the attorney's fee. Thus, the Court affirmed the trial court on all four issues.

Can Lower-Tier Parties Initiate a Payment Freeze?: Supreme Court of North Carolina's Recent Decision Protects Lower-Tier Subcontractors and Suppliers

A recent ruling from the North Carolina Supreme Court exposes owners, contractors and higher-tier subcontractors to liability for money owed to lower-tier subcontractors or suppliers. According to the court in *O&M Industries v. Smith Engineering Company*, upon receipt of a Notice of Claim of Lien Upon Funds from a lower-tier subcontractor or supplier, all parties up the contractual chain will incur direct liability to the unpaid claimant upon making any subsequent payments. Merely retaining amounts equal to or in excess of the amount claimed will not shield a recipient against direct liability. While protecting participants in the construction process that arguably have the least amount of control over their own destiny, this ruling could have the collateral effect of substantially disrupting cash flow and cash-driven progress on ongoing construction projects.

North Carolina General Statute Section 44A-20 protects lower-tier parties from non-payment on a construction project by the use of a Notice of Claim of Lien Upon Funds ("Lien on Funds") against all parties up the contractual chain. Upon receipt of a Lien on Funds:

(1) All recipients must retain funds up to the total amount claimed in the Lien on Funds; and

(2) In the event a recipient makes any further payments down the contractual chain, such recipient shall become directly liable to the claimant to the extent of any such payments.

The owner in the *O&M* case, Kurz Transfer Products, LP ("Kurz"), contracted with Smith Engineering Company ("Smith") to provide design and construction of a regenerative thermal oxidizer system at the site of a manufacturing facility operated by Kurz. In turn, Smith subcontracted with the plaintiff, O&M Industries ("O&M"), to provide construction and delivery of a three-canister thermal oxidizer for incorporation into the larger system. O&M subsequently performed by shipping the constructed oxidizer to the project site in June 2001.

Believing Smith to be in financial trouble, O&M served Kurz with a Lien on Funds on June 8, 2001 in the amount of $113,655.00. Although O&M had constructed the oxidizer as of that date, O&M had not yet delivered it to the site. *See* N.C. GEN. STAT. §§ 44A-18(5) (North Carolina law allows for a Lien on Funds "earned" but not yet "due"). Following receipt of the Lien on Funds, Kurz made two payments to Smith totaling $314,831.25. Smith ceased work on the project in August 2001 and soon after filed for bankruptcy protection. Kurz retained and withheld payment from Smith in excess of the $113,655.00 claimed in O&M's original Lien on Funds. Subsequently, Kurz argued that it was not obligated to make any further payment to O&M, since the cost to complete the project following Smith's abandonment would exceed any amounts owed from Smith to O&M. Prior North Carolina courts have recognized that additional funds necessary to finish a project can be set off against amounts liened on the project. The *O&M* court found that neither the retention of funds, nor the subsequent claim of set-off, would be sufficient for Kurz to avoid personal liability. According to the court, any payment made by Kurz down the contractual chain after receipt of the Lien on Funds resulted in Kurz being directly liable to O&M for any amounts paid. Therefore, while a recipient is required to "retain" funds up to the amount of the Lien on Funds, mere retention, subject to subsequent set-off, will not shield the recipient from liability. The recipient has a separate and independent obligation to withhold further payments down the contractual chain, discharge the Lien on Funds or face direct liability up to any amount paid.

The *O&M* decision appears to leave recipients of a Lien on Funds with few "good" options. To avoid being forced into a payment freeze or incurring direct liability due to subsequent payment, recipients have the following options: (1) attempt to determine the potential validity of the claim; (2) pressure lower-tier parties to resolve the payment dispute, resulting in discharge of the Lien on Funds; (3) make payment in full to the claimant, which requires interfering in a lower-tier contractual arrangement and risking double-liability; (4) discharge the Lien on Funds by either purchasing a bond for the amount claimed or making payment in full to the clerk of court, resulting in additional costs and impacting project cash flow; or (5) escrowing the funds as a part of "payment" to the next tier down. If the recipient does not dispute the amount in the Lien on Funds is presently due, the best option may be payment of the claimed amount to the clerk of court or to escrow. Payment to the clerk of court will discharge the Lien on Funds and leave it to the lower-tier contracting parties to litigate their respective rights to those funds. However,

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as a Lien on Funds can be filed for amounts "earned" but not yet "due", the recipient may not be in a position to pay the claimed amount in full to the clerk of court. In such cases, the costs of purchasing a bond to discharge the Lien on Funds may be necessary to avoid straining project cash flow.

The recent *O&M* ruling, while admirably protecting lower-tier participants in the construction process, imposes a new burden and risk on owners, general contractors and higher-tier subcontractors. Close attention and management of payment status all the way down the contractual chain will help control and mitigate the risk, but recipients must be prepared to act quickly and prudently upon receiving a Lien on Funds to avoid being forced into a payment freeze or incurring direct liability due to improper payment.

No "Cookie Cutter" use of an A/E's Plans

Regardless of the kind of delivery system used for a project, the design documents represent the intellectual property of some person or company. As such, they are protected, often by contract, but always by virtue of state and federal law. The Ninth Federal Circuit Court (supervising trial courts in Alaska, Arizona, California, Idaho, Montana, Nevada, Oregon, and Washington) recently enjoined a developer from using a designer's documents for a master planned community in north-western Las Vegas. In *LGS Architects, Inc., vs. Concordia Homes of Nevada,* decided on January 11, 2006, the developer and the designer agreed to a license by which the developer was allowed to reuse the designer's plans for 80 homes in the planned community. When the developer decided to use the plans to build another 68 homes in an adjacent planned community, it failed to tender the precise amount required for "reuse" under the licensing agreement, and it failed to obtain the designer's agreement to the reuse. Hence, the license was violated, and the designer was entitled to an injunction against use of its drawings, a return of the drawings, and any public display by the developer of the designer's plans.

Clearly, designers should guard carefully their intellectual property rights, as is provided for example in the standard AIA documents. Developers, their financial backers, and contractors should be aware of the designer's rights and should purchase, at the front end of a project with repeatable features (such as a planned community, or a group of similar office buildings), the "reuse" license with a fee for reuse negotiated in the initial contract. Otherwise, the use of the design may be enjoined, a project halted, and any use (including photographs) of the design prevented.

Bradley Arant Lawyer Activities:

2006: Axel Bolvig will serve as a member of the 2006 General-Subcontractor Committee of Associated Builders & Contractors, Inc., Alabama Chapter.

2006: Joel Brown and Rob Campbell will serve as members of the 2006 Legislative Committee of Associated Builders & Contractors, Inc., Alabama Chapter. **Joel Brown** also will continue to serve as a member of the Education Committee of the ABC Alabama Chapter.

2006: Rob Campbell will serve as member of the Legislative Committee and **Joel Brown** will serve as a member of the Small Business Committee of the Business Council of Alabama.

January 17, 2006: Mabry Rogers presented an in-house seminar for a client regarding FAR compliance.

January 25, 2006: David Pugh presented a seminar on "Building Codes" in Birmingham, Alabama.

January 26, 2006: Rhonda Andreen, Stanley Bynum, Donna Crowe, Eric Frechtel, Arlan Lewis, and David Owen attended the ABA Forum on the Construction Industry's Midwinter Meeting, "Expecting the Unexpected: Anticipating and Managing Key Risks to Successful Projects," in New York City.

January 27, 2006: Stanley Bynum, Donna Crowe, Eric Frechtel, and Arlan Lewis attended the ABA/TIPS Fidelity and Surety 2006 Annual Midwinter Meeting in New York City.

March 16, 2006: Patrick Darby, Arlan Lewis, David Pugh, Harold Stephens, and Sabra Wireman presented a seminar on "Construction Insurance, Bonding and Liens in Alabama," in Birmingham, Alabama.

March 29, 2006: Jonathan Head and Joel Brown spoke to the Associated Builders and Contractors at their Annual Day on the Hill Meeting in Montgomery, Alabama.

April 18, 2006: David Owen presented a seminar to the Birmingham Chapter of the Alabama Society of Professional Engineers on the topic "Professional Services Contracts, Risk Allocation, Litigation and Discovery."

May 8, 2006: Wally Sears will be the panel leader for a presentation on "LNG Facilities – Challenges and Opportunities for the Owner and the Contractor in the International Market" at the International Construction Superconference in London, UK.

May 9, 2006: Wally Sears will present an in-house seminar to a client on basic construction contract law principles and the importance of good record keeping.

May 18-19, 2006: Rhonda Andreen and Arlan Lewis will attend the ABA Forum on the Construction Industry's Annual Meeting, "Swimming with the Sharks: Litigating the Construction Case and More," in San Diego.

June 2006: Nick Gaede will be teaching a course on International Arbitration in Fribourg, Switzerland. The course will be attended by students from the University of Alabama and the University of Fribourg Schools of Law.

June 14, 2006: David Bashford, John Bond, Eric Frechtel, Michael Knapp, Doug Patin, Mabry Rogers and Colin Stockton will present a seminar titled "Legal Issues Facing the Construction Professional: The Most Common Pitfalls and How to Avoid Them in North Carolina" in Charlotte, North Carolina.

