KEY CONSTRUCTION CLAIMS:

TOP 10 ISSUES FOR CITY ATTORNEYS

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INTRODUCTION:

My goal in this paper is to make you aware of essential claims available to contractors and discuss effective means for reviewing and responding to these claims. A short portion of this claim will address the general availability of contractor claims. The bulk of the discussion will focus on actual claims and issues associated with each identified item. However, rather than providing an in depth discussion of the legal basis for recovery of contractors claims—complete with case law and statutory citations—I intend to present a discussion with practical information and advice that will assist you, as an owner's attorney, in advising your city manager and council how to proceed through a dispute with a contractor.

More frequently than not, these disputes arise during the course of construction and are dealt with during the pendency of a project. Some, of course, will lead to a formal claims process or litigation. This paper will provide information that should be useful in advising your client how to respond to these claims and avoid costly litigation where available.

The topic of this paper indicates that I intend to provide a Top 10 List of Contractor's Claims. However, when reduced to their essence, contractors' claims typically fall into one of three following categories: 1) extra work; 2) lost productivity and efficiency; and 3) delay. Each of these three categories contain numerous issues and subcategories that a worthy of discussion. Some of the subcategories that I will discuss are as follows:

a) adequacy of design documents & unforeseen conflicts;
b) increased material and equipment costs;
c) changes required because of aesthetic preferences;
d) acceleration;

e) increased insurance/bonding premiums;
f) labor & material costs;
g) interruptions affecting means and methods;
h) completeness of contract documents;
i) late or nonpayment;
j) attorney's fees.

Keeping with the title of the presentation, there are ten subcategories. Subcategories a) through c) deal with extra work claims. Subcategory d) is associated with lost productivity claims. Subcategories e) through h) fall into the delay claims arena. Finally, the subcategories i) and j) relate to Prompt Payment Claims rather than one of the big three identified above. However, as owner's attorneys, you should be aware of these claims because of complexities in the manner in which they are calculated and how the Prompt pay Act works with the statutes waiving municipal sovereign immunity.

CONTRACTOR'S CLAIMS – GENERAL AVAILABILITY

In Texas, by entering into a construction contract, a city waives its immunity from liability as to the party with whom the city contracts. The supreme court has addressed this issue on a number of occasions.[1] Despite the Texas Supreme Court's best efforts to provide complete sovereign immunity to all cities that have used the words "sue and be sued" or similar language in their city charters or other authorizing documents, municipalities that enter into construction contracts are subject to liability.[2] By enacting

[1] *Catalina Dev., Inc. v. County of El Paso*, 121 S.W. 3d 704, 705 (Tex. 2003); *Wichita Falls State Hosp. v. Taylor*, 106 S.W. 3d 692, 696 (Tex. 2003); Travis *County v. Pelzel & Assocs., Inc.*, 77 S.W. 3d 246, 248 (Tex. 2002); *Federal Sign v. Texas S. Univ.*, 951 S.W.2d 401, 405 (Tex. 1997).
[2] *See Tooke v. City of Mexia*, 197 S.W.3d 325 (Tex. 2006); *but see* TEX. LOCAL GOV'T CODE ANN. §271.152.

chapter 271 of the local government code, the Texas Legislature expressly waived immunity from suit.[3]

Because cities waive immunity from liability by entering into a construction contract and because cities have had immunity from liability waived by the legislature, they should be prudent in their dealing with contractors throughout the course of a construction project. Many times, a possible claim can be prevented by careful contract drafting and clarity in the issuance of addendum prior to bid time. For example, if an owner has particular expectations and intentions regarding the performance criteria of certain machinery or structures that differ from common standards, the specifications should specifically state the owner's desires.

The same advice applies to response to questions submitted by bidders on a project. If an owner has the opportunity to clarify an item that has caused some confusion or answer a question, the owner should specifically, and with as much detail as possible, state the appropriate answer. In short, if words are available that can completely and accurately describe what you, as an owner, expect from a project, then use those words and avoid confusion. Remember, as the drafter of the contract that is put out to bid, the city will be on the losing end of a contract interpretation battle if an ambiguity exists in the contract documents.

