

WE DON'T ACCEPT I.O.U.s

A presentation on damages, claims and
issues with payment which arise from
construction projects.

Justin Garcia & Jaime Paoletti



OVERVIEW

This presentation will focus on real-life scenarios impacting owners, general contractors/CMs, subcontractors and design professionals. These are the most commonly-incurring claims, damages from those claims and avenues of payment.

- ❖ Contractual Provisions
- ❖ Bonding
- ❖ Insurance
- ❖ Dispute Resolution
- ❖ Claims
- ❖ Damages

NOTICE, DEFAULT, TERMINATION & DISPUTE RESOLUTION

- ❖ Most of your contracts will contain notice requirements for default and termination. There will also be a cure period. This is not complicated, but the court system is littered with companies that did not follow the notice of default, cure period, then termination sequence correctly.
- ❖ Time frame for providing notice, form of notice, to whom notice must be sent.
- ❖ Cure period could be a bar to recovery if you do not follow it.
- ❖ Consider supporting documentation required.
- ❖ Review default provision for the necessary steps to bring a claim; consider prerequisites to mediation, arbitration or litigation.
- ❖ If your contract requires arbitration or another form of ADR, you will run into the issue of getting all necessary parties to participate. ADR is a creature of contract, try to negotiate language that allows the contractor to join all necessary parties. If you are a general contractor, the obligation to participate in ADR should flow down from the prime contract.

USE CONTRACT DRAFTING TO MANAGE POTENTIAL DAMAGES CLAIMS

- ❖ Read and understand your contract.
 - ❖ You would be surprised how many people never read it!
- ❖ Your contract will drive avenues of recovery and exposure to potential liability. Your contract will drive your insurance requirements and bonding requirements.
- ❖ Plan for damages and consider/negotiate key contract terms.

INSURANCE

- ❖ Avenue of payment / recovery / defense costs / project funding
 - ❖ Commercial General Liability, Builder's Risk/Loss of Use, Errors and Omissions (personal liability)
- ❖ Resource for managing risk of claims
 - ❖ E.g. Indemnification, damage to the project...
- ❖ Talk to your lawyers and insurance agents/consultants to ensure appropriate insurance for a particular project and as contractually required.
- ❖ Example: Forest Manor

CONTRACTOR'S LIABILITY INSURANCE

- ❖ Protects the insured parties from injuries it may cause to other people or property, i.e. Third-Party Claims;
- ❖ Claims for Damages, other than to the Work itself, because of injury to or destruction of tangible property, including loss of use;
- ❖ Completed operations;
- ❖ Claims involving contractual liability insurance applicable to indemnification obligations related to third-party claims against insured.

BUILDER'S RISK – OWNER'S LIABILITY

- ❖ BRI is a payment source for **first-party** claims by Owner or Contractor for damage to the Work. In the event you have to make a claim on a builders risk policy....CONTACT YOUR LAWYER! It is easy to make a mistake. Don't give the insurer an unnecessary basis to deny coverage.
- ❖ Triggering a claim – each policy is different, but it will contain requirements. Written notice and proof of loss provided as soon as the loss occurs. Upon notice, insurer has a right and duty to investigate a claim and make a determination of coverage. The insured has a duty to cooperate with the insurer's investigation. Policy may contain pre-requisites to litigation (e.g. mandatory mediation, neutral appraisal).
- ❖ AIA contracts usually require an “all-risk” Builder's Risk policy in the amount of the initial Contract Sum plus value of subsequent Contract modifications, comprising the total value for the entire Project on a replacement cost basis.
- ❖ Insures the “Work”.
- ❖ What about existing structures or adjacent property? Is that the Project? Specify what needs to be covered on what basis and by whom.
- ❖ If there is insurance, property damage recovery is driven by policy language (e.g. replacement cost value vs. actual cash value).

LOSS OF USE

- ❖ Typically runs to the benefit of the owner.
- ❖ E.g. commercial building burns down; loss of use provides coverage for lost rent.
- ❖ CGL policy typically does not cover first-party loss of use claims.
- ❖ Therefore, to reduce damages exposure, consider drafting a contract where the Owner has the option to buy insurance, but waives all rights of action against the Contractor for loss of use of Owner's property, including consequential losses due to fire or other hazards, however caused *regardless* of whether the Owner has purchased the loss of use insurance.

