



istockphoto.com

# Legal Issues in Construction

By Mary Lou Jay

**K**eeping a handle on the legal issues associated with construction projects is important in any economy, but in today's tough market it can literally be a matter of survival. As more contractors turn to government work to see them through the downturn, they need to be aware of and adhere to the very specific legal and regulatory requirements that such projects carry. In addition, with increased competition and lower profit margins on private sector jobs, contractors can ill afford the costs of a legal battle over any aspect of a project.

ABC Delaware asked five area attorneys to share their expertise about potential legal pitfalls in construction and to suggest ways that contractors can help avoid legal problems or to win them if litigation becomes unavoidable.

## When the government is the owner

Any builder considering government work needs to be aware of the amount of red tape involved. "The rules and regulations that govern federal contracting work are in many instances so arcane and complicated that con-

tractors need to consult either with an attorney or with a particular consultant in that area to understand how to go about getting involved in that work, and what the rules of that game are," says Edward Seglias, managing partner of the Wilmington office of Cohen Seglias Pallas Greenhall & Furman PC. Just navigating through the federal acquisition regulations, which control how the government contracts with industry to provide goods or services, can be a labor-intensive effort, he warns.

"Contractors should be sure that they are familiar with government record-keeping requirements," adds Kevin Fasic of the Law Offices of G. Kevin Fasic in Wilmington. "Government projects, especially federal government projects, will have things like affirmative action requirements or documentation of payroll issues; there are reports, reams of documentation that you need to supply to different government agencies. That's probably one of the most difficult things about government jobs."

Seglias notes that the federal government is very strict about compliance with its regula-

tions, and the penalties for not complying with them can be "draconian," and may even have criminal implications. "So doing business with the government can be good business but also can be risky business for those companies that don't follow the letter of the law," he advises.

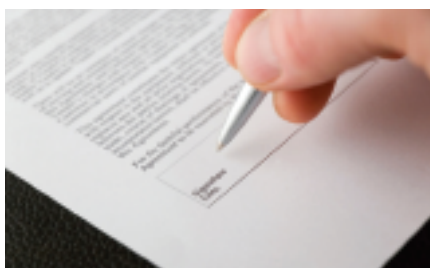
## Bonding and insurance

Government contracting typically involves both bonding and insurance requirements. "Know what is required of you under the contract documents then make sure that you have the right coverage," says Chad J. Toms, counsel with the Wilmington office of Whiteford Taylor Preston. "Most of the time it's a matter of making sure that you have obtained the correct bond or insurance coverage as is required under the contract you signed."

Contractors should understand their rights, advises Donald Logan, of Logan & Associates, Attorneys at Law, in New Castle. "Bonding has gotten more and more difficult, and if a contractor wants to get bonding he has to demonstrate that he is entitled to it. The indemnification

agreements that contractors are being required to sign for the sureties are pretty extensive; they essentially have all of the contractor's assets." The quality of the bonding company is critical, since owners and general contractors frequently have lists of bonding companies they will not deal with because of previous problems.

Any builder whose contract includes large insurance and bonding provisions should get them analyzed by insurance agents and bond brokers. "Many times you will see subrogation, indemnification provisions, or duties to defend that subcontractors or contractors' carriers won't agree to. So contractors or subs find themselves unknowingly making promises that their insurance company is not going to keep," Logan adds.



istockphoto.com

General contractors should periodically check on subcontractors' insurance, advises Scott Wilcox, an associate with Bayard, P.A., in Wilmington. "Just because a subcontractor provides a valid insurance policy at the beginning of the project doesn't mean that the insurance policy remains in effect throughout the job." If the subcontractor lets the policies lapse, the general contractor could be left without a resource to draw upon if it has a claim against the subcontractor.

When a subcontractor decides to draw on a bond, it must make sure to follow the specific requirements of the bond or insurance policy, including complying with the time limitations for making claims. "The goal of insurance companies is to minimize the amount of potential payouts," says Wilcox. "If you get legal counsel involved early on, they can typically identify some of those efforts by the insurance company to delay and minimize potential payout and hopefully get a just payout that maximized the benefit for the contractor."

