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Trading On Uncertainty: Legal Strategies For Addressing Tariff-Driven Material Cost Escalation

by Edward J. Parrott, Senior Partner and Matthew D. Baker, Associate

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Introduction

Following the Trump Administration's move to impose tariffs on lumber, steel, and aluminum imports, the construction industry experienced notable material price increases and faces continuing uncertainty about how public policy will impact materials markets. This article (i) discusses legal avenues for contractors to seek recovery for tariff-based material cost overruns, and (ii) proposes how industry stakeholders can control material cost escalation risks.

In April 2017, the Trump Administration announced tariffs of approximately 20% on Canadian softwood lumber imports that were finalized by the U.S. Department of Commerce in November 2017. On March 1, 2018, the Trump Administration further announced tariffs of 10% on aluminum imports and 25% on steel imports. On May 31, 2018, these tariffs became effective against Canada, Mexico and the European Union. As U.S. trading partners move to impose retaliatory tariffs and U.S. policymakers consider further tariffs, future materials costs remain uncertain. Contractors should respond to these developments by evaluating their rights to recover for material cost overruns on current projects and ensuring that future contracts adequately address responsibility for such risks.

Grounds To Recover Tariff-Driven Material Cost Overruns

The question of whether material cost escalation is legally compensable or sufficient to excuse contractual performance generally depends on the terms of the applicable contract. Absent a contract provision permitting relief, the law has traditionally been reluctant to provide compensation or excuse contractual performance based on the grounds of normal material cost increases. Material price fluctuations have been viewed as a function of the market and an inherent risk of doing business. Consequently, the law generally views market-driven material price fluctuations as part of the bargained-for risk assumed under a fixed price contract.

Legal doctrines excusing performance in the face of unforeseen or changed circumstances impose a high bar for obtaining relief. For example, the legal doctrine of commercial impracticability only excuses contractual performance where a party's performance is rendered commercially impracticable by the occurrence of unforeseen circumstances involving risks not assumed by either party, the non-occurrence of which was a basic assumption underlying the contract. As discussed in the Restatement of Contracts (Second) § 261:

> A mere change in the degree of difficulty or expense due to such causes as increased wages, prices of raw materials, or costs of construction, unless well beyond the normal range, does not amount to impracticability since it is this sort of risk that a fixed-price contract is intended to cover.

Material price increases occasioned by the government's adoption of tariffs as opposed to those caused by market-based forces may provide stronger grounds for invoking the doctrine of legal impracticability. The former type of price escalation is more difficult to anticipate and results from unique circumstances outside of the realm of the *status quo*. Regardless, doctrines such as commercial impracticality generally only serve as a defense for a contractor in the face of a contractual breach and do not typically provide affirmative grounds to seek recovery for increased costs of completion.

A contractor's best grounds to seek recovery for tariff-driven material cost increases will likely be the terms of their contract. In assessing their rights, contractors should review all applicable contract documents for the project. Subcontractors should review all provisions incorporated through any flow down clause and government contractors should review all incorporated Federal Acquisition Regulation provisions. If the relevant contract contains a material cost escalation provision, the contractor should ensure that it adequately documents its claim and complies with any conditions precedent to its assertion. However, absent a material price escalation provision, contractors should examine the following types of provisions with care:

- *Force Majeure* Provision: A *force majeure* provision generally excuses contractual performance when events that the parties could not have anticipated or controlled render performance impossible or impracticable. Most contracts narrowly define what constitutes *force majeure* (French for "superior force") and limit the definition to circumstances including wars, labor strikes, acts of God (i.e., hurricanes, earthquakes, droughts etc.), and specific unforeseen acts by government or regulatory authorities. However, some *force majeure* provisions embrace broader sets of commercial risks or include a catchall provision generically including "other circumstances outside the parties' control" within the definition of *force majeure*. Although the contractual language is ultimately determinative, normal material price fluctuations have generally not been understood to constitute a *force majeure* event. Nevertheless, material price escalation triggered by the government's implementation of trade barriers presents more favorable circumstances to argue for the existence of a *force majeure* event.

- Change in Law Provision: Some construction contracts include a provision allowing the contractor to recover costs resulting from changes in existing laws or judicial/ administrative interpretations of such laws. For example, where such costs are recovered from the owner, ConsensusDocs 750, § 3.27.1 (2016) permits the subcontract price to be "equitably adjusted for Changes in the Law enacted after the date of this Agreement..." Recovery under a change in law provision will largely depend on the language of the specific provision at issue and any conditions it imposes on recovery. Key issues include what is included within the term "law" (i.e., whether executive orders are included), what constitutes a "change" in law, and the applicable time-period during which the change must occur. Nevertheless, broader versions of change in law provisions may establish entitlement to recover tariff-driven material price increases.

- Tax Provisions: Some standard industry contract forms contemplate potential adjustments to the contract price due to changes in tax law. *Cf.* ConsensusDocs 750, § 3.27.1 (2016) with AIA A201, § 3.6 (2017). Although tariffs are indirect taxes on imports, broad descriptions of the types of taxes covered may be required to establish an argument for recovery. In addition, FAR clause 52.229-3 which requires the contract price to include "all applicable Federal, State, and local taxes and duties..." also permits equitable adjustment for after-imposed federal taxes including "any new or increased Federal excise tax or duty...." 48 CFR 52.229-3(b), (c). Section 52.229-3 has been invoked by the Comptroller General in the context of a bid protest to support the position that a contractor was required to include import duties in its bid price. *See Towmotor Corp.*, 65 Comp. Gen. 373, 375 (Mar. 4, 1986). Although 52.229-3(c) only allows recovery for a subset of the taxes and duties set forth in 52.229-3(b), an argument can be made based on *Towmotor* that 52.229-3(c) would permit recovery for increased import duties actually paid or directly passed through. Practically, there is little difference between such federally created costs and costs such as federal fuel tax increases for which 52.229-3(c) has been found to permit recovery. *See Appeal of Consol. Const., Inc.*, ASBCA No. 46498, 99-1 B.C.A. ¶ 30148 (1998). Nevertheless, tax provisions including 52.229-3(c) may not provide recovery for increased costs paid to domestic suppliers or delays required to locate a more affordable domestic supplier.

