

Construction Law



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Contracts

Cost adjustment clauses in construction contracts

The last year has seen a topsy-turvy market for petroleum products with oil at one time approaching \$150 per barrel and, at another time, priced below \$40 per barrel. The result is that, over the last 12 months, diesel fuel has sold at anywhere from \$2.30 to \$5.00 per gallon—a 100 percent range.

The impact on the construction industry of such price swings in petroleum and other commodities is immediate and severe due to the heavy incorporation and use of raw materials on construction projects and due to the prevalence

of lump sum contracts. This can create a host of problems and unintended consequences for the construction industry, including high contractor bids which build in a cushion, severe contract losses and defaults, impacted and delayed projects, and litigation as parties attempt to mitigate, shift or recover unanticipated losses.

One approach to address this problem is through the use of price adjustment clauses in contracts. Price adjustment clauses are permitted already in certain federal contracts pursuant to the Federal Acquisition Regulations. In addition, various state

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Legal Developments

Duty of reasonableness in cost-plus contracts

Under a cost-plus contract, the contractor or subcontractor performing the work invoices for all of its actual costs plus a mark-up for overhead and profit.

A not uncommon problem which arises with cost-plus contracts is a dispute over whether the invoiced costs were reasonable. This was the situation in a case recently decided in the Federal District Court for the Southern District

of West Virginia, *Frontier-Kemper Constructors v. Elk Run Coal Co.*, in which a coal mine owner disputed the invoices of a construction company hired on a cost-plus contractual basis to construct a shaft in a coal seam using a raised bore method. The contractor provided a budget cost of \$410,000. The actual costs invoiced, however, were over \$1 million above that budget amount.

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Contracts (continued)

highway departments routinely use such clauses with regard to the cost of items such as asphalt, paving, cement, diesel fuel, steel and other materials.

Adjustment clauses, however, must be carefully considered before adoption and implementation. Adjustment clauses need to be carefully drafted and should identify the specific building material considered to be at risk for price fluctuation. Adjustment clauses should set forth a notification procedure by which the owner would be notified by the contractor of the price increase, should identify the price guide to be used to measure the change in price and should state how often during the job the clause may be triggered.

As to the trigger for adjustment, there are any number of variations. The most common is known as the "invoice method," by which the contractor uses an invoice or certification from its supplier to substantiate the changes in the price of the materials from the time the contract was signed to the time of the actual purchase. Another type of trigger is known as the "index method," by which an increase in the contract price based on

escalation is documented by reference to a designated price index guide for the particular commodity, such as diesel fuel, steel, asphalt or cement, with the ability to adjust the index price for regional and local fluctuations and conditions. This approach works best in those cases where the supplier is unwilling or unable to provide a fixed price quote until the time of actual purchase of the material during the project.

A third type of trigger is a hybrid of the "invoice method" and "index method," whereby the parties agree to a "certified bid cost" in which the contractor certifies its estimate of the identified material's cost based on either its current supplier price or an index price listing. In the event this "certified bid cost" should increase by more than a certain set percentage, such as 5 percent or 10 percent, either upward or downward based on the supplier's price or an index price listing, the contract would then be equitably adjusted accordingly.

In closing, cost adjustment clauses, properly drafted, should work to reduce risk to both contractor and owner and, in doing so, reduce conflicts and promote cooperation, all of which is beneficial to project success.

– Scott D. Cessar

Firm News

Eckert Seamans expands West Virginia presence

On January 1, 2009, all 13 attorneys from the Charleston-based Hendrickson & Long PLLC combined their practices with Eckert Seamans, giving the firm a significant expansion in West Virginia and an important Charleston presence.

The attorneys at Hendrickson & Long, in particular Scott Long, are not strangers to the Eckert Seamans Construction Group, as Scott Long and Scott Cessar previously teamed up on trials and arbitrations of two complex construction cases in West Virginia which included making law in West Virginia extending the scope of negligent misrepresentation claims against design professionals. This experience was a contributing factor in recognizing the synergies in joining together.

Over the recent years, Eckert Seamans Construction Group attorneys have been involved in major claims involving hotels, water plants, radio stations, college buildings, steel mills, metals plants, highways and other significant projects from as far south in West Virginia as Mingo County, as far east as Martinsburg, in Morgantown, and throughout the Northern Panhandle of the state. The addition of the Hendrickson & Long attorneys provides the Construction Group with substantial depth, experience and name recognition throughout all of West Virginia's counties and courts and in the capital, Charleston, where the Hendrickson & Long firm had been one of the area's premier boutique litigation firms.

Legal Developments

(continued)

Before the court, the drilling contractor contended that, based on the plain language of the cost-plus clause in the parties' agreement, the coal mine owner agreed to pay the actual cost of the work performed, even if the actual costs exceeded the budgeted costs plus the contractually-agreed mark-up.

