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Summer 2016

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The Supreme Court Upholds Implied Certification Under The False Claims Act But Imposes "Rigorous Materiality" Standard

by Robyn N. Burrows, Associate

In the Watt Tieder Winter 2015-2016 Newsletter, we previewed the Supreme Court's much-anticipated decision regarding the viability of the "implied certification" theory under the federal False Claims Act ("FCA"). On June 16, 2016, the Supreme Court in *Universal Health Services, Inc. v. United States et al. ex rel. Escobar et al.*, 136 S.Ct. 1989 (2016) issued its decision clarifying the scope of implied certification. Under the implied certification theory, contractors who have submitted otherwise valid claims for payment may nevertheless be subject to FCA liability if they are in violation of a *material* statutory, regulatory, or contractual requirement. Although the Supreme Court's recent decision in *Escobar* upholds the doctrine of implied certification, there is a silver lining for those contractors who have unwittingly violated a statutory, regulatory or contractual requirement. Specifically, the court actually restricted the FCA's potential scope through a rigorous and demanding standard of "materiality."

In *Escobar*, parents brought a FCA claim against a clinic after their daughter died while under the care of unlicensed clinic staff. The parents claimed that the clinic failed to comply with state regulations governing qualifications and supervision of staff members. The First Circuit found FCA liability on the basis of implied certification. On appeal, the Supreme Court's decision addressed two separate issues: (1) whether the implied certification theory is valid, and, if it is, (2) whether a contractor's claim is false if the particular statute, regulation, or contract provision does not expressly state that compliance is a condition of payment.

In response to the first question, the Court held that the implied certification theory may provide a basis for FCA liability when a defendant who submits a claim for payment makes certain representations about the goods or services provided but omits violations of material statutory, regulatory, or contractual requirements. However, two conditions must be present before liability attaches. First, the claim must make *specific* representations about the goods or services. In other words, the claim must not merely request payment. Second, the failure to disclose noncompliance with material requirements must make the defendant's representations "misleading half-truths." Because the clinic submitted payment codes representing certain treatments had been provided and identifiers corresponding to specific job titles requiring a license, the Court found that the clinic's failure to disclose its staff's licensing violations constituted a misrepresentation.

The Court next considered whether liability under the implied certification theory requires compliance with a statutory, regulatory, or contractual requirement to be an express condition of payment. The Court answered this question in the negative, holding that such requirements do not have to be expressly designated as conditions of payment to be considered material to the government's payment decision. However, the Court *also* noted that the government's designation of a particular requirement as a condition of payment is *not* automatically dispositive of materiality. Rather, the relevant inquiry is whether the defendant knowingly violated a requirement it knew was material to the government's payment decision.

The Court's decision is notable due to its adoption of an exacting "materiality" standard. The Court explained that materiality looks to "*the effect on the likely or actual behavior of the recipient of the alleged misrepresentation.*" Thus, materiality is not found when noncompliance is minor or insubstantial. Nor can materiality be found simply because the government has the option to decline payment if it knew about the violation. The Court also stated that if the government pays a claim despite knowledge that requirements were violated, that constitutes "very strong evidence" that the requirement is not material. Conversely, evidence that the defendant knows the government consistently refuses to pay claims based on noncompliance with a particular requirement is evidence of materiality.

In sum, the Supreme Court's decision represents a very measured approach towards implied certification. The Court has provided both a means to prevent fraud and abuse without targeting unwary contractors for simple regulatory violations. While contractors must still remain mindful of compliance with important statutory, regulatory, and contractual requirements, the Court's decision provides protection against an overly zealous interpretation of the FCA.

Defending The Surety Using FAR 28.106-5 And The Consent Of Surety Requirement For Federal Contract Modifications Over $50,000 Or 25% Of Contract Value

by Rebecca Glos, Partner

This article explores Federal Acquisition Regulation ("FAR") 28.106-5 and its effect on limiting the ability of the United States government to increase a Miller Act surety's bond coverage without the surety's consent. FAR 28.106-5 provides a clear requirement that Consent of Surety is required for contract modifications over $50,000 or 25% of contract value. This Consent of Surety requirement is a powerful sword for the Miller Act surety when negotiating with the government, both before and after a default termination of its principal.

Overview Of FAR 28.106-5

FAR 28.106-5 provides as follows:

> 28.106-5 *Consent of surety.*
>
> *(a) When any contract is modified, the contracting officer shall obtain the consent of surety if –*
>
> *(1) An additional bond is obtained from other than the original surety;*
>
> *(2) No additional bond is required and –*
>
> *(i) The modification is for new work beyond the scope of the original contract; or*
>
> *(ii) The modification does not change the contract scope but changes the contract price (upward or downward) by more than 25 percent or $50,000; or*
>
> *(3) Consent of surety is required for a novation agreement (see Subpart 42.12).*
>
> *(b) When a contract for which performance or payment is secured by any of the types of security listed in 28.204 is modified as described in paragraph (a) of this subsection, no consent of surety is required.*
>
> *(c) Agencies shall use Standard Form 1414, Consent of Surety, for all types of contracts.*

(Emphasis added).

Advantages Offered By FAR 28.106-5

FAR 28.106-5 provides the Miller Act surety with protection from excessive government-initiated contract modifications by assuring that the original underwriting expectations are not changed without the surety's consent. Consider the following example: Principal A has a contract with the government to build a project for $50 million. The government issues a unilateral contract modification adding $20 million of work to the principal's scope, which the principal does not dispute. In the event that the principal defaults, does the surety's Miller Act bond cover the additional work? FAR 28.106-5 says no – not without the surety's consent. The significance of such a safeguard offered by FAR 28.106-5 is that, oftentimes, circumstances can change. A bond principal's financial capability may change over the course of the project. A surety may lose confidence in the principal's ability to do the work. Regardless of the circumstances leading to the surety's reluctance to expand its coverage, the good news is that it may not have to if the additional work increases the original contract price by more than 25 percent or $50,000.