- Change Order Provision: Typical change order provisions link entitlement to a change order to "changes in the work" or "changes in scope." However, these provisions are frequently customized and should be scrutinized for potentially helpful language which may entitle the contractor to recover for material cost increases.

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The above list of key provisions is not necessarily comprehensive, and contractors should examine the entirety of their contracts to locate all available grounds on which to seek recovery for tariff-driven material cost increases.

Strategies To Manage Material Cost Escalation On Future Projects

Contractors seeking to manage future risks associated with material price increases should consider adding a material price escalation provision to their contracts. A material cost escalation provision provides for the adjustment (upward or downward) of the contract price when key material costs exceed an established baseline. Much like the differing site condition clauses prevalent in the industry, material price escalation provisions can benefit both owners and contractors. Volatile materials markets force contractors, who traditionally bear the risk of cost fluctuations, to mark-up their pricing with contingencies to account for such uncertainty. The clause would allow the contractor to shed the material cost risk. Owner's also would benefit from lower bid pricing absent the contingencies. Please note that for federal projects, the Federal Acquisition Regulation already permits inclusion of material price escalation clauses in fixed price contracts where "there is serious doubt concerning the stability of market or labor conditions." 48 CFR 16.203-2.

In our view, an effective material price escalation clause must clearly establish a baseline for the price of the material(s) at issue and establish a methodology for how increases or decreases in material prices are determined and documented. Common methods include comparisons to an established baseline price based on: (i) catalog prices; (ii) actual costs; or (iii) material cost indices. The circumstances of every party and project differ. However, the following provision provides a starting point to draft an appropriate material escalation clause:

> If during the performance of this contract, the price of ________ significantly increases, through no fault of contractor, the price of _____ under this agreement shall be equitably adjusted by an amount reasonably necessary to cover any such significant price increases. As used herein, a significant price increase shall mean any increase in price exceeding _____ percent (____%) experienced by contractor from the date of contract signing. Such price increase shall be documented through quotes, invoices, or receipts. Where the delivery of ___ under this agreement is delayed, through no fault of contractor, as a result of the shortage or unavailability of ____________, contractor shall not be liable for any additional costs or damages associated with such delay(s).

This provision can be further fine-tuned to provide for upward and downward adjustments, notice requirements, mark-up limitations, tipping points and caps, point of departure triggers, supporting documentation requirements and audit rights.

Conclusion

Recent tariffs on key construction materials have injected uncertainty into materials markets creating new risks for the construction industry. Affected stakeholders should respond by: (i) evaluating their rights under their current contracts, and (ii) incorporating an appropriate material cost escalation clause into their future contracts.

SURETY LAW

How Solid Is The Penal Sum Of Your Bond In Virginia?

by Jonathan R. Wright, Associate

Introduction

For over a century and a half, it has been blackletter law in the United States that the "penal sum" or, as used by Virginia courts, the "face amount," of a surety's bond is the limit of a surety's liability. While there are some well-known exceptions, as a general rule, American courts have remained faithful to the sanctity of the face amount of a surety bond.

But what about when a construction contract, incorporated by reference into a bond, contains an attorneys' fees provision? In Virginia, may a court award attorneys' fees against a surety *in excess* of the face amount of the bond where bad faith or a takeover of work is not involved?

Virginia Needs A Clear Statement Of Law On This Issue

Surprisingly, the law is not clear in Virginia on whether a court can award attorneys' fees against a surety in excess of the face amount of the bond. When considering the issue of attorneys' fees exceeding the face amount of a bond, one would presume that Virginia would follow other jurisdictions that generally cap damages against sureties to the amount of the bonded obligation. However, this precise issue has eluded direct consideration by Virginia's highest courts.

One of the few Virginia Supreme Court decisions even mentioning the concept of attorneys' fees in excess of the face amount of a bond is 35 years old and ambiguous enough to provide fodder to both sides of the argument. In *Board of Supervisors of Stafford County v. Safeco Insurance Company of America*, the Virginia Supreme Court considered whether the county could recover consequential damages against Safeco under a performance bond in excess of the face amount of the bond. *Safeco*, 226 Va. at 339. The bond in question contained the following limiting language: "[T]he liability of the Surety for any and all claims hereunder shall in no event exceed the penal amount of this obligation as herein stated." *Safeco*, 226 Va. at 333. The Virginia Supreme Court held:

> Under the statute and the limiting language of the bonds we hold that the trial court correctly ruled that the County could not properly claim consequential damages other than interest. The principal amount of the judgment against Safeco may not exceed the aggregate principal amount of the bonds. We hold that the County has made out a prima facie case for recovery of a judgment in the principal amount, limited to the face amount of the bonds.

Id. at 339.