INDEMNIFICATION PROVISION

- ❖ § 3.18.1 (AIA A201 General Conditions) To the extent not covered by the Owner's obligations under Section 10.3, and to the fullest extent permitted by law, the Contractor shall indemnify and hold harmless the Owner and its agents and employees of any of them from and against claims, damages, losses, and expenses, including but not limited to attorneys' fees, arising out of or resulting from performance of the Work, provided that such claim, damage, loss, or expense is attributable **to third-party claims** for bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the Work itself), but only to the extent caused by the negligent acts or omissions of the Contractor, a Subcontractor, anyone employed by them, or anyone for whose acts they may be liable. Such obligation shall not be construed to negate, abridge, or reduce other rights or obligations of indemnity that would otherwise exist as to a party or person described in this Section 3.18. **The Contractor's duty to indemnify, including without limitation, duties pursuant to §9.15, shall be limited to the available proceeds of insurance coverage.**

- ❖ INDEMNIFICATION OBLIGATION SHOULD FIT WITH INSURANCE CO

PAYMENT AND PERFORMANCE CLAIMS

FAILED PERFORMANCE OR FAILED PAYMENT ON A PROJECT

PAYMENT AND PERFORMANCE BONDS

- ❖ Payment Bonds (Typically runs to the benefit of the subcontractor)
- ❖ Performance Bonds (Typically runs to the benefit of the GC/CM or Owner)
- ❖ Filing a bond claim
- ❖ A311 v. A312
 - ❖ Notice provisions
- ❖ Proving your claim and the bond claim process

PAYMENT BOND CLAIMS

- ❖ AIA (A312), the EJCDC (C-615), and ConsensusDocs (ConsensusDocs 261)
- ❖ Two types of claimants: (1) claimants employed by or in a direct contractual relationship with the contractor, and (2) claimants that lack contractual privity with the contractor. For claimants with privity, the surety's obligations do not exist until the claimant gives notice to the surety and owner of a claim and its amount "with substantial accuracy." For claimants lacking privity, there are three conditions precedent that must occur: (1) within 90 days after having last performed labor or furnished materials included in the claim, a claimant lacking privity must provide written notice to the contractor and surety stating with "substantial accuracy" the amount of the claim and name of the party for whom the labor or materials was provided; (2) a claimant lacking privity must either have (a) received at least a partial rejection by the contractor of its written notice, or (b) within 30 days of that written notice, not received any communication from the contractor indicating the claim will be paid, and (3) where a claimant is not paid within the 30 days of its notice, the claimant must send written notice to the surety and contractor stating that a claim is being made, and including a copy of the previously provided notice. However, if the contractor itself notifies the claimant lacking privity or surety of its non-payment, then that is sufficient to satisfy the claimant's notice requirements above.

PERFORMANCE BOND CLAIMS

- ❖ A312-2010 contains several procedural steps that the owner must follow to make a valid claim on the bond. First, the owner must notify the contractor and surety that it is considering declaring the contractor in default. The second condition precedent differs between A312-2010 and its predecessor, A312-1984. Under A312-1984, the owner must, within 15 days, request and attempt to arrange a meeting with the contractor and surety to see if an agreement can be reached on future performance. If using A312-2010, the owner need not request a meeting if it provides notice of potential default to the contractor and surety. But A312-2010 does allow the surety itself to request such a meeting. Next, under both editions of A312, the owner may, after 20-days' notice to the contractor and surety, declare the contractor in default and formally terminate the contractor's right to complete the contract. It is important to note that A312 incorporates the underlying contract by reference, which may contain additional requirements for declaring default and terminating the contractor. The owner must then agree to pay the balance of the contract price to the surety, or to another contractor selected by the surety. Lastly, the AIA form requires that the owner not be in default itself on the contract and follow the contract termination procedures, including any opportunities to correct the cited deficiencies as mandated by the contract and the applicable law.
- ❖ A311 Difference – It is simpler than the 312, default by the contractor, declaration by the owner of that default, and that the owner itself not be in default. Owner does not have to agree to pay balance of contract to the owner.

MECHANICS' LIENS

- ❖ Statute of limitations (Conn. Gen. Stat. §§ 49-34 and 49-35)
 - ❖ Within 90 days after contractor ceased performing services or furnishing materials;
 - ❖ Best practice: record and serve within 90 days.
- ❖ Cannot file liens on public property (public bonds require bonds).
- ❖ In jobs on public property, you have to make claims against bonds.
- ❖ Substitution of bond for lien from suitable surety.