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James F. Archibald, III .... (205) 521-8520 .... jarchibald@bradleyarant.com
David H. Bashford .... (704) 338-6001 .... dbashford@bradleyarant.com
Axel Bolvig, III .... (205) 521-8337 .... abolvig@bradleyarant.com
John D. Bond, III .... (704) 338-6007 .... jbond@bradleyarant.com
Joel E. Brown .... (205) 521-8416 .... jbrown@bradleyarant.com
Stanley D. Bynum .... (205) 521-8000 .... sbynum@bradleyarant.com
Roy D. Campbell, III (Jackson) .... (601) 948-9934 .... rdcampbell@bradleyarant.com
Rhonda R. Caviedes Andreen .... (205) 521-8683 .... rcaviedes@bradleyarant.com
Donna M. Crowe (Washington, D.C.) .... (202) 719-8212 .... dcrowe@bradleyarant.com
Chris Danley (Washington, D.C.) .... (202) 719-8230 .... cdanley@bradleyarant.com
J. Patrick Darby .... (205) 521-8332 .... pdarby@bradleyarant.com
Julie S. Elmer .... (205) 521-8431 .... jelmer@bradleyarant.com
Eric A. Frechtel (Washington, D.C.) .... (202) 719-8249 .... efrechtel@bradleyarant.com
A. H. Gaede, Jr. .... (205) 521-8323 .... ngaede@bradleyarant.com
John W. Hargrove .... (205) 521-8343 .... jhargrove@bradleyarant.com
Jonathan B. Head .... (205) 521-8054 .... jhead@bradleyarant.com
Gary C. Huckaby (Huntsville) .... (256) 517-5140 .... ghuckaby@bradleyarant.com
David G. Hymer .... (205) 521-8289 .... dhymer@bradleyarant.com
Danielle Daigle Ireland (Jackson) .... (601) 948-9942 .... direland@bradleyarant.com
Michael W. Knapp (Charlotte) .... (704) 338-6004 .... mknapp@bradleyarant.com
Jeffrey D. Komarow (Washington, D.C.) .... (202) 719-8211 .... jkomarow@bradleyarant.com
Michael S. Koplan (Washington, D.C.) .... (202) 719-8251 .... mkoplan@bradleyarant.com
Arlan D. Lewis .... (205) 521-8131 .... alewis@bradleyarant.com
Michael D. McKibben .... (205) 521-8421 .... mmckibben@bradleyarant.com
James William Manuel (Jackson) .... (601) 948-9936 .... wmanuel@bradleyarant.com
Mitchell S. Mudano .... (205) 521-8544 .... mmudano@bradleyarant.com
Andrew J. Noble, III .... (205) 521-8342 .... anoble@bradleyarant.com
David W. Owen .... (205) 521-8333 .... dowen@bradleyarant.com
Douglas L. Patin (Washington, D.C.) .... (202) 719-8241 .... dpatin@bradleyarant.com
Jeffrey A. Peters .... (205) 521-8583 .... jpeters@bradleyarant.com
J. David Pugh .... (205) 521-8314 .... dpugh@bradleyarant.com
E. Mabry Rogers .... (205) 521-8225 .... mrogers@bradleyarant.com
Katherine L. Ruff (Washington, D.C.) .... (202) 719-8208 .... kruff@bradleyarant.com
Walter J. Sears III .... (205) 521-8202 .... wsears@bradleyarant.com
J. R. Steele (Washington, D.C.) .... (202) 719-8222 .... jsteele@bradleyarant.com
H. Harold Stephens (Huntsville) .... (256) 517-5130 .... hstephens@bradleyarant.com
Colin R. Stockton (Charlotte) .... (205) 338-6005 .... cstockton@bradleyarant.com
Robert J. Symon (Washington, D.C.) .... (202) 719-8294 .... rsymon@bradleyarant.com
Sabra Barnett Wireman .... (205) 521-8549 .... swireman@bradleyarant.com

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CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

Rhonda Caviedes Andreen
James F. Archibald, III
David H. Bashford (c)
Axel Bolvig, III
John D. Bond, III (c)
Joel E. Brown
Stanley D. Bynum
Roy D. Campbell, III (j)
Donna M. Crowe (d.c.)
Danielle Daigle Ireland (j)
Chris Danley (d.c.)
Julie S. Elmer
Eric A. Frechtel (d.c.)
A. H. Gaede, Jr.
John W. Hargrove
Jonathan B. Head
Gary C. Huckaby (h)
David G. Hymer
Michael W. Knapp (c)
Jeffrey D. Komarow (d.c.)
Michael S. Koplan (d.c.)
Arlan D. Lewis
James William Manuel (j)
Michael D. McKibben
Mitchell S. Mudano
Andrew J. Noble, III
David W. Owen
Douglas L. Patin (d.c.)
Jeffrey A. Peters
J. David Pugh
Katherine L. Ruff (d.c.)
E. Mabry Rogers
Walter J. Sears III
J. R. Steele (d.c.)
H. Harold Stephens (h)
Colin Stockton (c)
Robert J. Symon (d.c.)
Sabra Barnett Wireman

Contractors Beware: Immigration Reform Already Is Here

For a variety of reasons, the immigration debate moved to center stage this year. Much of the recent interest arises from border security, and much of the federal government's enforcement efforts have focused on entities actually aiding in the trafficking of illegals. However, bills are pending now in Congress which will affect contractors directly, and, more importantly, the Department of Homeland Security ("DHS") already has taken new initiatives and issued important proposed regulations which apply to contractor employers now.

Employers in the construction industry have reason to be concerned. Some estimates indicate that seventeen percent of unauthorized workers are employed in construction. That equates to well over a million illegals in construction, or about 20 percent of the construction workforce. Fully 40 percent of new construction jobs are filled by Hispanics. Unlike what many might expect, the concentration of new immigrants is in the Deep South. What does this mean? As government enforcement begins to shift or to expand from traffickers to general employers, the construction industry likely will be targeted first.

As background, recall that the law which enacted I-9 compliance, the Immigration Reform and Control Act ("IRCA"), went into effect in 1986. Since then, the primary obligation on employers was to complete I-9 forms on each employee. IRCA really contained minimal enforcement mechanisms (primarily administrative fines). The whole focus of the legislation was establishing documentation requirements designed to prevent the hiring and retention of unauthorized workers by employers. Later IRCA was refined and amended by the Illegal Immigration Reform and Responsibility Act of 1996 ("IRIRA"). IRIRA did establish some criminal penalties for smuggling, document fraud, and unauthorized employment related to smuggling. Still, enforcement mechanisms against employers were

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very weak. In addition, workers (and some employers) continued to dodge the requirements by using false documentation or failing to maintain the documentation required. Because enforcement was lax in this period few fines were assessed and the ones that were given to employers were relatively small and often resolved through compromise agreements.

From a legislative standpoint, those two laws bring us up to date. Last year, a bill was introduced in the House aimed at tightening border security. That bill made employers the enforcers of the law by requiring them to verify the status of all new hires and current employees. Fines of $25,000 for paperwork violations were included. The Senate later began considering its own bill which has additional provisions allowing illegals to become citizens and describing a guest worker plan. The differences in the bills make it likely that a compromise major immigration reform bill will take some time to pass.

Turning to historical enforcement activity, the number of workplace enforcement actions was extremely low throughout the 1990's. However, things have begun to change, and we can expect much more enforcement in the future. The huge governmental agency which was created in the aftermath of 9-11, The Department of Homeland Security ("DHS") contains sub-agencies dealing with immigration including U.S. Immigration and Citizenship Services (formerly INS), which oversees immigration benefits and the immigration enforcement agency, Immigration and Customs Enforcement ("ICE").

This year, ICE announced an interior immigration enforcement initiative. In June of this year, Julie Myers, the Assistant Secretary of the Department of Homeland Security, testified before the Senate Judiciary Committee about immigration workforce enforcement. Explaining that ICE has learned that it is not effective to approach the situation "piece meal" by assessing administrative fines against individual employers, ICE is planning to target companies who unlawfully employ aliens and to detain and to remove the workers in an expeditious manner. By operating this way, the agency hopes to send a strong message to foreign nationals in their home countries that they will not be able to move from job to job in the U.S. once ICE shuts down their employer.

In an effort to achieve these goals, ICE increasingly is bringing criminal charges against employers in addition to bringing charges for civil penalties. Criminal charges against employers who hire illegal workers include charges for money laundering and knowingly harboring and transporting illegal aliens. Recently there have been instances in which contractors who were working on government projects were charged with False Claims Act violations when the Social Security numbers of some of the workers on the claims form were not valid. By making examples of certain employers in high-profile cases, ICE hopes to discourage the practice of employing illegals by other employers.

Clearly, ICE also is trying to work with other government agencies to use any available avenue stop the use of illegal workers. These include the Office of Special Counsel, the Social Security Administration, the Department of Labor, and the Internal Revenue Service. By using existing laws of these other agencies, working together, and bringing more criminal actions rather than civil actions, the U.S. government hopes to change the landscape of immigration enforcement even before actual immigration reform legislation is passed.

The statistics paint poignantly the picture of the new workforce enforcement environment. While in 1997 only three employers were charged with workplace violations, and only 862 employees were charged with working illegally, those numbers rose in 2005 to 178 charges against employers and 1,160 charges against illegal workers. The enforcement actions continue to increase. Between October of 2005 and June of 2006, ICE initiated 592 investigations at critical infrastructure worksites, up 48 percent from 2005 year totals. Many of the sites investigated were construction sites. Security sensitive sites and critical infrastructure facilities are still the most likely construction sites to be watched and possibly raided. These include military facilities, airports, federal buildings, nuclear plants, chemical plants, and financial institutions.

In addition to these stepped up enforcement efforts, two new regulations came out this summer related to workplace enforcement. First, DHS issued a proposed regulation explaining steps employers should take when receiving a Social Security no-match letter. These are the customary letters to employers informing them that certain of their employees have incorrect Social Security numbers. This regulation sets forth a "safe harbor" for employers who take these suggested actions after receipt of such a letter. The first step is for the employer to check its records to determine if there was an error. If there was no error, the employer then should ask the employee to resolve the problem with the Social Security Administration. This step should be taken within 14 days, which is a reasonable time according to the regulations. If the matter still is not resolved, an employer needs to reverify the employee's work authorization within 60 days using the same procedure as the original I-9 procedure but with added precautions. At this point the employer cannot use any document containing the Social Security number that is the

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subject of the no-match letter, and no document without a photograph can be used to establish identity. If this fails, the employee must be discharged.

The second proposed regulation involves the manner in which I-9 forms can be kept electronically. In general, these forms must meet certain standards including legibility and readability. The forms must be indexed. The regulations do allow for electronic signatures. It is likely no accident that this regulation comes out at this time of increased workplace enforcement. ICE will be able to search these forms more quickly and effectively if they are kept in an electronic format. It is important to note that employers are not required to keep the I-9 forms in electronic format, but it is an available option.

Given the increasing number of raids and criminal charges being brought against employers of illegal aliens and these new regulations, it is obvious that employers face a new environment of increased immigration enforcement. The careful contractor needs to study its practices and adjust procedures as necessary. The following ten guidelines can provide a starting point for reviewing the practices of your business:

Remember: Failure to verify will lead to discharge of the employee, and not to mention a possible enforcement action. Thus, hours of training and morale building will be lost if the employee is discharged.

What Can Contractors Do In This Changing Environment?

1. Make sure that I-9 forms are in order and perform a self-audit or have an outside firm conduct one if one has not been done recently.

2. Make sure that I-9 forms are kept separately from personnel files and that documents are purged when it is legally permissible. I-9's must be kept for the full period of employment and one year afterward, subject to a minimum period of three years after the date of hire.