At first blush, the holding appears to state that only interest may exceed the face amount of the bond. But a closer examination reveals that it is unclear whether the issue of attorneys' fees is even before the court on appeal. The holding encompasses "consequential damages *other than interest*." *Safeco*, 226 Va. at 339 (emphasis added). But the court did not mention interest when it framed the issue on appeal: whether "the trial court erred in…denying the County the right to seek compensatory damages in excess of the face amount of the bonds." *Id.* at 331-332. This is important because the county's other counts in the complaint sought, "judgment in the face amounts of the bonds… with interest, costs, and attorney's fees." *Id.*

Without examining the underlying briefs of a 35-year old case, it is unclear whether attorneys' fees are even part of the *Safeco* decision. It is possible that the appealed consequential damages count also included a request for attorneys' fees in addition to interest, with the court only mentioning interest because it is treated differently. In other words, this would mean that the court considered attorneys' fees as being included in the consequential damages. Alternatively, the court might not have mentioned attorneys' fees because that issue was not before the court, and the court's reference was made, in *dicta*, as a general statement that interest may exceed the face amount of a bond.

Also, even if *Safeco* is on point, the importance of the holding is reduced by its reference to the statutory basis for limiting damages to the face amount of the bond. *See Safeco*, 226 Va. at 339 ("[u]nder the statute and the limiting language of the bonds…"). The statute referenced by the court was a previously repealed statute that "provided that judgment against a surety could not be obtained for more than the amount to which his liability was limited on the bond." *Id.* at 338 (referring to §8-353 of the Code of 1950). According to the *Safeco* court, the statute was repealed because it "merely declared what were 'longstanding and clear principles of substantive law.'" *Id.* The repealed statute is referenced in the holding because the saving provision of Virginia Code Section 8.01-1 would retroactively apply the repealed law to the facts of *Safeco*. Nevertheless, it provides an argument to attorneys wishing to diminish the effect of the *Safeco* by stating that the decision depended on a now-repealed statute.

Other Virginia cases do not address the attorneys' fees issue directly and are of limited value on the specific issue of attorneys' fees other than standing for the general proposition that recovery is limited to the face amount of a bond. In other cases, where the face amount of a bond is exceeded, extenuating circumstances such as bad faith or surety takeover of work make those cases inapposite to this analysis.

Why Is This Important?

Virginia's lack of a clear judicial interpretation on this issue is important because the ambiguity

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leads to needless increased attorneys' fees and bonding costs. Even a newly minted attorney could fashion together a good-faith argument that, based on the current state of the case law, attorneys' fees may be recovered in excess of the face amount of a bond. Moreover, to the extent the text of a hypothetical bond limits recovery for "completion costs," "cost to complete the work," or other similar costs to the face amount of the bond, it could be argued that the limitation does not include attorneys' fees because they are not completion costs. The result is extended legal briefings on the issue and increased costs to the client.

An even worse scenario would be in an arbitration where the arbitrator (or panel) is unfamiliar with Virginia law and understands the bond limit in Virginia to only "cover the cost of completion of the improvements." *See Bd. of Supervisors of Fairfax County v. Ecology One, Inc.*, 219 Va. 29, 36 (1978). In jurisdictions where statutes permit recovery of attorneys' fees on successful bond claims, such as Florida, Washington, or Texas, the concept of attorneys' fees being layered on top of the face amount of a bond may be typical practice for a non-Virginia arbitrator. Given the ambiguous state of Virginia law, it would be difficult to overturn such an award based an arbitrator's manifest disregard of the law.

Conclusion

The easiest way for a surety to address the issue of whether attorney's fees may exceed the penal sum of the bond is to include express language in its bonds specifically addressing attorneys' fees. For example, such language could state that "in no event shall the total liability of the Surety, including liability for any attorneys' fees, costs, and/or pre-judgment interest to the extent applicable, exceed the amount of this bond." In the meantime, the industry must await the legislature or a court to clarify whether attorneys' fees may be recovered in excess of the face amount of a bond in Virginia.

To determine how Watt Tieder can help address or mitigate the issue of attorneys' fees on the face amount of a surety bond in Virginia, please contact Jonathan Wright: (703) 749-1062 or jwright@watttieder.com.

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Case Update: Recent Appellate Court Ruling Potentially Increases Sureties' Performance Bond Exposure In Illinois For Payment Claims

by Albert L. Chollet III, Partner

Introduction

In June 2018, the Third District Appellate Court of Illinois issued an opinion which provides cause for uncertainty and a substantial increased risk for sureties doing business in Illinois. The appellate court found that an unpaid wage and welfare fund for union laborers had the right to assert a claim for non-payment against a performance bond.

In V*alley View School District 365-U for the use of IBEW Local 176 Health, Welfare, Pension, Vacation and Training Trust Fund Trustees v. Hartford Fire Insurance Company*, the trustees of union benefit funds brought claims for non-payment of wage and welfare contributions against the surety's AIA A312 performance bond notwithstanding the existence of a companion AIA A312 payment bond. The claims were made after the expiration of the one-year limitation provision in the payment bond, but before the expiration of the two-year limitation period in the performance bond. The surety denied the union benefit funds' claims as time-barred under the payment bond. When the trial court ruled in favor of the union benefit funds, finding that the union benefit funds had properly and timely asserted a claim against the performance bond, the surety appealed. The appellate court affirmed the trial court's ruling.

As discussed below, three noteworthy factors weighed upon the appellate court's ruling in *Valley View*: the exacting language of the Illinois Bond Act and the Illinois Supreme Court's 2014 opinion in *Lake County Grading Co., LLC v. Village of Antioch*, and the Illinois Prevailing Wage Act.