Consider this second example: Principal B has a contract with the government to build a project starting on January 1, 2015. Due to issues solely within the control of the government, notice to proceed on the project is suspended indefinitely. During the suspension, the principal suffers delay damages, which the government acknowledges and agrees to

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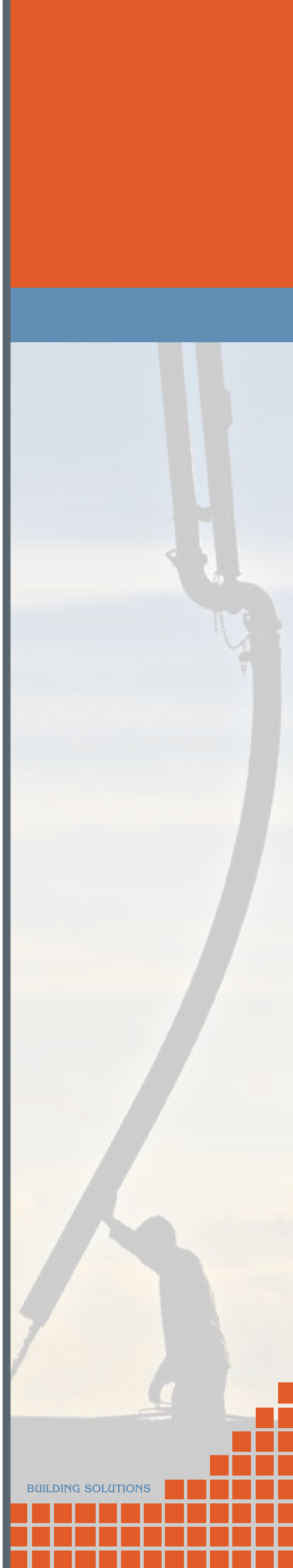

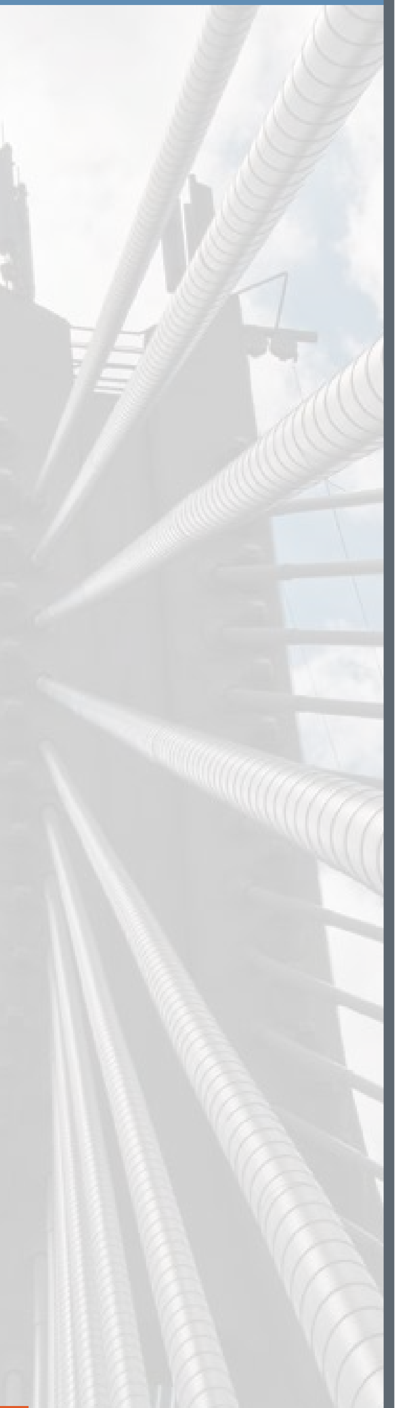

compensate by contract modification, thereby increasing the contract price by $51,000. Does the surety's Miller Act bond cover the additional work? FAR 28.106-5 says no – not without the consent of the surety. Furthermore, if the financial circumstances of the principal have changed during the delay period, such that the principal can no longer perform the work, the surety has an argument that the unauthorized delay exonerates the surety's bonds. In our example, the principal may have been financially capable to perform the bonded work in 2015. Nevertheless, the delay not only cost $51,000 to remedy, but it pushed the principal (and surety) into a period when the principal could no longer perform the work.

Authority Governing FAR 28.106-5

Case authority interpreting FAR 28.106-5 is sparse, thereby leaving the clear and obvious wording of the regulation as the only guidance. *See Am. Contractors Indem. Co. v. United States*, 111 Fed. Cl. 240, 249 (2013) *aff'd sub nom. Am. Contractors Indem. Co. v. United States,* 557 F. App'x 979 (Fed. Cir. 2014) ("As stated above, ACIC was a prior approval surety and the increase in the bond amount [$240,000] is greater than the $50,000 minimum stated in the regulation. Thus, there is no dispute that 13 C.F.R. § 114.19(e) applies. The question, rather, is whether ACIC agreed or acquiesced to this alteration before it received written approval from the SBA on June 2, 2004."). *Cf. In Re C.H. Hyperbarics, Inc.*, ASBCA No. 49375, 04-1 B.C.A. (CCH) ¶ 32568 (Mar. 23, 2004) ("When the Contract was later amended and the new contract price exceeded the total contract award by more than 25 percent, the surety consented to increase the amount of the bond by 100 percent of the dollar amount of Modification No. P00003.").

Limitations On The Application of FAR 28.106-5

Notably, FAR 28.106-5 is a defense of the surety, not the principal. The fact that a particular change increases the contract price by 25% or $50,000 does not mean that the principal is relinquished from having to obtain a bond or that the extra work is not bondable. Rather, the original surety is not "required" to bond the extra work without its consent. FAR 28.102-2(d) provides that when the contract price increases, the government may secure additional bonding through one of three methods:

> *(d) Securing additional payment protection. If the contract price increases, the Government must secure any additional protection by directing the contractor to –*
>
> *(1) Increase the penal sum of the existing bond;*
> *(2) Obtain an additional bond; or*
> *(3) Furnish additional alternative payment protection.*

The requirement to provide additional bonding exists for the principal, but there is no similar requirement for the existing surety on the bonded contract.

The FAR provisions requiring the surety's consent stem from a well-established understanding that "[t]he surety bond embodies the principle that any material change in the bonded contract, that increases the surety's risk or obligation without the surety's consent, affects the surety relationship." *Nat'l Sur. Corp. v. United States*, 118 F.3d 1542, 1544 (Fed. Cir. 1997). "Specifically, a surety will be discharged entirely from its obligations where the change to the underlying agreement is cardinal, i.e., amounts to a substituted contract or imposes fundamentally different risks on the surety than those to which it had agreed. Where the alteration is less than cardinal, the surety's obligation 'is reduced to the extent of loss due to the modification.'" *Preferred Nat. Ins. Co. v. United States*, 54 Fed. Cl. 600, 605 (2002). "For example, one ground for discharge is when material modifications that increase the surety's risk are made to the bonded contract without the surety's consent." *Lumbermens Mut. Cas. Co. v. United States*, 654 F.3d 1305, 1313 (Fed. Cir. 2011).

Arguments That Protection Under FAR 28.106-5 Has Been Waived

In practice, negotiating with the government over FAR 28.106-5 issues has been very straightforward. Lacking significant contradictory case authority to fight over, the parties are left with the plain wording of the regulation. In one recent negotiation, a clever Assistant United States Attorney tried to equate "notice" to "consent." The form Miller Act bond contains the following language: "Notice of those modifications to the Surety(ies) are waived." Relying upon this notice language, the government relied on a body of case law wherein the surety was not relieved when it was not given notice of particular changes. *See, e.g., United States for the use of T.M.S. Mechanical Contractors, Inc. v. Millers Mutual Fire Ins. Co.*, 42 F.2d 946, 952 (5th Cir. 1991); *Continental Bank & Trust Co. v. American Bonding Co.*, 605 F.2d 1049 (8th Cir. 1979).