3. Have a plan in place to respond to Social Security no-match letters.

4. Have a designated person assigned the responsibility for keeping up with the I-9 process.

5. Take appropriate steps to see that subcontractors have an I-9 system that is in compliance.

6. Be sure that the person in charge of I-9 compliance examines and copies the original documents and attaches them to the I-9.

7. If mistakes are discovered in an audit, make corrections and initial and date them on the current date (do not back date; do not white out).

8. Be certain that the company does not have constructive or actual knowledge that an employee is not work authorized. For example if an employee admits he is not work authorized or requests that you as the employer sponsor him for a work visa, this information is inconsistent with the belief that the employee is legally authorized to work.

9. If you have a federal or state contract, consider taking additional precautions such as requiring subcontractors to verify all Social Security numbers for workers, in addition to performing customary I-9 compliance. These jobs will be subject to increased scrutiny, could result in raids and, at a minimum, the negative publicity associated with such raids, and would result in false claims act charges for improper social security numbers.

10. Create an action plan so that your company will be prepared in the event of an ICE audit:

a. In case of a raid, you *immediately* should call your lawyer. As with any governmental criminal investigation, the subject of the investigation has the right to remain silent and does not have to talk with the investigators.

b. Just as you would prepare an action plan for a possible OSHA visit, do so now in the event of a future visit by ICE. Designate a point person to be in charge of the investigation on behalf of the company. Be aware that if ICE comes without a warrant, the company representative should ask for three days to provide I-9 documents, and the company should not waive that right. However, if the government comes with a warrant, the three day period has no application.

c. In advance of any investigation, talk to your workers about the possibility of an ICE enforcement action and let them know that they do not have to talk to the agents. Recently there have been reported occurrences of agents badgering Hispanic workers by name calling, and it is important that contact between the workers and the agents be kept to a minimum because such activity can result in confusion and incorrect information.

d. Plan to use a conference room or other area that is separate from the worksite as a place to supply documents and have your point person meet with government agents. Be certain to get the business card of the investigator and have someone take notes of the meeting so that you have a record of everything discussed

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and requested. Do not be surprised if you have on your premises agents from a variety of government agencies including ICE, the Department of Labor, the Office of Special Counsel, and possibly others such as Housing and Urban Development if it is a government funded project.

Recent Decisions May Require Licensed Engineers to Testify

1. Alabama

The decision on July 28, 2006 has raised many questions concerning the scope of its applicability. The decision holds that any "engineering" subject can be testified about only by an engineer licensed in Alabama. It is unclear whether testimony pertaining to estimating or scheduling would be governed by the holding. Additionally, it is questionable whether this holding will apply to testimony in Federal courts or arbitration proceedings. Bradley Arant Rose & White LLP will be monitoring this issue closely and will provide an update in forthcoming newsletters.

2. Illinois

A recent Illinois Supreme Court decision examined whether an engineer must be licensed in Illinois before being allowed to testify as an expert in litigation there. The case concerned a motor vehicle accident in which a car crossed a raised median and collided with another vehicle. The Plaintiff, a surviving passenger in the vehicle that did not cross the median, filed suit against multiple parties, including the designers of the intersection where the accident occurred. Her claims included negligence against the designers.

Plaintiff filed a pleading that contained an affidavit from her expert witness, whose opinion was that the defendants failed to meet the ordinary standard of care in their design of the intersection. Plaintiff's expert was a civil engineer who was licensed in the District of Columbia but not in Illinois. The Defendant filed a motion to strike the affidavit.

The Illinois Supreme Court's decision examined only the narrow issue of whether licensure as a professional engineer in Illinois is a prerequisite to testifying as an expert witness in a civil case there. The court held that while the presence of an Illinois license may be a factor for a trial court to consider in deciding on whether to allow an expert witness, the lack of such license is not a bar to giving expert testimony in a civil case. In reaching its decision, the court noted that there is no predetermined formula for how an expert acquires specialized knowledge or experience, and also that expert testimony is admissible if the expert is qualified by knowledge, skill, experience, training, or education and the testimony will assist the trier of fact in understanding the evidence.

Despite the court's holding, there exist multiple reasons why a party would want to have its engineering expert licensed in the state before attempting to have them deemed qualified as an expert there. First, as was mentioned earlier, licensing is still a factor that a trial court can consider in determining whether the individual should be permitted to give expert testimony. Additionally, an engineer who testifies in a state without being licensed there might be committing a criminal act (While this litigation was on-going the Illinois Department of Professional Regulation issued a cease and desist order against the expert; the order found that the expert was engaged in the practice of professional engineering without a license). The Illinois Supreme Court held that a witness would not necessarily be precluded from testifying as an expert just because the giving of such testimony could constitute a criminal act, but the court reasoned that whether the engineer might have been committing a criminal act by testifying was a separate issue to be decided in a separate proceeding.

A party would be well advised to obtain in-state licensure of an engineering expert. The lack of such licensure could be a consideration that the trial court uses, along with others, to disallow the relevant witness. Additionally, the expert could be opening himself/herself up to criminal liability by offering such testimony. Generally, it is easy for an engineer to become licensed in a state where he/she will testify. A small amount of effort to attain such licensure initially could prevent larger problems for both the party and the expert further down the road.

Supreme Court Reaffirms Challenges To Contracts To Be Determined By Arbitrator When Contracts Contain Arbitration Clause

In *Buckeye Check Cashing, Inc. v. Cardegena*, the United States Supreme Court reaffirmed how a challenge to the validity of a contract should be handled when an arbitration clause is included within the contract at issue. In the case, the claimants brought a class action in Florida state court alleging that Buckeye was charging illegal interest rates. Specifically at issue were the terms of a Deferred Deposit and Disclosure Agreement each claimant was forced to sign when they cashed their checks. Of importance in this matter was the fact that Buckeye included a clause which required all disputes to proceed to arbitration.

Consistent with the arbitration provision contained in the agreement, Buckeye requested the court to compel the claims to arbitration. The claimants opposed this demand

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and responded that the arbitration clause at issue was of no effect given the fact that the agreements (which contained the arbitration clause) were void because the argument violated various state lending and consumer protection laws. The claimants argued that the court, rather than an arbitrator, should determine whether the contracts were void.

In ruling that a challenge to a contract as a whole, and not specifically to a contract's arbitration clause, must be determined by the arbitrator, the Supreme Court rested on three long standing propositions. First, as a matter of the Federal Arbitration Act, an arbitration provision is severable from the remainder of the contract. Second, unless a challenge is directed to the arbitration clause itself, the arbitrator must first establish whether the contract is valid. Third, these arbitration principles apply to both state and federal cases.

Using the three propositions described above, the Supreme Court determined that regardless of whether the matter was filed in state or federal court, because the claimants were challenging the legality of the contract as a whole and not specifically the arbitration provision, the arbitration provision was enforceable separate and apart from the contract. As such, the court held that a challenge to the contract should be determined by an arbitrator, not the court.

Even if one opposes arbitration, this case is welcome news in clarifying the scope of the initial challenge to an arbitration proceeding, lending certainty in an area where uncertainty has crept in because of the movement of arbitration out of its "founding" nests of construction and labor into consumer transactions.

Alabama's First Interpretation of its Private Prompt Payment Statute

The Supreme Court of Alabama recently answered completely new questions regarding its private prompt payment statute ("the Act"). The Act requires owners to pay general contractors, and general contractors to pay subcontractors, in a timely fashion (either pursuant to the contractual terms the parties agreed on, or within statutorily prescribed times). It requires a payor to state its disputes in writing, if any, with a contractor or subcontractor's bill within either fifteen or five days, respectively. If a payor fails to state its dispute in writing and does not pay timely, it is subject to twelve percent simple interest and attorneys' fees on the unpaid amounts.

The Act is largely untested in litigation, as are many of the relatively new prompt payment acts around the country. One question payors have had regards the "bona fide dispute" provision, which allows a payor to withhold up to two times the amount of a disputed portion of a payment request, and whether a payor would still be liable for interest and fees if it eventually lost the dispute. The Supreme Court of Alabama has held that a payor is not responsible for interest if it loses a bona fide dispute, but that it remains responsible for attorneys' fees. "We conclude that the statute provides for awarding attorney fees irrespective of whether a party is entitled to interest…."

The court also answered two ancillary issues in its opinion. First, a payor who withholds money and prevails at trial is entitled to an award of attorneys' fees. In the court's words, the provision for attorneys' fees can "cut both ways." Second, the court held that the specific use of "judgment" with relation to an award of attorneys' fees meant that a party who wins at trial may not receive an award of fees for its appellate expenses.

Courts in other states have not always made the sharp distinction between recovery of interest and fees, but Alabama's statute is written differently, wrote the Court. This decision may produce some peculiar results where the amount of fees is high when compared to the principal amount recovered, but is faithful to the text of the Act that reads "the party in whose favor a judgment is rendered ***shall be entitled*** to recover payment of reasonable attorneys' fees…." (emphasis added)

Oregon Court Clarifies the Obligations of a CGL Carrier to its Additional Insured

Construction projects can be dangerous. In spite of efforts by owners and contractors to promote a safe workplace, injuries occur. Prime contractors often seek contractual protection from injury claims, by obtaining indemnity agreements in their subcontracts. In addition, prime contractors will require their subcontractors to name them as an "additional insured" under their subcontractors' commercial general liability ("CGL") insurance. If the subcontract is followed and enforced, the prime contractor should be able to tender a personal injury claim or lawsuit directly to its subcontractor's CGL carrier, and the subcontractor's CGL carrier would be obligated to defend the prime and pay the claim, in accordance with the subcontractor's CGL policy. This approach makes sense where the indemnifying subcontractor is responsible for causing the injury, but it may not make sense where the injury is unrelated to the subcontractor's activities.

In Oregon, the State legislature enacted Or. Rev. Stat. Section 30.140, that generally declares such arrangements void as against the public policy of Oregon. ORS Section 30.140(1) provides that "any provision in a construction

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agreement that requires a person or that person's surety or insurer to indemnify another against liability for damage . . . caused in whole or in part by the negligence of the indemnitee is void." Like many anti-indemnity statutes, the purpose for this statute is to eliminate indemnity clauses that create a "license to be negligent." The Oregon legislature apparently feared that prime contractors would have no incentive to assure safety if they knew that any liability could be passed down to their subcontractors' CGL carriers, regardless of their own fault. In one case, the Oregon Supreme Court applied this provision to invalidate a provision requiring a subcontractor to procure additional insured coverage for its prime contractor. *Walsh Construction Co. v. Mutual of Enumclaw*, 104 P.2d 1146 (Or. 2005). In that case, there was no evidence that the subcontractor caused the injury for which the prime contractor was seeking additional insured protection.

