BRADLEY ARANT ROSE & WHITE LLP First Quarter 2000

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

A. H. GAEDE, JR.
STANLEY D. BYNUM
E. MABRY ROGERS
GARY C. HUCKABY (HUNTSVILLE)
ANDREW J. NOBLE, III
WALTER J. SEARS, III
H. HAROLD STEPHENS (HUNTSVILLE)
MICHAEL D. MCKIBBEN
DAVID G. HYMER
AXEL BOLVIG, III
J. DAVID PUGH
JAMES F. ARCHIBALD, III
DOUGLAS E. ECKERT
RODNEY L. MOSS
ARLAN D. LEWIS
JOEL E. BROWN
DONNA M. CROWE
ANGUS N. MCFADDEN

Internal Revenue Service Issues Construction Industry Audit Guidance

The Internal Revenue Service recently released an audit guide that addresses IRS audits of businesses in the construction industry. The purpose of the guide is to train IRS examining agents and to alert them to issues specific to firms in the construction industry, including general contractors, subcontractors, commercial project owners, residential construction developers, highway contractors, architects and engineers, materials suppliers, construction lenders, and surety companies.

The guide differentiates among types of contracts, small and large contractors, and what is being constructed. It also includes examples and hypothetical fact scenarios. The guide lists frequent problems the IRS has encountered in the construction industry, including improper income recognition, failure to report income, underreported income, and improper deductions and adjustments. Accounting methods, changes in accounting methods and construction joint ventures also are highlighted. We believe that the IRS, in the future, will examine with renewed interest issues surrounding the tax treatment of construction joint venture income.

Companies facing federal income tax audits may want to review this guide in order to identify the issues and activities the IRS is likely to be looking for. In addition, this guide may be a good introduction to new personnel, or a resource for seasoned financial officers, with respect to dealings with the IRS. You can obtain a copy of the guide from us by calling any one of the attorneys listed above, or a member of our Tax Practice Group.

A Reasonable Interpretation of an Accounting Standard May Not Preclude a False Claims Charge

The False Claims Act (31 U.S.C. § 3729(a)(1)) prohibits any person from knowingly presenting a false or fraudulent claim for payment or approval by the Federal government. It comes into play under all government contracts. It is enforceable both by the government and in a *qui tam* action by a "whistle blower." In the latter, the "whistle blower" can obtain his or her attorney's fees, plus some percentage of the recovery. Hence, the development of the False Claims Act by the Federal courts is important to all procurement and construction contractors who deal with the Federal government.

In *U.S. ex rel. Oliver v. Parsons Co.,* 195 F.3d 457 (9th Cir. 1999), the whistle blower charged that the Contractor had improperly allocated direct costs into its overhead pool, in order to increase its overhead charges on performance of a particular

INSIDE

2001 Park Place • Suite 1400 • Birmingham, Alabama 35203 • (205) 521-8000
200 Clinton Avenue West • Suite 900 • Huntsville, Alabama 35801 • (256) 517-5100
801 Pennsylvania Avenue, N.W. • Suite 230 • Washington, D.C. 20004 • (202) 347-8893

contract. Apparently, the question regarding the Contractor's behavior revolved around interpretation of a Federal Cost Accounting Standard, which the Court, unfortunately, does not quote in its opinion. The Ninth Circuit (which oversees the Federal trial courts for Alaska, Arizona, California, Idaho, Montana, Nevada, Oregon, Washington, Guam, and Hawaii) reversed the trial court determination that the Contractor could not have been guilty of a "false" claim, because the Contractor's interpretation of the Standard was "reasonable." The Ninth Circuit ruled, instead, that "falseness" is determined by whether or not the Contractor was correct in its interpretation of the Cost Accounting Standard, an issue to be determined by the trial court. The Ninth Circuit held, further, that the reasonableness of the Contractor's interpretation *was* an issue as to its intent, which is the third prong for finding liability under the False Claims Act. The three prongs are (1) a claim was made by the Contractor to the United States, (2) the claim was false or fraudulent, and (3) the defendant knew the claim was false or fraudulent. As to the third prong, the reasonableness of the Contractor's interpretation is relevant, but not as to the second prong, according to this Court.

While this case appears to be a departure from what many construction and procurement lawyers have thought to be the proper reading of the False Claims Act, two things should be kept in mind: (A) the "reasonableness" of interpretation of a Regulation is still highly relevant, and it likely will defeat the "knowledge" requirement under the Act and (B) the Ninth Circuit was very clear that its holding regarding "reasonableness" applied to statutes or regulations, *not* to reasonable interpretations of contractual clauses.

There was no finding on liability in the particular case; instead the Ninth Circuit remanded the case for further proceedings as to the proper interpretation of the Standard, with, if necessary, yet further proceedings as to the "knowledge" requirement. The case emphasizes the importance that management should place upon careful attention to appropriate procedures in reviewing and submitting claims, including bills for services rendered, to the Federal government.

Parent Corporation May Not Be Liable for Subsidiary's Environmental Clean-up Costs

The Federal Sixth Circuit Court of Appeals (this is the Federal court which hears appeals from the Federal trial courts in Kentucky, Michigan, Ohio, and Tennessee) has found that a parent corporation was not liable for its subsidiary's clean-up costs imposed as a result of an EPA order under CERCLA (the "Superfund" act). The Court furthermore found that the parent corporation could not be found liable as a successor corporation, by virtue of its purchase of the subsidiary's assets.

IBC purchased all of the outstanding stock of Chemwood (such that Chemwood became IBC's subsidiary), and IBC purchased, at the same time (1979) some (but not all) of Chemwood's assets. Chemwood had been manufacturing wood preservatives at a site in Tennessee, and had stopped in 1976. Chemwood continued some operations after 1976, but it ceased operations altogether in 1988. When Superfund liability was imposed on Chemwood in 1992, it still had assets, but not enough to satisfy its Superfund liability. Its assets were depleted in 1995.

In response to Chemwood's insolvency, the plaintiffs attempted to hold IBC liable on two theories: (a) successor liability as the purchaser of Chemwood's assets and (b) parent company liability as the owner of Chemwood's stock. The Circuit Court agreed with the District Court's decision that IBC was *not* liable under *either* theory. Most notably, the Circuit Court applied the law of Tennessee to the question, rather than developing the notion of a "Federal common law" for Superfund cases.

This is an important case during this period of mergers and acquisitions, and it provides some predictability to a significant question. The case must be consulted for the nuances of Tennessee law which exonerated IBC. Unfortunately, the Sixth Circuit has indicated that the case has only limited precedential value. The Court's decision may be consulted at 1999 U.S. App. Lexis 15140 (July 1, 1999).

CGL Coverage for Contractual Liability

Reversing over 40 years of decisional law, the California Supreme Court interpreted the words "legally obligated to pay as damages" of a Commercial General Liability Policy to include contractual liability for property damages. In *Vandenberg v. Superior Court*, 982 P.2d 229, 88 Cal. Rptr. 2d 366, 21 Cal. 4th 815 (1999), the California Supreme Court re-visited the original decisions in this area and found that prior interpretations of this policy language had been reached without regard to traditional principles that govern the interpretation of insurance contracts. The California Supreme Court found that the insurers in this insurance coverage case could not avoid coverage solely on the grounds that the damages assessed against the insured in the underlying case had been based upon a contract theory of liability instead of a tort theory.

The liability insurers had denied coverage because the insured's liability was based on breach of a contract–a lease agreement. In arbitration, the insured had been held liable for clean up costs and damages associated with pollution from the insured's underground storage tanks at an automotive sales and service facility that the insured operated. The arbitrator determined that the pollution was not sudden and accidental and that the landlord was entitled to recover $4,000,000 because of the contamination of the property from the insured's improper installation, maintenance and use of the underground storage tanks.

The parties in the underlying arbitration had settled all claims except those claims based on the theory that the contamination constituted a breach of the lease agreements. Thus, all non-contractual claims had been specifically released in advance of the arbitrator's award and the ensuing coverage litigation.

Nonetheless, the California Supreme Court determined that the policy terms "legally obligated to pay as damages" in the context of a property damage claim included both damages stemming from contract liability and tort liability.

The California Court of Appeals has repeated and explained this holding in a later decision, *Certain Underwriters at Lloyd's London v. Superior Court*, 89 Cal. Rptr. 2d 706, 75 Cal. App. 4th 1038 (Court of Appeal, Second District, Division 3, California Oct. 25, 1999, as modified Oct. 27, 1999). In a declaratory judgment action over coverage obligations, the California Court of Appeals explained that the *Vandenberg* decision did not require an insurer to defend or indemnify where *administratively imposed cleanup costs* were not part of a suit and the insurer had no obligation to defend. Instead, the Court of Appeals explained that *Vandenberg* stands only for the proposition that the form of the underlying proceeding (whether sounding in contract or in tort) does not control coverage. Coverage is resolved by a determination of whether the acts of the insured created a risk covered under the policy which resulted in either bodily injury or property damage to another. If those requirements are satisfied, then it does not matter that the third party claimant's theory of recovery was based on contract rather than on tort. The Court of Appeals explained that the terms "legally obligated to pay as damages," at issue in *Vandenberg*, necessarily referred to "damages" ordered by a court of law.

In the construction industry, liability is often imposed by contract, without regard to whether the underlying conduct is a tort (*e.g.*, negligent conduct). Insureds should be mindful of this opinion if faced with contractual liability for events for which they were not negligent.

Georgia Courts Embrace "Pay-When-Paid" Clauses

A federal court applying Georgia law recently interpreted a pay-when-paid clause to be a condition precedent to the prime contractor's duty to pay the subcontractor. *Associated General Contractors v. Martin K. Eby Construction*, 67 F. Supp. 2d 1375 (M.D. Ga. 1999). Eby, the prime contractor, executed a subcontract with AMC to perform mechanical work for a correctional institution. Although AMC completed its work, Eby withheld final payment and retainage until it received final payment from the Owner. The subcontract provided that Eby would pay AMC the retainage and final payment after "the Contractor has been paid by the Owner for the Work set forth in the Subcontract." The court noted that this language was clear and unambiguous, establishing a condition precedent to AMC's entitlement to payment.

Pay-when-paid and pay-if-paid clauses attempt to shift the risk of the owner's nonpayment or insolvency to the subcontractor. Many courts narrowly construe such clauses, holding that they merely affect the timing of payment. If the clause is deemed ambiguous, the court may interpret it as merely establishing a reasonable time for payment. *DEC Elec., Inc. v. Raphael Constr. Corp.*, 558 So. 2d 427, 429 (Fla. 1990). For example, clauses stating that, "payment to the subcontractor will be due within 10 days after receiving payment from the owner," have been held to be ambiguous, therefore establishing only that the subcontractor be paid within a reasonable period of time. In contrast, a clause stating that, "payment from the owner is a condition precedent to the prime contractor's duty to pay subcontractor," is more likely to be enforceable. *See Harvey Concrete, Inc. v. Argo Construction & Supply, Co.*, 939 P.2d 811 (Ariz. Ct. App. 1997).

The *Eby* case is noteworthy, because the payment provision in *Eby* did not contain explicit language such as "condition precedent," "expressly," or "only." See also *Printz Services Corp. v. Main Electric Ltd.*, 949 P.2d 77 (Colo. Ct. App. 1997) (the clause, "provided like payment shall have been made by Owner to Contractor," was unambiguous and created an enforceable pay-when-paid provision).

Contractor Who Follows Plans and Specifications Found Not Liable for Damage to Building

A contractor who constructs a project in accordance with plans and specifications prepared by the owner or some other party should not be liable if a defect in those plans causes the project to fail at a later date. In Louisiana, this general rule is codified at Louisiana Revised Statutes § 9:2771, which provides "no contractor shall be liable for destruction or deterioration of or defects in any work constructed . . . if the destruction, deterioration, or other defect was due to any fault or insufficiency of the plans or specifications." This rule exists in other jurisdictions. Perhaps the best known example is the so-called "government contractor defense" which shields contractors supplying goods and services to the U.S. Government from liability for damages attributable to a defective government-supplied design. *See Boyle v. United Technologies Corp.*, 487 U.S. 500 (1988) (holding that government contractor who supplied a military helicopter was not liable for a pilot's death if the pilot's helicopter crashed due to a design defect attributable to Government).

The Louisiana statute was recently applied to protect a fire protection system contractor from liability when a chemical plant exploded in Louisiana. *In Marzell Ike Dumas v. Angus Chemical Co., Inc.*, 729 So. 2d 624 (La. App. 1999), the fire protection contractor installed the fire protection system in accordance with plans and specifications prepared by a third party. When a series of explosions at the plant caused eight deaths, hundreds of injuries, and more than $150,000,000 in property damage, a class-action lawsuit was filed against numerous parties involved in the design and construction of the plant, including the fire protection system contractor. The trial court dismissed the claims against the fire protection system contractor.

On appeal, the Louisiana Court of Appeals affirmed under § 9:2771. The Court explained that any contractor that adheres to plans and specifications furnished by a third party is relieved from liability for injuries or property damages caused by some defect in those plans and specifications.

The Court of Appeals cautioned contractors that they cannot always count on being shielded from liability. Where the contractor knew, or should have known, that the plans and specifications could create a hazard, then the contractor may be liable. While it is certainly not the contractor's job to analyze the safety of a design furnished by a third party, a court might conclude that the contractor cannot " shut its eyes" to apparent hazards arising from a defective design. If during the course of constructing plans and specifications prepared by a third party, the contractor determines that a safety-related defect may exist in the design, we recommend that the contractor notify the owner and designer so that one of them can take appropriate steps to address the hazard.

Freezing Assets of Foreign Corporation Made More Difficult by U.S. Supreme Court

As international construction projects become more widespread, U.S. contractors, owners, and investors may find themselves asserting claims against foreign companies. Collection of judgments against foreign companies can be difficult. To avoid the problems associated with enforcing judgments in foreign countries, some U.S. companies suing foreign defendants in the U.S. have sought injunctions to freeze the U.S. assets of the foreign defendants. These injunctions, called *Mareva* injunctions, permitted U.S. claimants to prevent foreign defendants from moving assets out of the United States before final judgment.

In a recent decision, however, the United States Supreme Court has restricted the power of U.S. District Court judges to issue *Mareva* injunctions. *See Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc.*, 119 S. Ct. 1961, 144 L. Ed. 2d 319 (1999). In this case, U.S. investors sued a large Mexican construction company, alleging default on $75 million in notes. The investors sought a *Mareva* injunction to stop the Mexican contractor from selling certain assets to satisfy claims asserted by Mexican creditors. The Mexican contractor's sale of assets, without the injunction, would have left few assets to satisfy the claim asserted by the U.S. investors.

Reversing a decision of the Second Circuit Court of Appeals, the U.S. Supreme Court held that a *Mareva* injunction could not be issued to stop the Mexican contractor from selling its assets. In a 5-4 decision, the Supreme Court explained that the *Mareva* injunction remedy was not available from the English Court of Chancery at the time of the U.S. Constitution in 1787 or at the time of the Judiciary Act of 1789. Therefore, it is not a remedy available to a U.S. District Court today. Indeed, prejudgment injunctions were unavailable until the *Mareva* decision in 1975, and that decision has been characterized as a significant departure from established legal principles.