Miller Act Claim/Little Miller Act Claims (Bond Claims)

❖ Miller Act

- ❖ Federal Court
- ❖ Payment bond claims
- ❖ Applies to public projects

❖ Little Miller Act

- ❖ State Court
- ❖ Payment bond claims
- ❖ Applies to public projects

- ❖ If you do not receive payment within 60 days of supplying material or labor, you can make a claim on the bond, but claim must be made within 180 days of last date you provided material or labor.
- ❖ Claims for unpaid retainage must also be made within 180 days of last date you provided material or labor.
- ❖ Specific notice requirements: amount, for whom work was performed, description of project, served on both surety and contractor.
- ❖ Surety has 90 days to pay any portion not subject to good faith dispute and/or shall issue a denial if necessary.
- ❖ Attorneys' fees are recoverable if surety fails to perform.

CHANGE ORDERS & EQUITABLE ADJUSTMENTS

- ❖ Driven by contract terms
 - ❖ Notice, again, is critical
- ❖ Prepare supporting documents
- ❖ Understand nature of change order
- ❖ How does change impact contract time and contract sum?
- ❖ How will disagreement be resolved?

LOSS OF PRODUCTIVITY/ DELAY DAMAGES

- ❖ Record-driven
- ❖ Provide notice immediately
- ❖ Notify the appropriate party that there are issues not attributable to you.
- ❖ Often times, the nature of the claim doesn't allow you to bring the claim until the project is complete, but to the extent possible, you need to collect the data and make the record of the compensable loss.

COMPENSABLE VS. UNCOMPENSABLE DELAY

- ❖ Compensable delay: typically caused by unforeseen conditions or by the Owner
 - ❖ Out of Sequence Work
 - ❖ Design Issues
 - ❖ Design Changes
 - ❖ Slow Responses to RFIs
 - ❖ Failure to Coordinate Trades
 - ❖ Failure to make timely payments
 - ❖ Acceleration
 - ❖ Stacking
 - ❖ Extended Overtime/Fatigue
 - ❖ Changed Conditions
 - ❖ Weather/Winter Conditions
 - ❖ Site Access/Vertical Transportation

- ❖ Uncompensable delay: attributable to the Contractor or third parties not under the control of the owner
 - ❖ Labor Turnover
 - ❖ Poor Supervision/Poor Planning
 - ❖ Inadequate Subcontractor/Trade Coordination/MEP Conflict Elimination
 - ❖ Low Bid Hours

CONTRACTOR'S ACTUAL DELAY DAMAGES

- ❖ Labor and equipment standby costs
- ❖ Extended project overhead
- ❖ Extended or unabsorbed home office overhead
- ❖ Labor and material escalation

NO DAMAGES FOR DELAY CLAUSES

- ❖ Many contracts will provide that sole remedy for the contractor in the event of construction delays is an extension of time
- ❖ Generally enforceable, but strictly & narrowly construed
- ❖ Where such provisions exist, consider bringing a claim for acceleration costs; loss of inefficiencies attributable to factors other than delay

LIQUIDATED DAMAGES

- ❖ To be enforceable a liquidated damages must be intended as liquidated damages and not as a penalty
- ❖ Actual damages must be uncertain or difficult to determine
- ❖ Based on reasonable forecast of actual damages that the owner would incur should the work not be completed on schedule, determined as of time of contract

PROVING DAMAGES

- ❖ Actual cost records preferred over estimates of damages.
- ❖ Quotations, purchase orders, payroll records, invoices and accounting ledger.
- ❖ Where estimated costs are used, the weight given will depend on the method or approach utilized. This requires an expert to perform an analysis. The right one makes a difference.
- ❖ You do not have to prove damages to a mathematical certainty. However, evidence must prove that the damages are “reasonably certain”.