When relying upon FAR 28.106-5, the surety is not suggesting that its express waiver of notice of changes is meaningless. The government is entitled to rely upon the express terms of the Miller Act bond. However, "notice" and "consent" are different. Regardless of what notice is or is not given by the government, the surety retains the right to "consent" to contract modifications over the regulatory thresholds. The government cannot expand the notice waiver provision beyond its intended scope, and rely upon the same to require unlimited extra work from the surety.

These issues arise regularly in our construction practice in all arenas – local, state and federal. Fortunately, in the federal arena, the FAR provides a clear rule regarding when consent is and is not required.

ARBITRATION

Selecting And Drafting The Standard Of Review For Arbitration Awards In California

by Brent Mackay, Partner

After what seems like an eternity, you finally get the arbitration award that you have been waiting for. Your eyes focus and you begin to comprehend the written words, filling you with either elation, disappointment, or, perhaps, a mixture of both. If the result is favorable, your instinct is to preserve the award, have it confirmed at the appropriate trial court, and then hopefully collect. If the result is unfavorable, you begin thinking of how to get the award corrected or vacated altogether. Whether the award is ultimately confirmed, corrected, or vacated depends on the standard of review agreed upon by the parties.

This article focuses on the selection and drafting of the standards of review for arbitration awards in California.

Standards Of Review For Arbitration Awards

- General Rule: No Judicial Review Unless Narrow Statutory Bases Apply

The general rule in California is that arbitration awards are binding and final, that is, not subject to judicial review, except on narrow statutory grounds. This general rule is set forth in the case *Moncharsh v. Heily & Blase* 3 Cal. 4th 1 (1992).

In Moncharsh, an attorney terminated employment with his firm and continued representing some clients who had signed retainer agreements with his former firm. A dispute arose between the attorney and his former firm regarding fee-splitting, and the dispute was submitted to arbitration. The arbitrator ultimately found in favor of the law firm, and the attorney who had left the firm sought judicial review on the basis that the fee-splitting was allegedly illegal. The California Supreme Court concluded that in the absence of some limiting clause in the arbitration agreement, the merits of an arbitration award, whether questions of fact or law, are not subject to judicial review except on the grounds set forth in the California Code of Civil Procedure ("CCP") sections 1286.2 and 1286.6. *Id.* at 33.

The narrow statutory grounds for reviewing an arbitration award largely relate to circumstances involving fraud, corruption, or the arbitrator exceeding his or her powers. Under section 1286.2, an award may be vacated if: (1) the award was procured by corruption, fraud, or other undue means; (2) there was corruption in any of the arbitrators; (3) the rights of the party were substantially prejudiced by misconduct of a neutral arbitrator; (4) the arbitrators exceeded their powers; (5) the arbitrator substantially prejudiced the rights of a party by refusing to hear material evidence, or postpone the hearing upon sufficient cause, or by "other conduct" contrary to the provisions of Title 9 [Arbitration]; or (6) the arbitrator making the award either failed to timely disclose a ground for disqualification of which he was aware or failed to timely disqualify himself, if applicable, under section 1281.91. CCP § 1286.2(a). Pursuant to CCP section 1286.6, an arbitration

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award may be corrected only if: (1) there was an evident or patent "miscalculation of figures" or "mistake in the description of any person, thing or property referred to in the award;" (2) the arbitrators exceeded their powers but the award may be corrected without affecting the merits of the decision; or (3) the award is "imperfect as a matter of form, not affecting the merits of the controversy." CCP § 1286.6.

As a matter of practice and experience, most arbitrators identify, timely disclose, and request a waiver of potential conflicts. Similarly, almost all arbitrators freely allow the parties to present evidence. (This occurs much to the chagrin of the party who receives previously requested documents half-way through the arbitration hearing.) Consequently, a party's chances of vacating an arbitration award under section 1286.2 or correcting the award under section 1286.6 are minimal in the absence of credible evidence of fraud or corruption, or where the arbitrator's award somehow violates a statutory right or a well-defined public policy. *See, e.g., Kelly Sutherlin McLeod Architecture, Inc. v. Schneickert*, 194 Cal. App. 4th 519, 534 (2011).

Likewise, although it is certainly possible for an arbitrator to exceed his or her power under CCP sections 1286.2 and 1286.6, parties should understand that the grounds for judicial review of an arbitration award on that basis are indeed narrow. Under existing case law, arbitrators do not "exceed their powers" merely by rendering an erroneous decision on a legal or factual issue, so long as the issue was within the scope of controversy submitted to the arbitrators. *See Moshonov v. Walsh*, 22 Cal. 4th 771, 775-76 (2000). This is true even where an arbitrator renders a legally incorrect decision that explicitly contradicts the parties' agreement. *Safari Assoc. v. Superior Court*, 231 Cal. App. 4th 1400 (2014).

- Exception: Parties May Agree To Expanded Judicial Review

Notwithstanding the general presumption of non-reviewability under *Moncharsh*, the California Supreme Court recognized in *Cable Connection, Inc. v. DIRECTV, Inc.*, 44 Cal. 4th 1334 (2008), that parties may contract out of the presumption by agreeing to an expanded or heightened judicial review.

DIRECTV involved a dispute between a television provider (DIRECTV) and a class of dealers over wrongfully withheld commissions and assessment of improper charges. The underlying agency agreement required arbitration and the matter was submitted to an arbitration panel. The panel determined that arbitration on a class-wide basis was permitted, and DIRECTV petitioned to vacate the award on the basis that, among other things, "the award reflected errors of law that the arbitration clause placed beyond their powers and made subject to judicial review." *Id.* at 1342. The trial court vacated the award and the court of appeals reversed, holding such provisions unenforceable. The California Supreme Court reversed the appellate court with directions to instruct the trial court to vacate the award. Ultimately, the DIRECTV court determined that the parties' agreement clearly evidenced an intent for expanded judicial review because the language stated that: (1) the arbitrators would apply California substantive law; (2) the arbitrators would articulate a basis for the award; (3) the arbitrators shall not have the power to commit legal errors; and (4) the award was reviewable by the courts for any such legal error. *Id.* at 1361-62.

Similarly, the California legislature has recognized that parties to a public construction contract may agree to an expanded judicial review of arbitration awards, subjecting an arbitration award to vacation if it is based on legal error or not supported by substantial evidence. CCP § 1296.

Selection And Drafting Considerations

In light of *Moncharsh* and *DIRECTV*, parties should keep in mind the following when selecting and drafting the appropriate standard of review.

First, decide what standard of review should apply. While this may seem obvious, the obvious is sometimes overlooked. Experience has shown that many arbitration provisions are either silent on the issue or, potentially worse, contain ambiguous language arguably supporting either review standard.