The Court apparently was concerned that *Mareva* injunctions could be abused by federal courts at the expense of foreign defendants. The decision sends a message to federal court judges that injunctive relief must be tailored carefully to the claims at issue. It appears that a *Mareva* injunction might be available, however, if the claimant has a lien or other legally cognizable interest in the assets at issue. For example, a contractor with a lien against U.S. assets held by foreign corporation might obtain a *Mareva* injunction stopping the foreign company from selling the assets, even under this recent decision.

Contract Drafting: Indemnity Clauses

Most construction contracts contain an indemnity clause, the breadth of which varies considerably. These clauses are such that Y agrees to indemnify X against liability for injuries arising from Y's construction activity, even where X is negligent, in whole or in part. The variations on the clause are enormous, and themselves require considerable attention. A few states have enacted laws prohibiting enforcement of, or invalidating, indemnity clauses in the construction context. Georgia is one of those states, but read on, as the contract manager often instructs others in the company.

In *Federal Paperboard Co., Inc. v. Harbert-Yeargin, Inc.*, 53 F. Supp. 2d 1361 (N.D. Ga. 1999), a trial court in Georgia was faced with the conflict between an indemnity clause and Georgia's prohibition against indemnity clauses. The owner owned and operated a paper mill in Georgia. The contractor performed a turn-around in 1994. Contractor's employee died in the rotating shaft of the paper machine, during the turn-around, and his widow sued owner. Owner demanded indemnity from contractor, who refused not only liability but also participation in defense of the claim. The suit was settled by owner for nearly $800,000. Owner then sued contractor for indemnity. Contractor argued that owner had a complete defense to the widow's claim, such that, under Georgia law, no indemnity claim could be made against contractor. Furthermore, contractor argued that Georgia's law striking down indemnity in construction contracts for "sole negligence" of the indemnified party made the contract indemnity clause unenforceable. The court, in a painstakingly meticulous opinion, agreed that the indemnification clause was illegal under the Georgia statute, but held the clause nevertheless enforceable because the contract contained a clause (which most construction contracts contain) requiring contractor to purchase "contractual liability" insurance. Because contractor had such insurance, the court reasoned that the illegal clause was nevertheless enforceable under the insuring agreement clause, because the risk was in fact shifted to an insurance company, not to the contractor.

This case should be brought to the attention of your contracts department or your outside lawyer. Of interest, in addition, is the fact that the court found that certain defenses which the contractor could have raised with respect to the settlement between the owner and the widow were waived when the contractor refused to participate in the trial or to intervene when settlement was discussed.

Many states have specific statutes addressing indemnity clauses and their enforceability. Likewise, many other states have statutes addressing the enforceability of limitations of liability clauses, which are similar to but different from indemnity clauses. When one is entering into a contract in a particular jurisdiction, it would be wise to consult your lawyer regarding these clauses, as well as other common clauses such as "no damages for delay," "attorneys fee" clauses, and notice clauses.

Prime Contractor Who Was Not Delayed May Bring Suit on Behalf of Subcontractor for Delay Damages

The United States Court of Appeals for the Federal Circuit recently held that a prime contractor on a federal project may bring suit on behalf of its subcontractor to recover the subcontractor's delay damages, even when the prime contractor has not suffered delay. *E.R. Mitchell Construction, Co. v. Danzig*, 175 F.3d 1369 (1999). In *Mitchell*, the subcontractor was delayed for 60 days while the government resolved contract defects. The government paid the subcontractor additional direct costs, but rejected the subcontractor's claim for delay damages, because the prime contractor finished the project early. The government argued that a prime contractor cannot bring a delay claim on behalf of its subcontractor when the prime contractor is not delayed.

Under the *Severin* doctrine, the federal government is not liable for costs incurred by subcontractors if it can show that the general contractor is not liable to the subcontractor for those costs. If the government fails to meet this burden, the claims of the subcontractor are treated as though they are the claims of the prime contractor. The government failed to meet its burden in *Mitchell*.

Mitchell is interesting because, although the *Severin* doctrine shifts the burden to the government, the government attempted to avoid the subcontractor's pass-through claim by showing that the prime contractor finished the project on time. In rejecting the government's argument, the Court of Appeals held that prime contractors may bring claims on behalf of their subcontractors, provided the government fails to demonstrate that the prime contractor cannot be liable for the subcontractor's damages. *Mitchell* does, however, suggest caution.

The *Mitchell* court stated that its decision was based on the fact that the government had approved the subcontractor's schedule. The court specifically refused to address the situation where the government does not have knowledge of the subcontractor's schedule obligations. This qualification may preserve an argument that the government is not liable for the costs of a subcontractor's unabsorbed overhead where the prime contractor is not delayed and where the government was not aware of the subcontractor's schedule.

Mitchell additionally illustrates what appears to be a trend in the courts and boards to analyze subcontractor delays independently of delays to the prime contractor or delays to the project, in general. Thus, in analyzing a subcontractor's delay claim, a court or board may require an independent schedule analysis showing the particular impact or delay to the subcontractor.

Consolidation Authorized Only If Arbitration Clause Allows

Arbitration can be less efficient than litigation in a multi-party dispute because most arbitration clauses and arbitration rules do not provide for consolidation of related cases. The rules in litigation provide for consolidation of related cases "when actions involving a common question of law or fact are pending before the Court." Fed. R. Civ. P. Rule 42(a). In *Glencore, Ltd. v. Schnitzer Steel Products Co.*, 189 F.3d 264, 267 (2d Cir. 1999), the Second Circuit Court of Appeals for New York, Vermont and Connecticut confirmed that there is no source of authority in either the Federal Arbitration Act or the Federal Rules of Civil Procedure for a trial court to order consolidation of arbitration proceedings. Such authority must be granted by the arbitration clauses in the various contracts. Because arbitration is purely a creature of contract, the Court reasoned that arbitrations are not "actions . . . pending before the court and, thus, are not subject to consolidation under the Federal Rules of Civil Procedure."

Most arbitration clauses do not address the issue of consolidation of proceedings or joinder of parties. The Construction Industry Disputes Resolution Procedures of the American Arbitration Association do not provide a procedural mechanism for consolidation of arbitrations in the absence of a contractual agreement by all the parties. In 1995, the Construction ADR Task Force of the AAA considered a rule authorizing arbitrators to consolidate related arbitrations, but the proposed rule was rejected in favor of leaving the parties to decide for themselves, in their arbitration clauses, whether they want consolidation.

While consolidation of arbitrations may conserve cost of duplicative proceedings and reduce the risk of inconsistent decisions, it is not always tactically advantageous to consolidate proceedings. Contractors should be aware that some arbitration clauses can give the contractor the sole discretion to consolidate or join related arbitrations. With proper coordination of arbitration clauses in contracts, all or part of disputes among contracting parties can be consolidated into a single hearing.

Lawyers' Activities

January 11, 2000	Nick Gaede presented "Legal Eagles - Providing Legal Service in the 21st Century" to New Horizons group and UAB.
January 27, 2000	Mabry Rogers and Wally Sears participated in the ABA Forum on Construction conference on "Insuring Projects with Fragmented Responsibility." Their discussion was on the Role of the Surety.
February 27, 2000	Ed Cassady, one of our Construction and Procurement Law Partners, joins BE&K as General Counsel. Congratulations to both.
March 9, 2000	Wally Sears, Mabry Rogers, Jim Archibald, and Joel Brown will participate in a Lorman seminar "Construction Contracting for Public Entities."
May 4, 2000	Wally Sears will present "Handling Construction Risks" at a program provided by Practising Law Institute.
June 7-9, 2000	Forbes Conference - *Far East and South America Infrastructure* - We invite any client's interest in involvement with this program.
July 28, 2000	Axel Bolvig and Wally Sears will present a seminar on design-build at the annual convention of the Alabama chapter of Associated Builders & Contractors.

Disclaimer and Copyright Information

The lawyers at Bradley Arant Rose & White LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications.

This newsletter is a periodic publication of Bradley Arant Rose & White LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact your lawyer or any of the lawyers in our group whose names, telephone numbers and e-mail addresses are listed below; or visit our web page at www.barw.com.

A. H. Gaede, Jr. . . . . (205) 521-8323 . . . . ngaede@barw.com
Stanley D. Bynum . . . . (205) 521-8000 . . . . sbynum@barw.com
E. Mabry Rogers . . . . (205) 521-8225 . . . . mrogers@barw.com
Gary C. Huckaby (Huntsville) . . . . (256) 517-8337 . . . . ghuckaby@barw.com
Andrew J. Noble, III . . . . (205) 521-8342 . . . . anoble@barw.com
Walter J. Sears . . . . (205) 521-8202 . . . . wsears@barw.com
H. Harold Stephens (Huntsville) . . . . (256) 517-5130 . . . . hstephens@barw.com
Michael D. McKibben . . . . (205) 521-8421 . . . . mmckibben@barw.com
David G. Hymer . . . . (205) 521-8289 . . . . dhymer@barw.com
Axel Bolvig, III . . . . (205) 521-8337 . . . . abolvig@barw.com
J. David Pugh . . . . (205) 521-8314 . . . . dpugh@barw.com
James F. Archibald . . . . (205) 521-8520 . . . . jarchibald@barw.com
Douglas E. Eckert . . . . (205) 521-8519 . . . . deckert@barw.com
Rodney L. Moss . . . . (205) 521-8251 . . . . rmoss@barw.com
Arlan D. Lewis . . . . (205) 521-8131 . . . . alewis@barw.com
Joel E. Brown . . . . (205) 521-8416 . . . . jbrown@barw.com
Donna M. Crowe . . . . (205) 521-8418 . . . . dcrowe@barw.com

Note: The following language is required pursuant to Rule 7.2 Alabama Rules of Professional Conduct: *No representation is made that the quality of the legal services to be performed is greater than the quality of the legal services performed by other lawyers.*

BRADLEY ARANT ROSE & WHITE LLP Second Quarter 2000

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

A. H. GAEDE, JR.
STANLEY D. BYNUM
E. MABRY ROGERS
GARY C. HUCKABY (HUNTSVILLE)
ANDREW J. NOBLE, III
WALTER J. SEARS, III
H. HAROLD STEPHENS (HUNTSVILLE)
MICHAEL D. MCKIBBEN
DAVID G. HYMER
AXEL BOLVIG, III
J. DAVID PUGH
JAMES F. ARCHIBALD, III
DOUGLAS E. ECKERT
RODNEY L. MOSS
ARLAN D. LEWIS
JOEL E. BROWN
DONNA M. CROWE
STACEY A. THURMAN

Alabama Refuses to Enforce Arbitration Clause Because Contract Did Not "Substantially Affect" Interstate Commerce

In *Sisters of the Visitation v. Cochran Plastering Co., Inc.*, 2000 WL 264243, the Alabama Supreme Court held that an arbitration clause in a construction contract was unenforceable because the contract did not "substantially affect" interstate commerce. This decision is another in a long series of decisions in which this state Supreme Court has struggled with enforcement of arbitration clauses.

In *Sisters of the Visitation*, a Catholic religious order that owned a monastery in Mobile, Alabama undertook a restoration project involving repairs to its chapel. It entered into agreements with several contractors including Cochran Plastering Company, an Alabama company. Under the contract, Cochran agreed to repair damage to the plaster ceilings and walls of the chapel. The contract between the Sisters and Cochran included an arbitration clause. Pursuant to the arbitration clause, the Sisters filed a demand for arbitration claiming that Cochran had negligently damaged certain paintings in the chapel and had failed to complete its work. The Sisters made claim for $50,000 for completion of the repair work and $525,000 for restoration of paintings that Cochran allegedly damaged.

Cochran filed an action in circuit court seeking to enjoin the arbitration proceeding. Cochran claimed that the arbitration clause was not enforceable under the Federal Arbitration Act, because the contract did not involve interstate commerce, and was also not enforceable under § 8-1-41(3) of the Code of Alabama, prohibiting specific enforcement of pre-dispute arbitration agreements.

In deciding *Sisters of the Visitation*, the Alabama Supreme Court discussed the decision of the United States Supreme Court in *Allied-Bruce Terminix v. Dobson*, 513 U.S. 265 (1995). In *Allied-Bruce*, the United States Supreme Court overturned an Alabama Supreme Court decision refusing to enforce an arbitration clause in a pest extermination contract. *Allied-Bruce* held that Congress intended for the Federal Arbitration Act to reach expansively, as far as the Commerce Clause of the United States Constitution will allow. Arbitration clauses in contracts governed by the Federal Arbitration Act are specifically enforceable. Although the Alabama Supreme Court considered *Allied-Bruce*, the court also discussed and relied on *United States v. Lopez*, 514 U.S. 549 (1995), in which the United States Supreme Court struck down an act of Congress (the Gun-Free School Zones Act) on the basis that the Act exceeded the authority of Congress under the Commerce Clause of the Constitution. The court focused on language in the *Lopez* decision that activities must "substantially affect" interstate commerce to fall within the reach of the Commerce Clause. As a result, the Alabama Supreme Court adopted the requirement that the underlying contract "substantially affect" interstate commerce before it will enforce an arbitration clause under the Federal Arbitration Act. It declined to adopt the less stringent requirement that the contract merely "affect" or "involve" interstate commerce.

To determine what transactions "substantially affect" interstate commerce, the Alabama Supreme Court established a test to consider the following factors: (1) Citizenship of the parties; (2) Whether tools or equipment obtained specifically to perform the contract moved in interstate commerce; (3) Whether labor or materials obtained specifically to perform the contract

IN THIS ISSUE

moved in interstate commerce, and if so, the allocable share of local vs. interstate labor and materials; (4) Whether the object of the contract is capable of subsequent movement across state lines; and (5) Whether the contract is sufficiently separate from other contracts subject to the Federal Arbitration Act, such that not enforcing the arbitration clause would not substantially disrupt activities that Congress intended to be subject to the Act. Applying the five factor test, the Alabama Supreme Court held that the contract did not substantially affect interstate commerce and that the Federal Arbitration Act was, therefore, not applicable to the contract. Accordingly, the court ruled that § 8-1-41(3) was applicable and controlling.

Several justices dissented from the majority opinion. In particular, Chief Justice Hooper noted that Section 2 of the Federal Arbitration Act provides"[a] written provision in . . . a contract evidencing a transaction <u>involving</u> commerce to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable and enforceable. . . ." Moreover, Hooper emphasized that *Allied-Bruce* directed that the FAA be applied in the broadest possible way. Hooper also questioned the majority's reliance upon *Lopez* as precedent, noting that *Lopez* involved application of a criminal statute and did not arise from a commercial dispute.