MEASURING INEFFICIENCY DAMAGES

- ❖ Measured Mile “Gold Standard” (comparison between baseline and the actual work: good to use on projects with detailed inspections and quantity measures and contractor maintains detailed cost coding)
- ❖ Actual Cost (T&M tickets, demobilization/remobilization)
- ❖ Earned Value (comparison of value work completed to actual cost of work)
- ❖ Total Cost (look at total cost vs. total payment)
- ❖ Modified Total Cost (breaks out contractor-caused inefficiencies)
- ❖ Industry studies

CONTRACT DAMAGES

- ❖ Expectation damages: In a breach of contract action, the prevailing party is entitled to compensation which will place it in the same position it would have been in had the contract been properly performed. Put non-breaching party in the place it would have been *but for* the breach.
- ❖ Direct damages: Damages flowing directly from the breach
 - (E.g. lost profit; diminution in value of damaged property; cost to repair or replace defective construction)
- ❖ Consequential damages: Damages that, although not an invariable result of every breach, were reasonably foreseeable or contemplated by the parties at the time the contract was entered into as a probable result of a breach. (e.g. a contractor who claims that the owner's actions forced it into bankruptcy or an owner who claims lost interest on tied-up project funds)
 - Unless specifically delineated, whether damages are direct or consequential may be a complex question of fact.

MUTUAL WAIVER OF CONSEQUENTIAL DAMAGES

- ❖ **AIA A201 (General Conditions) § 15.1.6** Mutual waiver of consequential damages: Owner's rental expenses, losses of use, income, profit, financial, business and reputations, loss of management or employee productivity or of the services of such persons; Contractor's principal office expenses, losses of financing, business and reputation, loss of profit except anticipated profit arising directly from the Work.
- ❖ Incorporate into all contracts regardless of form.
- ❖ Make sure that subcontractors adopt the waiver precluding consequential damages against the Contractor.

TERMINATION FOR CAUSE

- ❖ If Contractor is terminated for cause ...
- ❖ **§ 14.2.4** If the unpaid balance of the Contract Sum exceeds costs of finishing the Work, including compensation for the Architect's services and expenses made necessary thereby, and other damages incurred by the Owner and not expressly waived, such excess shall be paid to the Contractor. If such costs and damages exceed the unpaid balance, the Contractor shall pay the difference to the Owner. The amount to be paid to the Contractor or Owner, as the case may be, shall be certified by the Initial Decision Maker, upon application, and this obligation for payment shall survive termination of the Contract.

TERMINATION FOR CONVENIENCE

- ❖ **§ 14.4.3** In case of such termination for the Owner's convenience, the Owner shall pay the Contractor for Work properly executed; costs incurred by reason of the termination, including costs attributable to termination of Subcontracts; and the termination fee, if any, set forth in the Agreement .
- ❖ Consider negotiating termination fee or reasonable overhead and profit on the Work not executed.