Seglias notes that recent court decisions in Pennsylvania have made it more difficult to obtain insurance for work that is considered to be a construction defect or not the work of an occurrence. Delaware courts could look to the Pennsylvania courts for guidance if faced with similar cases.

"Nowadays the whole issue of insurance

coverage for a particular loss is more difficult to resolve in favor of the contractor," he adds.

### Indemnification issues

Generally, under Delaware's anti-indemnity statute a project owner may not shift responsibility for its own negligent acts to the contractor. The statute essentially precludes A (the owner) from contractually requiring B (the contractor) to indemnify A for A's own negligence," says Toms. The Delaware Supreme Court applied this statute in a case involving Chrysler Corporation where one of Chrysler's own employees was alleged to have caused an injury to a subcontractor's employee, resulting in a suit against Chrysler.

"However, where insurance is present to cover the incident, public policy dictates that an injured party be allowed to recover from as many sources as possible. In that case, Chrysler had required the contractor to add Chrysler as an additionally insured on the contractor's policy. While the Court did not decide that such a contractual obligation would normally be enforceable, it did conclude that once insurance covering the accident had been secured, the anti-indemnity statute did not render the claims unenforceable against the issuer of the insurance. The end result is that in certain circumstances what you may be precluded from demanding directly through contractual indemnity, you may creatively obtain through insurance," Toms adds.

### Common contract disputes—scope and specifications

Logan has found the most common legal disputes in construction revolve around three issues:

scope of work, contract amount and schedule.

Understanding the contract documents is the best way to minimize such problems.

Logan's firm offers a class through ABC that points out potential problem areas that contractors should be watching for, such as indemnification and dispute resolution.

Getting a professional to review contract terms can help stave off problems, especially in cases where the contractor senses something is off in the contract language.

Wilcox frequently sees disputes over construction change orders. To minimize problems, "Document, document, document," he advises. "It's the key to preventing litigation. I always recommend that my client immediately follow up a request for a change in scope of work if it will lead to a change order."

Other legal disagreements arise over contract interpretations. If a site has an unforeseen condition that makes a job more difficult, for example, a contractor or subcontractor may have the responsibility for completing their work without any additional compensation, depending on what the documents say. "The general contractor or subcontractor need to know the specification and scope of work required under the contract and plans. Additionally, they need to know their rights for requesting additional time for delays to avoid being charged if they fall behind on a job," Wilcox says.

Contractors and subcontractors must be careful to understand and follow materials specifications. "An expensive mistake occurs when a contractor bids a job using the costs of a lesser grade material and then is required to install a more expensive product onsite. Or



istockphoto.com

even worse, install the cheaper material and then be faced with the possibility of being required to rip it out and start over with the materials called for by the specifications and plans,” Toms says.

### Payment issues

Contract disputes often involve payment terms and money owed to various parties. “Contractors should understand up front the timing of payments and the prerequisites that are needed before they get paid. Do they have to provide lien waivers before payment? Does the architect need to approve invoices based upon percent completion?” Toms explains.

He says that chargebacks are often added to be used as a bargaining tool when litigation appears likely. To be prepared, contractors need to ask the right questions before they sign a contract: Who gets to decide chargeback rights? Is there an appeals process and how does it work? How much is the architect involved?

“The number one, proactive way to minimize contract disputes is to understand the bid package and the contracts before signing,” Toms adds. Is the contract a standard AIA document, or a contract custom drafted by the owner? Unless they check carefully, contractors can unwittingly sign a contract without even realizing that it contains non-standard clauses.

Federal case law holds the owner responsible for errors or omissions in the contract document. “It’s not the contractor’s obligation to ferret them out, or, if they encounter them, to resolve those issues without compensation,” Seglias. “That’s often where the dispute is: should the contractor receive compensation, and if so, how much?”

