» BUILDING SOLUTIONS®

WATT TIEDER

WATT, TIEDER, HOFFAR & FITZGERALD, L.L.P.

Attorneys at Law

Winter 2014-2015

Inside...

The newsletter of
Watt, Tieder, Hoffar & Fitzgerald, LLP

visit us on the web at
www.watttieder.com

BUILDING SOLUTIONS

Public-Private Partnerships: Design-Build Contractors Take Heed! – Part Two

by Robert G. Barbour and Timothy E. Heffernan, Senior Partners

Robert G. Barbour

Timothy E. Heffernan

Public-private partnerships (PPP) offer potentially huge rewards for Design-Build Contractors that understand how to target, bid and manage the PPP process. The first part of this two-part article addressed upfront considerations and the basic contract agreements typically used in connection with PPP projects. This second part will address best practices and ways to mitigate the risks associated with PPP project performance.

Is The Project Public Or Private?

Whether a Concession Agreement is a public or private contract often has a major impact on the terms and conditions of the Concession Agreement and the Design-Build Contract. Public projects are typically subject to state procurement laws, which often limit or prohibit the use of various contractual clauses or remedies that may affect the ultimate pricing of contract work. For instance, a public PPP project may be subject to prompt pay requirements, prevailing wage requirements, subcontracting socioeconomic programs, a "no damages for delay" clause, a mandatory differing site conditions clause, and payment bond requirements in lieu of mechanic's lien rights. Whether a given PPP project is a public procurement is likely controlled by the State's enabling legislation. It is important for any stakeholder to analyze and understand the State's statutory and regulatory requirements as they pertain to the Concessionaire and the Design-Build Contractor before bidding as part of a PPP team.

Will The Project Receive Federal Credit Assistance?

When conducting business in the United States, contractors have to be familiar not only with potentially applicable State requirements, but with various Federal Government rules and regulations as well. If a PPP project involves a highway or railway, for instance, the Federal Highway Administration (FHWA) may make funding available through the Transportation Infrastructure and Innovation Act (i.e., TIFIA loans), loan guarantees and/or standby letters of credit to qualifying private developers. When federal assistance is being provided, public owners, at a minimum, must include a clause in a Concession contract that requires the Concessionaire to comply with "laws applicable to a transportation project that has received or receives federal-aid funds." The Concessionaire then will flow down this provision to the Design-Build Contractor. As a result, a Design-Build Contractor needs to understand what federal requirements are applicable to a PPP project before submitting its final proposal and committing to its price. Given the stake involved in most PPP projects, the Design-Build Contractor must ensure that its bid properly construes applicable Davis-Bacon prevailing wage rates for labor, Buy America requirements for material purchases, subcontracting participation requirements by qualified disadvantaged business enterprises and any other uniquely federal requirements that might apply to the project.

How Will The Project Manage Design?

Significant savings can be realized when the design-build delivery model is used properly. Achieving and maximizing such savings are the hallmark of a successful PPP. The design-build delivery method is specifically tailored to achieve cost advantages during the design phase and construction period by enabling value engineering and constructability reviews to occur in a collaborative manner before 100% design drawings are complete. Moreover, the

BUILDING SOLUTIONS

delivery method facilitates prompt identification and correction of design errors or necessary redesign caused by unexpected field conditions by placing the designers and the construction personnel on the same team.

These advantages enable the Design-Build Contractor to better manage the inherent cost and schedule risks on PPP projects. These advantages can be lost, however, if the Public Owner interferes with the design through unreasonable oversight of the Design-Build Contractor.

The Public Owner typically reserves the right to review the design at various stages of its development for compliance with the contractual design standards, performance requirements, governmental approvals, and applicable laws. In order to avoid unnecessary interference with the design process, both the Concession Agreement and Design-Build Contract should clearly spell out the applicable design and performance standards that the designer of record is to follow. Any oversight of the design process should be limited to a determination of whether the specified standards have been followed or achieved. Clarity in this regard is essential. If properly addressed in the contract documents, the Public Owner's demand for performance to standards not spelled out in the contract, or attempts to impose preferences on the design, should result in a change order adjusting the contract price and/or the time for performance. The Concession Agreement and the Design-Build Contract should also provide a clear and speedy procedure to address design-related disputes (*e.g.*, through a standing Dispute Board).

In addition to articulating a clear design review standard, clarity with regard to the timing of conducting the design review process in a PPP project is vital. In connection with the traditional design-bid-build delivery system, Public Owners have ample time to review design submittals from their design consultants. Altering the nature and timing of the design review traditionally conducted by Public Owner engineering departments is a challenge. Many fast-track Design-Build Contracts have been negatively impacted by Public Owners who ignore or fail to heed contractually required turnaround times for review. As such, the participants in PPPs would do well to obtain a meaningful commitment from the Public Owner to devote the resources necessary to ensure timely review of submittals. Best practices suggest that the parties agree up front on how to address delays to the design review process. For instance, the parties might agree that any submittal is deemed approved upon expiration of the contract review period, so long as this constructive approval does not constitute a waiver of the Design-Build Contractor's duty to comply fully with the specifications, governmental approvals and applicable law. Alternatively, in the absence of constructive approval, the Concession Agreement and the Design-Build Contract both could be drafted to identify an untimely design review as a Compensation Event and/or a Delay Event. Such an agreement would protect the Design-Build Contractor against the Public Owner's breach and provide an incentive for the Public Owner to meet its contractual obligations.

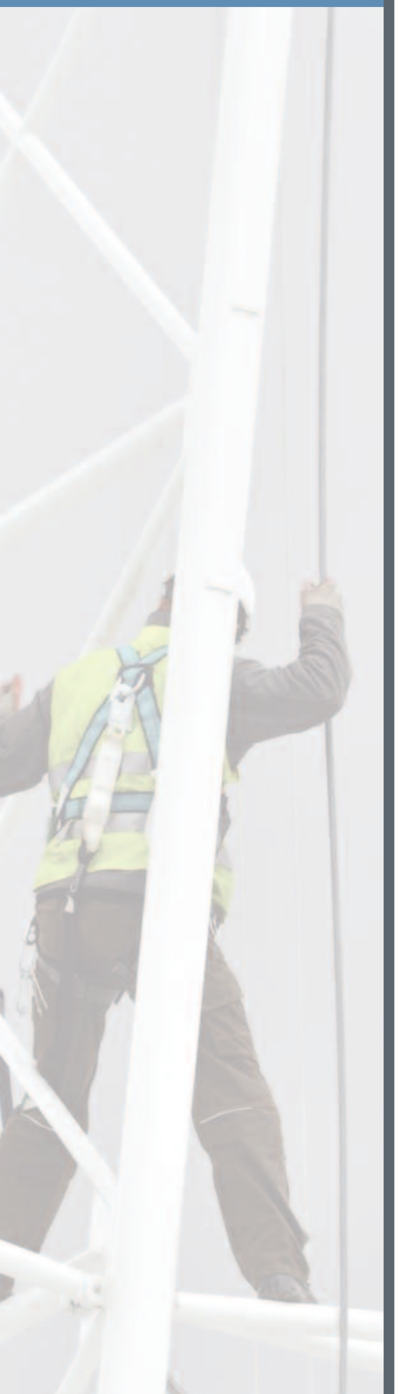
Over the shoulder design review can be a two-edged sword. In many circumstances, an over the shoulder review by the Public Owner can facilitate design review, minimize formal written comments and/or help avoid outright rejection and re-submittal of a design submittal. This same type of review, however, can also lead to a proliferation of changes, incorporation of owner design preferences, and increased project delays — resulting in discord among the parties.