The Oregon Statute has an exception. Section 30.140(2) preserves indemnity agreements, and agreements to provide additional insured protection, where the liability "arises out of the fault of the indemnitor, or the fault of the indemnitor's agents, representatives, or subcontractors." The "license to be negligent" concerns that motivated adoption of the statute do not exist where the subcontractor that was required to obtain additional insured coverage for the prime contractor was at fault for the injury.

In *Hoffman Construction Company v. Travelers Indemnity Insurance Company*, (Nov. 28, 2005), a federal district court in Oregon applied the exception stated in Section 30.140(2) and found that a subcontractor's CGL carrier was obligated to provide a defense and coverage to an additional insured prime contractor where there was evidence that the subcontractor was at fault for the injury. The case arose out of an injury suffered by a workman in the "clean room" of a Hewlett Packard plant being constructed by Hoffman. The "clean room" mostly involved work by one of Hoffman's subcontractors, Advanced Technologies Group ("ATG"). Hoffman was an additional insured under ATG's CGL policy, issued by Travelers. When the injured worker asserted a claim against Hoffman, Hoffman tendered the claim to Travelers.

The Court rejected Travelers' attempt to obtain a summary judgment dismissal of Hoffman's request for indemnity based on Section 30.140(1) and *Walsh*, reasoning that Travelers was obligated to defend and indemnify Hoffman because ATG was arguably at fault for the injury. Even thought the injured worker was not an ATG employee, the Court found that ATG's failure to properly construct temporary steps in the "clean room" may have caused the injury. Therefore, Travelers' obligation to defend and indemnify Hoffman as an additional insured was preserved by the Section 30.140(2) exception. The Court ordered Travelers to defend and indemnify Hoffman, granting Hoffman's cross-motion for summary judgment.

In some states, including Oregon, indemnity clauses that purport to indemnify a prime contractor against its own negligence are not enforceable. In these states, *Walsh* and *Hoffman* illustrate that a similar approach may be applied to additional insured clauses in subcontract agreements. You should consult the particular laws of each state in which you work, to assure that your subcontracts, including any indemnity and insurance requirements stated in your subcontracts, are enforceable. In states like Oregon, it makes sense to draft your indemnity and additional insured clauses in such a way that the obligation is limited to situations where your subcontractor, or the agents of your subcontractor, are partially or entirely at fault for the personal injury or property damage for which indemnity and coverage will be sought.

One final practical point about "additional insured" obligations: every prime contractor should have in place a procedure for confirming that its subcontractors have in fact procured the additional insured coverage required by the terms of the subcontract. Far too often, the subcontractor fails to procure the "additional insured" coverage for the prime contractor, and the prime contractor is left exposed. If the subcontract clauses are written properly, and steps are undertaken to assure that appropriate insurance is in place, the prime contractor can be protected from any personal injuries that arise from the subcontractor's work.

Recovery of Bid Preparation Costs Requires Causal Connection to Basis of Bid Protest Action

When a government agency solicits work through the competitive bid process, it is obligated to consider all bids fairly and honestly. A breach of this obligation often allows a bid protester to seek recovery of its bid preparation costs as part of its remedy. However, bid protesters cannot assume that the existence of a bid irregularity automatically entitles them to recover their bid preparation costs. In *Lakloey, Inc. v. University of Alaska*, the Supreme Court of Alaska held that a bid protester was not entitled to recover its bid preparation costs where there was no evidence that the bidding irregularities wasted costs already expended in bid preparation or otherwise caused the protester to incur additional costs.

On March 5, 2003, the University of Alaska solicited bids for improvements to an existing facility. All bids were to be opened at 2 p.m. on March 20, 2003. Lakloey

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submitted its bid before 2 p.m. on March 20. Before 2 p.m., but after Lakloey submitted its bid, the university issued Addendum #2 which changed several bid criteria, adjusted the amount of required builder's insurance, and changed the bid opening date to April 1. Lakloey submitted a protest letter to the university alleging that the issuance of Addendum #2 violated the conditions of the solicitation, the university's procurement regulations, and Alaska's procurement code. The university rejected Lakloey's protest and Lakloey appealed the denial on March 31. Despite its pending protest, Lakloey submitted another bid on April 1. All of the bids exceeded the available project funds and were therefore rejected by the university.

Alaska Statute 36.30.585 limits a successful bid protester's damages to "reasonable bid or proposal preparation costs." Lakloey argued that several bid irregularities had occurred and thus, under the statute, it was entitled to its full bid preparation costs. First, by allowing only 15 days for the preparation of bids, the university violated Alaska Statute 36.30.130 which requires at least 21 days between the dates of solicitation and bid opening. The university had also failed to provide written justification for the reduced bidding period. The court agreed that the university had violated the statute, but held that Lakloey had not alleged, much less proved, that it suffered any damages caused by the shortened bidding period or the lack of written justification. Consequently, this violation did not entitle Lakloey to recover its bid preparation costs.

Lakloey also argued that the issuance of Addendum #2 on the originally scheduled bid opening date violated a statement in the instructions to bidders that any addenda would be issued no later than the day before bid opening. The court held that Lakloey had not asserted that it acted any differently between March 19 and 2 p.m. March 20, than it would have if Addendum #2 had been issued on March 19. Moreover, because Lakloey was able to submit a bid for the solicitation as modified by Addendum #2, its pre-Addendum #2 non-insurance-related bid preparation costs were not wasted. Thus, Lakloey had not demonstrated that it had relied to its detriment on the representations made about the timing of addenda and was not entitled to recover any bid preparation costs.

The court's decision in *Lakloey* illustrates that, in order to recover bid preparation costs, successful bid protesters should be prepared to demonstrate a causal connection between the basis of the bid protest and the additional costs incurred, or resources wasted, in bid preparation.

Contractors in Maryland May Acquire an Interlocutory Mechanics' Lien Without Waiving Their Contractual Rights to Arbitrate

The Court of Appeals of Maryland recently held that a contractor does not waive its contractual right to compel arbitration merely by obtaining an interlocutory mechanics' lien.

The Maryland Code, which sets out the requirements for filing and enforcing a mechanics' lien at Md. Code Ann., Real Prop. § 9-101 *et seq.*, provides that a petition to establish and enforce a mechanics' lien be filed within 180 days after the work has been finished or materials have been furnished. From the petition and any exhibits filed by the contractor, the court may conclude that there is a reasonable ground for a lien to attach and enter an order directing the owner to file an answer as to why the lien should not attach. The court's order will also set a date for a hearing on the petition. After reviewing the record, the court may either enter a final order establishing or denying the lien in the amount not in dispute, or enter an interlocutory order which: 1) establishes the lien; 2) describes the property to which it attaches; 3) states the amount of the claim; 4) states the amount of bond that the owner may file to have the lien released; 5) may require the claimant to files a bond; and 6) assigns a date for the trial of all matters at issue.

In *Brendsel v. Winchester Constr. Co.*, a contractor sought payment from a property owner for whom it had provided labor and materials. The contractor filed a petition to establish and enforce a mechanics' lien which, among other things, sought a stay of proceedings after an interlocutory lien was established pending the outcome of an arbitration proceeding between the parties. In response to the court's order to show cause why a lien should not be granted, the owner filed an answer denying that any amount was due the contractor and a counterclaim seeking damages for overcharging and defective work.

At the same time as the answer and counterclaim were filed, the parties filed a consent motion in which they agreed to postpone the scheduled hearing on the request of an interlocutory mechanics' lien, to conduct limited discovery, and to permit an interlocutory lien to be established during the discovery period in the amount sought by the contractor. In addition, the parties expressly agreed in the motion that "neither this Consent Motion nor their activities during the Discovery Period, nor the issuance of the interlocutory lien order proposed hereunder, shall prohibit or waive any party's right to proceed in arbitration, or to object thereto, to the same extent as if this

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Motion had not been filed and the actions proposed hereunder had not been taken."

Shortly after receipt of the consent motion, the court entered an interlocutory mechanics' lien in the amount sought by the contractor and declared that neither the consent motion, discovery conducted during the discovery period, nor the order would prohibit or waive the parties' rights to arbitration. That same day, the owners filed an amended answer and counterclaim. The contractor answered the counterclaim, asserting, among other things, that the counterclaim was subject to arbitration. After limited discovery which included depositions, the owner filed a motion for partial summary judgment on its counterclaim to which the contractor responded with a petition to compel arbitration and stay all further judicial proceedings on the grounds that the counterclaim was subject to arbitration. The owner opposed the petition, arguing that the contractor had waived its right to arbitration by seeking a mechanics' lien and by failing to provide written notice of a demand for arbitration within a reasonable time after the dispute had arisen.

Considering the totality of the circumstances and citing the decisions from other courts, the Maryland Court of Appeals declined to adopt a *per se* rule that the mere seeking of an interlocutory lien constitutes a waiver of arbitration. The court made it clear that "with respect to waiver of a contractual right to arbitrate disputes, that waiver involves a matter of intent that ordinarily turns on the factual circumstances of each case and that the intention to waive must be clearly established and will not be inferred from equivocal acts or language." As the *Brendsel* court further explained, an interlocutory mechanics' lien is in the nature of a provisional remedy sought to maintain the status quo so that an arbitration proceeding can have meaning.

Given the predominant view across jurisdictions that the availability of such provisional remedies is permitted under the Federal and Uniform Arbitration Acts and does not conflict with the right to enforce arbitration agreements, the *Brendsel* holding is likely indicative of how courts will consider an interlocutory mechanics' lien in light of a party's right to arbitrate.

Joint Venture Management Strategies

Joint Ventures can be problematical, particularly for the minority venturer. In a helpful decision, the Armed Services Board of Contract Appeals allowed the minority member of the JV to appeal under the Contract Disputes Act of 1978, despite the fact that the JV's Management Committee (controlled by the majority partner) did not authorize the appeal. The issue between the Government and the JV was the amount of work to be performed by the JV's own forces as the prime contractor. The JV itself refused to dispute the Government post-contract award requirement of 25%, so the minority partner disputed the directive. The Government asked that the dispute be dismissed because the JV Management Committee did not authorize the dispute.