Good project records are the best defense in any construction contract litigation. “Making sure that you document and maintain a good paper trail is important in any contractual relationship but particularly in the construction context, since there’s so much happening on a job site,” says Fasic. “When you get to the end of project and have to settle up, you have something to support your position.” If contractors have difficulty with a subcontractor and need to backcharge, assess liquidated damages or ultimately throw someone off the project, they have a paper trail to support their actions.

### Surviving difficult times

During a construction market downturn, “contractors need to understand their bankruptcy risks and manage them,” says Toms. “They need to ask themselves, ‘What entity

owes me money or is involved in the project, how financially stable is that entity, and what happens to me if they file bankruptcy?’”

“Contractors out there are having problems with people they never had problems with before,” says Wilcox. “Don’t assume that because you’ve been working with someone for five years, that contractor is going to be reliable on this job.” General contractors need to be sure that their subcontractors are making all necessary payments to materials suppliers so the project doesn’t have a mechanic’s lien filed against it or a bond claim made when it ends.

“The best way contractors can protect themselves is to become much more diligent in the financial and operational management of any project,” says Seglias. “They need to understand where the projects are and what the problems and difficulties are, so they can address them early. They also need strong financial management systems in place to track costs as they’re being incurred, so contractors can compare their budgeted amounts against the actual costs expended. They need to do that on a very regular basis, monthly at a minimum.”

To protect themselves against non-payment, Logan recommends that contractors insert a suspension clause into contract documents, which allows them to suspend work if an invoice they have submitted isn’t paid within a set amount of time, such as 30 or 60 days. “That is a very practical tool because the contractor does not have to declare the party in breach and does not have to terminate the contract. It simply suspends work, and avoids the threat of damages from a general contractor or owner because the contractor has that right. It doesn’t require any notice, it only requires the passage of time.”

### Taking the proactive approach

The old saying is true when it comes to legal matters: the best defense is a good offense.

“I can’t think of a reason why you ever wouldn’t be proactive,” Seglias says. “It’s good cost management, good business. Maintaining a proactive attitude throughout a job helps avoid difficult situations, or at least minimizes their impact to a project. . . . If litigation can’t be avoided, typically the party that has the better set of project documents, who has documented events, has been more proactive in dealing with events is more likely to be on the winning side.”

“If you see a potential problem, and you are proactive, you are more likely to resolve the dispute and expend less time and money than if you wait for something to happen,” says Wilcox. “In a small state like Delaware, where

## Avoiding Legal Problems: Best Practices for Contractors

- Read and understand all contract documents before you sign. Consult the appropriate professional (attorney, accountant, insurance agent, bonding professional) if you don’t understand or don’t feel comfortable with any provision.
- If a project is too risky, turn it down. You don’t lose money on jobs you don’t take, but you can lose money when you take a bad job.
- Obtain all necessary insurance and/or bonding so your company and your employees are covered if there’s a problem and you’re liable.
- Document, document, document. Keep a complete project file from the start of the job. Include all contract versions change orders, notes and correspondence. Take photos and videos throughout the project, especially if there is a problem that could escalate into litigation.
- Teach employees the importance of documentation. Reinforce that message frequently, and check to make sure they are doing it properly.
- Treat employees fairly. With the uncertainty and fear in today’s economy, people are more apt to take legal action if they feel an employer has been unfair.
- Develop and maintain positive relationships with the owner, general contractor, suppliers, vendors and subcontractors. People who know and respect one another are more likely to watch out for each other and be willing to work out problems.
- Before you go to court, try mediation with a neutral third party. Even if you can’t resolve all issues, you may narrow them down. That means less money spent on legal fees.
- If you have a problem, don’t wait too long to ask for legal advice. A brief consultation up front could end up saving you the time and expense of a drawn-out court battle.

## Litigation going green?

Green building projects may be good for the environment but they could be bad news for the construction industry in the not-too-distant future.