Certainly, one should be cognizant of the current economic conditions in the country. When, as now, money is tight and times are perceived to be tough, contractors are much less willing to ignore potential losses when claims arise. With less opportunity to recover unclaimed dollars later in a project or in other projects, claims tend to receive careful attention in tighter economic markets. Awareness of this trend can be important

[3] TEX. LOCAL GOV'T CODE ANN. §271.152.

information for city attorneys in evaluating and responding to the merits of a contractor's claim. If times are good and we are in a "seller's market" where projects and development are widespread, contractors are more likely to write off small losses as a cost of doing business because they will likely be able to make up the difference on the next job. Opportunities for more work can also result in horse trading for changes or value engineering that might even out a loss with a potential savings or gain. Knowing the economic climate and the general position of a contractor can assist in negotiations regarding claims and disputes.

1) EXTRA WORK CLAIMS

A claim for costs associated with extra work is the most common form of contractor claim. These claims arise when an item of work as bid turns out to be more expensive than expected. Disputes often arise when contractors or their subcontractors have differing interpretations from the owner or design professionals about the specifications and the manner for achieving compliance. First and foremost, an owner should always include language in its contracts that requires a contractor to present all supporting documentation to the owner's project representative in accompaniment of any claims. If a claim arrives on the owner's desk with supporting documentation, the owner should specifically request additional supporting documentation in writing. On public projects, especially those that require prevailing wages, contractors will have documentation to demonstrate their costs for both labor and materials.

Owners should require, both in contract language and in practice, written change requests or proposals in the event a contractor believes extra work is required. The

ability to provide proper oversight and control over potential cost escalations requires that no extra work is done or charged to the contract absent a previously agreed upon change order. This point is extremely important: No Extra Work Shall be Paid for by the Owner Unless Previously Authorized by Written Change Order or Change Directive.

Ultimately, owners seek to obtain the completed project with as few hiccups and hurdles as possible. The resolution of change orders pr claims is essential to clearing any such hurdles. If claims are presented by contractors on your projects for extra work, you should be prepared to analyze the contract documents and plans to determine whether the work claimed as extra was, in fact, not included in the original scope. If your review determines that such work was not included in the scope as originally presented, then a review of the supporting documentation should demonstrate the fair value of the work as performed.

a) Adequacy of design documents & unforeseen conflicts

In Texas, unless expressly assigned to the owner or design professional, the contractor warrants the adequacy of the design for the intended purposes of a project.[4] This doctrine certainly applies to the design of the project as a whole. If the parties are building a wastewater treatment plant, the ultimate ability of the completed project to adequately clean wastewater falls on the contractor as opposed to the owner.[5] However,

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[4] *Alamo Cmty. College Dist. V. Browning Constr. Co.*, 131 S.W.3d 146, 155 (Tex. App.—San Antonio 2004 (*rev'd on other grounds*); *Lonergan v. San Antonio Loan & Trust Co.*, 104 S.W. 1061 (Tex. 1907).

[5] In *Lonergan*, the owner hired a contractor to build a bank. Upon completion, the bank collapsed. The contractor claimed the owner bore the responsibility for paying for the reconstruction because it has presented the contractor with the design for the building. The court held otherwise. The court held that the builder was in better position than the owner to determine whether the design was sufficient to support a standing structure. Because of this relationship, and because the contractor failed to construct a building that would remain standing, the court ordered the contractor to pay for the reconstruction effort.

there is less clarity in the law about whether this doctrine can be used to charge the contractor for lack of detail or dealings with particular issues that do not affect the project's overall integrity.

In contracts between the owner and contractor, except those for design-build projects, the owner presents the design documents to the contractor. For all practical purposes, the contractor controls its means and methods of construction, but the design documents provide the basic plan and list of tasks that must be completed. If a task is required, but important information is omitted, contractors will argue the liability for that omission falls on the owner. In a situation where a particular work item requires extra work to accomplish the intended design, the *Lonergan* Doctrine will not likely control.