There is a general belief that resolving disputes through arbitration is cheaper and quicker than court-based litigation. This is at least in part based on the appeal process being effectively eliminated by the default standard of review under *Moncharsh*, which, as previously discussed, presumes non-reviewability. As a result, parties desiring finality of an award may wish to select the *Moncharsh* review standard. On the other hand, parties wishing to avoid the risk of liability for an arbitration award based on legal error or unsupported by substantial evidence may wish to select an expanded review as recognized in *DIRECTV*.

Second, the drafting party should expressly identify the desired standard of review. Parties choosing presumptive non-reviewability under

Moncharsh technically do not have to draft anything concerning the standard of review because *Moncharsh* applies in the absence of a clear intent to an expanded review. Regardless, the drafting party should still draft its agreement with language expressly stating that any arbitration award is exclusively reviewable under CCP sections 1286.2 (for vacation) and 1286.6 (for correction), and that an expanded review under *DIRECTV* (and section 1296 if applicable) is expressly rejected. Although not required, by doing so the drafting party likely eliminates the other side from arguing post-award that an expanded review applies.

Although it is not entirely clear what is the minimal type and amount of language to sufficiently evidence an agreement for an expanded review, the case law does provide some guidance. As previously discussed, the arbitration provision at issue in *DIRECTV*, which evidenced an agreement for an expanded review, included language stating that: (1) the arbitrators would apply California substantive law; (2) the arbitrators would articulate a basis for the award; (3) the arbitrators shall not have the power to commit legal errors; and (4) the award was reviewable by the courts for any such legal error. *Id.* at 1361-62. Notably, the *DIRECTV* court made it a point to state it was not deciding whether one or more of the subject clauses alone or some different formulation would be sufficient to confer an expanded scope of review. *Id.* at 1361. It simply found that the facts of the case were sufficient to evidence an intent for an expanded review, and advised parties seeking to allow judicial review of the merits of an arbitration award to provide for that review "explicitly and unambiguously" in order to "avoid an additional dispute over the scope of review." *Id.* at 1361.

In case law subsequent to *DIRECTV*, California courts have clarified that a provision requiring an arbitrator to render an award in accordance with California substantive law does not constitute an agreement to an expanded review. *See Gravillis v. Coldwell Banker Residential Brokerage Co.*, 182 Cal. App. 4th 503, 518 (2010).

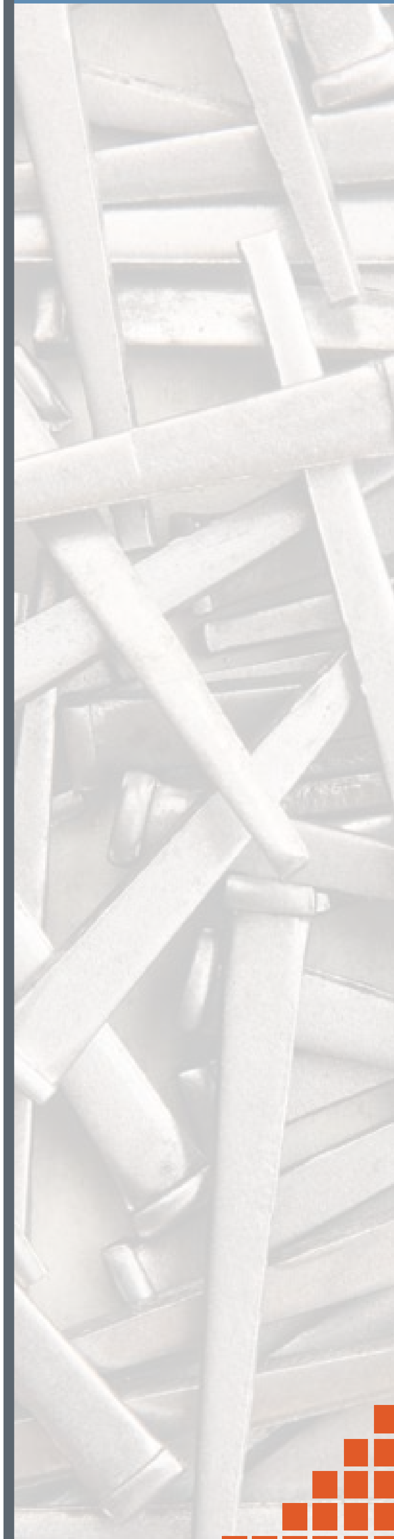
Based on *Moncharsh*, *DIRECTV*, and *Gravillis*, parties desiring an expanded review should be sure to draft their agreements using express, positive language both restricting the arbitrator to issuing a decision based on law and supported by substantial evidence, and making the award judicially reviewable on those grounds. Although not required, drafters seeking to eliminate any shred of doubt should simply mirror the language found in the *DIRECTV* arbitration provision.

Parties to a public construction contract desiring expanded judicial review should draft their agreement to, at a minimum, expressly state that the arbitrator's award "shall be supported by law and substantial evidence pursuant to section 1296," and reviewable by the courts. Ideally, the provision would also include language explicitly rejecting section 1286.2 as the standard of review so as to eliminate the other side from arguing post-award against a heightened review.

Finally, the best time to choose the standard of review for an arbitration award is at the time of drafting the underlying agreement—long before any dispute arises. The same contractual provision agreeing to submit any disputes to arbitration can, and should, also identify the applicable standard of judicial review. Although the parties can jointly agree to an expanded review in a submission to the arbitrator, this may not be a viable option once the dispute resolution process has commenced as the parties at that point are less likely to agree to anything, let alone the applicable standard of review.

Conclusion

An arbitration award in California is presumptively non-reviewable under *Moncharsh*, subject to narrow statutory exceptions. Only if the parties have expressly and unambiguously agreed to an expanded review may a court review an award on the merits. Which review standard should be selected is, like most things in life, a matter of tradeoffs—finality (avoiding lengthy and expensive appeal process) versus ensuring that the award is consistent with the rule of law (avoiding an award based on legal error). Regardless of the desired standard, the agreements should be drafted to clearly identify the chosen standard and expressly reject the other. By doing so, the parties are more likely to avoid a post-award dispute concerning the applicable standard of review. Simply stated, before the agreement is finalized, determine the appropriate standard of review and draft accordingly. ◂



Slight Signs Of Life For Denial Of Justice Claims? A Look at *Phillip Morris v. Uruguay*

by Daniel Rodriguez, Associate

Suppose for a moment that you are an investor from Country A, investing in a public works project in Country B as part of a public private partnership. In the course of your contract to build this large public works project that will contribute to the economic development of Country B, Country B enacts regulations that directly impair your ability to recoup your investment on this project.