Best practices suggest that there be some relatively quick contractual mechanism for resolving technical disputes related to whether the design is in compliance with the contract requirements. This can help avoid re-designs and re-submittals, while preserving design and construction budgets and maintaining the overall schedule. Where dispute review boards are not used, one alternative approach is to have senior representatives from the Public Owner, Concessionaire and the Design-Build Contractor meet in an attempt to reach a mutually satisfactory resolution that permits work to proceed. If this cannot be achieved, the contract should provide for the appointment of a technical expert who can at least provide the parties with a non-binding opinion after meeting with the parties and reviewing the submittals. The Public Owner and/or Concessionaire can disagree with the decision and direct the performance of work as they like, but there must be a clear written directive that permits the Design-Build Contractor to exercise its rights under the disputes process, while performing as directed.

Who Is Responsible For Impacts If The Project's Footprint Changes?

For PPP transportation projects in particular, the acquisition of right of way is often an important component of the Concession Agreement. Untimely acquisition of property can cause critical path delays or cause work to be conducted out of sequence with resulting productivity losses. Either impact is detrimental to the project and potentially catastrophic for

...continued on page 4



the Design-Build Contractor and project subcontractors. The planned right of way is customarily identified in the Final Environmental Impact Statement/Report and in the Concession Agreement, and is subject to modifications made necessary through development of geometric approval drawings, or by change orders.

Most of the risk associated with the acquisition of right of way is associated with: (i) unforeseeable costs and/or (ii) schedule delays. With regard to cost risk, Concessionaires have taken different approaches. Some Concessionaires take full responsibility for the acquisition cost of all property within the planned right of way. Other Concessionaires only accept the financial risk up to an agreed upon monetary threshold and pass the risk of any cost over the threshold to the Design-Build Contractor. More creatively, a Concession Agreement may provide that the Public Owner agrees to pay the increase in cost over any agreed upon right of way price, so long as the Public Owner also receives any savings if the costs are less than the initial price. It is further possible for the parties to agree to a sharing formula depending on the percentage of increase or decrease in right of way cost in comparison with an initial estimate. Although the formula for risk assumption may vary, best practices dictate that the responsibility be clearly defined in the Concession Agreement.

The risk of schedule delay caused by right of way acquisition has similarly been allocated in various ways. When the Project right of way has not been secured prior to award of the Concession Agreement and the requirement to secure the right of way is flowed to the Design-Build Contractor, the Design-Build Contractor usually accepts the risk that certain parcels may be delayed due to the need for condemnation actions or prolonged negotiations with difficult property owners. On the other hand, even where the Concessionaire agrees to obtain the right of way, the Concessionaire may not accept liability in the event that parcels are not delivered in a timely manner. When negotiating the Concession Agreement and the Design-Build Contract, parties should clearly address issues including which party is responsible for securing the right of way, when the right of way parcels will be available, and who bears the risk for late delivery.

Other foreseeable problems should be addressed and the obligations should be flowed down to the party best suited to bear the risk. For example, although a state government may have the right to award a Concession Agreement for a toll road, the toll road may feature one or more exits onto roads that are under the jurisdiction of a local government. How the ramp connects with these roads and other requirements that may be imposed, such as interchange landscaping and sidewalks, must be carefully considered as the Concessionaire and Design-Build Contractor may be obligated to meet the state government's obligations towards the local government.

When Do Liquidated Damages Begin To Run?

The failure to achieve either Substantial Completion or Final Acceptance by a specific date normally results in the assessment of significant liquidated damages. Consequently, the contractual definitions of Substantial Completion and Final Acceptance are among the most important terms in the Design-Build Contract. These definitions not only impact the assessment of liquidated damages, but the milestone dates typically trigger the commencement of the warranty period, as well as responsibility for utility costs, operations and maintenance. Particular care should be taken in negotiating the definition of each term in the Design-Build Contract.

Design-Build Contractors are accustomed to seeing a definition of Substantial Completion that does not incorporate punch list or other Work scope that does not impact the owner's ability to occupy or utilize the Work safely for the intended purpose. On a PPP Project, revenue operations are of paramount importance to the Concessionaire and its Lenders. Therefore, it makes sense that any substantial liability for liquidated damages cease once the project can be safely utilized for the collection of revenue. Some Concession Agreements and Design-Build Contracts, however, have deviated from the traditional approach by requiring the completion of work that is not essential to safe commercial operation as a condition of Substantial Completion. At a minimum, the Design-Build Contractor should negotiate a substantially reduced sum for liquidated damages once the project is taken over and operated.

Final Acceptance on a PPP project is defined as the completion of all of the Scope of Work, other than that required for Substantial Completion, completion of punch list items, and delivery of project documentation, including final as-built drawings, warranties, operating manuals, and certificates of acceptance by the Public Owner. Most Concession Agreements and Design-Build Contracts assess liquidated damages for failure to achieve the Final Acceptance Date, in an amount sufficient to cover the contract administration costs being incurred as the project closes out. Problems can arise when the definition of Final Acceptance varies from this definition. For instance, the Design-Build Contractor's risk exposure to liquidated damages increases significantly if the contract requires resolution of all claims or liens against the Concessionaire or its property rights as a condition of Final Acceptance. Best practices suggest that both the Concession Agreement and the Design-Build Contract permit the Concessionaire and the Design-Build Contractor respectively to reserve specifically identified claims against the Public Owner or the Concessionaire and still be able to achieve Final Acceptance. The recognition of a reservation of express claims would not place either the Public Owner or the Concessionaire in a position where damages for non-performance were being sustained and therefore no entitlement to liquidated damages should exist.

If the best practices discussed above are used throughout the process of drafting and negotiating the Contract documents and careful consideration is given to how risk is allocated, the Design-Build Contractor can markedly improve its prospects for successful and profitable completion of a PPP project.

Business Divorces – Plan Ahead

by Mark Rosencrantz, Of Counsel

Introduction

For many people, starting a new business ranks as one of the most exciting things they will ever do. Visions of large sales, huge profits, and a long period of financial prosperity are on everyone's mind.

However, even with the best of intentions on everyone's part, change is inevitable. People may wish to cash out, partners you thought would be honest and reliable turn out not to be, and people can have honest yet irreconcilable disagreements on the best path forward for the company.

In such cases, there may not be a good way for the owners to continue in business together. However, unless companies planned ahead – and most do not – there is frequently no easy way for one party to extricate themselves from a company. In such situations, not only might the owners lose the value of their equity in a business they invested a great deal of time and effort to build, but also the retirement security inherent in owning a business.

Such cases are often referred to as "business divorces." The term covers a wide range of scenarios from a company being shut down and dissolved and the owners and employees going their separate ways, to the departure of a founder and a dispute over whether employees and customers can follow.