An application for rehearing of this case is pending before the Alabama Supreme Court. In the meantime, any party seeking to enforce an arbitration provision in the State of Alabama should give careful attention to whether its transaction "substantially affects" interstate commerce and should consider the five-part standard articulated by the Alabama Supreme Court. By contrast, any party in Alabama seeking to avoid enforcement of an arbitration clause may now find a defense available if the underlying transaction does not have a substantial connection with or impact upon interstate commerce.

More broadly, as we have pointed out in earlier issues, courts nationwide are troubled by the enforcement of arbitration clauses, particularly in the context of consumer transactions.

Sidecasting in Wetlands Held Addition of a Pollutant For Clean Water Act Purposes

Contractors digging in a wetlands have new cause for concern. In *United States v. Deaton*, No. 98-2256 and 98-2370, 2000 U.S. App. LEXIS 6298 (4th Cir., Apr. 7, 2000), the Fourth Circuit Court of Appeals (which covers the states of Virginia, West Virginia, Maryland, North Carolina, and South Carolina) handed contractors and developers a significant defeat by holding that sidecasting in a jurisdictional wetlands is the discharge of a pollutant under the Clean Water Act.

"Sidecasting" is a construction term describing the deposit of dredged or excavated material from a wetland back into the same wetland. In the *Deaton* case, the contractor used a back hoe, a front-end truck loader and a bulldozer to dig a 1,240 foot ditch. As dirt was excavated from the ditch, it was piled on either side of the ditch.

The problem for the contractor and developer was that the ditch happened to pass through a "wetlands," and wetlands are regulated under the Clean Water Act. In pertinent part, the Clean Water Act prohibits the discharge, without a permit, of any "pollutant" into navigable waters (including wetlands).

The *Deaton* defendants argued that because the definition of "pollutant" in the Clean Water Act (33 U.S.C. § 1362(12)) includes the word "addition," sidecast dirt is not a pollutant. As the Court summarized defendants' position: "[b]ecause sidecasting results in no net increase in the amount of material present in the wetland . . . it does not involve the 'addition' (or discharge) of a pollutant." *Id.* at *11.

On appeal, the Fourth Circuit flatly rejected defendants' argument, reasoning that once the soil was excavated from the wetlands it became a new material and a pollutant. Thus, when the soil was placed on the side of the ditch, a pollutant was being "added" to the wetlands.

The moral of *Deaton* is simple: developers, owners or others working in a wetlands should consider soil removed from the ground as a "pollutant" for Clean Water Act purposes and treat it accordingly. See the next article for a complication.

Corps of Engineers Promulgates New Nationwide Permit Regulations Regarding Wetlands Activities

Developers and contractors working in wetlands should be careful to review new regulations published by the United States Army Corps of Engineers.

The Clean Water Act requires that parties engaging in activities which will result in a discharge of dredged or fill material into "waters of the United States" (including wetlands), under certain circumstances, obtain a permit before commencing such activities. The Corps issues two basic types of wetlands permits: general permits (also referred to as Nationwide Permits or NWPs) and individual permits.

Since its initial issuance in 1977, NWP 26 has been something of a catch-all permit, authorizing the discharge of dredged or fill material into headwaters and isolated waters, provided the discharge does not result in the loss of greater than 3 acres of waters of the United States or 500 linear feet of stream bed.

On March 9, 2000, the Corps adopted regulations which materially alter the current NWP program. Specifically, the Corps adopted five new NWPs to replace NWP 26, modified six existing NWPs, and either adopted or amended a number of General Conditions (which apply to all or certain specified NWPs).

The replacement of NWP 26 with five new NWPs is significant because it represents a fundamental shift in the Corps' approach to the NWP program. Whereas NWP 26 had operated as a catch-all, the new NWPs are "activity specific" permits which are designed to impose additional limitations on those engaged in golf course construction, playing field construction, utility line construction, aggregate and hard rock mining, and drainage ditch construction. Thus, the burden is now on the developer or contractor to identify which specific NWP may apply.

Those who previously relied upon the catch-all NWP 26 will now be required to meet the more stringent requirements of the new NWP regulations. In some situations it may be better to apply for an individual permit.

Engineers and Other Professionals – OSHA's Unpaid Police Force?

A recent decision by the United States Court of Appeals for the Seventh Circuit (Illinois, Indiana, Wisconsin) limits OSHA's ability to subject engineers and other professionals to OSHA's construction standards. See *CH2M Hill, Inc. v. Alexis Herman and OSHA*, 192 F.3d 711 (7th Cir. 1999).

The Milwaukee Metropolitan Sewerage District undertook a $2.2 billion program for construction of eighty miles of sewer tunnels. CH2M Hill served as the lead engineering consulting firm on the Project. When an explosion in one of the tunnels, resulting from an unexpectedly high concentration of methane gas, killed three men, OSHA issued citations to the tunnel contractor and to CH2M Hill. CH2M Hill appealed. After an administrative law judge agreed with CH2M Hill that it was not "engaged in construction" and therefore not subject to OSHA's regulation, the OSHA Review Commission reversed, and CH2M Hill again appealed. On appeal, the Seventh Circuit Court of Appeals found in favor of CH2M Hill, concluding that on the facts presented, CH2M Hill was not "engaged in construction" and therefore was not subject to OSHA regulations.

Previously, the OSHA Review Commission had taken the position that professionals only were to comply with OSHA construction standards if they exercise "substantial supervision over actual construction." As part of its decision to impose sanctions on CH2M Hill, the Commission adopted a new test – that a professional firm will "engage in construction work" if it: 1) possesses broad responsibilities in relation to construction activities, including both contractual and *de facto* authority directly to the work of the trade contractors, and 2) is directly and substantially engaged in activities that are integrally connected with safety issues notwithstanding contract language expressly disclaiming safety responsibility.

CH2M Hill argued that the new test was too broad and contrary to existing law. In deciding the case, the court suggested that the new test may not be appropriate under the law, but it did not directly decide that issue because it found that CH2M Hill did not even meet the new test, and therefore was not subject to the construction standards. The Court did note, however, that it was disturbed by the Commission's decision to ignore contract language in evaluating how the regulations would apply. The Court stated clearly that unless the contract language is merely perfunctory, the contractual bargain of the parties should be upheld.

This limits OSHA's ability to force design professionals to be unpaid OSHA policemen on a project. Design professionals should ensure that responsibilities are clearly spelled out in their contracts.

Owner Suffers Consequences of Ordering Inadequate Fix, Despite Contractor's Warning

It doesn't always pay to take the easy way out, particularly in the face of an informed opinion that it's going to cost you later on. In *Pike v. Howell Building Supply Co., Inc.*, 748 So. 2d 710 (Miss. 1999), the Supreme Court of Mississippi denied an owner's claim for damage resulting from a subsurface condition where the contractor notified the owner of the condition and the owner instructed the contractor to proceed without adequately remedying the defect.

The owner hired a general contractor for the construction of a convenience store. The construction and installation of the gas tanks and pumps was performed by a separate prime contractor. When the time came to pour the concrete directly above the gas tanks, the general contractor informed the owner that the dirt placed around the tanks could not be sufficiently compacted to provide adequate support for the concrete. The owner asked if extra steel in the concrete would make any difference. The contractor stated that adding extra steel would not hurt, but that it would not be sufficient to prevent failure. Nevertheless, the owner directed the contractor to add extra steel and pour the concrete. The concrete ultimately collapsed and caused a gas line to rupture. The owner filed suit against the contractor, its surety, and the tank installer. The jury returned a verdict in favor of the contractor and the Court of Appeals reversed.

On appeal, the Mississippi Supreme Court stated that a contractor who knows or should know of a defective subsurface condition does not perform his contractual obligations in a workmanlike manner if he fails to notify the owner of the existence of the condition. However, in this case, the court found that the contractor warned the owner of the soil condition and that the remedy suggested and implemented by the owner would not support the concrete. The court's opinion does not indicate whether the contractor notified the owner orally or in writing, but it appears that at least some of the discussion was oral. Nevertheless, it was held that the duty to notify the owner was fulfilled.

The court held that the owner's instruction to the contractor to proceed, with knowledge that the remedy was likely inadequate, constituted a waiver of any defect in the pouring of the concrete caused by the insufficient fill and compaction of the underlying soil. Thus, the owner failed to prove that the contract was breached or that the contractor was negligent. Accordingly, the court reinstated the trial court's judgment in favor of the contractor.

This is the proper result, but we hasten to add that the court might have reached a different result had the plaintiff been an injured third party.

What Happens If Your Insurance Program Does Not Match up with the Contract Documents?

The importance of carefully matching your insurance coverage to the insurance requirements of your contract is highlighted by *Doherty v. Davy Songer, Inc.*, 195 F.3d 919 (7th Cir. 1999) (Illinois, Indiana, Wisconsin). In this case, the subcontract required the subcontractor to "maintain . . . insurance coverage . . . insuring . . . Subcontractor's, Contractor's and/or Contractor's agents,' servants' and employees' liability to pay for any bodily injuries or death received or sustained by any person or persons, including employees of Contractor, in any manner caused by, arising from, incident to, connected with, or growing out of the work governed by this Agreement."

While Doherty, one of the subcontractor's employees, was working on the project, two of the general contractor's employees negligently dropped a cylinder onto Doherty's hand, which ultimately led to amputation of one of his fingers. Doherty brought suit against the contractor and the two negligent employees. They turned to the subcontractor and demanded insurance coverage.

The subcontractor had obtained insurance that covered liability arising out of its work; so, it turned to its insurance company for help. However, the subcontractor's insurance company denied coverage. It said that the damages arose out of the negligence of the general contractors' employees, not out of the subcontractor's work. In response, the general contractor brought the subcontractor into the lawsuit and claimed that the subcontractor had breached the subcontract by not providing the necessary insurance coverage. The general contractor argued that the subcontract language quoted above was broad enough to require coverage of the negligent acts of his own employees. The subcontractor and his insurance company took the position that the contract language required insurance coverage only for work done by the subcontractor under the subcontract and, therefore, since the accident was caused by employees of the general contractor, there was no obligation on the part of the subcontractor to provide insurance coverage.

The general contractor's insurance company settled with Doherty and paid him $225,000. The remaining dispute was that of the general contractor and its insurance company against the subcontractor. The court held that the language in the subcontract that required coverage for injuries, "in any manner caused by, arising from, incident to, connected with, or growing out of the work governed by this Agreement" extended the liability coverage beyond what injuries the subcontractor might cause to include any injuries related to the subcontractor or to the subcontractor's work. The court reasoned that since the injury negligently caused by the general contractor's employees affected an employee of the subcontractor who, at the time, was employed in performing the work of the subcontract, then the subcontractor had a contractual obligation to provide insurance coverage for this injury. As a result, the court held that the subcontractor breached its subcontract because it failed to purchase the required insurance.

The subcontractor argued that even if it did breach the subcontract, the contractor suffered no damages because the contractor's insurance company paid for the settlement and because the contractor's insurance policy recited that it was the "primary" policy. The court observed that parties may shift, by contract, their burdens of risk and that, when they do so, they affect the obligations of their insurance companies. The subcontract created just such a reallocation of risk. The subcontractor's insurance was intended by the parties to cover the risk of Doherty's injuries and the resulting settlement costs. Therefore, the court ruled that the proper measure of damages for the general contractor was the amount that would have been due under the policy that the subcontractor should have obtained, namely, the cost of settlement with Doherty and related expenses.

It is important that contractors and subcontractors confirm with their risk managers or insurance agents that their insurance coverage matches what is required by the contract documents. Otherwise, you could end up being your own insurance company, like the subcontractor in this case.

Mississippi Supreme Court Refuses to Allow Change Order "Catch-22"

In *Sentinel Indus. Contracting Corp. v. Kimmins Indus. Service Corp.*, 743 So. 2d 954 (Miss. 1999), the Mississippi Supreme Court held that a subcontractor could recover for extra work without written change orders even though Mississippi law does not recognize "constructive change orders." This case arose out of a series of contracts for the dismantling of an ammonia plant for shipment to and reassembly in Pakistan. The owner hired Sentinel as general contractor. Kimmins was a subcontractor to Sentinel.

After the project was completed, Kimmins filed suit against the owner, Sentinel, and Sentinel's sureties to recover for extra work. The change order provision in the subcontract between Kimmins and Sentinel required Kimmins to obtain written approval from Sentinel prior to performing any extra work. Relying on Mississippi law that change order provisions are upheld and will not be judicially altered or deleted, Sentinel argued that Kimmins was barred from recovery because it failed to obtain written change orders. However, Article 7 of the prime contract, incorporated by reference into Kimmins' subcontract, provided that Kimmins was to carry out instructions and directives, "[n]otwithstanding that a change order has not been issued." Accordingly, Kimmins argued that, under the prime contract, it had no choice but to perform the extra work without a change order upon Sentinel's direction, particularly since Sentinel denied all 14 written change order requests submitted for the work.

The court found that Sentinel engaged in a "persistent pattern of conduct" in requiring Kimmins to perform extra work, and also failed to act in good faith when it refused to issue change orders. The court held that through Article 7 of the prime contract, Sentinel represented to Kimmins that it should continue work notwithstanding the absence of a change order. Therefore, Sentinel was estopped from asserting that Kimmins could not be paid for extra work due to lack of change orders.

It should be noted that this case does not import the concept of "constructive change orders" into Mississippi law. The court explicitly stated that the trial court erred in instructing the jury on "constructive change orders" because that concept is not recognized in Mississippi law. Generally, under Mississippi law, a contractor who proceeds with work without procuring a written change order proceeds at his own peril. *Id.* at 963. In this case, a key factor in the court's decision was the fact that Kimmins actually submitted change order requests required by the contract, but was placed in an impossible position when those requests were unreasonably denied. Thus, if Kimmins had not submitted change order requests, it may have been denied recovery.

Supreme Court Ruling That FAA Venue Provisions Are Permissive Launches Race to the Courthouse

In *Cortez Byrd Chips, Inc. v. Bill Harbert Const. Co.*, 2000 WL 289572 (U.S. March 21, 2000), Harbert contracted to build a wood chip mill for Cortez in Mississippi. After a dispute arose, the parties conducted arbitration in Birmingham, Alabama. The arbitration panel issued an award in favor of Harbert in December 1997. In January 1998, Cortez filed suit in the Southern District of Mississippi (the district within which the construction contract was performed) seeking to vacate or modify the award. Seven days later, Harbert filed a motion to confirm the award in the Northern District of Alabama. The Northern District of Alabama denied Cortez's motion to dismiss, stay or transfer the Alabama action, and the Court of Appeals for the Eleventh Circuit affirmed.

The Supreme Court reversed and held that the venue provisions in the Federal Arbitration Act ("FAA") are permissive, not mandatory, and thereby allow a party to file a motion to confirm, vacate, or modify an arbitration award either in the district where the award was made, or in any district proper under 28 U.S.C. § 1391, the general venue statute. Therefore, under 28 U.S.C. § 1391(a)(2), venue in the Southern District of Mississippi was proper, because the suit was based on diversity of citizenship and a substantial part of the events giving rise to the claim occurred in the Southern District of Mississippi. In reaching its decision, the Supreme Court acknowledged that under 28 U.S.C. § 1391(a)(1), venue in the Northern District of Alabama also was proper, but that in deference to the court of first filing, the Alabama court should have considered refraining from exercising jurisdiction.