The coal mine owner, however, argued that there are implicit in the terms of a cost-plus contract limitations on the amount that may be charged as actual costs to perform the work.

The court found this to be an issue that had never before been decided by a court in West Virginia and, relying on decisions from Kentucky, New York, Oklahoma and Louisiana, held that there is an implied requirement of reasonableness of the expenses paid and work performed pursuant to a cost-plus contract. The court held further that, while an owner assumes certain risks under a cost-plus contract, such as increases of prices of materials and wages, damages from the elements and possible errors and estimating costs, an owner does not assume the risk of careless or improper workmanship on the part of the contractor. With a cost-plus contract, the court found that a contractor must show that its work was performed efficiently and without the necessity of recurring remedial work which would be suggestive of poor workmanship. Consequently, the court found that there would need to be a trial on the issue of the reasonableness of the costs invoiced by the driller to the owner.

The lesson, therefore, from the *Frontier* case is a common sense one: just because it is a cost-plus contract does not mean that the contractor has carte blanche to bill its costs. The costs must be reasonable and it may well be that the contractor has to demonstrate the reasonableness of those costs to the owner upon request.

– R. Scott Long

Update

Statutes of limitations on performance bond claims

Properly calculating the statute of limitations for filing a lawsuit on a performance bond is not always straightforward, as shown by the recent Pennsylvania Superior Court case of *Preferred Fire Protection, Inc. v. Joseph Davis, Inc.* In this case, the general contractor on a public parking garage hired a subcontractor to install the sprinkler system. The subcontractor sought change orders for amounts above the contract price, which the contractor declined to pay. As a result, the subcontractor sued the contractor and the surety. The date when work was last performed was critical to the success of the claim against the surety.

The sprinkler system was completely installed as of March 15, 2001. Later that month, the building inspector performed a preliminary inspection and found that the system functioned properly. However, further testing and final certification were

required after the fire alarms were installed by another contractor. Final inspection and approval did not occur until June 18, 2003, at which time a certificate of occupancy was issued. The subcontractor, which had done no work on the site since March 15, 2001, was required to accompany the building inspector during the final inspection. Had the system failed inspection, the subcontractor's obligations under its contract would have continued.

Under the Pennsylvania's Public Works Contractors' Bond Law, the key date for calculating the statute of limitations is the last day that the bond claimant performed work on the project. Once this event occurs, there is a 90-day waiting period during which no lawsuit may be filed. The Bond Law's one (1) year statute of limitations begins at the end of the 90-day waiting period.

The key issue in the case was whether the subcontractor performed the last of its work on March 15, 2001, when the system was completed, or on June 18, 2003, when the subcontractor attended the final inspection. The date was critical because the suit against the surety, which was filed in 2004, would be time-barred if March 15, 2001 was the start of the limitations period.

The final safety inspection saved the subcontractor's claim from being time-barred. The Superior Court found that labor was last performed at the June 18, 2003 inspection since the subcontractor was required to attend the inspection, and had the system failed, the subcontractor would have been obligated to correct the problem. Also significant was the fact that the bond referenced "final completion," as opposed to "substantial completion," for the statute of limitations of actions.

– Jake McCrea

Practice Pointer

Misrepresentation claims against architects and engineers

As more and more courts permit contractors, sureties and other parties to file negligent misrepresentation claims against architects and engineers, the question that often arises is whether the party filing such a claim needs an expert witness to testify that there was a misrepresentation in order to meet its burden of proof and, if it fails to get such an expert witness, whether it risks having its claim dismissed.

Here's why: in a claim for negligent misrepresentation against a design professional, according to the Restatement (Second) of Torts Section 552—the standard adopted by those state courts recognizing such claims—it is necessary to show that the supplier of the (mis)information has failed to "exercise reasonable care or competence in obtaining or communicating the information."

Courts, however, disagree on the subject of whether an expert is needed to show that the professional has failed to "exercise reasonable care" or whether such an assessment is in the realm of understanding of a layperson.

For example, a Pennsylvania court has held that an expert witness was not required

when the issue was whether an engineer failed to properly mark the location of a pipeline on the drawings because the issue was simple and within the comprehension of a layperson. Hence, expert testimony was not necessary.

Conversely, a Georgia court found that expert testimony was necessary where the conduct at issue was an engineering firm's design of improvements to a wastewater treatment plant. The deciding factor requiring expert testimony was that the claim implicated the defendant's failure to meet industry standards.

Bottom line: it is probably best to hire an expert witness, even if the issue as to the misrepresentation seems simple and not technical. By having an expert witness, you can avoid the unnecessary cost and expense of litigating whether you need one in the first place and eliminate the risk of the court dismissing your case because you do not.