The ASBCA based its decision on the fact that the minority partner had taken the refusal to authorize an appeal to the arbitration dispute resolution process authorized by the JV Agreement. The question to the arbitrator was whether the managing partner's (and thus the Management Committee's) decision was proper with respect to the dispute. The arbitrator ruled it was not and granted the minority partner the right to challenge the Government's directive. The ASBCA found that the managing partner had agreed to be bound by arbitration of JV disputes and that the arbitrator's authority to award remedies was unlimited. Finally, the ASBCA held it was not limited to looking only at the JV Agreement or to the terms of the JV-Government contract to determine who had the authority to act on behalf of the JV.

Hence, this case (*Sarang-National Joint Venture,* ASBCA, 2006), provides a strategy for a minority JV partner to attempt to obtain redress for a wrong done the JV, where the majority partner objects. The strategy is not limited to an arbitration provision within the JV agreement, because the minority partner might have sought similar relief from a court under a Declaratory Judgment action.

Mold Remediation Specialists Beware! Court Finds Specialist Liable for Recommending Unnecessary Remedial Services

Mold remediation specialists may be liable to their clients for breach of contract when recommending remedial services not justified by the circumstances. In *Moore v. Chodrow*, the Florida Fourth District Court of Appeals found a mold remediation specialist liable to homeowners for performing remedial services after testing revealed such services were unnecessary. In *Moore*, the homeowners discovered a mold problem caused by a water leak in their condominium. Their contractor, who was not experienced in mold remediation, recommended a mold remediation specialist, Talmadge Moore, to address the issue. Moore inspected their condominium and performed tests. He recommended that the homeowners move out immediately, for health reasons, and entered into a contract with the homeowners for the rental of air scrubbers and dehumidifiers. The contract stated that the machines "are needed to control further damage caused by airborne mold." Moore further stated that he would monitor and

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change the filters on the equipment multiple times daily. The test results revealed that the mold levels inside the house were less than the levels outside. This is significant because the homeowners' expert testified that a health risk only arises when the mold levels inside the house are greater than those outside. Thus, the court found that the homeowners did not need to rent the machines. Moore, however, failed to share the results of the testing with the homeowners and further recommended that they continue to rent the machines. After some 300 days (at $400/day) of using the machines and employing the specialist's services, the homeowners contacted another specialist who advised them the machines were not necessary and had not been necessary at the time of testing. Further adding to the homeowners' case was the fact that Moore failed to properly place and monitor the equipment under the terms of the contract. Although Moore sued for payment of rental fees under the contract, the court found Moore at fault for breach of contract, and the homeowners were relieved from paying additional rental fees despite Moore's argument that he had not breached the contract. As this case illustrates, mold remediation specialists should, "at a minimum" (as the court directly stated), share testing results with their clients (in this case, that testing showed no airborne mold problem), before advising them to pursue a course of treatment. Moreover, when the testing does not support a course of treatment, specialists are best served not recommending potentially unnecessary services, unless confirming with the client, in writing, that the client elects to continue despite the specialists' advice that such services are probably not necessary.

New Contractor Licensing Requirements in Georgia

For those contractors performing, or considering performing, work in Georgia, be aware of Georgia's new contractor licensing requirements. *See,* O.C.G.A. §§ 43-41-1 through 43-41-17. The new law creates a statewide licensing requirement for all residential and general contractors in Georgia as well as "at risk" construction managers and the entity performing the construction component of design/build contracts. July 7, 2007 is the deadline by which everyone covered by the new law must have obtained a license.

The new law provided grace periods, all of which are now expired, for companies to apply for exemption from the examination requirements of the new law. All new applicants will be required to submit to the examination process.

The law contemplates three classes of license: (a) residential – basic for single and two family home construction; (b) residential – light commercial for buildings less than four stories, either wood or metal frame, brick veneer, 25,000 square feet or less, prefabricated structures and pre-engineered structures; and (c) general contracting for unlimited contracting work, including the lower "residential" classes.

BARW Hosts Associated Builder's & Contractor's "Future Leaders" Classes

The Alabama Chapter of The Associated Builders and Contractors is presently conducting its 2006/2007 "Future Leaders in Construction" Course ("FLIC"). Bradley Arant Rose & White is hosting the FLIC class sessions for ABC in Bradley Arant's Birmingham office. FLIC has been highly praised and well received as an excellent training and networking opportunity for ABC member employees who have exhibited leadership potential. The training days for this course are August 2nd, 9th, 16th and 23rd. The keynote speakers scheduled for the luncheons held on each of the course days are Jody Saiia of **Saiia Construction, LLC**, Bill Morton of **The Robins & Morton Group**, Geoff Golden of **Golden & Associates Construction** and Craig Beatty of **C.S. Beatty Construction**. Bradley Arant is very pleased to have the opportunity to host the course and wishes to extend ABC a special thanks for the opportunity to participate in the training of tomorrow's construction leaders.

Bradley Arant Lawyer Activities:

May 8, 2006: Wally Sears was the panel leader for a presentation on "LNG Facilities – Challenges and Opportunities for the Owner and the Contractor in the International Market" at the International Construction Superconference in London, UK.

May 9, 2006: Wally Sears presented an in-house seminar to a client on basic construction contract law principles and the importance of good record keeping.

May 18-19, 2006: Rhonda Andreen and Arlan Lewis attended the ABA Forum on the Construction Industry's Annual Meeting, "Swimming with the Sharks: Litigating the Construction Case and More," in San Diego.

June 2006: Nick Gaede taught a course on International Arbitration in Fribourg, Switzerland. The course was attended by students from the University of Alabama and the University of Fribourg Schools of Law.

June 6 and 8, 2006: **Wally Sears and Jim Archibald** presented two one-day seminars to sales, procurement, and project management employees of a large EPC contractor client on construction contracts, record keeping, and project execution in Beaumont and Tyler, Texas.

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June 14, 2006: David Bashford, John Bond, Eric Frechtel, Michael Knapp, Doug Patin, Mabry Rogers and Colin Stockton presented a seminar titled "Legal Issues Facing the Construction Professional: The Most Common Pitfalls and How to Avoid Them in North Carolina" in Charlotte, North Carolina.

June 28, 2006: David Owen lectured on the topic of "Legal Aspects of Construction Management" as part of a graduate course at the University of Alabama at Birmingham's School of Engineering.

July 19-21: Arlan Lewis and Mabry Rogers attended the 2006 ALFA Construction Practice Group Seminar on the topic of "Construction Claims – A Roadmap to Success: How Construction Professionals, Insurers and Counsel Prevent Claims and Limit Exposure." This was the first annual meeting of ALFA's newly formed Construction Practice Group.

July 22, 2006: John Bond and Wally Sears made a presentation on price escalation, force majeure, and black box (performance essential vendor equipment) liabilities at a large EPC Contractor's in-house seminar for senior management personnel in Las Vegas, Nevada.

July 25, 2006: Donna Crowe, Eric Frechtel, and J.R. Steele presented a seminar titled "Construction Lien Law" in Washington, DC on Maryland, District of Columbia, and Virginia mechanic's lien laws.

August 21- November 20, 2006: Wally Sears will teach a Construction Law course at the University of Alabama School of Law.

August 24, 2006: Axel Bolvig and Rhonda Andreen will present the legal portion of a seminar titled "Managing Construction Projects" in Birmingham, Alabama.

September 2006: An article titled "Mechanic's Liens in Alabama" written by **Axel Bolvig and Rhonda Andreen** will be published in the September issue of the National Association of Credit Managers' magazine.

September 28, 2006: Sabra Barnett, Rob Campbell, John Hargrove, Mitch Mudano, and David Pugh will present a seminar titled "Fundamentals of Construction Contracting" in Birmingham, Alabama.

October 2006: Mabry Rogers is the coordinator and will be one of the speakers at a Bradley Arant conducted client seminar to be presented at a client's headquarters in New York on the topics of Sarbanes-Oxley compliance for public companies and the upcoming changes regarding electronic discovery embodied in the Federal Rules of Civil Procedure. New York CLE credit will be given for the seminar.

NOTE: WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY CONTACT ANY ATTORNEY LISTED ON PAGE 7 OF THIS NEWSLETTER.

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The lawyers at Bradley Arant Rose & White LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications. *Receipt of this newsletter is not intended to, and does not, create an attorney-client, or any other, relationship, duty or obligation.*

This newsletter is a periodic publication of Bradley Arant Rose & White LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact your lawyer or any of the lawyers in our group whose names, telephone numbers and E-mail addresses are listed below; or visit our web site at www.bradleyarant.com.

James F. Archibald, III	(205) 521-8520	jarchibald@bradleyarant.com
David H. Bashford	(704) 338-6001	dbashford@bradleyarant.com
Axel Bolvig, III	(205) 521-8337	abolvig@bradleyarant.com
John D. Bond, III	(704) 338-6007	jbond@bradleyarant.com
Joel E. Brown	(205) 521-8416	jbrown@bradleyarant.com
Stanley D. Bynum	(205) 521-8000	sbynum@bradleyarant.com
Roy D. Campbell, III (Jackson)	(601) 948-9934	rdcampbell@bradleyarant.com
Rhonda R. Caviedes Andreen	(205) 521-8683	rcaviedes@bradleyarant.com
Donna M. Crowe (Washington, D.C.)	(202) 719-8212	dcrowe@bradleyarant.com
Chris Danley (Washington, D.C.)	(202) 719-8230	cdanley@bradleyarant.com
J. Patrick Darby	(205) 521-8332	pdarby@bradleyarant.com
Julie S. Elmer	(205) 521-8431	jelmer@bradleyarant.com
Eric A. Frechtel (Washington, D.C.)	(202) 719-8249	efrechtel@bradleyarant.com
A. H. Gaede, Jr.	(205) 521-8323	ngaede@bradleyarant.com
John W. Hargrove	(205) 521-8343	jhargrove@bradleyarant.com
Jonathan B. Head	(205) 521-8054	jhead@bradleyarant.com
Gary C. Huckaby (Huntsville)	(256) 517-5140	ghuckaby@bradleyarant.com
David G. Hymer	(205) 521-8289	dhymer@bradleyarant.com
Danielle Daigle Ireland (Jackson)	(601) 948-9942	direland@bradleyarant.com
Michael W. Knapp (Charlotte)	(704) 338-6004	mknapp@bradleyarant.com
Jeffrey D. Komarow (Washington, D.C.)	(202) 719-8211	jkomarow@bradleyarant.com
Michael S. Koplan (Washington, D.C.)	(202) 719-8251	mkoplan@bradleyarant.com
Arlan D. Lewis	(205) 521-8131	alewis@bradleyarant.com
Michael D. McKibben	(205) 521-8421	mmckibben@bradleyarant.com
James William Manuel (Jackson)	(601) 948-9936	wmanuel@bradleyarant.com
Mitchell S. Mudano	(205) 521-8544	mmudano@bradleyarant.com
Andrew J. Noble, III	(205) 521-8342	anoble@bradleyarant.com
David W. Owen	(205) 521-8333	dowen@bradleyarant.com
Douglas L. Patin (Washington, D.C.)	(202) 719-8241	dpatin@bradleyarant.com
Jeffrey A. Peters	(205) 521-8583	jpeters@bradleyarant.com
J. David Pugh	(205) 521-8314	dpugh@bradleyarant.com
E. Mabry Rogers	(205) 521-8225	mrogers@bradleyarant.com
Katherine L. Ruff (Washington, D.C.)	(202) 719-8208	kruff@bradleyarant.com
Walter J. Sears III	(205) 521-8202	wsears@bradleyarant.com
J. R. Steele (Washington, D.C.)	(202) 719-8222	jsteele@bradleyarant.com
H. Harold Stephens (Huntsville)	(256) 517-5130	hstephens@bradleyarant.com
Colin R. Stockton (Charlotte)	(205) 338-6005	cstockton@bradleyarant.com
Robert J. Symon (Washington, D.C.)	(202) 719-8294	rsymon@bradleyarant.com
Sabra Barnett Wireman	(205) 521-8549	swireman@bradleyarant.com