If contracting for road or utility work, the contractor will likely have an obligation to verify underground conditions prior to advancing the project into new areas by potholing or other means. If these efforts uncover unforeseen obstacles that require extra work to overcome, the contractor will request a change order. If the contract has a clause that the contractor has verified field conditions and accepts the risk of unanticipated conflicts, the owner can be comfortable rejecting this change request. However, owners should be prepared for the counter-argument that such boilerplate does not apply to unforeseeable underground conflicts. Contractors will also argue that the owner controls any as-builts from previous work and failed to adequately depict the items creating the conflict on the plans.

To overcome this dispute, the owner can negotiate a price for this additional work that the contractor believes is beyond the original scope. The owner may also want to take advantage of a field directive or change directive provision that may be in the

contract to keep work moving. These provisions act as a form of order that can not be ignored unless the contractor is deemed to be in breach of its contract. If a field directive is issued ordering the contractor to proceed, then it must do so. It can do so under protest and preserve its right to seek compensation at a later date, but such an order will ensure that the project does not come to a halt. A change directive will often be used to provide a similar order but will pay the contractor on a time and materials basis for the work in the event an agreement on the requested change order pricing cannot be reached.

Unforeseen conflicts can also arise frequently in mechanical installations in vertical structures. When a structural support beam interferes with the intended layout of piping or ductwork, creative solutions may become necessary. When this happens, extra work claims can arise. At times, these conflicts arise because of a failure to reconcile structural and mechanical plan sheets. If the project is for new construction, an owner may have a better case for rejecting an extra work claim than if it for an addition or remodel of an existing structure depending on provision of as-builts and contractual language.

b) Increased material and equipment costs

By way of example, assume you are constructing a facility that has CMU block walls. The specifications require a bull-nosed edge in certain locations and calls for prefabricated CMU with the bull-nose. Further assume that the particular type of CMU is unavailable due to material shortages related to hurricane damage reconstruction efforts. Because time is of the essence, the contractor brings in people to install standard CMU and then shape the block with rented equipment after the walls are erected. The

contractor then submits a claim for the additional costs associated with the extra labor and equipment consumed in achieving the desired finish.

Clearly, no one is at fault for the material unavailability due to a hurricane. However, the owner does not want to pay more to overcome this adversity than necessary. In evaluating this claim, the owner should require the contractor to provide proof of the cost differential between the bull-nosed CMU and the standard CMU block. Presumably, the contractor should have actually achieved some cost savings by purchasing the standard CMU block. The owner should also require a demonstration from the contractor that would allow the owner to see how many labor hours the contractor had planned for erecting the bull-nosed block versus the actual number of labor hours consumed to erect and post-fabricate the desired finish. Once this information is shared with the owner, along with the cost of the rented equipment, an informed decision about the value of the extra work can be reached. An offer for payment can then be made to the contractor. If the contractor can not provide this information, then the owner can choose to deny the claim for lack of supporting documentation if the contract has such a requirement.

c) Changes required because of aesthetic preferences

This issue and source of extra work is not nearly black and white as it may seem to an uninvolved party. Typically, the aesthetic design of a project is generated by either the owner or its architect. The selection and installation of finish level products can be a source of considerable uncertainty prior to installation. If after installation a desired look is not obtained, the owner or architect is likely not to accept the finished product. Look back at the CMU block example. Assume that the post-fabrication creation of a bull-nose

failed to achieve the same uniform finish as that of the prefabricated bull-nosed block. The contractor has done the work. The architect, however, rejects it because the aesthetics are unacceptable. Who pays for the additional costs involved in either correcting the bull-nose or removing the block for standard cornered CMU? There is not a simple answer.

Another example demonstrates the conflicts in the typical three-party relationship where separate contracts control the relationships between owner/architect and owner/contractor. An architect presents the owner with a product for wall covering, along with samples. The owner chooses the product which is then purchased and installed by the contractor. The owner rejects the product as installed because of color variations. The contractor will seek additional compensation for extra work to remove and replace the installation. The owner will have a hard time challenging this change even though the owner believes the responsibility may lie with the architect. Because the contractor has no recourse against the architect and did the work as requested, the owner is stuck in the middle and must attempt to get reimbursed from the architect for the funds paid to the contractor for extra work.