The Illinois Bond Act And The *Lake County Grading* Decision

The Illinois Bond Act requires a surety bond to secure both performance of a contract and payment for the material and labor performed in furtherance of a contract for public projects in excess of $50,000 for state-owned projects and $5,000 for political subdivision-owned projects. The Bond Act provides, in part, as follows:

> Except as otherwise provided by this Act, all officials, boards, commissions, or agents of this State in making contracts for public work of any kind costing over $50,000 to be performed for the State, and all officials, boards, commissions, or agents of any political subdivision of this State in making contracts for public work of any kind costing over $5,000 to be performed for the political subdivision, shall require every contractor for the work to furnish, supply and deliver ***a bond*** to the State, or to the political subdivision thereof entering into the contract, as the case may be, with good and sufficient sureties. The amount of ***the bond*** shall be fixed by the officials, boards, commissions, commissioners or agents, and ***the bond***, among other conditions, shall be conditioned for completion of the contract, for the payment of material used in the work and for all labor performed in the work, whether by subcontractor or otherwise.
>
> * * *
>
> ***Each such bond is deemed*** to contain the following provisions whether such provisions are inserted in such bond or not: 'The principal and sureties on this bond agree that all the undertakings, covenants, terms, conditions and agreements of the contract or contracts entered into between the principal and the State or any political subdivision thereof will be performed and fulfilled and to pay all persons, firms and corporations having contracts with the principal or with subcontractors, all just claims due them under the provisions of such contracts for labor performed or materials furnished in the performance of the contract on account of which this bond is given, when such claims are not satisfied out of the contract price of the contract on account of which this bond is given, after final settlement between the officer, board, commission or agent of the State or of any political subdivision thereof and the principal has been made.

30 ILCS 550/1 (emphasis added).

In *Lake County Grading Co., LLC v. Village of Antioch*, the Illinois Supreme Court considered the import of the above-quoted language in determining whether an unpaid vendor had standing to assert a claim against a performance bond when the surety did not also issue a payment bond. The Supreme Court concluded that "[e]ach such bond is 'deemed' to contain" both the completion and payment provisions of the Bond Act, even if such provisions are not expressly inserted in the bond. In short, the Supreme Court held that the statutory payment provision would be implied in a performance bond even though the bond was silent as to any payment guaranty.

In reaching this conclusion, the Supreme Court emphasized the policy behind the payment and completion provisions of the Bond Act. It noted that the Bond Act "guards the tax money allotted for public works by assuring that the terms, conditions and agreements of the contract will be fulfilled and paid by the surety if the contractor does not complete the project." As such, the court found its interpretation of the Bond Act to be consistent with the overarching policy behind the enactment of the Bond Act.

The *Valley View* Arguments And Decision

Notwithstanding the precedent set by the Illinois Supreme Court in *Lake County Grading*, the surety in *Valley View* attempted to distinguish the two cases. The surety emphasized that it, unlike the surety in *Lake County Grading*, issued a statutorily compliant bond, providing for both performance and payment guarantees as required by the Bond Act. Specifically, the AIA A312 performance and payment bonds in *Valley View* contained both performance and payment guarantees that collectively complied with the requirements of the Bond Act. The surety noted that the performance and payment bonds were contained within one instrument, on sequentially numbered pages, and, thus, should be read in conjunction with one another. The surety argued that to permit payment claims against the performance bond even though the claims were untimely under the payment bond, would render the payment bond a superfluous nullity, contravening all canons of contractual interpretation.

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The surety further argued that the policy implications were different in *Valley View* than in *Lake County Grading*. The trustees of the union benefit funds in *Valley View* had admitted that the claim was a claim for payment and not performance because the benefits were a component of labor performed on the bonded projects that was to be paid. As such, the surety maintained that it would potentially increase the exposure of all public project sureties within Illinois for claims sounding in non-payment. The surety contended that such an outcome would have the opposite effect desired by the Supreme Court in *Lake County Grading*, namely that by permitting the payment claims to be applied against the performance bond, the penal sum of the performance bonds would be reduced upon payment of such claims, which in turn would reduce the penal sum of the performance bond and associated funds available to public owners for completion of the bonded project.

The surety also attacked the standing of the union benefit funds trustees to maintain an action against the performance bond because the trustees were not named obligees under the performance bond. The fund trustees argued in response that wage and welfare contributions were a component of labor to be paid under the Illinois' Prevailing Wage Act. The Prevailing Wage Act mandates that all public entities "require in all contractor's and subcontractor's bonds that the contractor or subcontractor include such provision as will guarantee the faithful performance of such prevailing wage clause as provided by contract or other written instrument." 820 ILCS 130/4(c). As such, the trustees asserted that they had standing to bring a claim for non-payment on behalf of the union laborers as part of their obligation to enforce compliance of the Prevailing Wage Act.

In addition, the surety argued that the different time limitations in the performance bond (two years) and payment bond (one year) were appropriate under Illinois law because the time periods were reasonable. The appellate court acknowledged that this was a correct statement of law insofar as parties may reasonably limit the time for assertion of a claim under a contract, and the surety's position likely would have been successful had the appellate court not concluded that the union benefit funds trustees' claims could not be asserted against the performance bond.