Your local counsel in Country B advises that you have a very strong argument that these regulations are unlawful and you mount a challenge to the enforceability of these regulations through Country B's court system. But you run into an issue you had not fully anticipated: these courts provide you with no realistic hope of getting a fair adjudication. You do your best, appealing as high as you can go, but despite your best efforts, you are faced with judicial rulings that plainly misstate both the facts of your case and the law - suggesting incompetence at best or corruption at worst. As a stranger in a strange land, you resign yourself to defeat and simply assume that you can't fight city hall.

You may, however, have an additional avenue for relief: if Country A and Country B have entered into a Bilateral Investment Treaty (BIT) that requires each country to treat investors fairly and equitably, you may seek relief though an Investor-State Arbitration under the Rules of the International Centre for the Settlement of Investment Disputes (ICSID), fashioning your claim as that of a "Denial of Justice."

In many modern ICSID cases dealing with claims asserting a Denial of Justice, investors seek to paint the recipient of investment (the 'host' country) in a light similar to Country B, above. This tactic however, has a very mixed record of success, given that a prerequisite of a Denial of Justice claim is that investors must exhaust all remedies, and that ICSID tribunals afford a high level of deference towards local courts and procedure. Recent decisions by two ICSID tribunals, however, may breathe renewed life into a claim that has rarely proven successful.

Elements Of A Denial Of Justice Claim

The generally accepted definition of a "Denial of Justice" was set forth in *Elettronica Sicula S.p.A. (United States of America v. Italy)*, 1989 ICJ 15, in which the International Court of Justice stated that a Denial of Justice is "a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety."

In a recent ICSID decision, *Arif v. Moldova*, ICSID Case No. ARB/11/23, 8 April 2013, (predictably rejecting the Denial of Justice claim), the tribunal set forth the standard as:

> [T]he State can be held responsible for an unfair and inequitable treatment of a foreign indirect investor if and when the judiciary breached the standard by fundamentally unfair proceedings and outrageously wrong, final and binding decisions.

As a prerequisite to a Denial of Justice, a party must show complete exhaustion of all remedies before justice can be deemed 'denied.' The clearest example of this is *Loewen Group Inc. v. United States*, in which the tribunal found that the Mississippi Supreme Court's requirement of a $625 million bond to secure appeal of a $100 million jury award was a procedural Denial of Justice, but that the claim failed due to the investor's failure to seek a writ of certiorari from the United States Supreme Court. ICSID Case No. ARB(AF)/98/3, 26 June 2003

A Recent Victory For A Denial Of Justice Claim

The most recent case of a tribunal finding a Denial of Justice in this context was in *Dan Cake v. Hungary*. ICSID Case No. ARB/12/9, 24 August 2015. There, the tribunal's ruling was fairly straightforward - it ruled that under the Hungary-Portugal BIT the investor had a right to a particular bankruptcy hearing under Hungarian law, and that by refusing to grant any such hearing, the Hungarian court had shocked the tribunal's sense of judicial propriety. All parties agreed that no appeal of the court's ruling was possible, and so the tribunal easily held that there was also a clear exhaustion of remedies sufficient for the claim.

While early arguments propounded by the investor challenged the fairness *per se* of Hungary's bankruptcy laws, later arguments and the tribunal's decision were limited only to a procedural question of whether the courts had abided by those laws.

Denial Of Justice Claim Unsuccessful In *Phillip Morris v. Uruguay*

In the recent conclusion to the decade-long dispute between Phillip Morris and the Republic of Uruguay regarding the latter's enactment of strict cigarette regulations, an ICSID tribunal rejected Phillip Morris' claims that it was denied justice in the Uruguayan court system.

Over the past decade, many countries have taken regulatory steps in an attempt to curb tobacco use. These regulations most visibly take the form of packaging restrictions that specify the type, size, and content of warning labels to be printed on those products. At issue in the dispute between Phillip Morris and Uruguay were two novel restrictions on cigarette marketing in Uruguay. One restriction required that 80% of all cigarette packaging be devoted to health warnings, leaving only 20% for trademarks, logos, and any other information. The other was a "Single Presentation Requirement" (SPR), which required each cigarette brand to have a single presentation and prohibited different packaging for different "variants" of a particular brand. With regard to the SPR, Marlboro would be limited to one "variant" from among its many types (e.g., Marlboro Red, Blue, Gold, etc.).

Phillip Morris claimed that these restrictions unduly expropriated the trademark rights that they held under Uruguayan law. It also claimed that the provisions were inherently unfair and inequitable as the regulations were arbitrary and unlikely to achieve the goals of the state. With regard to the expropriation claims, the tribunal ruled in favor of Uruguay, finding that Phillip Morris' trademark rights did not bestow any particular right to use those trademarks, but only a right to keep others from infringing on them.

As to the unfairness and inequity of the restrictions themselves, the tribunal held in favor of Uruguay, though Phillips Morris' arbitrator choice did offer a compelling dissent to this particular ruling with regard to the SPR – finding the regulation to be arbitrary and lacking any rational basis for implementation.

- Phillip Morris' Denial Of Justice Claims Narrowly Defeated

In addition to Phillip Morris' claims challenging the laws as a 'regulatory taking' of its trademark rights, Phillip Morris also initiated litigation in Uruguay arguing that the law containing the 80% packaging requirement contained an unconstitutional grant of authority to the executive branch.

Phillips Morris appealed to the Supreme Court of Uruguay regarding the constitutionality of the law, while contemporaneously filing an action to nullify the executive's regulation under the law before the Tribunal de lo Contencioso Adminstrativo (TCA). The TCA stayed its proceedings pending the Supreme Court's decision.

The Supreme Court ruled that the law was constitutional because it did not authorize the executive to actually require warning labels covering more than 50% of the packaging. The Supreme Court stated that a delegation of power to the executive to require warning labels beyond 50% would indeed be unconstitutional.

Phillip Morris then returned to the TCA, which seemingly disagreed with the Supreme Court's interpretation of the law, finding that the regulation requiring 80% warning labels was indeed permitted by the law.

No appeal was possible between the two courts, and so Phillip Morris initiated its claim for Denial of Justice under the applicable BIT. The tribunal in a 2-1 decision ruled that this was merely a "quirk" of the Uruguayan system. They reasoned that the Supreme Court's interpretation of an administrative act was merely dicta and imposed no obligation on the TCA. In support, the tribunal referred to other cases that have dealt with court systems that have multiple strata of courts and jurisdictions that may render contradictory interpretations of a law.