These examples all demonstrate how extra work claims can arise from a contractor's performance of work that it believes goes beyond the scope of the original agreement. Of course, none of these examples have been presented with both sides of the issues presented. My goal here is to prepare you, as representatives of municipal owners, to recognize, analyze and prepare a response to contractor claims.

2) LOST PRODUCTIVITY AND EFFICIENCY CLAIMS

Lost productivity and efficiency claims arise for contractors when their planned activities on a project are negatively affected by circumstances outside of their control. A contractor typically has a plan for each aspect of the work to be performed and the coordination of trades on a jobsite. If that plan is disrupted, the contractor may be forced to take actions to overcome the disruption. Depending on the cause of the disruption, a contractor may present a claim for additional dollars to an owner.

d) Acceleration

The most common type of lost productivity claim arises when a contractor has to accelerate its performance to overcome an obstacle to timely completion. Prior to beginning a project, an owner should require the contractor to present a critical path method construction schedule. The contract for construction should also require monthly updates to that schedule. An owner should insist on these scheduling requirements so that it may monitor the project's pace and progression. If circumstances arise during the course of the project that interfere with the planned schedule, the owner will have the most basic information to review and assess the validity of a productivity claim.

At the beginning of a lost productivity or efficiency analysis, the owner must determine the cause of the interruption. Once that step has been completed, a review of the schedule should occur to determine which activities were affected. Once those determinations have been made, the owner will be in a position to evaluate the contractor's lost productivity claim. Owners should require the contractor to present information explaining the contractor's expectations at bid time compared to the actual resources devoted to the project to overcome the efficiency interrupting event.

By way of example, assume you are an owner that is constructing and addition to an existing facility such as a jail, hospital, or college. In the bid documentation, you represent to the contractor that the facility will remain in operation during the project but that certain areas of the existing structure will be turned over to the contractor for construction in phases. As a result of certain circumstances, the contractor does not get access to all areas as promised. Because of this fact, the contractor has to accelerate its performance in the areas turned over later than promised by working extended hours and devoting extra manpower to the job in order to achieve completion by the requisite completion date.

The contractor will likely submit a claim to the owner requesting additional funds to reimburse it for additional costs resulting from these acceleration efforts. Such costs could include overtime hours for labor or additional regular hours in the event extra laborers were brought onto the job for additional shifts. Other costs could included extra equipment rental or additional costs for expedited delivery of materials. As an owner, the underlying cause of the interference relating to jobsite access must be determined and responsibility assigned to that interference. If the responsibility lies with the owner, then the contractor may be entitled to some additional funds. However, the owner may still undergo an evaluation of the contractor's claimed costs to determine the actual value of the acceleration efforts.

3) DELAY CLAIMS

Contractor's delay claims may arise any time a project goes off schedule and is late in achieving completion for reasons beyond the contractor's control. The difference

between a delay claim and a lost productivity/acceleration claim is that in a delay claim, the project schedule impacts are not absorbed by the contractor's efforts to recapture time. While not always the case, acceleration claims results in damages for efforts made to finish on time despite delays. Delay clams result in damages resulting from costs incurred because of untimely completion.

As an owner's attorney, you should realize that delay damages may be waived. No damages for delay clauses are enforceable in Texas and appear frequently in construction contracts used in this state. The contract language employed for your projects can assist in the avoidance of delay claims. Instead of prohibiting the recoverability of delay damages, the contract can include language addressing causes for delay and assigning or absolving responsibility for various events of delay. Similarly, parties may waive their right to recover consequential damages. Often, delays to project completion result in consequential damages. Some consequential damages that may be available to a contractor are unabsorbed home office overhead, extended general conditions, and lost profits. In this section of the paper I have provided a few subcategories to delay damages that one might expect to see as an owner when a project suffers from delays.