Ultimately, the appellate court ruled that the union benefit funds trustees' claim against the performance bond was proper because the payment of wage and welfare contributions was a requirement under the Prevailing Wage Act and a component of completion of the principal's bonded contract. Because payment of these funds was a component of the principal's performance obligations owed to the owner, the appellate court concluded that the union benefit funds could assert its claim against the performance bond. In interpreting the Bond Act in conjunction with the facts of the case, the appellate court seized upon specific language in the Bond Act -"the bond" and "[e]ach such bond is deemed"- to rule that the performance bond was deemed to impliedly include a payment protection for claimants, finding persuasive the reasoning in *Lake County Grading*.

Conclusion

The question of how the *Valley View* opinion will be interpreted and applied in lower courts remains unclear. It would be dangerous to apply *Valley View* broadly to all payment bond claims, permitting all payment bond claims to be asserted against either the performance or payment bond or to conflate notions of non-payment with non-performance.

It would be similarly imprudent to overlook the key and distinctive facts of *Valley View* when presented with similar claims. The *Valley View* fact pattern has many distinctions from the run-of-the-mill subcontractor payment bond claim. *Valley View* involved the payment of wage and welfare contributions required under the Illinois Prevailing Wage Act. In addition, the specific terms of the principal's contract with the owner led the appellate court to the conclusion that payment of those contributions was a component of "performance." Consequently, non-payment provided standing under the performance bond, but it does not necessarily follow that all claims for non-payment can be claims for non-performance when convenient to serve the needs of a claimant.

Ultimately, the appellate court's expansive reading of the Illinois Bond Act in *Valley View* and disregard of the existence of a statutorily-compliant payment bond presents a precarious and potentially perilous situation for sureties that could greatly expand the extent of their bonded risk for payment claims beyond the penal sum of the payment bonds. The quandary in the wake of *Valley View* for both underwriters and claims professionals lies in the uncertainty of how it will be applied. What is certain is that *Valley View* results in potentially negative business and public policy outcomes, and it clearly reveals the need for clarification of the Illinois Bond Act. From both a business perspective and a legal perspective, it is an illogical absurdity to apply the Illinois Bond Act in such a manner as to render a perfectly valid payment bond a superfluous nullity. Unfortunately, until such time as the legislature provides clarification, sureties operating in Illinois will be navigating murky waters in terms of both underwriting projects and analyzing claims.

CONTRACTS

California Case Update: Supreme Court Clarifies Prompt Payment Obligations On Private Projects

by Christopher M. Bunge, Partner

Despite a statutory scheme codifying a contractor's obligations to promptly pay its subcontractors, California courts have disagreed over what types of disputes may allow a contractor to withhold subcontractor payments. On May 14, 2018, in *United Riggers & Erectors, Inc. v. Coast Iron & Steel Co.* 4 Cal.5th 1082 (2018), the California Supreme clarified contractors' prompt payment obligations, holding that a contractor can withhold payments from its subcontractor only when there is a good faith dispute concerning that specific payment. Controversies related to other work or claims for additional payments do not excuse the delay of payment for work on which there is no dispute.

The statute at issue is California Civil Code Section 8814, which requires contractors on private works of improvement to make retention payments to any of its subcontractors within ten days after receiving all or a part of its retention from the project owner. If a good faith dispute exists between the contractor and one of its subcontractors, Section 8814 allows the contractor to withhold from its subcontractor up to 150 percent of the estimated value of the disputed amount. It is this "good faith dispute" provision that has led to disagreement among California courts.

The two most prominent and most recent cases demonstrating this split in authority are *Martin Brothers Constr., Inc. v. Thompson Pacific Constr., Inc.* 179 Cal.App.4th 1401 (2009) and *East West Bank v. Rio School Dist.* 235 Cal. App.4th 742 (2015). In *Martin Brothers*, the appellate court held that any bona fide dispute between the contractor and subcontractor would support the withholding of retention. However, the *East West Bank* court disagreed, restricting the right to withhold payment to only those disputes that related to that payment.

In 2010, Universal Studios entered into agreements for the construction of its new Transformers movie roller coaster ride. Universal selected Coast Iron & Steel to design, furnish and install the metal work. Coast Iron & Steel retained United Riggers to install the metal work. The subcontract price upon execution was $722,742 but would increase to approximately $1.5 million after change orders. United Riggers completed its work to Coast Iron & Steel's satisfaction. However, United Riggers demanded an additional $274,158 because of alleged project mismanagement and outstanding change order requests. Coast Iron & Steel refused to pay the additional amount demanded, and in turn withheld retention from United Riggers, citing United Riggers' additional demands.

The dispute went to a bench trial, where the trial court found entirely in favor of Coast Iron & Steel. On United Riggers' appeal, the appellate court affirmed all but the trial court's decision on whether prompt payment penalties were owing to United Riggers as a result of Coast Iron & Steel's withholding. The appellate court disagreed with the trial court and held that Coast Iron & Steel could not use the parties' dispute over mismanagement and unresolved change order requests to justify withholding otherwise due and owing retention. United Riggers appealed to the California Supreme Court, which considered only the claim for prompt payment penalties.

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The California Supreme Court reviewed each of the state's prompt payment statutes, which included those related to public works of improvement as well as progress payments. It determined that the prompt payment statutory scheme was remedial in nature – to ensure contractors are not at the mercy of those upon whom they depend for payment. Consistent with this purpose, the court held that a direct contractor could delay payment when the sufficiency of the subcontractor's construction-related performance is the subject of a good faith dispute, "when liens or other demands from third parties expose the direct contractor to potential double payment, or when payment would result in the subcontractor receiving more than the minimum amount both sides agree is due." *United Riggers*, 4 Cal.5th at 1097. The court further clarified that a contractor could not withhold retention because a dispute has arisen related to whether additional amounts may be due and owing. "In effect, the payor must be able to present a good faith argument for why all or a part of the withheld monies themselves are no longer due." *Id.*

Applied to United Riggers' claim against Coast Iron & Steel, the court found that Coast Iron & Steel did not dispute that United Riggers' retention was due – the work was satisfactory. The only basis for withholding retention was that United Riggers demanded additional funds above and beyond the earned contract price. The court viewed Coast Iron & Steel's withholding as a punishment and not valid grounds for withholding the duly earned retention. In so doing, the court disapproved of the *Martin Brothers* ruling, thus setting a clear rule that a timely payment may be excused only when the contractor has a good faith basis for contesting the subcontractor's right to receive the specific payment that is withheld.