Business divorces are often necessary when an officer or managing member of a company is either failing to comply with required business obligations or is engaging in financial improprieties. Other red flags include companies failing to keep up with normal obligations such as paying employees and vendors, filing tax returns, responding to mandatory audit requests, holding meetings, or filing required materials with the SEC or state agencies. Customers reporting a continuing inability to get service needs addressed, calls returned, or the like should also generate increased attention.

Put simply, if the person in charge refuses to both remedy problems and provide appropriate explanations as to why the problems occurred (which may very well not exist), a business divorce may need to be considered. In today's legal climate a variety of situations exist in which even if one officer or director does not participate in wrongful activities, knowing of them but not stopping and correcting them can result in personal liability.

Regardless of the cause, without appropriate advance planning business divorces are generally expensive and contentious, and frequently leave all parties in financial and legal positions they do not like.

A Case Study

Consider the following scenario. Two people working at a large technology company come up with a great idea for a new software program that will fill a clear need. They eventually both resign and set up a new corporation in which they each own half of the company, they are each officers, and they are the new company's only two directors. Because one of the founders is much better at writing software he takes over responsibility for programming and technology

...continued on page 6

issues, while the other, whose background is more grounded in marketing and sales, takes over responsibility for sales, marketing, and general day-to-day business operations.

The company is a success, and quickly gains a Fortune 100 company as a client. The company's founders are soon able to stop working out of their homes and rent office space. Over the next year the company's client list expands, and adds large and prestigious clients. The future seems to be bright.

However, the company never seems to generate quite as much income for the founders as it should. Further, the technology partner grows concerned when he begins receiving emails and calls from third parties that the company is failing to, among other things:

- Pay vendors and subcontractors in a timely manner;
- Pay employees and independent contractors in a timely manner;
- Generate and file income tax returns as they become due; and
- Attend to other business obligations in a timely manner.

The technology partner then realizes that despite having been in business for three years, the company has never conducted a board meeting. Efforts to set up a meeting are ineffective, because the sales and marketing partner refuses to attend, and he holds 50 percent of the voting interest, which means the company cannot achieve the quorum necessary to vote on anything. Moreover, the sales and marketing partner generally never seems to be available, and seems always to be on the road on sales calls, at industry conferences, or at marketing events. Worse, as time passes the technology partner has more and more trouble reaching the sales and marketing partner by phone, or even getting responses to emails or text messages.

The final straw comes when the technology partner, who has not taken a vacation during the entire three years the company has been in existence, attends an industry conference, and decides to stay in a luxury hotel as a reward for three years of non-stop work. Upon checking in, the hotel staff extends a warm welcome and indicates they are happy to finally meet the other half of the company's brain trust. When asked, the staff indicates that the sales and marketing partner is a frequent guest who often throws lavish parties and always tips well.

Upon returning home, the technology partner is able to get a copy of the company's bank and other financial records, and retains an independent accountant to review the company's finances. The accountant reports that the sales and marketing partner has been using the company's bank account as if it was his own to finance a lavish bi-coastal lifestyle complete with parties in Los Angeles, Miami, and the Hamptons, as well as attendance at events such as the Super Bowl and the World Series.

The technology partner reaches a decision that he can no longer continue to do business with the sales and marketing partner. However, the company's governing documents do not allow the technology partner to simply walk away from ownership responsibilities, which include, among other things, his personal guarantee of the company's lease and line of credit, as well as his legal responsibility as an officer and director that the company file accurate tax returns when they are due. Similarly the company's governing documents do not have provisions allowing for one founder to fire the other, force a buyout of shares, or force a sale of shares. Equally problematic, the software, which the technology partner spent three years writing and perfecting, and is the company's greatest asset, belongs to the company, which means that the technology partner has no right to take the software with him if he leaves.

As a result, the technology partner is left with several choices, none of which are particularly appealing:

- Hire an attorney and sue the sales and marketing partner for breaching duties to the company, and improperly using money. This might solve some monetary issues but not fix the underlying problems.
- Hire an attorney and sue the sales and marketing partner and the company and ask that a third-party receiver be appointed to run the business at least on a temporary basis.
- Hire an attorney and sue the sales and marketing partner asking that the company be dissolved, and the assets sold off to pay the company's creditors, and if anything is left to be distributed to the owners.

Plan Ahead

With careful advance planning the technology partner's options after discovering the wrongdoing described above could be much different. For everyone's protection, and regardless of whether the company is a corporation, a limited liability company, a limited liability partnership, or any other business entity, the following should be considered well in advance of any problems arising:

- Are there an odd number of directors or other managers to avoid deadlocks? Directors and other managers do not need to be owners, so consideration should be given to having at least one neutral, disinterested director who can act solely in the best interests of the company. Agreements can even be structured such that a neutral director only votes to break deadlocks.
- Is there a provision allowing for one owner to either require that the company buy back his shares and/or allow the company to require an owner to sell their shares back? Parties can agree well in advance on specific wrongdoing that can trigger a forced buyout, as well as a method to select a valuation expert and a valuation methodology the expert should use.
- Are there provisions explaining who gets to use company assets such as customer lists, software, and trade secrets following the departure of a founder or other owner?
- Do all owners, or at least all directors or managers, have equal access to bank accounts and records, accounting records, and the company's other financial records? One owner not having access to such records can create problems, and having access can be a critical first step in identifying and proving wrongdoing.
- In the event a partner is forced to sell their interests as a result of wrongdoing, are they prohibited from competing against the company for a period of time? Even in states like California, which generally prohibit non-compete agreements, such a provision would likely be enforceable, and give the company a chance to recover from the departing owner's wrongdoing.

Conclusion

Like their name indicates, business divorces are not fun, and can be destructive to companies. With advance planning, however, protections can be built in to make the process significantly less expensive and destructive.