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BRADLEY ARANT ROSE & WHITE LLP **Fourth Quarter 2006**

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

Rhonda Caviedes Andreen
James F. Archibald, III
Sabra M. Barnett
David H. Bashford (c)
Axel Bolvig, III
John D. Bond, III (c)
Joel E. Brown
Stanley D. Bynum
Roy D. Campbell, III (j)
Donna M. Crowe (d.c.)
Danielle Daigle Ireland (j)
Chris Danley (d.c.)
Julie S. Elmer
Edward J. Everitt
Eric A. Frechtel (d.c.)
A. H. Gaede, Jr.
John W. Hargrove
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Gary C. Huckaby (h)
David R. Hume, Jr.
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Jeffrey A. Peters
J. David Pugh
Katherine L. Ruff (d.c.)
E. Mabry Rogers
Walter J. Sears III
J. R. Steele (d.c.)
H. Harold Stephens (h)
Robert J. Symon (d.c.)

Update on Engineer Testimony Rules and Regulations

As was touched on in the third quarter newsletter, a July 28, 2006 opinion by the Supreme Court of Alabama announced a dramatic change to legal standards for expert engineering testimony in Alabama. The court was faced with the meaning of a 1997 amendment to Alabama's engineering licensure statute, which added the word "testimony" to the definition of what constitutes the "practice of engineering" in Alabama. The court held that, as a result of the 1997 amendment, an expert seeking to provide testimony on issues related to engineering must be a licensed Professional Engineer ("PE") with the State Board of Licensure for Professional Engineers and Land Surveyors ("the Board").

In addition to the evidentiary implications of the recent Supreme Court holding, there are also criminal penalties for violation of the licensing statute. The Alabama Code makes it a Class A misdemeanor for anyone to practice, or hold himself or herself out as qualified to practice engineering within this state without being licensed by the Licensure Board. This fact raises the stakes for lawyers, engineers, and litigants seeking to understand the effects of this ruling.

The decision leaves many questions unanswered. For example, it does not explore whether the administrative definition and licensing statute apply to engineering tasks performed in other jurisdictions for litigation pending in Alabama, including: 1) design, research, testing, and production engineering conducted by manufacturing employees; 2) engineering analysis done outside the State of Alabama; or 3) testimony from a deposition conducted outside the State. These were not considered by the Alabama court.

In response to the uncertainty created by the recent decision, the Board held a public meeting on August 10-11, 2006, to receive comments from interested parties, including members of the legal and engineering communities. In response to the issues raised at the hearing, the Board, on August 28, 2006 issued an advisory opinion further outlining the Board's definition of "testimony." That advisory opinion provides, in part, as follows:

> [T]estimony that constitutes the practice of engineering is also limited by the Board's administrative definition of testimony by being applicable only to testimony related to engineering activities in the State of Alabama. This opinion, for instance, would not prevent a person who is not

Inside:

www.bradleyarant.com

Birmingham Office
One Federal Place
1819 5th Avenue North
Birmingham, AL 35203
(205) 521-8000

Huntsville Office
200 Clinton Ave. West
Suite 900
Huntsville, AL 35801
(256) 517-5100

Montgomery Office
Alabama Center for Commerce
401 Adams Avenue, Ste. 780
Montgomery, AL 36104
(334) 956-7700

Washington, D.C. Office
1133 Connecticut Ave. N.W.
Twelfth Floor
Washington, D.C. 20036
(202) 393-7150

Jackson Office
188 East Capitol Street
One Jackson Place
Suite 450
Jackson, MS 39215
(601) 948-8000

Charlotte Office
Bank of America Corp. Ctr.
100 N. Tryon Street
Suite 2690
Charlotte, NC 28202
(704) 332-8842

> licensed in engineering in Alabama from testifying in Alabama about engineering work or design performed outside of Alabama, such as the design of an automobile part or other product designed outside of the State of Alabama, nor would it prevent an unlicensed individual from offering opposing testimony should the court declare the opposing expert otherwise qualified.

This excerpt, taken together with the definition of "testimony" in the Board's regulations, suggests that the Board intends for an expert who conducts all of his or her "engineering work" in a foreign state to be allowed to testify in Alabama without violating the licensure statute. While the Board has attempted to clarify and narrow the scope of the recent ruling, substantial uncertainty remains.

If an engineer's activities are not exempted under the advisory opinion, or if a trial court determines that the witness is engaged in the practice of engineering, he or she must have an Alabama Engineering license in order to testify. Alabama provides reciprocal licensure for engineers who are currently licensed in another state. Additionally, the Board may authorize an applicant licensed in another state to practice engineering on a temporary basis while his or her application is pending.

Alabama's next legislative session does not begin until February 2007. Until the legislature addresses the situation, litigants should carefully plan their strategies in cases where engineering testimony is needed.

Other states have recently ruled on this issue as well. The South Carolina Supreme Court recently refused to endorse an interpretation of the professional engineer licensing statute that had the potential of either preventing out of state experts from testifying in South Carolina courts or imposing the burden of getting licensed in South Carolina simply to be permitted to provide forensic testimony. Additionally, the Supreme Court of Illinois held that while the presence of an Illinois license may be a factor for a trial court to consider in deciding on whether to allow an expert witness, the lack of such license is not a bar to giving expert testimony in a civil case.

Prohibiting A Bid By Another Company May Be Problematic

Public bidding depends on free and open competition to obtain the lowest responsive price. Prospective bidders must be wary of any practice which might be construed to limit competition. In a recent decision by the federal appellate court that supervises federal trial courts on the west coast, a distributor for Johnson Controls ("JCI") alleged it had been instructed by JCI, pursuant to its distributorship agreement with JCI, not to submit bids on at least two public projects (Long Beach VA Hospital; University of California, Riverside). Apparently the distributor complied and then filed an arbitration (under the distributorship agreement) alleging antitrust and interference with the contract. The arbitrators found in the distributor's favor. The distributor also filed a qui tam action alleging violation of the federal and California False Claims Acts. Whether bid-rigging can be a violation of either the federal or California False Claims Acts is a complex issue that generally requires full development of the factual underpinning for "false certification" or "fraud in the inducement" theories regarding the government's award of the underlying contract. Hence, the distributor was allowed to go forward with its qui tam suit against JCI.

We have no reasons to believe that preventing bids by potential competitors occurs frequently, if at all. To the extent your company encounters such a situation (or suspects it), you will want to seek your lawyer's guidance.

Claims To The Government Must Be Certified In Good Faith

On October 13, 2006, the Court of Federal Claims issued an opinion reminding contractors that certified claims to the government must be "made in good faith" and that "to the extent a contractor increases the claim submission by the fraudulent addition of items or costs or by misrepresenting its claim items or costs," the contractor will be "liable to the government for an amount equal to such unsupported part of the claim."

The general contractor certified a claim for $64 million in equitable adjustments even though only $13.4 million of the claim constituted "incurred damages," with the remaining $50 million as projected future costs. After the government denied its claim, the contractor filed a complaint seeking damages in the full amount of the claim, without distinguishing the incurred from the future costs.

The court held that the Contract Disputes Act requires that claims be certified in "good faith" and that "the amount requested [must] accurately reflect[] the contract adjustment for which the contractor believes the government is liable." After listening to testimony of the contractor's own witnesses, the court found that the contractor had submitted the claim as a negotiating ploy; that the general contractor did not believe that the government owed it $64 million as a matter of right; and that its claim was "an attempt to defraud the United States." The court stated that even though a contractor may claim future expenses, the contractor's claim must show that projected costs are in good faith, in compliance with the FAR, and clearly identified as costs not yet incurred.

The court found in favor of the government on its counterclaims against the contractor for fraud. The court held that the contractor made its claim for purposes other than a good faith belief that the government owed the contractor the amount certified in its claim and awarded the government $50 million, the amount of the certified claim that was "fraudulent

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without question." In doing so, the court chastised not only the contractor, Daewoo, but its lawyer and consultant as well.

A contractor must only certify a claim in the amount that it believes in good faith is due and that at the time of certification the data submitted is accurate and complete to the best of the contractor's knowledge. Further, the court noted that a contractor cannot "cure" a fraudulent claim. Therefore, this case reminds contractors that before certifying claims to the government, it is important to include only costs and pricing amounts for which the contractor believes in good faith the government is liable. When the claim includes the claims of subcontractors, the contractor must believe the subcontractor has stated a *prima facie* case, but need not audit the subcontractor's claim.

Attorneys' Fees in Arbitration: Be Careful What You Ask For

It is not uncommon for an arbitration agreement to be silent about whether the arbitrator(s) may award attorneys' fees. Even so, the parties often ask for their attorneys' fees once arbitration is underway. After all, if you don't ask for them, you won't get them, and the other side will probably ask for them anyway. We can always withdraw the request later. Or so goes one school of thought. Recently, the federal appeals court supervising trial courts in Colorado, Kansas, New Mexico, Oklahoma, Utah and Wyoming decided that such a request for attorneys' fees would cost the losing party $193,000.