Thus, the primary effect of the decision in *Cortez* is that parties to an arbitration proceeding will be forced to race to the courthouse to be the first to file a motion to confirm or vacate an arbitration award, in order to "forum shop." However, winning the first to file race will not necessarily decide venue. The venue chosen by the first to file, although proper under 28 U.S.C. § 1391, may still be subject to change pursuant to 28 U.S.C. § 1404(a) and the doctrine of *forum non conveniens*.

One way to avoid the race to the courthouse and subsequent litigation over convenient venue is for parties to include in their arbitration agreements a venue selection clause. Part of the Supreme Court's rationale for holding that venue was permissive under the FAA was its recognition that § 9 of the FAA authorizes the enforcement of an agreement between the parties as to the forum in which an arbitration award is to be confirmed. The Court observed that if the FAA required confirmation of an award only in the district of the arbitration, a proceeding to confirm an award commenced in the forum previously agreed upon by the parties (but outside the district of the arbitration) would be stayed if a party objected, and would therefore defeat the FAA's "statutory policy of rapid and unobstructed enforcement of arbitration agreements." The Supreme Court thereby endorsed pre-selection by the parties of the forum in which an arbitration award is to be confirmed.

Parties that pre-select a specific forum for confirmation of an arbitration award may do so freely. The Supreme Court, in *Stewart Org'n, Inc. v. Ricoh Corp.,* 487 U.S. 22 (1988), explained that venue for federal court proceedings is permissive and subject to contractual agreement.

Wrinkle in the Recovery of Field Overhead

In *M.A. Mortenson,* ASBCA Nos. 40750, 40751, 40752, 98-1 BCA ¶ 29, 658, *aff'g on recon.* 97-1 BCA ¶ 28,623, the ASBCA appeared to apply FAR 31.203(b) to disallow a contractor's recovery of field overhead on a percentage markup basis, where there was no delay, and left in place a prior recovery based on a *per diem* basis, when there was a delay. In its first application of *Mortenson*, the ASBCA seems to have recognized a distinction in the FAR's that may provide an avenue for field overhead recovery when the calculation method applied by the government understates the amount otherwise allowed by the FAR's. *Caddell Constr. Co., Inc.,* ASBCA No. 49333 (December 20, 1999), *aff'g on recon.,* (March 29, 2000)

In late 1991, Caddell contracted with the Army Corps of Engineers to construct a wastewater treatment plant. The Corps notified Caddell, prior to the start of construction, that field overhead costs were not allowed in the pricing of change orders, unless the contract duration was extended by the change. Prior to that Project, the Corps consistently had allowed Caddell to recover field overhead as a percentage of cost or as a *per diem* cost.

During the project, the Corps allowed Caddell to recover field overhead on a *per diem* basis for suspensions of work involving schedule extensions. No compensable time extensions were granted as a result of changes to the work. Thus, the government paid no field overhead on over $2.3 million in changes to a $17 million project. At the end of the Project, Caddell submitted a claim for $210,000 of additional field overhead arising out of modifications issued under the "Changes" clause that did not involve a time extension. The Contracting Officer denied the claim, and Caddell appealed to the ASBCA. Not surprisingly, the Board held that *Mortenson*'s application of FAR 31.203(b) does not allow a contractor to recover field overhead on a percentage markup basis, when there was no delay, while leaving in place prior recovery based on a *per diem* basis, when there was a delay. The Board did not address what we view to be a valid distinction between field overhead paid for a time extension under the "Suspension of Work" clause, which cannot be calculated on a percentage basis because no direct costs are involved, and overhead related to changed work under the "Changes" clause.

On March 29, 2000, the Board issued a confusing, yet significant affirming opinion. In its Motion for Reconsideration, Caddell argued that the Board 1) erroneously applied FAR 31.203(b) to *per diem* overhead paid under the "Suspension of Work" clause and 2) erroneously assumed Caddell was seeking field overhead in excess of that which would have been allowed had the overhead been calculated solely on a percentage basis consistent with FAR 31.2.

The Board (including one of the judges on the *Mortenson* panel) seemed to go out of its way, however, to acknowledge that FAR 31.201-2(c) may allow a contractor to recoup the field overhead it would have billed through exclusive use of *either* a percentage basis or a *per diem* basis. Through an apparent mix-up in the evidentiary record, the Board determined that Caddell's claim was not for a sum certain calculated solely on a percentage basis and, consequently, concluded it did not have jurisdiction to decide the issue.

The ASBCA's holding in *Caddell* seems to recognize, albeit by abstention, a contractor's ability under the FAR's to apply either a percentage or daily rate to calculate field overhead in an end-of-project claim, so long as the contractor properly credits the overhead paid on changes during the project to avoid double recovery of the same cost pool. The validity of this field overhead calculation methodology, of course, could depend upon the flexibility that the government affords the contractor in pricing the overhead component of the changes during the negotiations and any reservation of rights in the changes.

In the wake of *Mortenson*, a technique contractors may use to insure that they are adequately compensated for the field overhead component of forward-priced changes is to negotiate separate field overhead cost pools for changes that affect price and changes that affect time. For a change that affects both price and time, both percentages or a percentage and a daily rate would apply. This approach may be difficult to convey to Contracting Officers and government auditors given their interpretation of *Mortenson*. For example, the DCAA Audit Manual states that the ASBCA held in *Mortenson* that "FAR 31.203, when applicable, prohibits more than one allocation method for recovery of job site/field overhead." Thus a contractor may want to consider an alteration to its accounting practices to apply field overhead consistent with *Mortenson*, such that field overhead is consistently accounted for one way during the original contract period and another way during extensions. The Contractor may thus be able to persuade the government that it is not departing from the requirement in FAR 31.105(d)(3) that the contractor use its established accounting system that is consistently applied for all contracts.

Effectiveness of Geotechnical Information Disclaimers

The effectiveness of a disclaimer of the accuracy of soil data provided by an owner as a part of a bid package was once again addressed in the recent case of *Morris, Inc. v. State of South Dakota Department of Transportation*, 598 N.W.2d 520 (S.D. 1999). In that decision, the South Dakota Supreme Court reversed a summary judgment in favor of the State, holding that "general disclaimers included in the package of bidding materials . . . are of no effect when the government makes material misrepresentations." *Id.* at 524. This decision and the general rule stated is consistent with the well-known *Spearin* doctrine and with holdings of a number of federal and state courts. See *United States v. Spearin*, 248 U.S. 132, 39 S. Ct. 59, 63 L. Ed. 166 (1918); *Western States Mechanical Contractors, Inc. v. Sandia Corp.*, 110 N.M. 676, 798 P.2d 1062 (N.M. App. 1990).

The bases for these decisions are: (a) There are certain investigations the contractor is not expected to perform; (b) The owner, instead, performs geotechnical tests and provides basic information to all bidders (indeed it is frequently necessary for the owner or its designer to perform such tests in order to determine the foundation system for the project); and (c) While the bidders are responsible to review and interpret the data provided, the owner understands the bidders will use (and rely on) the information provided. Under these circumstances, the owner is expected to provide reasonably accurate information (*e.g.* impliedly warrants the information) and is expected not to misrepresent material facts.

The *Morris* case presented a seemingly compelling case. As part of the bid documents the State provided soil borings for an aggregate pit which represented the quantity and quality of material available. The disclaimer stated: "The information covering the pit for the project is given to you for informational purposes only. The Department of Transportation does not guarantee the quantity or quality of the material listed in the above information . . . ." The material was not as represented in large part because the information (which was not dated) had been developed 10 years earlier, and all of the material identified on the information had been removed from the pit.

United States government contract forms and AIA forms typically have differing site conditions clauses which allow the contractor to recover for extra cost and time if (i) the subsurface conditions differ materially from those indicated in the contract (normally the bid documents), or (ii) the subsurface conditions are of an unusual nature which differ materially from those normally encountered in the area. Such clauses provide relief from the common law rule that the contractor bears the risk of site conditions. The justifications for differing site conditions clauses are fairness and cost savings. Fairness, in that if the owner provides the data, the contractor should be able to reasonably rely on the data, and cost savings on the theory that without the clause, bidders would include large contingencies to cover the risk of unknown subsurface conditions which, when encountered, can result in very large costs.

The situation in *Morris – i.e.,* data provided and disclaimer attempted – is not unusual. Many owners want to, in effect, control the information and thereby avoid having bidders include contingency amounts in their bids, and at the same time, avoid the risks that the information is not correct. The U. S. National Committee on Tunneling Technology (Nat'l Acad. of Science) has recommended against the use of disclaimers. 1974 Report: Better Contracting for Underground Construction, page 1. Understandably, courts look with disfavor on such disclaimers. However, if the disclaimer is clear and there is no misrepresentation, the disclaimer may well be upheld. *See, e.g., Berkel & Co. Contractors, Inc., v. Providence Hospital*, 454 So. 2d 496 (Ala. 1986).

There are a few cases where owners have attempted to "mix and match" (or better stated, mix and mismatch) by providing subsurface information, a disclaimer of that information, and a differing site conditions clause. In *Fattore Company Inc. v. Metropolitan Sewerage Commission*, 454 F.2d 537 (7th Cir. 1991), the court held that the differing site conditions clause took precedence over the disclaimer provision and allowed the contractor to pursue its claim under the differing site conditions clause in the contract.

Lawyers' Activities

March 9, 2000	Mabry Rogers, Wally Sears, Jim Archibald and Joel Brown, assisted by Anne Henderson (a legal assistant) gave presentations to a sell-out crowd of 80 at a Lorman seminar held in Birmingham. The topic was "Construction Contracting for Public Entities in Alabama."
April 5, 2000	Wally Sears presented "Design-Build: Does it Avoid Claims or Has the Fox Finally Made it into the Chicken Coop?" at a program on handling construction risks sponsored by Practising Law Institute in New York City.
April 7, 2000	Mabry Rogers and Terry Kelley (a legal assistant) conducted an all-day in-house seminar for an Alabama contractor on the subject of their new standard subcontract.
April 14, 2000	Nick Gaede presented "Payments Assurance and International Contracts" for one of the leading general contractors in the United States.
April 28, 2000	Nick Gaede attended and participated in the 10th Annual General Meeting of Terralex in Cologne, Germany. Terralex is an international group of 140 law firms of which Bradley Arant is a member. Nick Gaede is an active participant in its international dispute resolution group.
May 5, 2000	Rodney Moss gave a seminar for the Code Officials' Association of Alabama regarding the Implications of Life Safety Tradeoffs in the 2000 International Building Code.
June 1, 2000	David Pugh will participate in a Lorman sponsored seminar on Alabama construction lien law.
July 19, 2000	Nick Gaede, Mabry Rogers, Rodney Moss and Joel Brown will present a seminar in Montgomery, Alabama, sponsored by Lorman, on the topic of "Can This Job Be Saved?" The seminar will focus on various job "disaster" hypotheticals.
July 28, 2000	Axel Bolvig and Wally Sears will present a seminar on design-build at the annual convention of the Alabama chapter of Associated Builders & Contractors in Asheville, North Carolina.
Sept. 22, 2000	Mabry Rogers, Rodney Moss, Joel Brown and Donna Crowe will present a seminar in Birmingham, Alabama, sponsored by Lorman, on the topic "Construction Management/ Design-Build."

Disclaimer and Copyright Information

The lawyers at Bradley Arant Rose & White LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications.

This newsletter is a periodic publication of Bradley Arant Rose & White LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact your lawyer or any of the lawyers in our group whose names, telephone numbers and E-mail addresses are listed below; or visit our web site at www.barw.com.

A. H. Gaede, Jr.	(205) 521-8323	ngaede@barw.com
Stanley D. Bynum	(205) 521-8000	sbynum@barw.com
E. Mabry Rogers	(205) 521-8225	mrogers@barw.com
Gary C. Huckaby (Huntsville)	(256) 517-8337	ghuckaby@barw.com
Andrew J. Noble, III	(205) 521-8342	anoble@barw.com
Walter J. Sears	(205) 521-8202	wsears@barw.com
H. Harold Stephens (Huntsville)	(256) 517-5130	hstephens@barw.com
Michael D. McKibben	(205) 521-8421	mmckibben@barw.com
David G. Hymer	(205) 521-8289	dhymer@barw.com
Axel Bolvig, III	(205) 521-8337	abolvig@barw.com
J. David Pugh	(205) 521-8314	dpugh@barw.com
James F. Archibald	(205) 521-8520	jarchibald@barw.com
Douglas E. Eckert	(205) 521-8519	deckert@barw.com
Rodney L. Moss	(205) 521-8251	rmoss@barw.com
Arlan D. Lewis	(205) 521-8131	alewis@barw.com
Joel E. Brown	(205) 521-8416	jbrown@barw.com
Donna M. Crowe	(205) 521-8418	dcrowe@barw.com
Stacey A. Thurman	(205) 521-8086	sthurman@barw.com

Note: The following language is required pursuant to Rule 7.2 Alabama Rules of Professional Conduct: *No representation is made that the quality of the legal services to be performed is greater than the quality of the legal services performed by other lawyers.*

BRADLEY ARANT ROSE & WHITE LLP Third Quarter 2000

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

A. H. GAEDE, JR.
STANLEY D. BYNUM
E. MABRY ROGERS
GARY C. HUCKABY (HUNTSVILLE)
ANDREW J. NOBLE, III
WALTER J. SEARS, III
H. HAROLD STEPHENS (HUNTSVILLE)
MICHAEL D. MCKIBBEN
DAVID G. HYMER
AXEL BOLVIG, III
J. DAVID PUGH
JAMES F. ARCHIBALD, III
DOUGLAS E. ECKERT
RODNEY L. MOSS
ARLAN D. LEWIS
JOEL E. BROWN
DONNA M. CROWE
STACEY A. THURMAN
ROBERT CAMPBELL

Retainage Reconsidered

Subcontractors have targeted retainage as their next goal to correct "payment injustice." Most subcontractors (and likely many general contractors) consider retainage as important as prompt payment. The retainage question is one which can be addressed in contract negotiations, but it cannot always guard contractors against the predator owner, who never intends to pay all of the retainage, nor the owner against the slippery contractor who will never come back to a job to finish the punch-list absent the withholding of substantial funds. One solution, which can be negotiated in private contracts, is an escrow fund for retainage, with clearly defined events and conditions for releases of the retainage, preferably in "stages." Of course, any such device, in order to work, would likely need a "cop" (lawyers like to call him a "neutral") to judge whether the various conditions or events have in fact occurred.

Partial Legislative solutions, for public projects, have already been enacted in many states, including Alabama, allowing the contractor to substitute certain securities for retainage, with the contractor obtaining interest on the escrowed securities. At least the interest consequences of retainage are reduced at the general contractor level by such a device.