Coast Iron & Steel's withholding of retention from United Riggers to counter United Riggers' demands for additional money was not some novel tactic, nor was it expressly illegal. Since at least 2009, contractors have been using the *Martin Brothers* ruling to shield them from prompt payment penalties while leveraging against or defending themselves from subcontractor claims. Those days are now over. The decision in *United Riggers* strengthens the prompt payment penalties under Civil Code section 8814, and further reminds contractors of the protections afforded to subcontractors under California law.

New Maryland Law Exposes General Contractors To Liability For Unpaid Subcontractor Wages

by Jonathan R. Wright, Associate

The construction business in Maryland is about to get more expensive and complex. On October 1, 2018, general contractors will become directly liable to employees of subcontractors for unpaid wages on a project for construction under the General Contractor Liability for Unpaid Wages Act ("Act"). In addition, if a court finds that the wages being withheld were not part of a "bona fide dispute," the court may award damages of ***three times the wage, plus reasonable attorneys' fees and costs***. *See* Md. Code, Lab. & Empl. Art. § 3-507.2(b).

The Act effectively requires a general contractor to be a policeman for timely wage payments to a subcontractors' employees. This will add a significant risk and administrative costs to all construction projects. These costs will ultimately be passed on to the end user of the project—consumers—in the form of increased rents, property costs, and retail prices.

The New Law

In the Spring of 2018, the Maryland General Assembly passed the Act and it became law without Governor Hogan's signature by operation of the Maryland Constitution. The Act will take effect on October 1, 2018, and adds the following text to Maryland Code, Labor and Employment Article 3-507.2:

In an action brought under subsection (a) of this section [payment of wages within two weeks], *a general contractor on a project for construction services is jointly and severally liable for a violation of this subtitle that is committed by a subcontractor*, regardless of whether the subcontractor is in a direct contractual relationship with the general contractor.

2018 Md. Laws Ch. 846 (H.B. 1539); 2018 Maryland Laws Ch. 17 (S.B. 853) (emphasis added).

Per the Act, the term "construction services" "includes the following services provided in connection with real property: (1) building; (2) reconstructing; (3) improving; (4) enlarging; (5) painting; (6) altering; (7) maintaining; and (8) repairing." Md. Code, Lab. & Empl. Art. § 3-901(b). Thus, the new law affects almost every aspect of construction.

The Act also includes a right for the general contractor to be indemnified by the subcontractor for such wages, unless there is an indemnification provision already in the construction contract or the nonpayment of wages arose due to lack of prompt payment by the general contractor to the subcontractor.

Potential Impacts To The Construction Industry

However, the right of indemnification should be of little comfort to general contractors. On a project that encounters completion and payment issues, a general contractor could find itself defending mechanics' lien claims on behalf of an owner while at the same time defending scores of these new wage claims from individual employees of the subcontractors. If a subcontractor is insolvent or files bankruptcy, the indemnity could be worthless.

Moreover, the Act is vague. It does not explain the extent of a general contractor's liability if the employee has worked on multiple construction projects. As currently written, an employee could join multiple general contractors to a lawsuit if that employee has worked on multiple projects, thereby paving the way for expensive litigation for the parties involved.

The Act also does not explain what the term "bona fide dispute" means in the construction context, nor does it expressly exempt a general contractor for liability where non-payment to a subcontractor is permitted under the construction contract. It is possible that construction disputes involving backcharges, delays, and other issues will be litigated in an employee wage payment case to determine the extent of a general contractor's liability. Until such clarity is achieved, these and other issues will have to be litigated—at the cost of general contractors—to obtain certainty.

The Act also disincentivizes general contractors from working with smaller or unknown subcontractors where payment to employees is not ensured. This means less work for startup companies, disadvantaged business entities, or smaller subcontractors. Furthermore, general contractors are likely to require subcontractors to obtain wage payment bonds or insurance to protect themselves from wage claims. This increases the cost of a construction project and precludes smaller subcontractors from work if they are unable to obtain requisite bonding.

Conclusion

With passage of the Act, Maryland joins the ignominious ranks of other states such as California and Oregon which have enacted similar business-chilling statutes. General contractors and small, startup, and DBE subcontractors will bear the initial impact from the new law. Ultimately, however, the increased costs will find their way to the Maryland consumer who buys homes or shops at the retail establishments in Maryland.

To determine how Watt Tieder can help address the impacts of the Act to your business, please contact Jonathan Wright: (703) 749-1062 or jwright@watttieder.com.