In this example, assume a project is planned and put out to bid. The lowest bidder is awarded the project. The project begins with the contractor beginning site work and excavation activities. As a result of an intervening event, the project is delayed. Assume that the reason for the delay is the filing of a lawsuit whereby a local group seeks and receives an injunction because they claim the municipality failed to properly conduct and complete a preliminary environmental study and the project threatens the habitat of an

endangered species. Ultimately, the court determines that the environmental study was not completed properly, but the underlying arguments concerning the endangered species have no merit and the project can proceed. Meanwhile, the project has been delayed fifteen months.

e) Increased insurance/bonding premiums

Insurance costs have risen in Texas in the last few years. As a result of economic pressures on insurance companies, additional claims and losses resulting from hurricanes and other storms, premiums for many types of policies have gone up. The contract requires the contractor to maintain comprehensive general liability insurance, builder's risk insurance, worker's compensation insurance, and automobile insurance. During the fifteen-month delay, the contractor's insurance and bond premiums go up. The contractor may submit a claim for reimbursement of the rise in costs associated with the passage of time since the delay was clearly not its fault. Depending upon the contract language, the owner is likely liable for the increase in costs.

f) Labor & material costs

During that fifteen month delay, the economy has begun to suffer a recession. Normally, this might create a surplus of labor due to job losses in other industries and residential construction. However, the project at issue is a civil project to construct a new water treatment plant. The work on this project is highly specialized and requires skilled labor. During that delay, there have also been two major hurricanes that have hit the Gulf Coast cause significant damage to industrial complexes. Accordingly, much of the skilled labor that was not actively working a jobsite after the storms has been dedicated to rehabilitation efforts.

These conditions that did not exist prior to the delay event have caused a labor shortage. In order to overcome these conditions, the contractor has had to hire out-of-state subcontractors to perform the labor required. This results in increased costs for which the contractor will seek payment from the owner. Such costs include travel to the job, lodging, and expenses. Also, because the market has tightened for this labor, rates have risen so the core cost for the work has gone up. An owner should be aware that these costs may be included in a claim for delay.

In addition to increased labor costs associated with the delay, material prices are rising. In a civil project such as the water treatment plant used in this example—but equally applicable in the construction of roadways and other infrastructure—three major material components involved in the construction are concrete, steel, and asphalt. With increased worldwide demand recently, the cost of these materials has risen remarkably. Owners in this situation can expect to receive a contractor's claim for additional costs associated with material acquisition. Again, an owner should request and require the presentment of data demonstrating the expected costs at bid time as compared to actual costs once commencement of construction is permitted. Owners should look carefully at the timeline of activities and review the prices for the materials at various points in the process to truly evaluate the actual value of the delay damages requested by the contractor.

g) Interruptions affecting means and methods

Most, if not all, construction contracts give the contractor the right to control its own means and methods of construction. If this control is usurped by the owner, project manager, or design professional, the contractors planned activities can become elongated

and subject to delay damages. Assume your city has contracted with a contractor for the construction of a concrete structure. This structure can be either horizontal or vertical for the purpose of this example. The contractor has available to it, a number of alternative options for concrete curing once the pours occur. If the contractor chooses to pull forms after 24 hours and cure the concrete by applying moisture and a curing compound, it can proceed through all the pours in a few weeks. However, if the design team comes in and demands that the contractor keep its forms in place for 3 days prior to pulling them and applying a curing compound, then the contractor has lost control of its means and methods and will suffer delays as a result.

The delay claims associate with this might include costs for additional form rental as well as lost time and increased general conditions for jobsite expenses because the concrete curing could not proceed as quickly as expected. An owner should typically avoid interfering with a contractor's means and methods. If it occurs a claim could arise. One should also note that this type of activity can result in a lost efficiency claim as well because the contractor might have to reassign labor crews or demobilize and remobilize certain areas of the project if the progress and coordination of the project is adversely affected by the interference.

h) Completeness of contract documents

Another act which can cause or contribute to delay relates to the contract documents and the completeness of the design. On many projects, a bid can be awarded and then, prior to the issuance of a notice to proceed, the owner and contractor engage in value engineering to cut costs and deliver the project for less than originally bid. Assume that the owner chooses to value engineer certain aspects of the design for which new

structural plans must be issued. If there is a delay in acquiring the services of the structural engineer, or the engineer takes longer than anticipated to reissue the drawings, the potential for performance delays can occur. Because the structural component of the project occurs near the outset of the project and involves materials, such as steel rebar, that are subject to current price increases, the potential for a delay claim exists here.