This issue is of profound importance to the industry. Historically, before retainage was so widespread, contractors could easily be required to finance the entire cost of the contract. Thus, progress payments, as a concept, were a vast improvement (and likely a factor in reducing the costs of construction) to the "common law" approach of payment only upon completion.

Various insurance products are available to minimize some of the risks that retainage helps ameliorate. The industry could work at an industry-sponsored "insurance fund" to guard against improper withholding by renegade owners and poor responsiveness by outlaw contractors. In any event, this development bears thoughtful attention.

Inside:

General Contractor Liability for Subcontractor Actions

Occasionally, a general contractor may find that it is liable for the acts of its subcontractors for things beyond the mere contractual obligations to the owner. Failure to guard against or plan for such situations can be devastating. Some of those circumstances are described in the three cases discussed below.

Liability for Subcontractor's OHSA Violations

Depending on the circumstances, a general contractor can end up paying a penalty for OSHA violations committed by one of its subcontractors. According to the U. S. Court of Appeals for the Tenth Circuit, a general contractor present at a jobsite who observes or should have observed one of his subcontractors commit an OSHA violation may receive an OSHA penalty provided the general had the authority to direct the subcontractor personnel to correct the hazard or to cease the proscribed activity but failed to do so. *Universal Construction Company v. Occupational Safety and Health Review Commission*, 182 F.3d 726 (10th Cir. 1999).

In *Universal*, an OSHA inspector observed a subcontractor's employee working in violation of OSHA's safety belt and lift bucket standards. It was undisputed that the subcontractor created the hazard and only the subcontractor participated in the hazardous activity. Nonetheless, the general contractor was cited and fined by OSHA. The citation and penalty were upheld on appeal to an Administrative Law Judge and in a subsequent appeal to the Occupational Safety and Health Review Commission.

The Court said the citation was justified by OSHA's "multiemployer worksite doctrine." Under this doctrine, an employer who either (1) controls a worksite or (2) creates a hazard may be liable under the OSHA standards even if the employees threatened are employees of another employer. Universal was considered to have been in "control" of the worksite and therefore liable. The thing to note, however, is that the opinion does not refer to any evidence that any of the general contractor's personnel ***actually saw*** the hazard. Rather, the opinion says the general contractor's "field manager and foreman were at the jobsite and ***were in a position to observe the violations.***" It would appear from this opinion that a general contractor could be held liable even though he had no actual knowledge of the violation. All that was required to charge the general contractor was a violation and the contractual authority to control the jobsite.

To date, five Circuit Courts of Appeal - - the 2nd, 6th, 7th, 8th and the 9th - - have adopted the "multiemployer worksite doctrine." The 5th Circuit has rejected the doctrine, and the D.C. Circuit has specifically avoided ruling on the issue due to "the perceived tension between the [doctrine and the statute]." Alabama, Georgia and Florida comprise the 11th Circuit which was created in 1981. Prior to that, the 11th Circuit states were in the 5th Circuit, and pre-1981 5th Circuit cases still carry great weight in the 11th Circuit but are not dispositive. The 5th Circuit rejected the doctrine prior to 1981 in a 1975 case and in a 1979 case. *Horn v. C.L. Osborn Contracting*, 591 F.2d 318 (5th Cir. 1979); *Southeast Contractors, Inc. v. Dunlop,* 512 F.2d 675 (5th Cir. 1975). However, given the increasing majority of Circuits that have adopted the doctrine, employers in the 11th Circuit should not assume that the 5th Circuit cases would be followed today.

Liability for a Subcontractor's Unpaid Taxes

Hunt Building Corporation was building a project in California for the federal government on federally owned land. Hunt contracted with at least three subcontractors that were not licensed under California's contractor licensing law. The unlicenced subcontractors failed to file state quarterly returns for unemployment insurance, disability insurance and employment training; one also failed to file state quarterly returns for personal income tax withholding. California assessed Hunt for the unpaid taxes in the amount of $38,714.28. Hunt appealed. The trial court reversed, but then the state appealed. The California Appeals Court held that Hunt was liable for the unpaid taxes plus interest. *Hunt Building Corp. v. Michael S. Bernick*, *79 Cal. App.4th 213 (2000).*

According to the California Unemployment Insurance Code, an employer is liable for unemployment taxes owed on behalf of its employees. An employer is not liable for the unemployment taxes of an independent contractor. "Independent Contractor" status, however, is determined by reference to statutory definitions and presumptions. Under the California Code, a subcontractor who is not properly licensed under California's contractor licensing laws loses its independent contractor status, and its employees are considered the statutory employees of the general contractor for whom the subcontractor works.

Had the project at issue been a private or state project, the analysis would have ended there. However, the project at issue was a federal project on federally owned land. Under long standing U.S. Supreme Court precedent, contractors are exempt from state licensing laws when working on federal projects. *Leslie Miller, Inc. v. United States*, 352 U.S. 187, 77 S.Ct. 257, 1 L.Ed.2d 231 (1956). Therefore, Hunt argued that because no state license was required for any of the subcontractors, the subcontractor's independent contractor status was not compromised, and it was not the statutory employer of the subcontractors' employees.

The California Appeals Court rejected Hunt's argument relying on 26 U.S.C. § 3305(d) which provides that "No person shall be relieved from compliance with a State unemployment compensation law on the ground that services were performed on land or premises owned, held, or possessed by the United States, and any State shall have full jurisdiction and power to enforce the provisions of such law to the same extent and with the same effect as though such place were not owned, held, or possessed by the United States." Thus, the law in California now requires that a general contractor be liable for unpaid unemployment taxes by its unlicenced subcontractors, even when the project is on land owned by the federal government. This decision represents yet another reason for general contractors to make sure that their subcontractors are in full compliance with applicable licensing laws. Relying merely on a contract clause which requires compliance is not enough. The required disclosure of a current license number and submission of a current license is recommended.

Liability for a Subcontractor's Workers Compensation Obligations

A recent Florida case illustrates that a general contractor can be responsible for workers compensation payments to injured subcontractor employees. In addition, the general contractor was disappointed to learn that the payments made to the injured worker were not covered by general liability insurance. *American States Insurance Co. v. Pioneer Electric Co.*, 85 F. Supp.2d 1337 (S.D. Fla. 2000).

The general contractor, American Lighting and Signalization ("ALS"), subcontracted with Pioneer Electric Co. Under the Subcontract, Pioneer agreed to indemnify ALS from claims of bodily injury and property damage. Likewise, Pioneer agreed to obtain worker's compensation and commercial general liability insurance and to cause such policies to name ALS as an additional insured.

At least initially, Pioneer complied with the contract. At some point, however, Pioneer allowed the worker's compensation coverage to lapse. A Pioneer worker was injured and pursued his worker's compensation claim against the general contractor, ALS, under Florida's statutory employer doctrine. Under the statutory employer doctrine, the general contractor can be liable for workers compensation payments to subcontractor employees. ALS paid the worker's compensation claim. ALS then sued Pioneer to be reimbursed the benefits it had paid out to the Pioneer worker. The Complaint included a number of counts including breach of contract, statutory indemnity, contractual indemnity, common law indemnity, misrepresentation and equitable subrogation. The commercial general liability ("CGL") carrier, American States Insurance Company, filed a declaratory judgment action to determine what, if any, rights and obligations under the CGL policy were implicated by ALS's claims.

The Florida Court held that there was no coverage for three reasons. First, ALS's claim was for economic losses only. Admittedly, the original worker's compensation claim was for bodily injury, but ALS paid that claim, apparently without tendering the defense to Pioneer or the CGL carrier. Because the CGL carrier was not presented with the bodily injury claim and was therefore denied an opportunity to defend, the court held that it was not obligated to respond to the indemnity claim which was for economic losses only.

Secondly, the court held that there was no coverage because of Pioneer's failure to cooperate. American States had not even learned of the pendency of the claim until well after ALS filed the complaint against Pioneer and then only after ALS sent a copy of the complaint. After that, American States engaged in a series of efforts, which the Court found to have been in good faith, to provide a defense to Pioneer. Pioneer frustrated American States' efforts. Having been denied an opportunity to defend Pioneer, the Court held that American States could not be responsible for indemnifying ALS.

Finally, the policy expressly excluded coverage for damages arising from any of Pioneer's obligations under worker's compensation laws. The Court held that this exclusion effectively shielded American States from any liability to ALS on the worker's compensation claim.

Conclusion

There are many circumstances when a contractor can be held responsible to third parties for the actions of its subcontractors. This liability is often dependent upon the laws of the state where the project is located. Your attorney can advise you when situations arise that may result in liability.

Paper and Ink No Longer Needed: E-Signatures Have Arrived!

Under a new federal law, electronic signatures on electronic documents have the same legal effect as ink signatures on paper documents. On June 30, 2000, President Clinton signed into law the "Electronic Signatures in Global and National Commerce Act" (the "E-Sign Act"). This new law makes electronically signed documents subject to the Act legally valid or enforceable. The E-Sign Act also is intended to promote the use of electronic record retention accompanied by appropriate safeguards to assure authenticity and integrity. E-Sign legislation supporters predict that the E-Sign Act will promote e-commerce, increase the speed and efficiency of conducting business, and simplify record keeping, thereby saving businesses and government agencies lots of money.

The E-Sign Act specifically provides that any signature, contract or other record relating to a transaction that affects interstate or international commerce "may not be denied legal effect, validity or enforceability solely because it is in electronic form." The E-Sign Act is not intended to affect any other requirements for enforceability or effect under applicable law. In addition, the E-Sign Act allows contracting parties to "opt out" of the Act and to refuse to use or accept electronic records or electronic signatures.

Previously, several states enacted their own e-signature laws, but different state legal rules, standards and security requirements caused confusion and inconsistency, often impeding e-commerce between citizens of different states. Attempts to remedy this problem through the promulgation of the Uniform Electronic Transactions Act (UETA) by the National Conference of Commissioners on Uniform State Laws met with limited success. Versions of UETA were enacted by approximately 20 states. The E-Sign Act attempts to preempt these differing state laws with a single uniform national standard. If a state has enacted UETA without modification, however, the preemption provisions may not apply. Businesses should determine whether a particular state has enacted UETA to determine which rules – the E-Sign Act or UETA – will govern e-signatures. While the new federal law strives for broad preemption of state e-signature laws in favor of a national standard, the exception for states that enacted UETA means that the extent of preemption will likely require resolution by the courts.

The E-Sign Act does not apply to every contract. Purely intrastate contracts that do not affect interstate commerce may not be governed by the new federal law. In addition, the E-Sign Act, by its own express terms, does not apply to wills and documents involving adoption, divorce or other matters of family law. It also does not appear to apply to the Uniform Commercial Code, a set of model laws adopted by many states that governs many commercial transactions. Court orders and notices, foreclosure or eviction notices, termination notices relating to health insurance or life insurance, product recall notices, and documents that accompany the transportation or handling of hazardous materials are excepted from the Act. The E-Sign Act allows federal regulatory agencies, such as the SEC, to interpret the Act. Moreover, the Act allows a state or federal agency to impose paper requirements if there is a "compelling governmental interest."

The E-Sign Act becomes effective on October 1, 2000. Records that must be retained under federal or state law are not subject to the Act until March 1, 2001. Further delays to implementation are contemplated by the Act where a federal or state regulatory agency has initiated but not completed rulemaking proceedings to require written records. Finally, in spite of the rapid growth and widespread popularity of the internet and computers, many government officials and business leaders may be reluctant to leave behind the pen and paper that they are accustomed to using. The E-Sign Act does much to make electronic contracts enforceable, but it does not force people to make electronic contracts.

The E-Sign Act promises to change the way many companies do business. On a construction project, contracts, daily reports, requests for information, change orders, and other key project documents may be now be transmitted electronically, with electronic signatures to make the documents legally binding. The process of circulating a change order for execution to the owner, contractor, and architect that previously might have taken weeks may now be completed in a matter of seconds. Federal agencies may now accept e-signatures on bids and may retain records in electronic databases instead of file cabinets. Such developments hold great potential for promoting speed and efficiency and for reducing the costs of doing business.

As e-signatures become more common, government agencies and private businesses must identify the kinds of documents for which e-signatures will be acceptable. For example, a project owner might agree to allow a contractor to submit RFIs and daily reports in electronic format with an electronic signature, while demanding that contracts and change orders be executed on paper with ink. The Act appears to give parties the flexibility to accept e-signatures on some documents but not others. Moreover, businesses must determine what kinds of e-signature devices will be acceptable. The Act does not favor any particular approach, so companies are free to utilize simple devices like coded passwords and signature cards, or more complicated devices like fingerprint and retinal scanners. Whatever documents and devices are selected for e-signatures, businesses should implement appropriate security protections to prevent unauthorized personnel from e-signing on behalf of the company.

Lender Must Arbitrate Claims Against Guarantors: Arbitration Clause Of Construction Contract Incorporated By Reference

In *Kvaerner ASA et al. v. Bank of Tokyo-Mitsubishi, Ltd.*, 210 F.3d 262 (4th Cir. 2000), a lender was required to arbitrate its claims against the contractor's guarantors, because the guaranties included a provision giving the guarantors the "same rights and remedies" as the contractor under the construction contract that contained an arbitration clause. The Federal Fourth Circuit Court of Appeals affirmed the trial court's finding that the lender and the guarantors had agreed to arbitrate, because the "same rights and remedies" language operated to incorporate the contractor's right to arbitrate disputes arising out of the construction contract.

Frequently, lenders take conditional assignment of construction contracts from the owner as security for construction loans. Lenders historically have been bound by arbitration clauses in construction contracts when exercising their rights as assignee. *See Cone Constructors, Inc. v. Drummond Community Bank*, 754 So. 2d 779 (Fla. App. 1 Dist. 2000). The Uniform Commercial Code § 9-318(1)(a) makes explicit that "the rights of an assignee are subject to . . . all terms of the contract between the account debtor and assignor and any defense or claim arising therefrom." These "rights" under the UCC provisions have been held to include the remedial procedure specified in the assigned contract. *Drummond* at 780.

Even though the trial court in *Kvaerner* found that there had been an assignment of the construction contract, by virtue of the lender's involuntary bankruptcy proceedings against the borrower, the Fourth Circuit did not reach the question of whether the lenders were bound by the arbitration clause as a result of the assignment. Instead, it found that the guaranties expressly incorporated the arbitration provision by reference, and that the lenders had thus independently agreed to arbitrate.

The lender argued, on appeal, that the guaranties contained a number of provisions inconsistent with an intent to arbitrate. The guaranties allowed the lenders to bring "a separate suit" from the owner directly against the guarantors. The guarantors also consented in the guaranties to jurisdiction in federal court and agreed "that all claims in respect of such action or proceeding may be heard and determined in such Federal court." The Court held that this language did not affect the right of the guarantors to invoke arbitration. The Court's rejection of the lender's arguments is particularly noteworthy and illustrates the strong preference for arbitration in federal court.