- Dissenting Opinion - More Than "Just A Quirk"

Phillip Morris' appointed arbitrator, Professor Gary Born, dissented, thoroughly rejecting the majority's ruling that Uruguay's system in this case was merely a quirk. He noted that while conflicts and jurisdictional splits regarding

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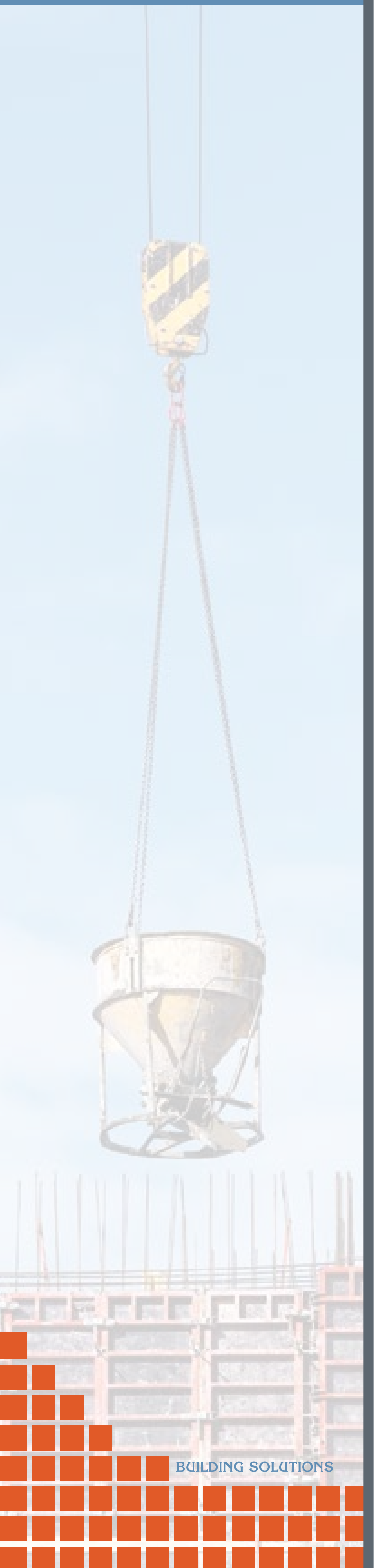


interpretation may exist in other countries, the particular situation in Uruguay was unique as it offered a conflict of interpretations *within the same case*. The ultimate issue was not the way in which Uruguay has chosen to set up its courts, but the fact that there is no mechanism to resolve this particular inconsistency within the system and that the TCA refused to follow the ruling of the Supreme Court.

Going Forward

While the result relegates *Phillip Morris v. Uruguay* to the long litany of cases where a Denial of Justice claim was denied, Professor Born's reasoned argument for the appropriateness of it under these circumstances may fuel the hopes of other parties with regard to this tactic. Ultimately, unless you are faced with a clear case that "shocks…the senses of judicial propriety," the chances of success on a Denial of Justice claim remain slim. And even in such a shocking case, arbitrators are particularly sensitive about condemning their judicial colleagues.

WATT TIEDER COMMUNITY SERVICE

Arlington Diocese WorkCamp 2016: "Show Know Mercy"

by Kevin J. McKeon, Senior Partner

SHOW
KNOW
MERCY
LUKE 6:36
MATTHEW 5:7

Except for those "fun" days when I get to be in court, arbitration or mediation, much of my work as a construction lawyer is accomplished in a drywall box with a window that we call an "office." But this Summer, I got to spend a week with my tool belt on, and swinging my old 22 oz. Estwing framing hammer while replacing a roof with a bunch of service-minded teenagers who had left their phones, tablets and computers at home for the week.

Our roof job was one of more than 150 similar projects performed by more than 800 high school kids and some 400 adult volunteers from 41 parishes during the week-long 2016 WorkCamp for the Roman Catholic Diocese of Arlington here in Northern Virginia. The WorkCamp is generally regarded as the biggest and most successful in the United States. The theme was "Show Know Mercy," taking inspiration from Luke 6:36 ("Be merciful, just as your Father is merciful") and Matthew 5:7 ("Blessed are the merciful, for they will be shown mercy").

After arriving at Massaponax High School (between DC and Richmond) just after dinner on Saturday, the kids and other adult crew leaders like me set up camp. My daughter, Reagan, joined another girl from our parish and a female crew leader in the "females only"-area on the second floor of the school, while I moved in with ten boys from our parish in a classroom on the first floor. When a friend of mine convinced me that volunteering as an adult crew leader would be a "blast," he neglected to tell me that part of the experience would involve sleeping on the floor, in a classroom with poor air conditioning, and sharing the space with a bunch of high school boys. Sometimes the smell reminded me of my time in the wrestling room at my old high school in Pennsylvania!

Saturday night we had our first evening program. The massive gym was set up as if for a Rolling Stones concert, with a 3-part stage, and 3 movie screens. As we walked in and enjoyed the cool of the air conditioning and the light show, there was a Christian rock band playing…loudly. "What have I gotten myself into?" I thought. I could tell that many of the "cool" kids seemed to feel the same way. It was amazing how that attitude changed through the week, and how we all really enjoyed getting to know and listen to the music of John Hopke and his band.

The program at night was always entertaining and enriching. One night included a live game show called "Will it Smoothie???!!" (what can you put in a blender and get high school kids to drink), while another night featured a beat-boxing, break dancing, and rapping performance by "Fr. Jewel and the Lost Sheep" (see some video on Twitter @arlingtonyouth from June 30). Each night also included inspiring, humorous talks by Katie Prejean, a dynamic, young Catholic speaker who obviously connected with the kids. But universally, the most powerful night included a public rosary, 3 hours of quiet Eucharistic Adoration, and some 1000 kids and adults going to confession.

Throughout the week, I was responsible for leading 5 teenagers that I met for the first time on Sunday morning for some team-building. My idea of team-building is a golf scramble foursome, but we were all encouraged to "Lean Into It" during the week: if scared of heights – climb a ladder; if no rhythm for dancing – move your feet anyway. So even by the end of the Sunday, I knew the kids well, and they knew me too. I decided not to let them know, however, that I'm a construction lawyer, so all week they looked for clues and came up with some guesses. I was proud that most of them thought I was actually a contractor!

My Crew

Each morning started by "putting the Mass in Massaponax:" a morning mass, followed by breakfast on the go, and then off to the work sites before 8 AM. I had to make sure my crew was properly harnessed up on the roof, and drank plenty of water throughout the day. I was paired up with Joe Gilfoil, a contractor-volunteer who happened to be a Project Manager for a local steel fabricator so we enjoyed swapping stories about dealing with our favorite engineers throughout the week. We kept working safely and diligently, and literally finished with the ridge cap and clean up right on schedule on Thursday afternoon. No changes, delays or claims.

Joe Gilfoil of Extreme Steel

WorkCamp concluded on Friday morning with a celebration in the gym. By this time, it felt like all 1200+ of us somehow knew each other, and one of the highlights that day included many kids taking the stage to talk about how the experience had changed them: no cell phones, sleeping on the floor, morning mass every day, hard work in service of others all day, much like the early Christian communities described in the Acts of the Apostles. Many described how having no cell phone for the week was actually a blessing, and caused them to truly connect with the other workcampers.