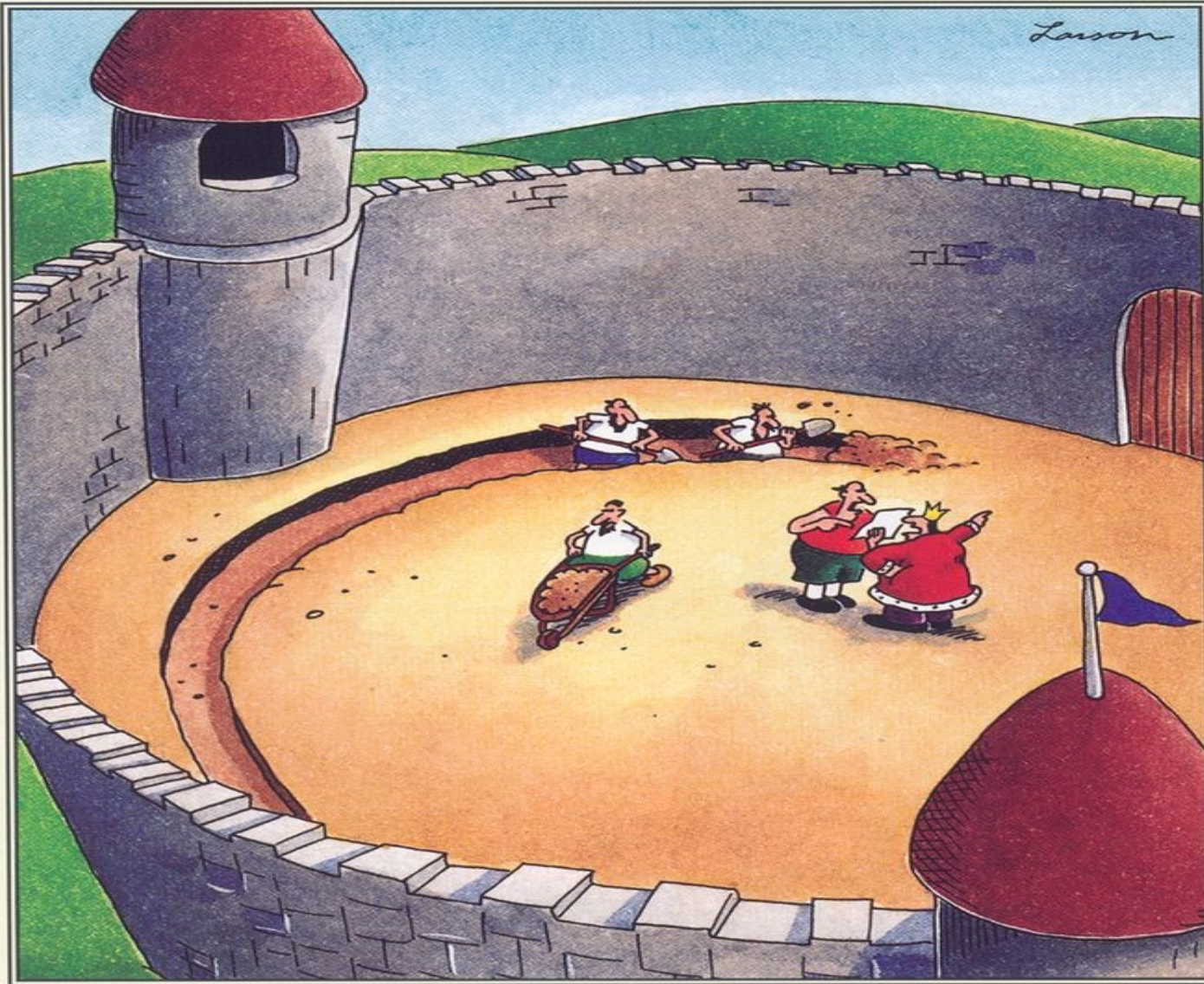
WRONGFUL TERMINATION DAMAGES

- ❖ Under common law:
 - ❖ The profits that would have been realized on the whole contract or the contract price LESS (1) any payments made by the owners on the contract AND (2) what it would have cost the contractor if it had completed the project in accordance with the contract.
 - ❖ Damages include profit on change orders for which the wrongfully terminated contractor would have been entitled.
 - ❖ Lost profit arguably includes reasonable overhead
 - ❖ Fixed overhead not deducted from gross income to arrive at net profit properly recoverable
 - ❖ Only variable costs that are directly avoided by no longer having to perform the contract should be deducted.

PAY IF PAID VS. PAID WHEN PAID

- ❖ Defense to claim by subcontractor
- ❖ Generally enforceable
- ❖ Pay-if-paid: need only pay subcontractors if contractor is paid by owner
- ❖ Pay-when-paid: only imposes a reasonable time period within which payment must be made, does not excuse non-payment.

4/16/90



Suddenly, a heated exchange took place between the king and the moat contractor.

MEASURE OF DAMAGES FOR DEFECTIVE CONSTRUCTION & DEFECTIVE DESIGN

- ❖ Defective construction: cost to repair or diminution and value, whichever is less
- ❖ Defective design: cost to correct the defective design itself AND the cost to correct work that has been installed in accordance with the defective design
- ❖ Can contractor bring claim against design professional?

INTEREST & ATTORNEYS' FEES

- ❖ Interest:
 - ❖ Set by contract
 - ❖ Prejudgment interest by state statute
- ❖ Punitive Damages:
 - ❖ Usually reserved for tort actions, however, an egregious breach of the covenant of good faith and fair dealing implied in every contract could serve as a basis for an award of punitive damages
- ❖ Attorneys' fees:
 - ❖ Not usually recoverable under American Rule unless permitted by contract or establish breach of a tort

SHOW ME THE MONEY

REMEMBER:

- ❖ Read and follow the claim process set forth in the contract.
- ❖ Gather the back-up and necessary assistance you will need so that you can demonstrate the cause and effect relationship between the compensable event and the claimed damages as best as possible – many disputes are won or lost on the basis of the care and accuracy with which damages are documented, summarized, supported and presented!



shutterstock.com • 268290824

Justin Garcia

Garcia & Milas, P.C.

JGARCIA@GARCIAMILAS.COM

1 Audubon St., 6 th Floor

New Haven, CT 06511

(203) 773-3824

Jaime Paoletti

Garcia & Milas, P.C.

JPAOLETTI@GARCIAMILAS.COM

1 Audubon St., 6 th Floor

New Haven, CT 06511

(203) 773-3824