The Federal Fourth Circuit Court of Appeals is the federal court that hears appeals from federal trial courts in Maryland, Virginia, West Virginia, North Carolina, and South Carolina.

Changes to Florida and Indian Country Lands NPDES General Construction Permit

On April 28, 2000, the EPA modified its Region 4 NPDES general construction permit (GCP) for storm water discharges. [65 F.R. 25122] The modifications, which apply only to Florida and Indian Country Lands, make significant changes to the original GCP issued on March 31, 1998. [63 F.R. 15622]

Under the Federal Water Pollution Control Act (the “Clean Water Act”), a storm water discharge of pollutants into waters of the United States is unlawful unless that discharge complies with a National Pollutant Discharge Elimination System (NPDES) permit. The EPA is the authority that issues general or individual NPDES permits in states that do not have an EPA-approved NPDES permit program. In EPA Region 4 (Alabama, Florida, Mississippi, North Carolina, Georgia, Kentucky, South Carolina, and Tennessee), only Florida and Indian Country Lands do not have their own EPA-approved NPDES program.

EPA modified the existing Region 4 GCP by imposing a new two-step process on parties seeking to take advantage of the Region 4 GCP. First: (i) for sites located in Florida, applicants for coverage under the GCP must determine if the discharges will be into waters classified as “impaired waters” due to excessive Total Suspended Solids; and (ii) for sites located on Indian Country Lands, applicants must determine if the discharges will be into “impaired waters” due to Total Suspended Solids, turbidity, or silt or sediment.

Second, if a site meets either of the Section 303(d) criteria described above, the site is subject to additional sampling and reporting requirements (which are described in Section V.C of the GCP). For example, the site must test, once per month, by grab bag sampling, subject to certain additional conditions, for Settleable Solids, Total Suspended Solids, Turbidity, and Flow. Such information must be submitted to the EPA on a monthly basis.

With regard to Florida, it should be noted that because the list of impaired waters (known as the “§ 303(d) List”) is subject to frequent changes, the Section 303(d) List applicable to the GCP is included as Appendix E to the final regulations. [65 F.R. 25128-33]. The Modified Region 4 GCP became effective on July 1, 2000. [65 F.R. 25133-45]

Public Contracts in Alabama to be Exempt From Sales And Use Tax

On May 23, 2000, Governor Seigelman signed into law Alabama Act 2000-684. This new law will make purchases for almost all city, county, state, and federal projects exempt from sales and use taxes.

Historically, some city, state, and educational contracts have been effectively tax exempt, by virtue of a contractual requirement that purchases be made on the (tax-exempt) owner’s purchase orders. Other contracts, of certain public or quasi-public corporations, have been tax exempt under statutes creating those corporations and regulations requiring the contractor to obtain an exemption certificate from the Department of Revenue. However, contracts with many public entities, such as the federal government or the Alabama Department of Transportation, have not been tax exempt. This new law will make almost all public works exempt from sales and use tax, regardless of past practices. In addition, it will apparently eliminate the requirement for some entities that tax-exempt purchases be made on owner purchase orders.

Effective October 1, 2000, a contractor’s or subcontractor’s purchases of tangible personal property to be incorporated into the realty will be exempt from all state, county, and municipal sales and use tax. The contractor or subcontractor’s purchases must be made pursuant to a contract with the United States, the State of Alabama, a county or incorporated municipality, a corporation created for public purposes under Alabama law, or any educational institution of the United States, the State of Alabama, or a county or incorporated municipality of the state of Alabama.

The exemption will not apply to purchases of property that is not incorporated into the realty (*e.g.* fuel, small tools, scaffolding or concrete formwork). In addition, the exemption will not apply if the government entity, public corporation, or educational institution is not itself exempt from state sales and use taxes.

Although the law becomes effective October 1, 2000, there are currently no regulations implementing Alabama Act 2000-684. The new law contemplates that the Department of Revenue will issue rules and regulations requiring contractors and subcontractors to apply for and obtain an exemption certificate that must be used when making qualifying tax-exempt purchases from vendors. The regulations may define the requirements for obtaining an exemption certificate.

Federal Court Applies Georgia Pay-If-Paid Rule to Bar Interest Claim on Retainage

In *Associated Mechanical Corp. v. Martin K. Eby Construction, Inc.*, 67 F.Supp. 2d 1375 (M.D. Ga. 1999), AMC was the mechanical subcontractor on a prison job in Georgia. Eby Construction was the general contractor. AMC completed its work at the end of 1992. In 1995, AMC sued Eby in federal district court in Macon, Georgia, for an equitable adjustment due to alleged delays and disruptions. AMC later added a claim for its contract retainage. The equitable adjustment claims were eventually dismissed by the court. In July, 1999, after a payment by the owner, Eby paid $231,820.09 to AMC as payment for the unpaid contract balance. AMC sought interest on the retainage through the date it was paid. Eby moved the court to dismiss that claim for interest on the grounds that the money had not been due under the subcontract until the Owner paid Eby and, therefore, no interest had run on it. Eby raised four arguments in its favor.

First, the subcontract provided that retainage was to be paid after the contractor had been paid by the owner for the work set forth in the subcontract. Following Georgia state court cases, the federal court found that this subcontract language set up a condition precedent to payment by Eby. That is, until the owner paid Eby for the work of the subcontract, Eby did not have to pay AMC. The owner did not pay Eby for the subcontract work for almost five years after the work was completed, and AMC argued that this subcontract language created an implied duty on Eby's part to actively and aggressively pursue release of payments from the owner. Since Eby apparently did not do so, AMC argued it should not be allowed to use this subcontract language as a defense to AMC's claim. The court was not persuaded by this argument and simply focused on what it called the plain language of the subcontract requiring payment by the owner before the contractor had to pay the subcontractor.

Second, the subcontract required that payment was to be made after the subcontractor completed, executed, and filed with the contractor a release on forms supplied by the contractor. Again, the court found that this language clearly and unambiguously established the intent to create a condition precedent to payment.

Third, the subcontract provided that the subcontractor would be paid after all disputes, claims, liens, causes of action and/or lawsuits which are related in any way to the subcontract or the subcontractor's performance of the work were resolved. The court again found a clear and unambiguous intention to create a condition precedent for payment. In fact, the very presence of this suit by AMC was taken as proof by the court that the condition precedent in this instance had not been met. So, this subcontractor found itself in the unusual position that its making of a claim for payment was evidence under the subcontract that it was not entitled to payment.

Fourth, the subcontract incorporated the final payment provisions that were in the prime contract. The prime contract required that, before final payment was made, Eby had to provide an affidavit stating that there were no claims of any kind, "which might constitute a lien upon the property of the owner." The prime contract permitted the owner to withhold payment if any claims were filed. Eby argued that it was unable to satisfy the prime contract requirements for payment because of AMC's lawsuit against Eby. It would seem that, if no lien had been filed or if any statutory requirements for perfecting a lien had not been met, then this condition precedent would be moot. However, there was no discussion in the case about whether or not a lien had been filed. Instead, the court found that this condition precedent was clear and unambiguous.

So, on all four of the grounds argued by Eby, the court decided that the subcontractor's retainage payment was not legally due because the conditions precedent were not satisfied. Because the payment was not due, no interest could run on it, and the court dismissed AMC's claim for interest.

Many state courts in this country construe pay-when-paid or pay-if-paid provisions to mean that they only grant the contractor a reasonable time to affect payment and do not reassign the risk of nonpayment to the subcontractor. An example is *Lafayette Steel Erectors, Inc. v. Roy Anderson Corp.*, 71 F.Supp.2d 582 (S.D. Miss. 1997). The AMC case shows that the contrary rule has legs in some states. It is important for contractors and subcontractors to review their subcontract payment language in light of the case decisions in the state where the project is to be built to be sure they understand the payment risks they may be accepting.

Joint Check Agreement Created a "Direct Duty" for Contractor to Pay Supplier

Joint check agreements are commonly used in the construction industry. However, as with any other contractual document, parties must examine the language closely to avoid unintended consequences. In *Glen-Gery Corp. v. Warfel Construction Company*, 734 A.2d 926 (1999), the Superior Court of Pennsylvania held that a joint check agreement providing that the contractor would issue joint checks "for all material purchased by [the subcontractor] for incorporation to [the project]," modified the subcontract agreement and made the contractor liable for the subcontractors obligation to "insure" payment of its suppliers.

The contractor, Warfel Construction, subcontracted masonry work to Lawver Masonry. Lawver contracted with Glen-Gery to supply block for the project. Shortly thereafter, Warfel and Glen-Gery became aware that Lawver was in poor financial condition. Glen-Gery thus requested that Warfel execute a joint check agreement ". . . for all material purchased by Lawver Masonry for incorporation to [the project]." Subsequently, when Lawver exceeded the amount of its subcontract, Warfel refused to pay Lawver more money on the project. Lawver then stopped work, and was terminated.

At the time of Lawver's termination, Glen-Gery alleged that it was owed $62,000. Warfel refused to pay based upon its suspicion that all of the material allegedly supplied by Glen-Gery had not been used for the project. The parties jointly hired an independent estimator to compare the amount of material needed for the project and the amount actually supplied by Glen-Gery. Unfortunately, a conflict arose regarding the estimator, and the proper amount of money due Glen-Gery was never determined. Consequently, Glen-Gery sued Warfel for the amount of its unpaid invoices, plus interest, and alternatively, for unjust enrichment.

The trial court entered judgment for Warfel and held that: (1) because Glen-Gery authored the joint check agreement, any ambiguities should be construed against it; (2) the joint check agreement was merely a payment mechanism between Warfel, Lawver and Glen-Gery, and was not intended to set Warfel up as a guarantor of payment to Glen-Gery; and (3) Warfel had no obligation to pay more money to anyone beyond the amount of Lawver's contract.

On appeal, the Superior Court held that the language of the agreement was clear that Warfel intended to pay Glen-Gery for all materials it supplied to Lawver for the project. The agreement contained no limit to the amount of money Warfel would pay Glen-Gery, thus the original subcontract price did not cap Warfel's payment obligations. Furthermore, Warfel's payment obligation survived Lawver's default because the agreement did not indicate that Glen-Gery would only be paid while Lawver was on the project.

The court also supported its reasoning by reading the subcontract and joint check agreement together. The subcontract provided that Lawver was to insure that all suppliers are paid, and that Warfel had the right to pay unpaid suppliers. By executing the joint check agreement, signed by Warfel and Lawver, the court held that the provision requiring Lawver insure payment to suppliers was changed, and created a "direct duty" for Warfel to pay Glen-Gery. Ultimately, the court remanded the case for a determination as to: (1) whether the material indicated in Glen-Gery's invoices was purchased by Lawver, and if so, (2) whether Lawver purchased the materials for incorporation into the project.

"Door-Closing" Statutes Prevent Out-of-State Contractors From Enforcing Contracts

Out-of-state contractors should make sure they are properly qualified to do business in a state before entering contracts to perform work in this state. For example, Alabama Code § 10-2B-15.02, a "door-closing statute," bars foreign corporations not qualified to do business in Alabama from enforcing their contracts in Alabama courts.

In *Hays Corp. v. Bunge Corp.*, 2000 WL 502607 (Alabama, April 28, 2000), a Georgia contractor (Hays) contracted to build certain facilities at a Bunge plant in Decatur, Alabama. When Bunge did not pay Hays, Hays sued Bunge in Alabama court, alleging numerous theories (breach of contract, open account, quantum meruit, unjust enrichment, lien). The trial court granted summary judgment to Bunge on grounds that Hays was not qualified to do business in Alabama.

In affirming summary judgment, the Alabama Supreme Court examined whether Hays fell under the "interstate commerce" exception to the door-closing statute that permits businesses engaged in interstate commerce to enforce their contracts despite their failure to properly qualify. The court rejected application of the exception and held that "[t]he construction contract at issue here involves intrastate commerce."

Sanjay, Inc. v. Duncan Construction Co., Inc., 445 So.2d 876 (Ala. 1983) is instructive regarding Alabama's classification of construction contracts as "intrastate." Sanjay, a foreign corporation, provided construction services to build a motel in Alabama, including materials prefabricated out-of-state and accounting and engineering functions performed out-of-state. In rejecting Sanjay's argument that the offsite accounting, engineering and prefabrication of materials rendered its activities "interstate," the Court held:

> If such were the case, the public policy of this state as expressed in our Constitution and statutes could be flaunted by virtually any foreign corporation in the construction business. The Court takes judicial notice that many component parts of any structure to be erected in the State of Alabama are often fabricated outside the State of Alabama and any foreign corporation doing construction business in the State of Alabama will perform accounting and engineering functions outside the state. If such prefabricating and performance of ministerial functions outside the State of Alabama had the effect argued by Sanjay, Inc., the public policy of this state would be frustrated and defeated.

Sanjay, however, does not explain the Supreme Court's reasoning in *Delta Construction Corp. v. Gooden*, 714 So.2d 975, 979 (Ala. 1998). In that case, the Court held that, although Delta's construction of a 40-bed personal care facility in Alabama was "intrastate" and therefore subject to the door-closing statute, it nonetheless "involved" or had an "effect" on interstate commerce so as to invoke application of the Federal Arbitration Act. Significantly, the Delta Court held that Delta's failure to properly qualify to do business in Alabama prevented it from invoking the assistance of the Alabama courts in enforcing the arbitration clause in its contract. *Id.* at 981.

Contractors performing work away from their home state should qualify to do business, obtain a contractor's licence, and do all of the other things necessary to comply with state and local laws, regulations and ordinances. Even innocent failure to do so can result in unintended and harsh consequences.

Bid Protests Revisited

Unsuccessful bidders are often tempted to challenge awards of public contracts. This temptation should be accepted with considerable caution, because the odds against such lawsuits are often very high. A recent example occurred in *TFT, Inc. v. Warning Systems, Inc.*, 751 So.2d 1239 (Ala. 1999), regarding the award of a radio system intended for use in connection with the destruction of chemical weapons in the State of Alabama. As with most states, Alabama's Code requires public authorities to award certain contracts to the lowest responsible bidder. After a two-day trial, the trial court required the State to resolicit bids for parts of the contract. The Supreme Court of Alabama, after review of the record, determined that the awarding authority had wide discretion in how it should solicit bids for the items (whether as an entire system or as parts), and the Court would not interfere with that discretion absent clear abuse or fraud.

Many states, including Alabama, are enacting legislation for prequalification of bidders. The pendulum is swinging toward discretion at the award level, residing in public authorities. While this pendulum can swing too far (such that the "discretion" is actually exercised in exchange for paved driveways and home swimming pools), it is a phenomenon which must be evaluated in considering a bid protest.

California City Liable to Electrical Contractor for "Abandonment"

In a decision not yet published, a California appeals court recently upheld a $2 million verdict in favor of Amelco Electric, where the City of Thousand Oaks "abandoned" the contract by imposing on Amelco an excessive number of changes that fundamentally altered the scope of Amelco's work. *Amelco Electric v. The City of Thousand Oaks*, Court of Appeals, Second Appellate District, Division Six (July 19, 2000).