In that case, Hollern initiated arbitration against Wachovia claiming that a Wachovia broker acted negligently and breached its fiduciary duties in managing a family trust. The account agreement between Hollern and Wachovia called for arbitration of all disputes according to either NASD or NYSE procedures, but was silent as to the award of attorneys' fees in the arbitration. Hollern chose NASD procedures, which grant arbitrators the authority to award attorneys' fees.

In her statement of claim, Hollern sought attorneys' fees. Wachovia likewise sought attorneys' fees in its answer. In addition, both parties signed an NASD Arbitration Uniform Submission Agreement in which they agreed to submit the issues identified in their pleadings to arbitration.

At the conclusion of the arbitration, the arbitrators asked the parties to submit affidavits of attorneys' fees. In her submission, Hollern argued that an award of attorneys' fees was not only permitted under NASD's procedures, but also under a Colorado statute, which she argued was applicable. Wachovia also relied on Colorado law in support of its claim for attorneys' fees.

The arbitrators issued an award denying Hollern's claims in their entirety and awarding Wachovia $193,000 in attorneys' fees under the Colorado statute.

Hollern filed a motion in district court to have the attorneys' fees portion of the award set aside. Hollern argued that the arbitrators erred in applying Colorado law and exceeded their powers in awarding attorneys' fees. According to Hollern, Virginia law governed the dispute and required that the parties expressly authorize an award of attorneys' in their arbitration agreement. Because the account agreement between Hollern and Wachovia contained no such express authorization, Hollern contended that the award of attorneys' fees was improper. The district court agreed and vacated the attorneys' fees portion of the award.

The appellate court reversed the district court. It found that even if Virginia law applied and required the parties to expressly authorize an award of attorneys' fees in their arbitration agreement, Hollern and Wachovia satisfied that requirement. Although the account agreement itself did not expressly permit an award of attorneys' fees, the parties' subsequent submissions to the arbitrators, in particular the Uniform Submission Agreement and the attorneys' fees affidavits, amended the original arbitration agreement to expressly authorize attorneys' fees.

Attorneys' fees can be a significant risk and expense in arbitration or litigation. One way to make that risk and expense more predictable in arbitration is to expressly address the arbitrator's authority to award attorneys' fees in the arbitration agreement. Where the arbitration agreement is silent, parties should be aware that certain conduct during the arbitration, such as specific requests for the award of attorneys' fees, may be found to modify their agreement, and that later withdrawal of such a request may not undo the modification.

Condominium Projects: Assessment of Risks

As the real estate market fluctuates, an owner/developer may seek to convert what started as a residential construction project (e.g., rental apartments) to a condominium/cooperative project. Such a transition creates increased risks for the contractor and should be evaluated carefully before agreed to by the contractor. For example, although a contractor may have insurance coverage for completed operations for residential work, that coverage may exclude condominiums and cooperatives. One reason for such an exclusion is that warranty obligations on residential projects are sometimes shorter in duration than warranties on condominium or cooperative projects. Indeed, in the District of Columbia, a 2-year warranty against structural defects is required by statute for condominiums. Another increased risk to the contractor arises from the multiple ownership aspect of a condominium project. Whereas, for a residential project, the contractor generally must satisfy only one owner at project completion, for a condominium project the contractor is subject to the standards, opinions and demands of multiple owners, and thus a higher level of individual scrutiny regarding material and workmanship. This tends to complicate, extend and increase

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the costs of the punchlist, close-out and warranty phases. Multiple ownership may also expose the contractor to potential lawsuits by multiple owners for construction defects, warranty issues, mold-related liability, and other claims.

While the laws of the jurisdiction where the project is located and the specific obligations in the proposed construction contract are paramount considerations for a contractor's risk assessment and choices, there are several contractual ways a contractor can try to partially mitigate the increased risks associated with a change from apartments to condominiums or cooperatives. For example, the contractor can price the cost of the change and add it to the contract price. This could take the form of an additional lump sum for labor and material per condominium unit, an additional lump sum for an expanded QA/QC plan, additional monthly amounts for extended warranty periods, or numerous other options. Contractors should carefully consult with their estimating team to make sure all cost issues are addressed.

Another way for a contractor to partially mitigate the increased risk is to contractually limit its liability. This could take the form of a cap on warranty liability, an indemnity and hold harmless agreement from the owner/developer for claims brought by individual owners, express waivers of liability by the owner/developer, and other contractual limits. In addition, there are several insurance carriers that offer project-specific insurance policies designed for residential exposure for both apartments and condominiums.

Because the risks of a condominium project are affected not only by the specific obligations expressed in the contract but also by the different laws of the various states, contractors should consult legal counsel to make sure their risk assessments address relevant legal issues.

How Much is Too Much? Preliminary Litigation and Waiver of the Right to Compel Arbitration

In a recent case, the Supreme Court of Alabama held that a general contractor's filing of a motion to dismiss and an Answer before filing a motion to compel arbitration was not a substantial invocation of the litigation process, as would constitute waiver of its right to compel arbitration.

Zedot, acting as a general contractor on a construction project in Jefferson County, entered into a subcontract with Red Sullivan's Conditioned Air Services, Inc. ("CAS") that contained an arbitration clause. However, after Zedot terminated CAS citing deficient work, CAS ignored the arbitration clause and sued in state court.

Zedot filed a Motion to Dismiss, arguing that the statute of limitations barred CAS's claim. The court converted the motion to a motion for summary judgment. After the court denied summary judgment, Zedot filed an answer to CAS's complaint as well as a counterclaim alleging breach of contract. In its answer, Zedot pleaded arbitration as an affirmative defense, stating that it asserted its counterclaim only to preserve that claim. One month later, CAS filed an answer to Zedot's counterclaim. A month after that, Zedot filed a motion to compel arbitration. CAS opposed the motion, arguing that Zedot had waived its right to arbitration by participating in the litigation process. The trial court agreed with CAS and denied Zedot's motion to compel arbitration, and Zedot appealed.

The Alabama Supreme Court reversed, adopting the "substantiality" test used by most courts in analyzing waiver of arbitration. The court stated that a party opposing arbitration "must demonstrate that the movant has substantially invoked the litigation process and thereby the opposing party would be substantially prejudiced if the case were submitted to arbitration." It then referred to the Federal Arbitration Act's preference for enforcing arbitration clauses, and to Alabama's presumption against waiver of the right to compel arbitration. The court stated that the fact that the motion was converted to a motion for summary judgment was not dispositive of the issue. Significantly, the court noted that the summary judgment motion did not impose upon CAS a burden to engage in discovery in order to oppose the motion.

The court held that CAS was not substantially prejudiced by having to arbitrate. Only four months had passed from the filing of the complaint to the filing of the answer, which claimed arbitration as an affirmative defense. No discovery had taken place, and no hearings were held. The court also noted that Zedot's initial motion to dismiss was based on the statute of limitations, and that Zedot had not had judgment entered against it on any aspect of CAS's claim.

One can glean an important lesson from this decision. The court found significant the fact that little discovery had taken place, and that Zedot had mentioned arbitration as an affirmative defense in its answer. When deciding whether to invoke an arbitration clause, sooner is always safer than later. Had Zedot answered and counterclaimed without mentioning arbitration in its answer, it is possible that the court would have decided that Zedot had substantially invoked the litigation process to CAS's prejudice, and therefore waived its right to compel arbitration.

No Notice? No Worries?

The rule that contractors who bring claims for damages based on differing site conditions must first provide "prompt written notice" to the contracting officer continues to be eroded in the government contract context. A recent Armed Services Board of Contract Appeals ("ASBCA" or "Board") opinion follows this current trend in the caselaw.

The recent ASBCA case, relying on four previous ASBCA decisions, held that in order to invoke the notice requirement contained in standard FAR clause 52.236-2 as a defense to a differing site condition claim, the government

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must establish that "it was prejudiced by the absence of the required notice." Furthermore, the Board held that the notice requirement is "waived if the government has actual or constructive notice of the conditions encountered," in spite of the words in FAR 52.236-2 that "the Contractor shall promptly and before conditions are disturbed, give a written notice to the contracting officer of" differing site conditions.

In this case, the contractor received a contract to bury electrical cable at Fort Carson, Colorado. The contract required the contractor to place the electrical cable underground and dig 4 to 6 inch conduits along a five-mile route. The basis of the differing site condition claim was that after the contractor began digging the conduits, the company discovered that the soil along the route was filled with underground debris including rebar, concrete and asphalt. The contractor claimed the debris constituted a differing site condition and that it was entitled to damage done to its drill as a result of this condition. The Board concluded that the differing site condition claim was valid.

In regard to notice, the Board found that the contractor discovered the differing site condition as of October 1 and that the government did not receive written notice of the conditions until December 12. However, the Board found that the contracting officer was aware of the condition as a result of several site visits and phone calls on the part of the contractor. The contractor continued to incur damage until it finished the job the following November and during that time continued to inform the government that the damage to its drill was a result of the differing site condition.

The Board made no finding as to the exact date the government gained actual or constructive notice of the differing site condition but nevertheless held that because the government had actual notice of the condition and was not prejudiced by a lack of written notice, the notice requirement was not a bar to the contractor's differing site condition claim. In so holding, the Board relied on the rule that "the written notice requirements are not construed hypertechnically to deny legitimate contractor claims when the government was aware of the operative facts." Thus, as a result of this case and cases like it, the written notice requirement in FAR 52.236-2 will not bar recovery in a differing site condition case if the government has knowledge of the condition or was not prejudiced by the lack of written notice.

Public Bid Laws and Bid Documents Requirements are Strictly Enforced -- Or Else

A recent case decided by the Louisiana Supreme Court articulates the standard that public bid document and bid law requirements must be strictly followed. Louisiana, like many jurisdictions, has adopted statutory requirements for the administration of public contracting projects. Often, the public bid package distributed to potential contractors is confusing, inconsistent, and invites error. However, a recent Louisiana case makes clear that in Louisiana it is critical to comply with *all* of the requirements in *all* of the bid documents or an awarded project may go to a competitor.

In this case, the City of New Orleans issued the requirements for a demolition project in a seven-page bid package. The bid documents required that a copy of the City's invitation to bid be attached to the back of the submitted bid package. Hamp's Construction was the low bidder on the base package and the second low bidder on the alternative package. The City accepted the alternative package and awarded the project to the low bidder, Concrete Busters of Louisiana, Inc.