A Contractor's Guide To The Freedom Of Information Act

by Robyn N. Burrows, Associate

Introduction

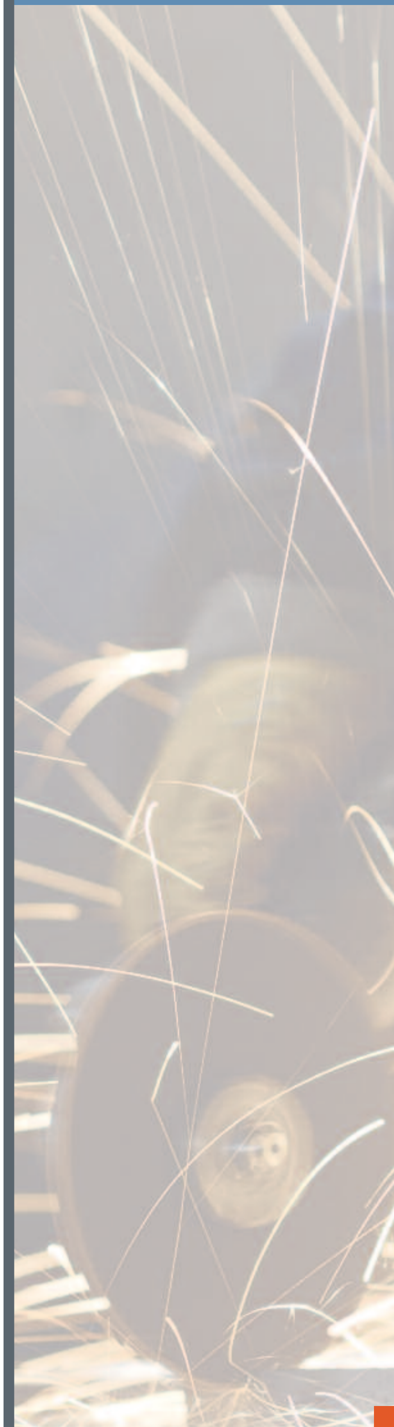
The Freedom of Information Act ("FOIA"), 5 U.S.C. § 552, provides citizens the means to discover information about the operations of their government. Although less obvious, the FOIA also provides citizens the means to learn about each other, particularly in the realm of government contracting. This is a tremendous boon for smaller businesses wishing to obtain a competitive edge against larger, more sophisticated applicants. With a simple FOIA request, a company can view other contractors' previous bid applications and increase its chances of obtaining lucrative contracts.

Although the FOIA serves as a powerful resource, those conducting business with the government should be aware that their communications with government employees, including the submission of any documents, may become agency records subject to disclosure upon a competitor's request. Contractors should not assume that simply marking their material as "confidential" guarantees full protection. As demonstrated in a recent district court decision, what a contractor or government agency considers protected information may actually be disclosable depending on a court's interpretation of applicable FOIA exemptions. This is particularly true in light of President Obama's January 21, 2009 FOIA Memorandum, which makes clear that "in the face of doubt, openness prevails."

Exemption 4 Of The FOIA

The FOIA requires agencies to disclose records upon request from any member of the public, subject to nine statutory exemptions. These exemptions include prohibitions against disclosing records containing national security information, personal information, deliberative communications, and information pertaining to law enforcement. Unless the requested records

...continued on page 8



fall into one of the exemptions, an agency is required to disclose the records within twenty days, absent unusual circumstances. In reality, the process almost always takes at least several months to complete, depending on the complexity of the search and processing procedures.

Of the nine exemptions, Exemption 4 most frequently impacts information that contractors submit to the government. Exemption 4 protects two categories of information: (1) trade secrets and (2) commercial or financial information obtained from a person that is privileged or confidential. Exemption 4 is unique in that it is designed to ensure the availability and reliability of information submitted to the government by assuring submitters that their information will remain safeguarded to prevent competitive disadvantage.

Most courts define a trade secret as a commercially valuable plan, formula, process, or device that is used for the making, preparing, compounding, or processing of trade commodities that result from innovation or substantial effort. Trade secrets may be found in a variety of documents, including contracts, manufacturing descriptions, schematics, or product formulas. Confidential material makes up a much broader category. In evaluating the applicability of Exemption 4 to confidential information, agencies consider whether the contractor provided the information voluntarily or involuntarily. If a contractor involuntarily submits information, the information is protected only if disclosure is likely to either impair the government's ability to obtain necessary information in the future or cause substantial harm to the contractor's competitive position. If a contractor voluntarily submits information, the information is protected only if the contractor would not customarily release it to the public. Under this more deferential standard, a contractor's information is much more likely to be protected from disclosure. Information may also be withheld under Exemption 4 if it is privileged, including information subject to the attorney-client privilege, the critical self-evaluative privilege, the confidential report privilege, or a protective order.

Potential Pitfalls For Government Contractors

Despite the protections afforded to trade secrets and confidential and privileged information under Exemption 4, contractors should still be mindful that risks remain. For example, the United States District Court for the Northern District of California recently ordered the Department of Defense ("DOD") to disclose a contractor's subcontracting information in response to a FOIA request, despite the agency's Exemption 4 claim. See Order Den. Cross Mots. for Summ. J., *Am. Small Bus. League v. Dep't of Def.*, No. C 14-02166 WHA, 2014 WL 6662427(N.D. Cal. Nov. 23, 2014). The case arose after the American Small Business League requested the most recent master Comprehensive Subcontracting Plan ("CSP") submitted by Sikorsky Aircraft Corporation for participating in the Comprehensive Subcontracting Plan Test Program for DOD. The CSP identifies all subcontract amounts a contractor awards to small businesses on all of its government contracts. When DOD failed to respond within the statutorily required timeframe, the requester sued to compel the production of records.

In its opposition, DOD claimed that it could not release the CSP pursuant to Exemption 4. In support of its claim, DOD filed the declaration of Amy Johnson, the Director of Supply Management at Sikorsky. Johnson's declaration argued that the CSP contained Sikorsky's protected information, including Sikorsky's make-or-buy process, the type of supplies and services Sikorsky subcontracted, the techniques of identification and development of potential sources, subcontractor proposal evaluation criteria, and flow-down of subcontracting requirements, among other sensitive information. DOD also identified certain proprietary information, including training program information, dollar amounts of awarded subcontracts, Sikorsky's small business goals, methodologies for spending allocation, and specific commodities for which Sikorsky subcontracts.

With this information, DOD contended that a competitor could determine Sikorsky's approach to key manufacturing and sourcing decisions that DOD evaluates in its contract proposal review. A competitor might use this information to determine the strengths and weaknesses in Sikorsky's proposals or to misappropriate operational and manufacturing strategies. This would allow a competitor to use Sikorsky's business information in crafting its own proposals and marketing material for similar DOD contracts.

Despite DOD's concerns about the sensitive nature of the information contained in the CSP, the court ultimately found that DOD failed to demonstrate that the requested information would be "likely to cause substantial competitive injury." According to the court, Johnson's declaration merely asserted that a competitor "could" use the information to assess the strengths and weaknesses of Sikorsky's bid proposals. The court therefore denied DOD's motion for summary judgment and required DOD to produce Sikorsky's CSP.

BUILDING SOLUTIONS

Reverse FOIA Lawsuits: How Contractors Can Protect Sensitive Business Information

The above case is a prime example of the risks contractors face in submitting confidential information to the government. Fortunately for Sikorsky, DOD agreed that Exemption 4 should prevent the disclosure of the requested records. DOD was therefore able to adequately represent Sikorsky's interests before the court. Other contractors, however, must fight the agency to prevent disclosure of their records.

To protect themselves, many contractors have initiated "reverse FOIA" suits. A reverse FOIA suit allows an individual that has supplied the government with data to file suit to prevent the agency from disclosing protected information. The procedure typically begins after an agency receives a FOIA request implicating a third party's records. Executive Order 12600 contains certain pre-disclosure notification procedures that agencies must follow. First, the agency must provide the submitter a reasonable period of time to object to the disclosure of any requested records. If the agency disagrees with the submitter's position, the agency must provide a written notification containing the agency's explanation. This notification must be provided within a reasonable number of days prior to a specified disclosure date. Although FOIA requesters are entitled to administratively appeal an agency's decision, submitters are not accorded this right.