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**

Sunshine After the Rain? The 2017 Updates To The FIDIC "Rainbow Suite" Contract Forms

by Christine J. Lee, Associate

The 1999 first edition "Rainbow Suite" of contracts issued by the Fédération Internationale Des Ingénieurs-Conseils ("FIDIC") have been the preeminent standard form contracts for international construction and engineering projects for the past 18-plus years. In December 2017, FIDIC launched the long-awaited new editions of the Red Book (Conditions of Contract for Construction), Yellow Book (Conditions of Contract for Plant & Design Build), and Silver Book (Conditions of Contract for EPC/Turnkey Projects). The updates in the second editions are extensive, although many of the changes are the same or similar across all three Books. The new editions have a stronger emphasis on *dispute avoidance* and are intended, among other things, to enhance clarity, promote the exchange of information among the parties, settle disputes more efficiently and quickly, and address certain ambiguities and/or omissions contained in the original editions.

At the outset, the most noticeable change is the significant expansion of the General Conditions, and the Guidance Notes - the updated editions now span over 200 pages each and include 21 separate clauses. With respect to substantive changes, this article will focus on the enhanced contract management provisions (including time limitations and notice requirements), variations, claims and determinations, and disputes - although numerous other changes are also included in the updates. For the sake of simplicity, the following discussion relates to the 2017 update to the Yellow Book ("YB2017").

Contract Management

The updated edition sets out more detailed and prescriptive contract management procedures and expands communications and time-related requirements. These enhanced procedures address certain previously ambiguous or uncertain aspects of contract management under FIDIC. For example, YB2017 expands the role of the Engineer by, among other things, expressly providing that the Engineer need not obtain the Employer's consent prior to making a determination on a matter or claim. The Engineer may exert its authority as provided by the contract, and the Employer is proscribed from imposing additional restrictions on the Engineer's authority.

Additionally, YB2017 tightens communications requirements by requiring that all formal communications be in writing (which includes email) and expressly identify within the document the type or nature of the communication being presented or submitted. Thus, if the communication is an instruction, the communicating document must be in writing and must expressly state that it is an "instruction." Furthermore, any formal communication (with the exception of most notices) must also reference the specific contract provision pursuant to which it is issued. Notices must be expressly identified as such. In fact, the updated edition expressly provides that the Contractor's progress reports, programs, etc. *cannot* constitute a notice. Another notable addition in YB2017 is that an electronic communication or notice is deemed to have been received the day after transmission.

Variations

The Variations provisions in the new edition has been updated to clarify ambiguities and/or omissions in the previous edition. For example, the Engineer is now required to issue Variation instructions in writing, and all Variation instructions must be expressly identified as a "Variation." This is in contrast to the previous edition, which allowed that an instruction could constitute a Variation if it was by nature a variation, even if it did not expressly identify itself as such. Furthermore, YB2017 provides that when the Contractor is presented a notice or instruction that is not labeled as a "Variation," the Contractor may issue a notice to the Engineer, prior to commencing any work, that the Contractor considers the instruction to be a Variation. The Engineer must then respond within seven (7) days by either confirming, reversing, or modifying the instruction. In the event the Engineer fails to respond properly and timely to such a notice, he/she will be deemed to have revoked the instruction. Finally, another notable addition is the express recognition that Variations may be objected to should the varied work be outside of the nature and scope of the contracted work, i.e., "Unforeseeable."

Claims And Determinations

The updated Claims provisions are a further reflection of the enhanced contract management procedures embodied in the 2017 updates. The updated edition now prescribes the same Claims procedure for both the Employer and the Contractor, essentially imposing reciprocity between the parties. In short, both the Employer and Contractor are now required to submit claims (should any claims need to be made) and must follow stricter administrative requirements.

YB2017 defines "Claim" and further identifies three categories of claims for: (1) time; (2) money; and (3) any entitlements outside of time and/or money. The third category of claims, however, are not defined in the new edition, and the resolution of these "other" type of claims are not subject to the new Claims procedure but, instead, are to be referred to the Engineer for agreement or determination.

The update also imposes more prescriptive time requirements on the parties. For instance, *both* parties are now required to provide notice within 28 days of the event(s) giving rise to a claim and must also submit a "fully detailed claim" within 84 days, including a detailed description of the circumstances giving rise to the claim, statement of the contractual or legal basis of the claim, "all contemporaneous records" supporting the claim, and supporting information/documentation for the amount of the claimed extension of time or change in the contract price. Should the required information not be provided sufficiently and timely, the notice of claim will be deemed invalid. It is also important to note that in the updated edition, the Engineer has the ability to waive the foregoing claim's time bars if there are circumstances justifying a party's failure to meet the time requirements. A party that protests such a waiver may then refer the matter to the Dispute Avoidance/Adjudication Board.

With respect to the Engineer's determinations, the update maintains for resolution the requirement that the Engineer first consult with and encourage the parties to reach agreement prior to making a determination. New provisions have been added, however, including a provision making the Engineer's determination final and binding unless a party issues a Notice of Dissatisfaction within 28 days.

The updated edition also introduces a "concurrent delay" provision. Concurrent delay—delay that is caused in part by both the Contractor and the Employer—is common in the construction industry. The FIDIC update does not address how concurrent delay is to be addressed, but instead requires that the parties negotiate this specific language on grounds that there is no standard or prevailing practice in the international arena for addressing concurrent delay.

Disputes

The most significant update with respect to dispute resolution in the new edition is the requirement that the parties jointly establish a standing Dispute Avoidance/Adjudication Board ("DAAB"). The DAAB takes the place of the Dispute Adjudication Board required under the 1999 edition. Consistent with FIDIC's emphasis on dispute avoidance in the updated editions, the DAAB's role is not simply to adjudicate disputes, but also to help the parties avoid disputes through regular meetings and site visits by the DAAB.