The second low bidder challenged the award because Concrete Busters had not attached the required "City invitation" to the back of its bid submission. The trial court focused on the satisfaction of "substantive formalities" and found for the City and for Concrete Busters. The appellate court disagreed and held that the bid requirements were to be strictly applied. Hamp's Construction argued that a public entity cannot waive any deviation from the bid requirements, so it was irrelevant whether the failure to attach an invitation was insignificant or "substantive." After tracing the development of public bidding law, the Louisiana Supreme Court held that the statute calling for compliance with the bidding requirements was not ambiguous, that the multiple revisions had made it clear that bid documents were to be strictly applied, and that the requirements could not be waived.

Further, the court held that a public entity cannot waive the requirements of the advertisement to bidders, the bid form, or the public bid law. Nor can the public entity distinguish between waivable and non-waivable, or substantive and non-substantive requirements in those documents. A "right to reject all bids" clause does not allow the public entity to circumvent the bid rules. The court focused on the application of the Louisiana statute that states: "the provisions and requirements of this [bid law], those stated in the advertisement for bids, and those required on the bid form shall not be waived by any public entity."

The practical relevance of this case centers on compliance with the requirements of the bid package. One can see that a simple error or omission can lead to disastrous results, either by not being awarded the job or having to fight the award in court. Public entities and contractors need to take to heart the significance of each requirement that is presented in a bid package because each one counts, and according to Louisiana, there is no room for waiver.

OSHA Violation Admissible to Show Construction Company's Negligence in Action Brought by Non-Employee

The Nebraska Supreme Court recently held a violation of an Occupational Safety and Health Administration (OSHA)

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regulation may be admissible as evidence of negligence where a third party non-employee brings a negligence action against a construction company.

In the summer of 2001, fire damaged John Orduna's home in Omaha, Nebraska. The fire caused extensive damage to the home, forcing Orduna to move out until it was repaired. Orduna subsequently hired Total Construction Services ("Total") to repair the home. After construction began, Orduna stopped by the house one night to collect some of his personal belongings from the basement. Meanwhile, Total had removed the basement stairwell and failed to erect any guardrails across the doorway—OSHA regulations provide that *employees* shall be protected from falling more than 6 feet by guardrails, covers, or personal arrest systems. Not knowing the stairwell had been removed, Orduna fell through the dark opening to the basement floor and fractured his ankle.

Orduna filed a negligence action against Total alleging the construction company was negligent in failing to keep the premises safe, failing to warn him of the unsafe or hazardous conditions on the premises and violating specific OSHA regulations. At trial, Total argued that any evidence of OSHA violations should be excluded since Orduna was not an employee and the regulations therefore did not apply to him. However, the trial court disagreed, reasoning that while OSHA exists to protect employees from unsafe work conditions, it should apply equally to any person who legitimately finds himself in the same place as an employee. Accordingly, the trial court allowed the jury to consider any OSHA violations it found as evidence of whether or not Total had been negligent.

On appeal, the Nebraska Supreme Court upheld the $183,000 jury verdict in favor of Orduna, finding evidence of OSHA violations is relevant and admissible in negligence actions involving an employer and non-employee. The court did limit its holding by recognizing that a violation will not establish negligence as a matter of law, but rather is evidence the fact finder may consider in deciding the issue of negligence. The court also noted that some OSHA regulations impose a higher standard of conduct on employers than would normally be recognized in the industry with respect to third parties and non-employees. In such cases where a non-employee brings suit, the employer would be permitted to argue those circumstances to the jury.

This case emphasizes the importance of complying with OSHA at all times. OSHA regulations help in securing the safety of employees and non-employees alike, but perhaps more importantly, they can help shield employers from exposure to unwelcome litigation and liability.

Bradley Arant Lawyer Activities:

August 21- November 20, 2006: Wally Sears is teaching a Construction Law course at the University of Alabama School of Law.

August 24, 2006: Axel Bolvig and Rhonda Andreen presented the legal portion of a seminar titled "Managing Construction Projects" in Birmingham, Alabama.`

September 2006: Axel Bolvig has been recognized for inclusion in *The Best Lawyers in America* in the specialty of Construction Law.

September 2006: An article titled "Mechanic's Liens in Alabama" written by **Axel Bolvig and Rhonda Andreen** was published in the September issue of the National Association of Credit Managers' magazine.

September 28, 2006: Rob Campbell, John Hargrove, Mitch Mudano, and David Pugh presented a seminar titled "Fundamentals of Construction Contracting" in Birmingham, Alabama.

September 29, 2006: Michael Knapp lectured on the topic of project documentation at the Federated Electrical Contractors' Fall Meeting in Anaheim, California.

October 2006: David Owen completed the Associated Builders and Contractors' Future Leaders in Construction Program

October 5, 2006: Mabry Rogers coordinated and was one of the speakers at a Bradley Arant conducted client seminar presented at a client's headquarters in New York on the topics of Sarbanes-Oxley compliance for public companies and the upcoming changes regarding electronic discovery embodied in the Federal Rules of Civil Procedure. New York CLE credit was given for the seminar.

October 10, 2006: Doug Patin presented a session on Builder's Risk Issues during the Construction Café at the International Risk Management Institute (IRMI) Construction Risk Conference in San Diego, California.

October 12-13, 2006: Rhonda Andreen, David Bashford, Jonathan Head, Michael Knapp, and Arlan Lewis attended the ABA Forum on the Construction Industry's Fall Meeting in Scottsdale, Arizona.

October 25, 2006: **Chris Danley, J. R. Steele, and Doug Patin** attended the Court of Federal Claims 19th Annual Judicial Conference in Washington, D.C.

NOTE: WE DO NOT VIEW THIS NEWSLETTER AS WRITTEN FOR ATTORNEYS BUT RATHER FOR PRACTICING MEMBERS OF THE CONSTRUCTION INDUSTRY. IF YOU OR YOUR LAWYER WOULD LIKE TO KNOW MORE INFORMATION ABOUT A PARTICULAR ARTICLE OR WOULD LIKE THE CASE CITES, YOU MAY CONTACT ANY ATTORNEY LISTED ON PAGE 7 OF THIS NEWSLETTER.

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James F. Archibald, III .... (205) 521-8520 .... jarchibald@bradleyarant.com
Sabra M. Barnett .... (205) 521-8549 .... swireman@bradleyarant.com
David H. Bashford .... (704) 338-6001 .... dbashford@bradleyarant.com
Axel Bolvig, III .... (205) 521-8337 .... abolvig@bradleyarant.com
John D. Bond, III .... (704) 338-6007 .... jbond@bradleyarant.com
Joel E. Brown .... (205) 521-8416 .... jbrown@bradleyarant.com
Stanley D. Bynum .... (205) 521-8000 .... sbynum@bradleyarant.com
Roy D. Campbell, III (Jackson) .... (601) 948-9934 .... rdcampbell@bradleyarant.com
Rhonda R. Caviedes Andreen .... (205) 521-8683 .... rcaviedes@bradleyarant.com
Donna M. Crowe (Washington, D.C.) .... (202) 719-8212 .... dcrowe@bradleyarant.com
Chris Danley (Washington, D.C.) .... (202) 719-8230 .... cdanley@bradleyarant.com
J. Patrick Darby .... (205) 521-8332 .... pdarby@bradleyarant.com
Julie S. Elmer .... (205) 521-8431 .... jelmer@bradleyarant.com
Edward J. Everitt .... (205) 521-8444 .... eeveritt@bradleyarant.com
Eric A. Frechtel (Washington, D.C.) .... (202) 719-8249 .... efrechtel@bradleyarant.com
A. H. Gaede, Jr. .... (205) 521-8323 .... ngaede@bradleyarant.com
John Mark Goodman .... (205) 521-8231 .... jmgoodman@bradleyarant.com
John W. Hargrove .... (205) 521-8343 .... jhargrove@bradleyarant.com
Jonathan B. Head .... (205) 521-8054 .... jhead@bradleyarant.com
Gary C. Huckaby (Huntsville) .... (256) 517-5140 .... ghuckaby@bradleyarant.com
David R. Hume, Jr. .... (205) 521-8614 .... dhume@bradleyarant.com
David G. Hymer .... (205) 521-8289 .... dhymer@bradleyarant.com
Danielle Daigle Ireland (Jackson) .... (601) 948-9942 .... direland@bradleyarant.com
Michael W. Knapp (Charlotte) .... (704) 338-6004 .... mknapp@bradleyarant.com
Jeffrey D. Komarow (Washington, D.C.) .... (202) 719-8211 .... jkomarow@bradleyarant.com
Michael S. Koplan (Washington, D.C.) .... (202) 719-8251 .... mkoplan@bradleyarant.com
Arlan D. Lewis .... (205) 521-8131 .... alewis@bradleyarant.com
Tom Lynch (Washington, D.C.) .... (202) 719-8216 .... tlynch@bradleyarant.com
Luke Martin .... (205) 521-8570 .... lumartin@bradleyarant.com
Michael D. McKibben .... (205) 521-8421 .... mmckibben@bradleyarant.com
James William Manuel (Jackson) .... (601) 948-9936 .... wmanuel@bradleyarant.com
Mitchell S. Mudano .... (205) 521-8544 .... mmudano@bradleyarant.com
Andrew J. Noble, III .... (205) 521-8342 .... anoble@bradleyarant.com
David W. Owen .... (205) 521-8333 .... dowen@bradleyarant.com
Douglas L. Patin (Washington, D.C.) .... (202) 719-8241 .... dpatin@bradleyarant.com
Jeffrey A. Peters .... (205) 521-8583 .... jpeters@bradleyarant.com
J. David Pugh .... (205) 521-8314 .... dpugh@bradleyarant.com
E. Mabry Rogers .... (205) 521-8225 .... mrogers@bradleyarant.com
Katherine L. Ruff (Washington, D.C.) .... (202) 719-8208 .... kruff@bradleyarant.com
Walter J. Sears III .... (205) 521-8202 .... wsears@bradleyarant.com
J. R. Steele (Washington, D.C.) .... (202) 719-8222 .... jsteele@bradleyarant.com
H. Harold Stephens (Huntsville) .... (256) 517-5130 .... hstephens@bradleyarant.com
Robert J. Symon (Washington, D.C.) .... (202) 719-8294 .... rsymon@bradleyarant.com

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