“We’re anticipating that green building requirements—because the regulations and recommendations are still new and unfamiliar, coupled with the unprecedented flow of stimulus money to green projects – will spurn disputes and possibly litigation as the parties grapple with how to define green building expectations into their contracts,” says Chad J. Toms, counsel with the Wilmington office of Whiteford Taylor Preston. “If a project is designated to hit a certification level, whose job is it to make it get there, and if certain targets are missed how does that relate to contractual expectations? Will owners expect to get some of their money back if their green expectations are not met? If so, how much and from whom? All of these things need addressing on the front-end”

“I think there’s going to be a greater level of litigation because of owners’ expectations of what the performance of a building is going to be versus what the final product actually does,” agrees Donald Logan, of Logan & Associates, Attorneys at Law, in New Castle. “There will be litigation arising from the fact that the building isn’t functioning the way it was intended for whatever reason.”



istockphoto.com

the members of the construction community know each other, being proactive also helps to preserve relationships.”

There are several other things that contractors can do in addition to documentation, says Logan. For example, they should check the credentials of companies they haven’t worked with before to be sure they have all appropriate state and county licenses and registrations. They should make sure that any contracts they sign establish a fair playing field; if, under the contract, the owner’s legal fees are will be paid by the contractor if the owner wins an action, it should also state that the owner pays the contractor’s legal fees if the contractor prevails in court. Having such language in a contract can be an incentive to both parties to resolve matters out of court.

If a legal problem threatens, don’t wait too long to ask for help. “By the time many parties call for counsel, they’ve missed opportunities to protect themselves,” says Toms. “Bonds and mechanic’s lien rights, for example, have a short window of time. If you keep thinking that things will work themselves out, that you’ll get paid eventually, and six months goes by, you’ve likely hurt your position. Contractors should be talking to their attorneys as soon as they think

there is a risk of default.”

“As legal counsel, I am in a better position to guide my client if I’m involved early on than when they have already taken certain steps that can compromise their position,” Wilcox says. An attorney can also be effective in advising a client behind the scenes prior to litigation. This approach avoids the escalation of matters that sometimes occurs when lawyers get involved but provides the contractor with guidance in trying to resolve the dispute.

“Sometimes, by the time I get involved, I’m late to the dispute and must work within the confines and boundaries of statements made between the parties in their early communications which sometimes are exchanged in anger,” adds Toms. “A good rule of thumb is to assume every written document or verbal communication will be part of litigation somewhere, so chose your words carefully.”

“Being informed about potential contract pitfalls is one of the best ways for contractors to anticipate and avoid legal problems. Assuming that you will have such problems and preparing for them with the facts to back up your position, is the best way to assure that if a legal battle arises, you’ll be on the winning side. ■

## Executive Orders Target Nonunion Contractor

Contractors involved in federal government project should be alert for more details about three executive orders that target non-union contractors, signed by President Obama in the first weeks of his term.

The first repeals the Beck Order, which required contractors to inform employees of their right to refuse to pay union dues earmarked for non-collective bargaining activities, including politics and lobbying. “The new Obama order also appears to vest the Secretary of Labor with broad authority over federal contractors, including the power to potentially blacklist contractors for violations of labor laws,” according to a document from ABC National. Contractors and subcontractors must also post a notice informing employees of their rights under federal labor laws and comply with all provisions of this notice. Any contractor that does not comply could lose their contract or face blacklisting. As of this writing, the Secretary of Labor has not yet released the details of what will be contained in the notice.

The second executive order prohibits reimbursement to federal contractors for costs associated with educating employees about unionization. That extends to preparing and distributing materials, hiring or consulting legal counsel, holding meetings and planning or conducting activities by managers, supervisors or union representatives during work hours.

“It is likely this order will face a legal challenge almost immediately,” according to ABC National. “The U.S. Supreme Court issued a ruling last year in the case of Chamber v. Brown that appears to undermine the legality of this Order.”

The third order—which may impact only companies involved in maintenance work—requires contractors “to offer workers employed under a predecessor contract the right of first refusal of employment in positions for which they are qualified,” ABC National states. “Penalties include back wages and the possibility of a three year debarment from federal contracts.

All of these executive orders will be more fully explained in regulations that will be released later this year. Watch for communications from ABC with details about how they will affect open shop contractors.