An owner should anticipate this possibility and, if engaging in a joint effort to value engineer the project, obtain an agreement with the contractor to waive any claims arising from delays associated with the value engineering. If such a waiver is not available, the owner should acquire all knowledge available before agreeing to a contract modification related to potential delays so it can properly evaluate the actual cost savings in comparison to the downstream exposure to delay damages.

Prompt Payment Claims

The Prompt Pay Act appears as chapter 2251 of the government code.[6] That statute applies to municipalities. The statute provides a remedy if a municipality delays payment for goods or services in breach of a contract or agreement. Also, absent terms governing timeliness of payments under a construction contract, the statute provides times certain by which payments become due depending on the size of the municipality or other governmental entity.[7]

i) Late or nonpayment

In virtually all situations where a contractor is performing work for a city, the regular submission of pay applications occurs. Additionally, there may be occasions where the contractor will submit change requests or invoices for extra costs. If the

[6] TEX. GOV'T CODE ANN. §§2251.001-.055.
[7] *Id*. at §2251.021

relationship with the contractor sours, there may be a number of work items performed under protest. In that situation, the contractor will incur costs that are not paid for or reimbursed by the owner at the time of performance.

The Prompt Payment Act allows the contractor to recover interest on unpaid amounts. The interest is calculated as prime plus one.[8] However, the calculation is not that simple. The rate is determined by looking at the published prime rate of interest in the July 1 issue of the Wall Street Journal in effect on September 1 for the fiscal year in which the payment becomes overdue. The interest calculation is simple interest and runs until the city mails or electronically transmits the payment to the contractor.[9]

The statute does provide an exemption for interest payments in the event there is a good faith dispute about the charges. The city must notify the contractor of its dispute.[10] If no notice is given, the interest calculation is not abated. Even if notice is given, but the ultimate dispute is determined in favor of the contractor, then the interest calculation applies from the date the invoice or request was received.[11] City attorneys must be diligent in payments to contractor in order to avoid Prompt Payment Claims.

The Prompt Payment Act provides a remedy to contractors for nonpayment. It does not provide an additional cause of action. The failure to pay, or pay timely, would be a breach of the construction contract. That breach gives rise to a cause of action. The Prompt Payment Act simply adds to the available remedies and actual damages that a contractor may recover in a claim situation. Furthermore, there is nothing in the Prompt Payment Statute that would prohibit the assessment of prejudgment interest pursuant to

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[8] *Id*. at §2251.025
[9] *Id.*
[10] *Id*. at § 2251.042
[11] *Id.*

the civil practices and remedies code in the event of an adjudication in favor of the contractor.[12] Accordingly, cities should be diligent in payment undisputed amounts so that they avoid the application of double interest payments.[13]

j) Attorney's fees

The good news about attorney's fees in breach of contract claims is that the statute waiving sovereign immunity prohibits contractors from recovering them.[14] However, the Prompt Pay Act specifically allow recovery of attorney's fees incurred in seeking to recover unpaid sums withheld in violation of that chapter.[15] This conflict in the law has not yet been addressed by the courts. Accordingly, city attorneys should be prepared to argue that either attorney's fees are not recoverable or that the only attorney's fees that the city might be liable for are those specifically incurred in the attempts to collect monies that were late or withheld.

CONCLUSION

Hopefully, this paper has provided some information about various types of claims that a city might see from a contractor performing a construction project. My paper does not identify every conceivable claim on which a contractor might be allowed to seek recovery. However, I have identified the most frequently seen claims and attempted to provide real-world examples to assist you in understanding how some of these claims might arise.

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[12] TEX. CIV. PRAC. & REM. CODE ANN. §41.007
[13] *See* TEX. LOCAL GOV'T CODE ANN. §271.153; *and see* TEX. FIN. CODE ANN. §304.003.
[14] TEX. LOCAL GOV'T CODE ANN. §271.159.
[15] TEX. GOV'T CODE ANN. 2253.043