During a two-year Civic Center construction project, the City issued 1,018 sketches to clarify or change the original contract drawings, including 248 sketches that changed the electrical design. Every part of the electrical work was changed at least once. The number and extent of the changes indicated that the electrical design was not complete at the time of bid. To complicate matters, many of the revised drawings were not "clouded," and many were drawn at a different scale, further inhibiting Amelco's ability to determine what was required by the contract. Amelco was forced to increase its administrative staff to handle the changes, and the work proceeded much less efficiently.

Although Amelco submitted requests under its contract with the city for additional money, it was unable to estimate the cumulative impact to its work until later, because it was impossible for Amelco to estimate the impact that the changes would have on its lost efficiency. Ultimately, Amelco submitted a total cost claim for just over $2 million.

The court noted that in California, where a construction contract has been abandoned, "the contractor who completes the project is entitled to recover the reasonable value of its services on a quantum meruit basis." Although no clear standard of "abandonment" was articulated by the court, it apparently was willing to find abandonment because the number, timing and nature of the changes exceeded reasonable expectations, and not because the facility as constructed was materially different than the "scope" originally envisioned.

Although Amelco prevailed with its total cost claim, contractors should be careful to observe that before allowing a total cost claim, many courts may require a specific showing that it was impractical to prove actual losses directly, that the original bid was reasonable, and that the contractor lacks responsibility for the additional costs.

Surety Rights and Liabilities: Recent Developments

Two recent cases address the limits of surety liability under public works bonds. In *Mycon Construction Corp. v. Board of Regents of the State of Florida*, 755 So.2d 154 (Fla.App. 4 Dist. Mar. 1, 2000), *rehearing denied* (Apr. 14, 2000), a Florida appellate court reaffirmed Florida precedent holding that a surety can not be held liable under a statutory performance bond for delay damages resulting from a contractor's default. In *Mycon*, the jury found both the contractor and the sureties liable for a variety of damages arising from the defective construction of a university dormitory. Included in the verdict was $750,000 for delay damages the owner incurred in relocating students during the period when repairs were being made to the dormitory. The court held that the surety had not breached any of its own contractual duties, and under the terms of the performance bond, the surety's liability was limited to "the cost of completion less the balance of the contract sum." *Id.*, at 155. In so ruling, the court relied upon *American Home Assur. Co. v. Larkin Gen. Hosp. Ltd.,* 593 So.2d 195 (Fla. 1992), wherein the Supreme Court of Florida held that the terms of a performance bond control the liability of a surety, and when construed together with the purpose of such bonds, demonstrate that a surety's obligation is simply to guarantee "the completion of the construction contract and nothing more." Thus, the appellate court reversed that portion of the verdict holding the surety liable for $750,000 in delay damages, and only the contractor was held liable for delay.

In *Vaughn Excavating and Const., Inc. v. P.S. Cook Co.*, 981 P.2d 485 (Wyo. 1999), the Wyoming Supreme Court ruled that a general contractor and a surety that had issued a public works bond were not liable to a subcontractor's supplier for interest, late penalties and attorneys fees. Here, the subcontractor contracted with the supplier for certain materials. That contract provided for the payment of interest, late fees, and attorneys fees upon default. The general contract did not provide for such penalties and damages. After the subcontractor defaulted, the supplier asserted a claim against the contractor's payment bond for the value of the materials furnished plus the penalties and damages set out in its contract with the subcontractor. The supplier requested that the court analogize its claim to one brought under the federal Miller Act, 40 U.S.C. § 270a *et seq.*, and cited cases to the court allowing recovery of interest, penalties and attorneys' fees under that statute. The court rejected that argument and ruled that the bonding statute clearly limits the surety's liability to "to those things which were clearly contemplated when the bond was executed." *Id.*, at 488. Given that the supplier's contractual penalties and damages were not embodied in the general contract, and that the surety and general contractor were not parties to the supplier's contract with the subcontractor, the court concluded that the interest, late fees and attorneys fees provided in the supplier's contract were not the types of damages "clearly contemplated when the bond was executed." In other words, the supplier's recovery was limited under the bonding statute to the value of materials furnished and statutory interest on that amount.

Both *Mycon* and *Vaughn* illustrate that bonds on public works may expose the surety to liability different than bonds on private jobs. Whether the surety would have been liable for the claimants' damages on a private project would have turned on the language of the bonds and, perhaps, the language of the general contract. Surety liability on public works turns, as well, on statutory language and public policy.

While the above cases address the limits of surety liability under public works bonds, another recent case addresses the rights of the surety to contract funds. In *Home Ins. Co. v. United States*, 46 Fed.Cl. 160 (Cl.Ct. 2000), a general contractor defaulted on a construction project at Cape Kennedy, Florida. After taking control of the project, the surety hired a completing contractor and paid off the materialmen and suppliers. At the same time, the surety instructed the government to make all future payments to the surety's account. Notably, no formal takeover agreement was executed by the parties. While most of the remaining contract balance was paid into the surety's account, the government mistakenly directed two payments to the defaulting contractor. After making unsuccessful efforts to recover those payments from the defaulting contractor, the surety brought suit against the government for the misdirected payments.

In dismissing the surety's claims, the Court of Federal Claims noted that the surety's remedy was limited to "reimbursement from the contractor for costs incurred in satisfying [the contractor's] obligations." The contract balance serves merely as collateral for the surety's right to reimbursement. *Id.*, at 163. While completion costs may often exceed that balance, here the surety was able to complete the project for an amount less than it had already been paid by the government. Thus, the court concluded that since the surety was paid more than it spent, the surety could not recover from the government an amount greater than it could have recovered from the defaulting contractor. The result would have been no different if there had been a takeover agreement between the surety and the government. Federal Acquisition Regulation 49.404 mandates language in all takeover agreements that the surety not be entitled to recover an amount in excess of its actual costs from the contact balance.

Sureties also have had difficulty asserting the claims of their principals under both equitable subrogation theory and the assignment provisions of the General Indemnity Agreement. In *Balboa Ins. Co. v. U.S.*, 775 F.2d 1158 (Fed. Cir. 1985), the court held that equitable subrogation is limited to the contract balance, and the surety's claim for costs incurred before the surety took over the work was denied. In another case, the assignment provisions of the General Indemnity Agreement were found to violate the Assignment of Claims Act, 31 U.S.C. § 3727. *See Fireman's Fund Ins. Co.,* ASBCA No. 50657, 2000 WL 246620 (Feb. 28, 2000).

OFPP Best Practices Guide Cautions Agencies Not To Penalize for Prior Claims

In the 1994 Federal Acquisition Streamlining Act, Congress stated that it is appropriate for the Government to consider past performance when evaluating potential contractors for future work. In May, 2000, the Office of Federal Procurement Policy released its guide to "Best Practices for Collecting and Using Current and Past Performance Information." The Best Practices Guide, which is not mandatory, provides examples for federal agencies to follow when evaluating contractor performance. OFPP believes that the use of past performance is a "major evaluation factor" in the award process and in making "best value" selections.

OFPP acknowledges that contractors have raised concerns regarding the evaluation process. Of particular concern is how the agency will evaluate problems on prior jobs and claims filed on those jobs. The Best Practices Guide instructs agencies to consider the role the Government may have played in problem projects. The Guide also cautions that "the source selection team should be cautious not to downgrade or penalize offerors for the judicious use of the contract claims process."

Because the Best Practices Guide is not mandatory, and because there may be room to dispute what is a "judicious use" of the claims process, contractors may yet be concerned about how past claims will be treated by the Government on future evaluations. The Guide recognizes that, in accordance with the FAR, contractors are afforded an opportunity to comment on their assessments within a few days of finalization, and may meet with the contracting officer's immediate supervisor to review the evaluation.

The Best Practices Guide may be found on the web at www.arnet.gov/Library/OFPP/BestPractices/pastperformguide.

About Bradley Arant

Bradley Arant Rose & White LLP was organized in Birmingham, Alabama around 1900. The firm presently has over 150 lawyers with offices located in Birmingham, Huntsville and Montgomery, Alabama and Washington, D.C. The firm represents a variety of local, regional, national and international organizations and is committed to understanding and responding to the needs of its clients.

The firm has a diversified civil practice including environmental law, labor and employment, health care, employment benefits, construction, litigation, general corporate, partnership and business entity law, mergers and acquisitions, banking, bankruptcy and creditor rights, tax, estate planning, energy, trade regulation, international trade, securities, municipal finance, real estate, governmental affairs, white collar crime, intellectual property and antitrust. The breadth of our practice not only permits us to serve the diverse needs of our regular clients but also gives us the depth and degree of practice emphasis required to assist new clients facing complex legal issues or transactions.

We are committed to providing the highest standards of legal service. In recognition of this commitment, many of our lawyers have been selected for membership in professional organizations that recognize outstanding attorneys in particular fields, including the American Law Institute, the American College of Trial Lawyers, the American College of Tax Counsel, the American College of Trust and Estate Counsel, the International Association of Defense Counsel, the International Association of Defense Counsel, the American College of Construction Lawyers, the American College of Bond Counsel, the American College of Bankruptcy, the American College of Mortgage Attorneys, the Alabama Law Institute, the Southern Federal Tax Institute, the American Tax Policy Institute and the American Bankruptcy Institute. Two of our lawyers have been members of the Product Liability Advisory Council. We have more lawyers listed in the most recent edition of *The Best Lawyers in America* than any other Alabama law firm. Since 1923, the *Martindale-Hubble Law Directory* has selected our firm to serve as the reviser of its *Alabama Law Digest*.

We also seek to improve the legal system. Throughout our history, our lawyers have been actively involved in local, state and national bar associations, in legal education and in other professional activities. Members of the firm have served as presidents of the Alabama, Birmingham and Huntsville-Madison County Bar Associations and have been elected chairs of the major practice sections within the Alabama Bar, including, in recent years, Litigation, Health Law, Labor Law, Tax, Real Property, Probate and Trusts and Environmental Law. A number of attorneys from the firm have been, or are, on the adjunct faculty at the University of Alabama School of Law, the Cumberland School of Law and other law schools. Four of the firm's lawyers are members of the International Bar Association, and the firm is a member of the Terralex international law firm group. Two former partners have served as federal judges.

We also are committed to improving government through the preparation and implementation of essential legislation at the state level in the areas of municipal finance, education and tax reform. One of our late partners drafted the legislation that allowed Alabama to be one of the first states in the country to offer industrial revenue financing. Another partner was appointed by the Governor to chair the most comprehensive tax reform proposal ever considered by the Alabama legislature. Members of the firm also have served on committees charged with drafting and revising numerous business and property laws, including the Alabama Business Corporation Act, the Alabama Limited Liability Company Act, the Alabama Uniform Partnership Act (1996), the Alabama Uniform Commercial Code, the Alabama Condominium Code, the Alabama Probate Code and Alabama's trademark and trade secret laws. Recently, the firm published a handbook that explains Alabama's governmental ethics laws.

While committed to excellence, we are sensitive to the need to control costs. We understand that the value of what we do is measured by the results. To provide more timely and cost-effective service to our clients, we have invested heavily in state-of-the-art voice and data technology. As a result, we are easily accessible to our clients – whether by phone, facsimile, video conferencing or E-mail. A large menu of off-the-shelf and custom applications for litigation support, budgeting, planning, communications, legal research and financial analysis is available to our attorneys to provide them with access to the tools they need to best serve our clients' needs. Because notebook computers are available to all attorneys and legal assistants, the firm's computer network capabilities are available at any location that can be reached by telephone.

Lawyers' Activities

June, 2000	Nick Gaede recently wrote an article for the International Construction Law Review titled "The Silver Book: An Unfortunate Shift from FIDIC's Tradition of Being Evenhanded And Of Focusing On The Best Interests Of The Project."
July 19, 2000	Nick Gaede, Wally Sears, Rodney Moss and Joel Brown presented a Lorman Seminar in Montgomery, Alabama on the topic "Can This Job Be Saved." This seminar will be available through a link on our webpage sometime in the future.
July 20, 2000	David Pugh spoke to the Alabama Construction Financial Managers, addressing recent changes to the AIA documents.
Sept. 19, 2000	Seminar: "Advanced Construction Law in Alabama" sponsored by NBI, to be held at the Harbert Center. David Pugh is to be joint speaker with Oscar Price, formerly of Johnston Barton Proctor & Powell LLP, now with All South Subcontracting.
Sept. 21, 2000	ABC Value Engineering Forum discussion reflects the work of Axel Bolvig's committee this year.
Oct. 27, 2000	Mabry Rogers, Rodney Moss, Joel Brown and Donna Crowe will present a seminar in Birmingham, Alabama, sponsored by Lorman, on the topic "Construction Management/ Design-Build."
Dec. 14, 2000	Mabry Rogers, Doug Eckert and Joel Brown will present an NBI sponsored seminar in Birmingham on the topic "Alabama Construction Law: What To Do When. . . ."

Disclaimer and Copyright Information

The lawyers at Bradley Arant Rose & White LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications.

This newsletter is a periodic publication of Bradley Arant Rose & White LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact your lawyer or any of the lawyers in our group whose names, telephone numbers and E-mail addresses are listed below; or visit our web site at www.barw.com.

A. H. Gaede, Jr.	(205) 521-8323	ngaede@barw.com
Stanley D. Bynum	(205) 521-8000	sbynum@barw.com
E. Mabry Rogers	(205) 521-8225	mrogers@barw.com
Gary C. Huckaby (Huntsville)	(256) 517-8337	ghuckaby@barw.com
Andrew J. Noble, III	(205) 521-8342	anoble@barw.com
Walter J. Sears	(205) 521-8202	wsears@barw.com
H. Harold Stephens (Huntsville)	(256) 517-5130	hstephens@barw.com
Michael D. McKibben	(205) 521-8421	mmckibben@barw.com
David G. Hymer	(205) 521-8289	dhymer@barw.com
Axel Bolvig, III	(205) 521-8337	abolvig@barw.com
J. David Pugh	(205) 521-8314	dpugh@barw.com
James F. Archibald	(205) 521-8520	jarchibald@barw.com
Douglas E. Eckert	(205) 521-8519	deckert@barw.com
Rodney L. Moss	(205) 521-8251	rmoss@barw.com
Arlan D. Lewis	(205) 521-8131	alewis@barw.com
Joel E. Brown	(205) 521-8416	jbrown@barw.com
Donna M. Crowe	(205) 521-8418	dcrowe@barw.com
Stacey A. Thurman	(205) 521-8086	sthurman@barw.com
Robert Campbell	(205) 521-8702	rcampbell@barw.com

Note: The following language is required pursuant to Rule 7.2 Alabama Rules of Professional Conduct: *No representation is made that the quality of the legal services to be performed is greater than the quality of the legal services performed by other lawyers.*

BRADLEY ARANT ROSE & WHITE LLP Fourth Quarter 2000

CONSTRUCTION AND PROCUREMENT LAW NEWS

Recent federal, state, and local developments of interest, prepared by the firm's Construction and Procurement Group:

A. H. GAEDE, JR. · WALTER J. SEARS, III · J. DAVID PUGH · JOEL E. BROWN
STANLEY D. BYNUM · H. HAROLD STEPHENS (HUNTSVILLE) · JAMES F. ARCHIBALD, III · DONNA M. CROWE
E. MABRY ROGERS · MICHAEL D. MCKIBBEN · DOUGLAS E. ECKERT · STACEY A. THURMAN
GARY C. HUCKABY (HUNTSVILLE) · DAVID G. HYMER · RODNEY L. MOSS · ROBERT CAMPBELL
ANDREW J. NOBLE, III · AXEL BOLVIG, III · ARLAN D. LEWIS · DAVID W. OWEN

New Florida Anti-indemnity Statute

Florida has recently amended its anti-indemnity statute, Florida Code § 725.06. This new law is effective July 1, 2000 and applies to all construction contracts entered into after that date.