The other highlight from the closing celebration was the appearance of the many people who benefited from the projects. An hijab-wearing Muslim mother of four young kids who had been put out by her husband took the microphone and tearfully thanked the kids for the work they did on her trailer, while a minister from a United Pentecostal Church explained how the new wheelchair ramp the kids built for his church would allow so many more people to attend services. One of the residents thanked the kids by belting out "God Blessed the Broken Road" to thunderous applause.

My parish group

When we arrived back at home that evening, Reagan found it hard to explain the week's events to my wife Tiffany and my younger kids without tearing up. In short, we had "leaned into it," and came away with a deeper faith and inspired for the future to see what this younger generation will do in service of others.

Breyer | Rechtsanwälte

Breyer | Rechtsanwälte ("Breyer") is a German international law firm dealing exclusively in the field of construction and infrastructure law, and is one of the only specialist construction law firms with offices located across Europe (Stuttgart, Munich, Frankfurt, Vienna and Bucharest).

Breyer represents many of Germany's and Austria's best-known construction firms and continues to work on the largest and most prestigious major projects both nationally (Germany) and internationally, throughout Europe, the Middle East and North Africa through to Asia and North America. From pumped storage power plants and wind farms to office towers and manufacturing plants, roads, airports and windfarms, Breyer is frequently called upon by clients to provide expert direction on transactions and disputes. In addition to advising some of Germany's largest contractors, Breyer's leading construction law team advises employers, project developers, international companies and world renowned architects and engineering firms from procurement and tendering through to completion and disputes resolution.

Consistently ranked in Legal500, Chambers & Partners, JUVE and Best Lawyers, Breyer's expert knowledge in both civil and common construction law provides a competitive edge in bridging the "grey gap" between common and civil jurisdictions for clients – a formidable strength which very few firms in construction law can acclaim.

Money—The Lifeblood Of Construction: Securing Payment Under German Law

by Dr. Wolfgang Breyer

The importance of cash flow in projects is rather straightforward and best summed up with the old saying "revenue is vanity, cash flow is sanity and cash is reality." The consequences of contractors and sub-contractors failing to have a proper cash flow are rather obvious, financial stress being most likely followed by insolvency. This appears to be a serious issue in England and Wales with various reports and studies released on payment and cash flow (Latham Report: "Constructing the Team" (1994) and Egan Report "Rethinking Construction: Achievements, Next Steps and Getting Involved" (2002)). One need only examine the empirical data contained in these reports to ascertain the delicate situation of contractors and sub-contractors and the need for a practical system for protecting payment and hence, cash flow.

The problems with payment and cash flow are not endemic only to England and Wales or confined to the construction industry, even at the EU level efforts have been made to address parts of this issue with the EU Late Payment Directive (Directive 2011/7/EU). The directive was designed to help small and medium enterprises to allow better management of their cash flow (larger companies were accused of stringing out trade payment to smaller companies beyond reasonable terms). Not all countries immediately pressed forward in implementing the directive, with Germany notably being the last. There has been much criticism whether the directive will be practically positive given that many of the directive's beneficiaries (in particular sub-contractors) are cautious to follow the enforcement mechanism for fear of being considered "difficult" or having too much "red tape" and thus losing work to competitors who are less stringent with payment. In any event, a laudable effort by the EU is to partially assist in improving a very real and perennial problem faced by trade contractors (or sub-contractors) in the construction industry.

Having touched on England and Wales (and Europe at large), where does Germany stand on the issues of cash flow and payment? The security of payment in construction was an issue German legislators first addressed at the beginning of the 20th century – incredibly progressive considering this was almost 100 years earlier in comparison to Common law jurisdictions such as England or Australia (1996 and 1999, respectively). The German "*Construction Payments Security Act*," adopted in 1909, was the first step in securing payment for contractors or sub-contractors (this introduced the concept "Baugeld" (construction money), payment amounts earmarked for the cost of a construction project). In the 1990s there were growing calls to help contractors enforce payment claims against employers because at that time, under the German Civil Code, the employer was not required to make any payment(s) to the contractor until taking-over (completion) of the works (unless otherwise agreed by parties). This effectively stifled cash flow in construction and insolvency was a very real consequence contractors faced whilst waiting for taking-over. Thus changes to the German law were introduced in 2000 relating to "cash flow" where contractors were able to demand progress payments, even if taking-over (completion) had not occurred ("*Gesetz zur Beschleunigung fälliger Zahlungen*" (Late Payment of Commercial Debts Act), 30.03.2000). Despite these seemingly radical changes, further amendments were made in 2008 with the "*Forderungssicherungsgesetz*" ("Enforcement of Payment Act"). There were a number of changes made to improve "cash flow" to contractors and sub-contractors. These included:

(1) Improvements to the changes in 2000 on allowing contractors and sub-contractor to request progress payments;

(2) Improvements to the legislative provision for securing payment under the German Civil Code § 648(a); and

(3) Directors of the contractor companies were personally liable to the sub-contractors for failing to pay the Baugeld.

Under Common law a bond is a deed by which one person, the bondsman, the "surety", (often called the "obligor" or "bondsman") binds himself to another (often called the "obligee" or "creditor") for payment of a specified amount at some future date or upon the happening of some particular event. The liability for the bondsman to pay will generally be based on a material breach of an underlying contract. There are essentially two types of bonds, on-demand and conditional, the key difference being conditional bonds are predicated on a breach of an underlying contract, whereas an on-demand bond will be paid by the bondsman "on-demand" without further conditions.

The distinction between bonds and guarantee, and conditional and on-demand bonds, under German law may appear confusing to English lawyers as one cannot compartmentalize legal principles between the two jurisdictions. Thus, examples will be used at times to assist in understanding the German law position. Firstly, the legal principle of "surety" is not foreign to German law and surety in the form of bonds can best be described as a "Bürgschaft." The different types of Bürgschaft (bonds) typically found in England are also found in Germany, these being:

(a) Bid bond/tender bond – this is not particularly common under the German system;

(b) Advance payment bond – "Vorauszahlungsbürgschaft;"