...continued on page 14

Conclusion

Although only a small fraction of the 2017 updates to the FIDIC forms are discussed above, the updates discussed exemplify the overarching themes of the updated editions of enhanced clarity, certainty, and dispute avoidance. FIDIC has taken a significant step towards addressing many of the shortcomings in the 1999 editions by adopting a far more comprehensive and prescriptive approach to the standard forms. Only time will tell whether the 2017 updates will truly help to promote the efficiency and efficacy of international construction projects based on the FIDIC forms and/or FIDIC principles.

FIRM NEWS

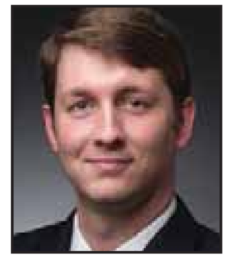
Victories

Watt Tieder Obtains $45 Million Jury Verdict for Power Plant Contractor


Shelly L. Ewald


David F. McPherson


Rebecca Glos


George "Trip" Stewart

On June 4, 2018, a federal jury in the Central District of California awarded $45 million to the Plaintiff Contractor in a dispute with the Los Angeles Department of Water and Power. The dispute involved liability for the Contractor's costs to accelerate its work on a $440 million power plant modernization project, which were incurred due to delays in delivery of equipment for which LADWP was responsible under the Contract. LADWP filed a counterclaim seeking over $190 Million and was awarded $1 Million by the jury.

Watt Tieder's trial team included **Shelly L. Ewald, David F. McPherson, Rebecca Glos** and **George "Trip" Stewart**.

Honors

U.S. News and World Report - Best Lawyers 2019

The following **Watt Tieder** attorneys were named among the Best Lawyers in America for 2018: **Lewis J. Baker, Christopher J. Brasco, Shelly L. Ewald, Robert M. Fitzgerald, Vivian Katsantonis, Jennifer L. Kneeland, Robert C. Niesley, Kathleen O. Barnes, Edward J. Parrot,** and **Carter B. Reid**.

Publications

International Construction Law, 2nd Edition, **Edward J. Parrott** (co-author), 2018 (Wiley Blackwell).

Recent And Upcoming Events

Watt, Tieder, Hoffar and Fitzgerald, June 29, 2018; Irvine, CA; **Rebecca S. Glos** and **Amanda L. Marutzky** presented on **"Subcontractor Default Insurance: Relevant Considerations for the Surety Claims Professional."**

2018 Midwest Surety & Construction Claims Conference, July 18-19, 2018; Chicago, IL; **Watt Tieder** co-sponsored the event. July 18th included a half-day seminar with a presentation on "Construction Documentation: Successfully Managing Risk and Preserving Claims." July 19th included an all-day seminar entitled "Comprehensive Review of the Surety's Defenses on Performance Bond Claims."

8th International Society of Construction Law Conference, September 26-28, 2018; Chicago, IL; **Shelly L. Ewald** will be chairing a panel on "Construction Law: Local Issues – Global Perspectives." GcilA members Wolfgang Beyer (Breyer Rechtsanwälte) and Guilliame Sauvaget (PS Consulting) will also be appearing on a panel on September 28, entitled "International Comparative Law on Common but Also Really Great EPC Contract Provisions - Same Contract, Same Issue, Choice of Law – Different Results?"

29th Annual Northeast Surety & Fidelity Claims Conference, September 26-28, 2018; Atlantic City, NJ; **Vivian Katsantonis, Christopher J. Brasco, Christopher M. Harris** and **Adam M. Tuckman** will speak on "Surety's Obligations for Post-Completion Defect Claims."

Boards of Contract Appeals Bar Association, October 9, 2018; Washington, D.C.; **Scott P. Fitzsimmons** will be presenting on Electronic Discovery at the United States Boards of Contract Appeals.

CMAA 2018 National Conference, October 14-16, 2018; Las Vegas, NV; **Christopher J. Brasco** and **Kathleen O. Barnes** will speak on "ADR Remedies for Disputes That Ail You."

ABA Fidelity and Surety Law Fall Conference, November 7-9, 2018; Philadelphia, PA; **Frank J. Marsico** will present on new/recent case law developments.

American Road & Transportation Builders Association ("ARTBA") Western Meeting, November 14-15, 2018; Newport Beach, CA; **Christopher J. Brasco** and **Kathleen O. Barnes** will speak on "10 Risk Management Hacks That Will Change Your Approach to Project Delivery."

Construction SuperConference, December 11, 2018; Las Vegas, NV; **Shelly L. Ewald** will be presenting on "Getting Your Bells and Whistles Admitted: Making the Most of Demonstrative Evidence in a Construction Trial;" and **Scott P. Fitzsimmons** will be presenting on "Litigating the Ongoing Project: Risks and Strategies."

Watt Tieder Welcomes A New Associate

Matthew D. Baker joins the McLean, Virginia office. Matt concentrates his practice in the areas of construction, government contracts, and commercial litigation. Matt is an experienced litigator who has successfully resolved matters for his clients through negotiation, alternative dispute resolution, and trial.

Matt represents the full spectrum of stakeholders in the construction industry including owners, architects, engineers, general contractors, subcontractors, material suppliers, and sureties. Matt has assisted clients with a variety of matters including breach of contract claims, payment bond claims, mechanic's liens, professional liability claims, and real property and commercial disputes.

Building on his experience helping clients navigate litigation, Matt also advises clients on the drafting/negotiation of contracts, risk management, handling claims, and investigating accidents/ occurrences.

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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**, **William Groscup**, **Christopher M. Harris** and **Marguerite Lee DeVoll**.

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