After receiving the agency's decision, a submitter may seek judicial review to enjoin the agency's disclosure of its records through a reverse FOIA suit. The FOIA does not expressly provide a mechanism for such a suit, although the Supreme Court has held that the Administrative Procedure Act provides a basis for submitters of information to contest a proposed disclosure by claiming that the agency's decision is arbitrary or capricious. *Chrysler Corp. v. Brown*, 441 U.S. 281, 317-18 (1979).

Conclusion

In light of the risks accompanying disclosure of sensitive business information, contractors should exercise caution before submitting information to government agencies and should check all applicable regulations to ensure conformance with any requirements for designating information as confidential or proprietary. In the event that a requester seeks protected information, contractors should be proactive and take advantage of pre-disclosure notification procedures by timely objecting to any proposed disclosures. If the agency nevertheless chooses to proceed, reverse FOIA suits are an important vehicle to ensure the agency complies with the requirements of Exemption 4 and may save a company from suffering a substantial competitive injury.

CONTRACTS

Are Public Agencies Pushing The Limits Of Risk Transfer In Design-Build Projects? Current Trends And Issues

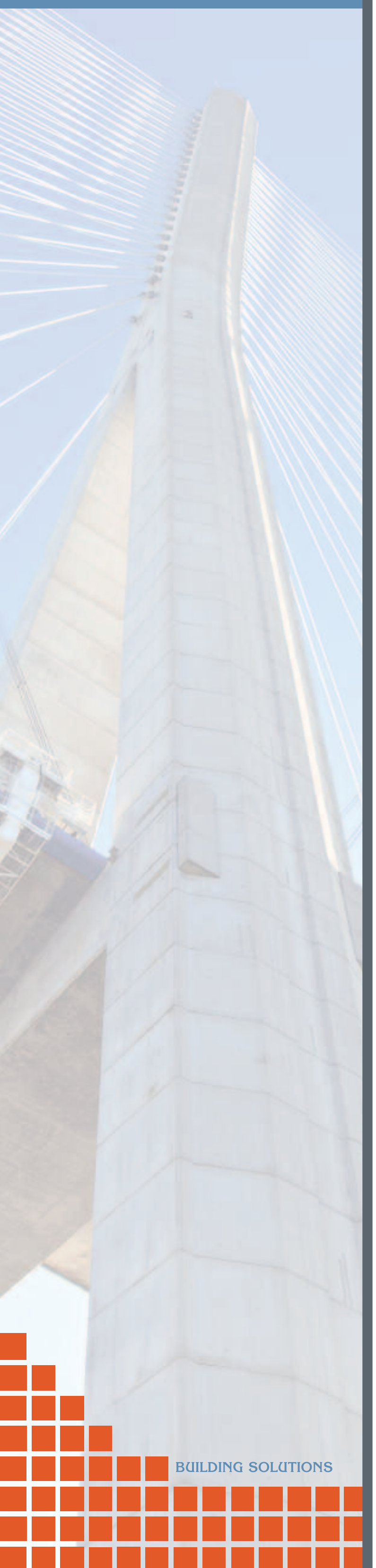
by Gregory J. Dukellis, Senior Partner

There is a continuing trend by public agencies to favor a design-build project delivery system for major infrastructure projects. This makes sense for public agencies - the typical design-build contract is well-drafted from the Owner's perspective with a focused attempt to allocate nearly all risk to the Contractor, and to identify the Contractor as a single point of responsibility for all issues that affect the design or construction. As with most contracts of this type, the primary question is how much risk the Contractor is willing to assume. This is where it gets tricky: typical limitations on risk transfer in the traditional hard bid scenario of design-bid-build are being pushed by public agencies in the design-build scenario.

What Are The Limits Of Risk Transfer?

As a general premise, risk should be allocated to the party that controls the risk and, for bidding purposes, the risk should be able to be priced. For example, traditionally, bidding contractors expect that, if the project is critically delayed by the Owner or a third party not

...continued on page 10



controlled by the Contractor, a time extension will be granted on a day for day basis. There is a current trend, however, in design-build contracts to shift third-party delay risk to the Contractor. A typical clause may provide that "the Contractor shall be entitled to a one-day extension of any affected Completion Deadline for every two days of delay in the Critical Path that is directly attributable to a delay." In other words, not only is the Contractor at risk for the assessment of liquidated damages for a delay it neither controls nor causes, it will not receive any additional compensation for all of the delay.

Similarly, public agencies are not allowing time extensions for concurrent delay. A typical design-build contract provision may provide:

> *Any extension of a Completion Deadline allowed hereunder shall exclude any delay to the extent that it:*
>
> a. Did not impact the Critical Path affecting a Completion Deadline;
>
> b. Was due to the fault or negligence, or act or failure to act of any Contractor-Related Entity;
>
> c. Could reasonably have been avoided by the Contractor, including by re-sequencing, reallocating or redeploying its forces to other portions of the Work (provided that if the request for extension involves an Authority caused delay, the Authority shall have agreed, if requested to do so, to reimburse the Contractor for its costs incurred, if any, in re-sequencing, reallocating, or redeploying its forces); or
>
> d. *Was concurrent with any other delay for which the Contractor is not entitled to an extension.*
>
> (Emphasis supplied).

In the traditional hard-bid scenario, many jurisdictions have placed legal limitations on a public agency's ability to limit damages for delays not caused by the Contractor or for the assessment of liquidated damages when there is concurrent delay. The current design-build trend of shifting certain third-party and concurrent delay risk to the Contractor raises potential issues of enforceability in these jurisdictions. Public agencies claim that such clauses knowingly allocate delay risk and that only a portion of delay damages are being limited. Although such limiting provisions may be tested in future court decisions, it is fair to say that the traditional risk allocation for third-party and concurrent delay is being challenged in the modern design-build contract, and this risk should be priced, to the extent it is quantifiable.

Another area where traditional concepts of risk allocation are being tested is differing site conditions. Under the hard-bid scenario, Contractors need not build into their bids contingencies for differing site conditions because the law generally provides that the Contractor is to be compensated for the extra costs caused by such conditions. Public agencies are now limiting the definition of a differing site condition and the remedies available with increasing frequency. Again, a public agency's ability to transfer this risk may be tested in the future, but for now it is a contingent risk that should be priced by the Contractor in its design-build bid.

The circumstances and events that give rise to a change order are also being significantly limited in design-build contracts. Although the typical design-build contract may appear to have an extensive list of events that give rise to a change order, in reality, the contract terms frequently limit recovery for most of the events. Again, the issue really becomes how much risk the Contractor is willing to assume and how that risk is priced. In this regard, besides limitations on the events that give rise to a change order, the contractual requirements for obtaining a change order can be burdensome. On a major design-build project, adequate resources must be devoted to the change order process so that each change order requirement is met in a timely and appropriate fashion. The failure to adhere to the contract's process may preclude otherwise meritorious requests for contract adjustments.