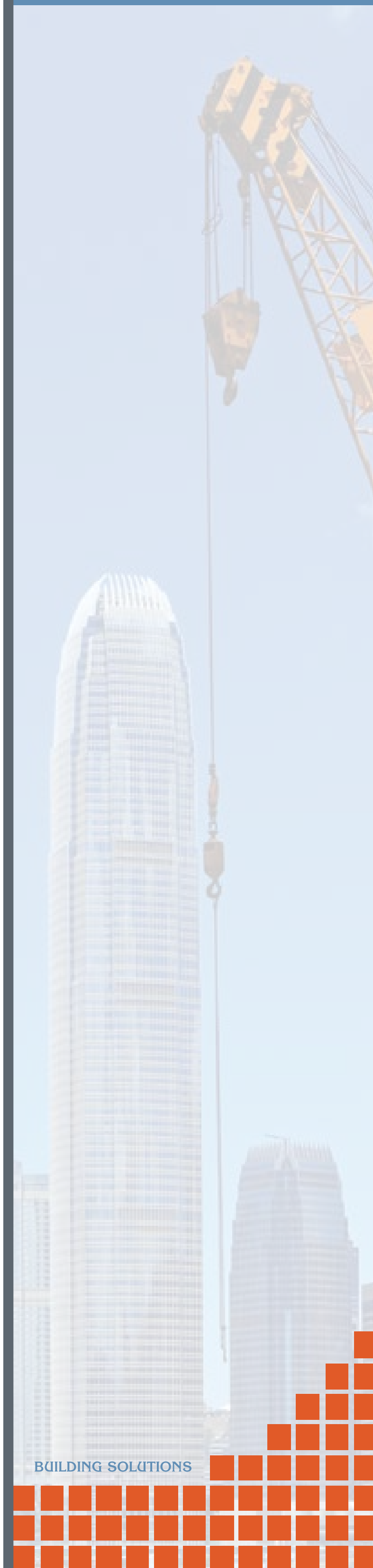
(c) Performance bond – "Vertragserfüllungsbürgschaft;"

(d) Payment bond – "Zahlungsbürgschaft;" and

(e) Defects liability period – "Gewährleistungsbürgschaft."

Under a Bürgschaft the Bürge (bondsman) places himself under a duty to the creditor of a third party to be responsible for discharging the third party's obligation (German Civil Code, § 765). In the context of a payment bond, the Bürge (bondsman) promises to pay the third party/debtor's (employer's) debt to the creditor (contractor) if the third party/debtor cannot make payment.

This article was published in Construction Law International, Volume 31, Issue 5, 2015. To read the full article along with cites and notes, please visit the GcilA Knowledge Centre at www.gcila.org/knowledge-center.



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FIRM NEWS

New Location For Watt Tieder Virginia Office

Watt Tieder's Virginia office has just completed an exciting move to a new building and upgraded office space. We are still located in the heart of Tysons but now have direct access to the Silverline Metro at Tysons Central Station. Our new space is energy efficient and features customizable conference rooms equipped with built-in electronics and video conferencing.

Our new address is: 1765 Greensboro Station Place, Suite 1000, McLean, Virginia 22102. Please update your contacts and plan to visit us soon!.

Honors

Chambers USA Guide To America's Leading Lawyers For Business

Watt, Tieder,Hoffar & Fitzgerald, L.L.P. is recognized in the 2016 edition of Chambers USA Guide to America's Leading Lawyers For Business as a Band One Construction Law Firm in the United States. Chambers and Partners has consistently named Watt Tieder and its attorneys among the top construction firms and attorneys both nationally and regionally since 2004.

Chambers also recognized the McLean, Virginia office as a Band One firm and the Irvine, California office as a Band Three construction law practice. The following Watt Tieder attorneys are recognized as leaders in their field for Construction Law: **John B. Tieder, Jr.**, **Robert M. Fitzgerald**, **Lewis J. Baker**, **Carter B. Reid**, **Vivian Katsantonis**, and **Robert C. Niesley**.

Super Lawyers

Watt, Tieder, Hoffar and Fitzgerald, L.L.P. is pleased to announce that its attorneys have once again been recognized by **Super Lawyers 2016**. **Super Lawyers** is an annual listing of lawyers who have achieved a high level of peer recognition and professional merit. Over sixty practice areas are evaluated during the selection process. Super Lawyers Magazine, published by Law and Politics, a division of Key Professional Media, Inc., is distributed nationwide.

The following **Watt Tieder** attorneys were named as 2016 Super Lawyers:

- McLean, Virginia – **John B. Tieder, Jr.**, **Robert M. Fitzgerald**, **Lewis J. Baker**, **Vivian Katsantonis** and Rising Star **Sarah Simmons Wronsky**
- Irvine, California – **Robert C. Niesley** and Rising Stars **Brent N. Mackay** and **Kaysie D. Garcia**
- Seattle, Washington – **R. Miles Stanislaw**, **Christopher Wright** and Rising Star/Super Lawyer Top Woman Attorney in Washington **Diane C. Utz**
- Chicago, Illinois – **John Sebastian**
- Las Vegas, Nevada – Rising Star **Jared Sechrist**
- Miami, Florida – Rising Star **Mariela Malfeld**

Legal 500

Legal 500 United States once again recognized **Watt, Tieder, Hoffar & Fitzgerald, L.L.P.** as a top tier construction law firm for 2016. **Lewis J. Baker** of the McLean, Virginia office was recognized as a Legal 500 Leading Lawyer.

Upcoming Events

University of Stuttgart, September 8-10; Stuttgart, Germany; **John B. Tieder, Jr.** to teach a Master's Degree course on U.S. construction law.

9th Annual Tunneling Short Course, "**Breakthroughs in Tunneling**," September 14, 2016; Boulder, Colorado; **Robert M. Fitzgerald** to speak.

International Bar Association, 2016 Annual Conference, September 18-23, 2016; Washington, D.C.; **Shelly L. Ewald** to speak on September 20 regarding the legal and practical issues encountered on Design-Build/EPC contracts.

Northeast Surety and Fidelity Claims Conference, September 22-23, 2016; Atlantic City, N.J.; **Christopher J. Brasco**, **Vivian Katsantonis** and **Adam M. Tuckman** to speak on "Understanding Ethical Limitations on Attorney Behavior During Settlement Negotiations" and "A Diagnostic Checklist for Affirmative Claims – a Surety's Evaluative Guide."

CMAA National Conference & Trade Show, October 9-11, 2016; San Diego, CA; **Christopher J. Brasco** and **Kathleen O. Barnes** to speak on "The Professional CM and Safety: A Conversation on Potential Liability Concerns" and "A Fresh Look at Productively Managing Lost Production."

Risk Management in Underground Construction Conference, November 14, 2016; Miami, Florida; **Robert M. Fitzgerald** to speak.

Construction SuperConference, December 5-7; Las Vegas, NV; **Shelly L. Ewald** to speak on "Changing Trends in Government Contracts and Claims." **R. Miles Stanislaw** and **Christopher Wright** also will be participating in a panel session on December 7 entitled "How to Maximize the Benefits of Arbitration and Achieve Positive Results from the Process."

Watt Tieder newsletters are posted on our website, www.watttieder.com, under the Resources Tab. If you would like to receive an electronic copy of our newsletter, please contact Peggy Groscup at: **pgroscup@watttieder.com**

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The Watt, Tieder, Hoffar & Fitzgerald newsletter is published quarterly and is designed to provide information on general legal issues that are of interest to our friends and clients. For specific questions and concerns, the advice of legal counsel should be obtained. Any opinions expressed herein are solely those of the individual author.

Special Thanks to Editors, **Robert G. Barbour, Keith C. Phillips, William Groscup** and **Heather Stangle**.

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