Lastly, be sure to check your jurisdiction's rules to determine if a certificate of merit is required prior to filing suit alleging negligence by a professional.

– Audrey Kwak

Practice Group News

Neil O'Brien tried a number of arbitrations over the last few months, including a two-day arbitration in a dispute between an excavation subcontractor and a general contractor, a four-day arbitration involving a subcontractor's claim for wrongful termination, a nine-day arbitration defending a general contractor against claims from a subcontractor for delay and impact, and a six-day arbitration representing a general contractor in claims against an owner and developer.

Chris Opalinski tried a several-day, multi-phase arbitration representing a general contractor with claims to recover monies for extra work, contract monies and retainage and in defending a defective work claim.

Scott Cessar and **Ed Flynn** tried an 11-day arbitration between a surety, owner and engineer involving differing site conditions and negligent misrepresentation claims.

New Laws and Regulations

Pennsylvania enacts home improvement contractor registration law

As of July 1, 2009, contractors performing home improvement services in Pennsylvania must be registered with the Bureau of Consumer Protection in the Office of the Attorney General or risk facing prosecution for violating Pennsylvania's newly enacted Home Improvement Consumer Protection Act. The registration process requires home improvement contractors to disclose substantial information regarding their corporate, work and personal history. Further, applicants will be required to pay a \$50 registration fee and to place their assigned registration number on all advertisements, contracts, estimates and proposals.

Home Improvement Contracts

The Act also requires home improvement contracts to be signed writings, containing

the entire agreement, including the date of the transaction, the contractors' address and telephone number, the approximate starting date and completion date, a description of the work to be performed, the total sales price, any down payment or advance payment for special order materials, and the names, addresses, and telephone numbers of all subcontractors on the project known on the date the contract is signed. Otherwise, the contract may be rendered invalid and unenforceable. In addition to these requirements, there are a number of new legal pitfalls relating to arbitration clauses and other contract clauses that may render home improvement contracts void. It is important to have all home improvement contracts reviewed by an attorney familiar with this new law.

Home Improvement Fraud

The Act also creates a new criminal offense known as Home Improvement Fraud. Under the Act, making false or misleading statements to induce a person to enter a contract for home improvement services, failing to perform or provides such services or materials for which advance payments have been received, misrepresenting oneself or one's business, misrepresenting the nature or cost of a special order item, altering a home improvement-related document without the owner's consent, or publishing a false or deceptive advertisement could constitute a felony, if the amount involved exceeds \$2,000.

– Timothy D. Berkebile

New OSHA crane regulations

The Occupational Safety and Health Administration (OSHA) estimates that some 90 workers each year are killed in crane-related accidents. Nonetheless, OSHA's standards regarding workplace safety for cranes and derricks have not been updated since 1971.

In an effort to improve this record and, after a five-year investigation period, the agency published a set of new proposed crane and derrick rules in the Federal Register on October 9, 2008. The rules represent a comprehensive overhaul of OSHA's crane and derrick workplace requirements. The guidelines were developed with input from crane operators, manufacturers, suppliers, and employers, as well as organized labor and insurance industry representatives.

OSHA's existing rules for cranes take up only a few pages in the Code of Federal Regulations; the proposed rules with preamble now consist of 250 pages in the Federal Register with over 40 separate sections of detailed requirements in such areas as crane assembly, crane operation, inspections, and operator training and

certification. The new rules apply to nearly all of the estimated 96,000 construction cranes in the U.S. The more demanding requirements of the rules will come at a significant cost to employers, with OSHA estimating compliance costs at \$123 million nationwide.

Arguably, the most significant new provision in the proposed rule is the "Operator Qualification and Certification" section, which requires crane operators to obtain certification through an accredited testing organization, the military, or the government directly. There are only a handful of accredited organizations in the United States at this time, although more will likely proliferate once the regulation is finalized. OSHA estimates that the cost to employers for certification compliance alone will reach \$37 million. The certification burden is further increased because, as currently written, the regulations do not contain a "grandfather clause," meaning that even experienced crane operators are not exempt from the new requirement.

In addition, the proposed regulations comprehensively addresses safety issues associated with cranes, including ground conditions, the assembly and disassembly of cranes, the operation of cranes near power lines, the use of safety devices and signals, and inspections of cranes. Under the new regulations, contractors at worksites must ensure that ground conditions at the site are sufficient to support the anticipated equipment and hoist loads. Moreover, exacting standards will be put in place for crane operators working near power lines to ensure that the cranes do not risk coming into contact with the lines. Finally, more rigorous inspection requirements will be imposed upon contractors, including various daily, monthly, and yearly inspections.

The official comment period for the new rules ended January 22, 2009, and the agency is in the process of reviewing and potentially incorporating these comments before finalizing the new requirements.

– Matthew J. Whipple

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