Conclusion

Public agencies are pushing the limits on risk transfer in the modern design-build contract. Consistent with the design-build philosophy, public agencies seek to allocate most of the design and construction risk to the Contractor. The limits of allowable risk transfer may be tested in future legal decisions. For now, the design-build Contractor should carefully assess the risk allocation of the modern design-build contract and understand the events and circumstances that may give rise to a time or price adjustment under the contract's terms. Although beyond the scope of this article, contract terms dealing with indemnity, dispute resolution, waiver of disruption claims, limitation of home office overhead damages, parent company guarantees, and events constituting a default likewise may be aggressively drafted in favor of the public agency and require close analysis by Contractors.

VIRGINIA UPDATE

Engineer Is Sheltered From Shaky Foundation Lawsuit By Virginia's Economic Loss Rule

by Hanna Lee Blake, Partner

Virginia's Economic Loss Rule (the "Rule") has proved a formidable obstacle to plaintiffs in the Commonwealth of Virginia. Intended to distinguish between claims arising in *contract* verses those arising in *tort*, the Rule has provided fodder for debate and extensive discussion in all of Virginia's courts. A recent decision from the Western District of Virginia, *McConnell v. Servinsky Engineering, PLLC*, 22 F. Supp. 3d 610 (W.D. Va. 2014) made clear that the Rule is alive and well in the Commonwealth. Indeed, an engineer escaped personal liability for allegedly defective design services in large part due to the Rule.

Case Background

The Owner, Kenneth McConnell ("Owner"), entered into a written contract with a Michigan company, Servinsky Engineering, PLLC ("the Company") to design the foundation for a fabric-roofed building on a farm intended to be used as a feed barn (the "Project"). Mark S. Servinsky ("Servinsky"), a professional engineer licensed in Virginia and principal of the Company actually performed the design services. According to the Owner's contract with the Company, the Company was to take area conditions into account in preparing the design.

Unfortunately, shortly after the building was constructed, the foundation failed. In the lawsuit, the Owner alleged that the designed foundation and structural posts were insufficient to handle local topography, wind and snow loads, contrary to the contract requirements. The Owner alleged that the building was too unstable to be safely used for its intended purpose and the attempted fixes to the structural deficiencies were insufficient to bring the building up to code and contract requirements.

In addition to the Owner's claims against the Company, he asserted claims against Servinsky personally. In particular, the Owner brought a breach of professional standard of care – a tort claim – against Servinsky for his performance of design services for the Company. In other words, the Owner claimed that Servinsky was personally liable for the Owner's damages.

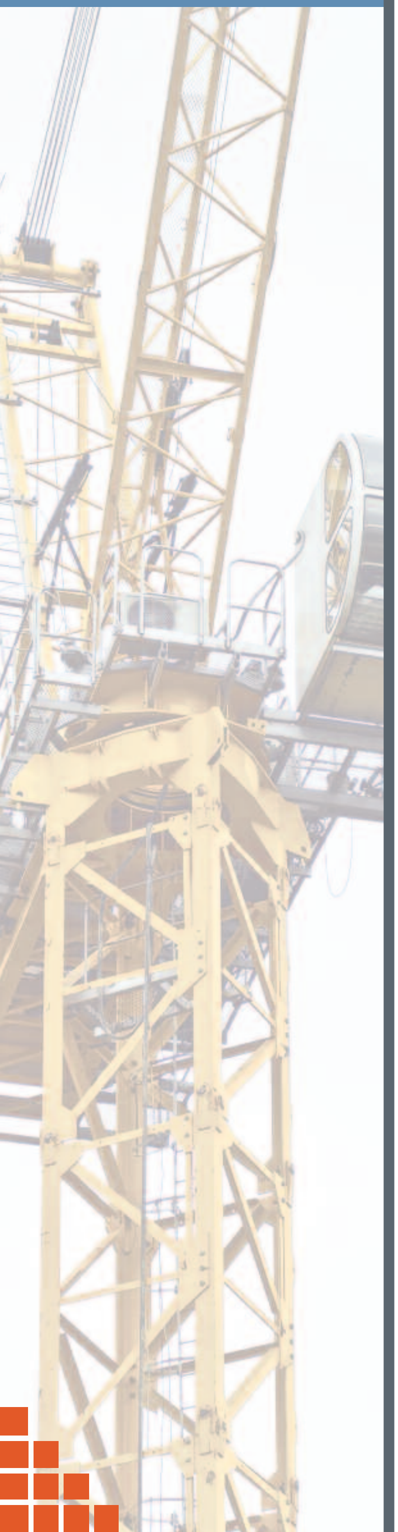
In response to the complaint, Servinsky filed a motion seeking to dismiss the Owner's claims against him based upon the Economic Loss Rule and because Servinsky had not entered into a contract with the Owner, *i.e.*, there was a lack of privity between the Owner and Servinsky. Based upon its application of Virginia law, including the Economic Loss Rule, the court sided with Servinsky and dismissed all of the claims against him personally.

The Economic Loss Rule Generally

Simply put, under Virginia law a party cannot sue for economic losses without establishing that it has a contract. Further, a plaintiff cannot sue in tort for a duty assumed solely by contract. Stated differently, the Rule provides that where the plaintiff is a party to a contract and has suffered only disappointed economic expectations, such as damages for inadequate value, lost profits or the cost to repair defective construction, the remedy sounds in *contract*, not in *tort*. In this situation, the plaintiff would be limited to a breach of contract claim and any damages permitted under the contract. Importantly, if the plaintiff is limited to its contract, special recovery such as punitive damages will be unavailable.

It is important to keep in mind, however, that a tort, such as negligence or breach of a professional standard of care, may be pursued against a party that violates a duty that arises independent of the parties' contract and for damages to persons or property beyond the scope of the contract.

...continued on page 12



Was The Loss Solely Economic?

In *McConnell*, the first issue the district court considered in its analysis was whether the Owner sought purely economic losses. In that regard, the court noted that the Owner sought monetary damages in order to remove the existing building and to erect a new building sufficient to withstand local conditions, as originally bargained for in the contract. The court determined that the Owner's loss was "economic," noting that economic losses occur when a product injures itself because one of its component parts is defective. Relying on the Virginia Supreme Court's decision in *Sensenbrenner v. Rust, Orling & Neale, Architects, Inc.*, 374 S.E.2d 55 (Va. 1988), the *McConnell* court found that such losses are not recoverable in a tort action.

In reaching its conclusion, the *McConnell* court explained that pursuant to the Rule, when the bargained-for level of quality in a contract is not met, the law of contracts provides the sole remedy. In that instance, tort recovery is not available to a plaintiff, such as the Owner in the *McConnell* case, because the contract defines the breach and the damages.

Was The Owner's Underlying Injury To "Persons" Or "Property?"

As noted above, the Rule does not bar a tort action if the plaintiff's injury is to persons or property. Consequently, this was the second issue the *McConnell* court considered. Initially, the court reviewed Virginia case law where courts had declined to dismiss negligence claims based on the Economic Loss Rule. In one case, the claims survived an attempt to dismiss because plaintiff alleged that the defendant breached an independent duty of care to prevent injury to property by spraying chemicals that killed pine tree crops. The *McConnell* court noted that in another case, the court refused to dismiss a negligence action based on the Rule where the plaintiff alleged that the defendant's failure to repair a leak caused mold infestation resulting in personal injury.

Distinguishing the cases supporting the exception, however, the *McConnell* court found that "a structurally deficient building [such as alleged by the Owner in *McConnell*] is an economic loss rather than injury to property." The court concluded that Plaintiff had not alleged any damages beyond economic loss in order to fall within the exception to the Rule.

Was There Privity Of Contract Between The Owner And Servinsky?

Having found that application of the Rule limited the Owner to a *contract* action, the McConnell court turned to the issue of privity. In that regard, the court noted that "[b]ecause the law of contracts provides the sole remedy for economic loss under Virginia law, privity is an indispensable requirement for a viable claim." The Owner's pleadings made clear that his contract was with the Company, not with Servinsky.

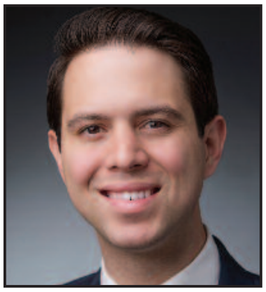
The court was not persuaded by the Owner's arguments that he should be permitted to seek economic losses directly against Servinsky since Servinsky actually performed the Company's design work and affixed his engineering seal to the foundation plans. Further, the court found that Servinsky had not assumed an independent tort duty by sealing the drawings and/or by performing professional services under the Company's contract.

The court concluded that the lack of privity was fatal to the Owner's claim for economic losses against the engineer and dismissed the case against Servinsky.

Conclusion

The McConnell decision demonstrates that Virginia's Economic Loss Rule is alive and well and will be applied by the courts to preclude tort claims for purely economic losses. Further, such claims will not succeed in the absence of privity. This case also reminds plaintiffs seeking to recover economic losses to properly plead their case. If a plaintiff is able to allege injury to persons or property, it should do so clearly and may be able to overcome a challenge under the Rule.

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**



A Legal Safe Haven For Contractors (Especially In Virginia): A Brief Survey Of Statutes Of Repose

by Daniel Rodriguez, Associate

Introduction To Statutes Of Repose

One legal concept that everyone in the construction industry should be aware of is the application of statutes of repose. Statutes of repose vary from state to state and are unique in their application to construction projects. Statutes of repose are similar to and sometimes confused with statutes of limitation, as they both set limits on when law suits or other legal action can be initiated. There are, however, two key differences between these two types of limiting statutes.

Key Differences Between Statutes Of Repose and Statutes of Limitation

One key difference between a statute of repose and a statute of limitation is that a statute of repose reflects an absolute time limit that, with some limited exceptions, cannot be tolled or modified. In the context of a construction project, you could imagine both statutes as clocks counting down to the moment when an owner, contractor, or subcontractor can no longer be sued for damages arising out of its performance. The countdown on a statute of limitations can be paused by mutual agreement for any number of reasons, extending the right to sue further into the future. In contrast, a statute of repose generally cannot be tolled or extended and, once it is triggered, sets an absolute bar to any claims being asserted after the term of the statute has expired.

The second key difference between a statute of repose and a statute of limitation relates to when the respective countdowns begin ticking. For purposes of the statute of limitations, many states employ the discovery rule in determining when a party's right to file a lawsuit accrues. Under the discovery rule, if a party's actions cause harm or injury to a person or property, the action against that party does not accrue until the harm or injury is actually discovered. Thus, under the discovery rule, if a contractor defectively builds a house with a gas leak, the *statute of limitations* to sue that contractor would not begin to run until the homeowner discovers the leak. What happens, however, if the leak is not discovered for 20 or 30 years? In those situations, the applicable statute of repose might bar a claim and, in so doing, ensure that contractors and other construction professionals do not live in perpetual fear of their work exposing them to litigation far into the future.

A Brief 50 State Survey Of Statutes Of Repose

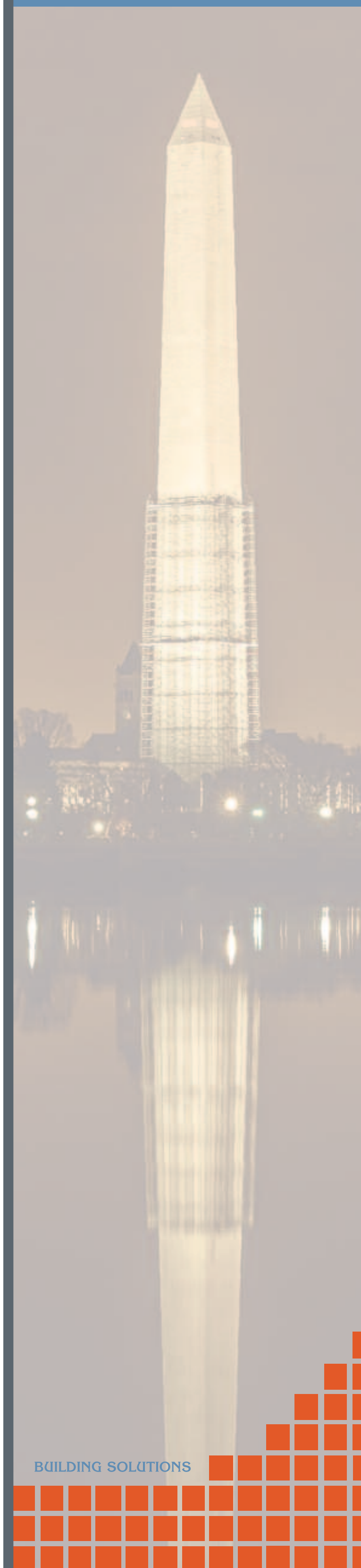
It is important to note that among the states and the District of Columbia there are a wide array of statutory frameworks that control when the countdown clock for the statute of repose begins to run. All but two states, New York and Vermont, have some form of a statute of repose. Most state statutes clearly define the parameters of the statute of repose and articulate the manner in which it may, if at all, be extended. All but six states clearly start the clock for the statute of repose for claims involving construction at substantial completion or the abandonment of the work at the earliest, with some setting an even later time for the statute of repose to start (*e.g.*, final completion, occupancy or acceptance of the work).

Three of those six states, Nebraska, Iowa and Kansas, have codified the rule that the statute of repose runs from the "act giving rise to the action." Illinois' statute of repose identifies the start date as the "act or omission," whose discovery would trigger the statute of limitation. New Jersey and Virginia have nearly identical language in their statutes stating that claims related to construction are barred 10 years and 5 years respectively "after the performance or furnishing of such services and construction." N.J.S.A. § 2A:14-1.1; Va. Code Ann. § 8.01-250. New Jersey courts have clarified the beginning of the statute of repose generally to occur at the moment of substantial performance. As discussed below, Virginia's statutory framework for statutes of limitation and repose is unique in its application.

Virginia's View Of The Statute Of Repose

As an initial matter, Virginia courts have rejected the discovery rule with regard to statutes of

...continued on page 14



limitations. As such, by way of example, the five-year statute of limitations for claims arising out of or relating to property damages would begin to run no later than final completion of the contract. Essentially, Virginia adopts the view that any property damage claim has accrued by final completion since the harm to the property has been sustained, whether or not the owner of the property is aware of it.

The fact that Virginia has rejected the discovery rule as to statutes of limitation does not, in and of itself, provide any guidance on the application of statutes of repose. Moreover, the Virginia Supreme Court has not clearly articulated what events amount to "performance or furnishing of such services and construction" for purposes of triggering the running of the statute of repose. Would the statute begin to run upon the acceptance or completion of discrete parts of a contract, acceptance or completion of the entire contract, or simply the performance or furnishing of particular services in question that were required under the contract? A recent ruling from a Virginia Circuit Court ruled in favor of the latter view.

The question of what event triggers the running of the statute of repose was an issue of first impression before the Arlington County Circuit Court in *Lexington Insurance Company v. R&R Mechanical Contractors, Inc.*, No. CL13002849-00 (Arlington County Circuit Court filed November 14, 2013). The issue in that case revolved around whether the contractor and subcontractor could be held liable for the damages allegedly resulting from the installation of an HVAC system.

The plaintiffs alleged that a particular pipe installed under a renovation contract caused their damages. The defendant argued in its plea in bar that the plaintiffs' claims were barred by the five-year statute of repose, arguing that the HVAC work was completed more than five years before the complaint was filed, even though additional, unrelated work under the prime contract and subcontract was completed within the five-year period preceding the filing of the lawsuit.

In a letter opinion issued on October 23, 2014 and incorporated into an order on November 14, 2014, the Arlington County Circuit Court ruled that the statute of repose begins when the particular work was performed that is alleged to have caused the damages claimed by the plaintiffs. In short, the court ruled that the question of fact relevant to determining when the statute of repose would begin to run was when the particular pipe in question was installed, not when the HVAC portion of the contract was completed, inspected and/or accepted. If installation of the allegedly deficient pipe was "performed or furnished" more than five years before filing of the action, then the statute of repose would act to bar the claims related to that installation.

The court reasoned that the legislature clearly intended the statute of repose to serve as a unique and strict limit to claims related to construction, and that the statute, by its plain language, makes no distinction requiring owner's acceptance or even substantial completion of that portion of the work in question. For that reason, the court applied the plain language of the statute and ruled that since the plaintiffs' claims all hinged on the allegation of a faulty installation of a particular pipe, the performance of that pipe's installation triggered the statute of repose. The court ruled that the question of fact regarding when the particular pipe in question was installed had not yet to be determined and would need to be the subject of further proceedings.

Conclusion

Ultimately, it is important for owners, contractors, and subcontractors to understand how the statute of repose operates in the jurisdiction where their work is being performed. Fortunately, in most jurisdictions, the statutes themselves incorporate the discovery rule and set out unambiguous markers for application of the statute. Parties to construction contracts governed by Virginia law should be aware, however, that the discovery rule will likely not delay the running of the statute of repose. This needs to be taken into account whether filing a complaint seeking to recover damages or defending against a claim for damages. Plaintiffs should be especially wary, and should file suit as soon as possible, if the statute of repose is even potentially an issue.

Watt Tieder Senior Partner Vivian Katsantonis Recognized As Fellow for Litigation Counsel Of America

Watt Tieder is proud to announce that senior partner **Vivian Katsantonis** was named a Fellow of the Litigation Counsel of America (LCA). The LCA is a trial lawyer honorary society whose membership is limited to less than one-half of one percent of North American lawyers vigorously vetted for skills, expertise and service. This highly selective, invitation-only society chooses its Fellows from a diverse group of partners, shareholders and independent practitioners with twelve or more years experience. LCA Fellows are selected after being evaluated for exceptional performance and accomplishment in litigation and trial work. The selection process is not only based upon excellence in litigation, but also effectiveness in a certain area of expertise and superior ethical reputation. The combination of these qualities means that LCA Fellows are "one of the most well rounded practice groups among any legal professional society and provides recognition and opportunities for those deserving the designation 'Fellow, Litigation Counsel of America.'"

Watt Tieder Welcomes New Associate

Lauren E. Rankins joins the Chicago, Illinois office, where she previously worked as a law clerk. Lauren's practice will focus on commercial litigation, construction contract disputes and surety law. Lauren received her J.D. from the John Marshall Law School, Chicago, Illinois in 2014 and her B.A. from the University of Wisconsin, Whitewater, Wisconsin in 2007. Lauren is a member of the Illinois bar.

Upcoming And Recent Events

American Bar Association Tort Trial & Insurance Practice Section, Fidelity and Surety Law Committee 2015 Midwinter Meeting Surety Program, January 21-23, 2015; New York, New York; **John E. Sebastian** spoke on bid mistakes; **Vivian Katsantonis** and **Christopher J. Brasco** spoke on "Maximizing the Utility of a Surety's Financing Contributions When Supporting the Completion of Federal Government Contracts."

Associated General Contractors Risk Management 2015 Conference on Surety Bonding and Construction Risk, February 2, 2015; Naples, Florida; **Vivian Katsantonis** spoke on significant risk issues for sureties in the construction industry.

Construction Users Roundtable 2015 National Conference, February 11, 2015; Phoenix, Arizona; **Kevin J. McKeon** spoke on "Actions Every Owner Should Take in Today's Market."

National Contract Management Association's Subcontract Management Training Forum 2015, March 12-13, 2015; Tyson's Corner, Virginia; **Timothy E. Heffernan** to speak on dispute avoidance.

Associated General Contractor's of America National Convention, March 18-20, 2015; San Juan, Puerto Rico; **R. Miles Stanislaw** to speak on the pitfalls of procuring liability insurance for high risk, big dollar contracts.

American Arbitration Association 2015 Construction Conference, March 27, 2015; Santa Monica, California; David F. McPherson to speak on drafting construction ADR clauses.

Inter-Pacific Bar Association Annual Conference, May 8, 2015; Hong Kong, China; **Keith C. Philips** and **Christopher Wright** to speak.

BUILDING SOLUTIONS®

WATT TIEDER

WATT, TIEDER, HOFFAR & FITZGERALD, L.L.P.

Attorneys at Law

PRSRT STD
US POSTAGE
PAID
PERMIT #6418
DULLES, VA

WATT TIEDER

WATT, TIEDER, HOFFAR & FITZGERALD, L.L.P.

8405 Greensboro Drive, Suite 100
McLean, Virginia 22102

8405 Greensboro Drive
Suite 100
McLean, Virginia 22102
(703) 749-1000

2040 Main Street
Suite 300
Irvine, California 92614
(949) 852-6700

10 South Wacker Drive
Suite 2935
Chicago, Illinois 60606
(312) 219-6900

6325 S. Rainbow Boulevard
Suite 110
Las Vegas, Nevada 89118
(702) 789-3100

1200 Brickell Avenue
Suite 1800
Miami, Florida 33131
(305) 777-3572

1215 Fourth Avenue
Suite 2210
Seattle, Washington 98161
(206) 204-5800

HFK Rechtsanwälte*
Maximilianstrasse 29
D-80539 Munich, Germany
Phone 011 49 89 291 93 00

Independent Law Firm

Global Construction &
Infrastructure Legal Alliance
91, rue du Faubourg Saint-Honoré
75008 Paris, France
Phone 33 (0)1 44 71 35 97

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**.

BUILDING SOLUTIONS