Under the old statute, indemnity clauses in construction contracts were enforceable only if there was a monetary limit on the indemnity obligation or if specific bargained-for consideration (*i.e.*, money) was given in exchange for the indemnity. The new law completely changes the old statute. It provides that indemnity is permitted only to the extent that it covers the negligence, recklessness or intentional wrongful conduct of the indemnitor, or persons employed by the indemnitor, in the performance of the construction contract.

Apparently, a party will no longer be able to obtain indemnity for matters of strict liability, or for its own negligence -- even its partial negligence. To the extent standard forms of indemnity go further than permitted under the new law (and most do), they will now be void in Florida as against the public policy of the State. Standard form indemnity provisions such as Paragraph 3.18 of AIA Form A201 (1997) General Conditions will likely be void in Florida, and parties should consider simply reciting the words of the new Florida statute in place of such indemnity provisions.

There also appears to be some question as to whether architects (who are indemnified parties under AIA Form A201) and other third parties (such as lenders) can be proper indemnified parties under the new statute. The new statute apparently only allows indemnity in favor of the "other party to the contract, their officers and employees." As there is likely to be further interpretation as this new law goes into use, those doing business in Florida should contact their attorney to specifically discuss this issue.

Inside:

Ohio Impliedly Warrants Non-Contractual Soils Report

Applying the *Spearin* doctrine, an Ohio appeals court recently held that the State of Ohio impliedly warranted the accuracy of information contained in a soils report and boring logs. The court held that Ohio warranted the information notwithstanding language excluding the information from the Contract Documents, disclaiming responsibility for the information, shifting the risk of use of the information to the contractor, and requiring the contractor to perform its own site investigation. Sherman R. Smoot v. Ohio, 2000 WL 64310 (Ohio App. 10 Dist. Jan. 27, 2000).

The general contractor, Smoot, brought a claim for Type I differing site conditions, claiming that actual subsurface conditions at the site were materially different from the conditions represented by the Contract Documents and the soils report. Specifically, the subsurface conditions did not allow the use of "trench footings." Instead, Smoot encountered large rocks, coal and shale, which caused the footing excavations to be irregular and oversized. Smoot had to construct footing forms inside the footing excavations instead of using the wall of the excavation as the form of the footing.

At trial, and on appeal, Smoot's Type I differing site condition claim was denied. The appellate court found that the footing details in the Contract Documents were clearly labeled "trench footing." However, Smoot's Vice President testified that Smoot relied on the soils reports in preparing its bid. The trial court and appellate court concluded that Smoot did not rely on the footing details in the Contract Documents. Because Smoot had not relied on *contractual* information about subsurface conditions, Smoot could not meet all the elements of a Type I differing site condition claim.

However, Ohio had made the soils report and boring logs available in the bid package. The bid package provided:

> The Soils Report and Soil Boring Logs are ... for information purposes only, and are not considered a part of the Contract Documents. The Soils Report and Logs are not approved nor guaranteed in any manner.... Use of the information is totally at the risk of the Contractor. Additional soils information, if needed by any Contractor, shall be obtained by the Contractor at no cost to [Ohio].

The appellate court held that, notwithstanding the state's disclaimer and the exclusion of the report from the Contract Documents, Smoot could still recover under the *Spearin* doctrine. Under the *Spearin* doctrine, the owner "impliedly warrants the accuracy of its affirmative indications regarding job site conditions." "Where the information provided by the government was obviously intended to be used by bidding contractors in formulating their bids, the implied warranty of job site conditions will prevail over express contract clauses that disclaim any responsibility for the accuracy of information provided to contractors, and that require contractors to examine the site and check the plans." According to the court, "The basis for the *Spearin* doctrine is the belief that it is unreasonable to expect every bidder ... to perform expensive job site investigations, which the government is in a position to perform once for the benefit of all bidders."

Smoot was allowed to proceed under the Spearin doctrine even though it could not meet one of the elements of a Type I differing site conditions claim -- namely, reliance on contractual information. Smoot is notable because it applies the implied warranty under the *Spearin* doctrine to subsurface investigation reports excluded from Contract Documents. Some states' courts have reached the opposite result. *See*, *Berkel & Co. Contractors v. Providence Hospital*, 454 So. 2d 496 (Ala. 1984). Caution must be exercised in relying on *Smoot* in jurisdictions other than Ohio.

ENGBCA Rejects Cumulative Impact Claim Methodology

The Board of Contract Appeals for the Corps of Engineers recently held that a contractor was not entitled to labor inefficiency costs for the cumulative disruptive impact of change orders because the contractor failed to perform a cause-and-effect analysis and prove that other non-compensable causes did not contribute to the loss. *J.A. Jones Construction Co.*, ENGBCA No. 6348 (July 7, 2000). This case is a departure from previous Board of Contract Appeals cases dealing with cumulative impact claims because the Board required the contractor, instead of the Government, to prove that other events did not cause the claimed impacts.

In its certified claim, the contractor, J.A. Jones, requested compensation from the Corps for loss of efficiency impact on unchanged work based on the number and magnitude of changes performed. Jones' original calculation of the impact was based on the "Leonard Study," which provides a framework to relate the magnitude of impact to the percentage of change on the original contract. Although Jones revised its method of calculating the claim after it filed the appeal, the Board made a point to state that the Leonard Study was inapplicable to Jones' claim for impacts to heavy civil work because the study was based upon much smaller projects, of different scope, and involving different trades.

Jones' revised approach calculated the impact of 49 changes over a 15-month period based on a comparison of productivity in certain cost codes between times when crews were working on only contract work and times when crews were working on both changes and contract work. The analysis assumed that all work performed by a crew was impacted for the entire month if one member of the crew worked on a change order for at least one hour during the month. Based on this "measured mile" approach, Jones' expert concluded that change orders had a 28 percent impact to efficiency under certain cost codes and then applied the impact to other codes.

The Board strongly criticized Jones' expert for failing to perform a cause-and-effect analysis that, in the Board's opinion, must consider the nature of the changes, the work they directly impacted, and the timing of changes. According to the Board, the expert offered no evidence of how the cost codes that were alleged to be most heavily impacted were even related to the changes at issue. The Board went even further to state that the expert's analysis should eliminate other potential causes of increased hours during the impact period, such as weather sensitivity of the work. The Board also appeared to require Jones to demonstrate that it had insufficient advance notice of the change to implement and sequence the changed work without impacting unchanged work.

The *Jones* case may illustrate a skepticism of Boards of Contract Appeals toward claims for the cumulative impact of changes on unchanged work. Surprisingly, perhaps, the case requires the contractor to prove not only its prima facie case, but also to prove a negative -- that other potential causes of impact did not contribute to the loss and that the contractor could not schedule changes to avoid impact.

Design-Build Licensing Laws Differ from State to State

The increased use of the design-build delivery system for construction projects means that contractors and designers must carefully consider the licensing requirements of the states where such projects are to be performed. Because extensive use of the design-build delivery system is relatively new, the laws of many states do not specifically address licensing of design-build entities, and the laws of some states prohibit or have been construed to prohibit design-build contracting. *See*, "Poll: Project Delivery/Design-Build Should Compete," *Engineering News-Record*, Nov. 27, 2000, p. 75. This article provides a general discussion of this increasingly important area of the law.

In nearly every state, statutes define the practice of architecture, the practice of engineering, and contracting. Those statutes also typically require architects, engineers and contractors to register, become licensed, or obtain a certificate before engaging in that profession. The statutory definitions of the practice of architecture and engineering fall into several general categories, including those which define the professions in terms of "performing" services, and those which define them in terms of "rendering" services. The form of the definition is important, because states generally prohibit the unlicenced practice of architecture and engineering, but not all activities equate to practicing architecture or engineering or to performing such services. For example, dictionary definitions of *rendering* include both "perform" and "furnish." Therefore, where a statute proscribes "rendering" services, does the contractor, who does not also have a design license, render services by furnishing plans prepared by a licensed A/E? Alternatively, so long as the contractor is only a conduit for those plans, is the contractor "performing" services?

In many states, contracts by unlicensed persons to perform services requiring a license are not enforceable by the unlicensed party. The risk is clear: a person may perform some or all of a contract but be denied payment for those services if the person has not complied with the state licensing law. Also, performance of services without proper license can expose a firm to criminal liabilities.

The design-builder may be vulnerable because the performing entity "offers" both design and construction activities. Hence, the licensing laws may effectively prohibit design-build unless the performing entity itself possesses both a design license and a construction license. A design-build entity "fronted" by a contractor (*i.e.*, the contract with the owner is design-build, but the contractor subcontracts for the design services) has the license needed to perform construction services but may lack the license needed to perform design services. Conversely, the design-build entity "fronted" by an A/E may have a design license but not a contractor's license. A design-build joint venture may be composed of parties who have design and construction licenses, but the joint venture itself may not have either license. As a result, the design-build entity may be found to lack a license required to allow recovery on its contracts.

Florida (Fla. Stat. Ann. § 481.229(3)), North Carolina (N.C. Gen. Stat. § 83A-13(b)), South Dakota (S.D. Codified Laws Ann. § 36-18A-11), Virginia (Va. Code Ann. § 54.1-406F) and Washington (Wash. Rev. Code Ann. § 18.08.410(7)), have statutorily exempted design-builders (fronted by a contractor) from the design licensing statutes. These statutes generally provide that a properly registered general contractor is not required to be licensed as an architect or engineer when offering to perform or performing services under a design-build contract as long as the architectural or engineering services offered or rendered are offered and rendered by a properly licensed architect or engineer. Such architect or engineer could be either a joint venture partner with the contractor or a subcontractor to the contractor.

In Georgia (2000 Georgia Laws Act 901 (S.B. 350), Section 43-4-14(e)), Illinois (Ill. Admin. Code tit. 68, § 1150.85(2)(A)-(C)), and Maine (Maine Rev. Stat. Ann. tit. 32, § 220(1)(C)(3)), statutes or regulations require information to be provided to the owner or developer of a design-build project about the design-build relationship with the designer. Generally, these statutes and regulations exempt a design-build contractor from having a design license if: (a) it contracts with a properly licensed architect or engineer to provide design services, (b) the architect or engineer is disclosed to the owner or developer, and (c) the owner or developer is notified if the contract with the architect or engineer is terminated.

Several states, including New York and Texas, have judicial decisions, rather than statutes, which protect the design-build delivery method. In *Charlebois v. J.M. Weller Associates, Inc.*, 531 N.E.2d 1288 (N.Y. 1988), the Court of Appeals of New York held that a design-build contract was not void as against the public policy underlying professional licensing laws. The contract in *Charlebois* called for the contractor to furnish the services of a licensed professional engineer as part of the overall package of architectural, engineering, and construction services. The contractor was not licensed to practice architecture or engineering. In upholding the enforceability of the contract, the court emphasized that the contract specifically provided that design services would be provided by a separately retained licensed professional.

Texas law assumes professional designers will discharge their obligation to the public, regardless of what entity (the owner or the design-builder) signs its pay checks. In *Seaview Hospital, Inc. v. Medicenters of America, Inc.,* 570 S.W.2d 35 (Tex. Ct. App. 1978), a general contractor was not precluded from entering into a turnkey contract requiring it to "provide" or "procure" architectural or engineering services through a subcontract arrangement. This arrangement satisfied the objectives of the licensing statutes -- to protect public health, safety and the general welfare by insuring that architectural and engineering work be *performed* only by duly licensed and qualified persons.

Other states, like Iowa and New Jersey, have judicial decisions that interpret the state licensing statutes adversely to the design-build entity, and Oklahoma's Attorney General has opined against joint ventures, citing the licensing statute.

The majority of states are unsettled; they may have traditional A/E licensing statutes, court decisions barring recovery in contract to unlicensed persons performing professional services, both, or no precedent one way or the other. In the last group of states, the uncertainty and the magnitude of the risks involved may be sufficient to discourage design-build projects.

Joint ventures may be able to perform design-build contracts in many jurisdictions, particularly in those not requiring the entity furnishing the design to obtain a license. When the joint venture itself must have a design license, the statutes must be researched to determine if there are any compositional requirements (for instance, whether all directors must be licensed architects) that would prevent it from getting such a license. The joint venture must also determine whether it can obtain a contractor's license, if the statutes require the joint venture, itself, possess a contractor's license, as opposed to one of its contractor members.

Because of the disparity in statutory licensing schemes and judicial decisions, design-builders are urged to make an independent, in-depth review of state licensing laws prior to undertaking a design-build project. Mabry Rogers, Donna Crowe and Rob Campbell recently updated the survey of licensing laws originally written by Mabry Rogers, Wally Sears and Jack Park and published in Chapter 3 of the Design-Build Contracting Handbook (John Wiley & Sons, Inc., 1992). If you would like a copy of the updated survey, please contact one of the lawyers listed at the end of our newsletter.

Revision of Subcontract Payment Terms Does Not Discharge Payment Bond Surety

The United States District Court for the District of Hawaii recently held that the alteration of subcontract payment terms does not discharge the general contractor's Miller Act payment bond surety. In addition, the court held that a Miller Act payment bond claimant has no duty to inform the surety that the general contractor is experiencing cash flow problems. United States f/u/b International Business Machines Corp. v. Hartford Fire Ins. Co., 2000 WL 1300372 (D. Hawaii, July 19, 2000).

IBM, a material supplier on a federal project, agreed to extend the payment period terms of its subcontract after the general contractor ("Richards") informed IBM that it was having financial difficulty. IBM agreed to reduce the amount due and accept payment over time. When Richards later failed to make payment in accordance with the revised subcontract, IBM sought to enforce its rights under the Miller Act payment bond.

According to the court, a Miller Act payment bond claimant must demonstrate that: 1) the labor or materials were supplied in furtherance of the work; 2) the claimant has not been paid; 3) the claimant had a good faith belief that the materials were intended for the project; and 4) jurisdictional prerequisites have been met (such as filing suit within one year of the last day of work or shipment of materials). IBM met all of the requirements for meeting this standard of recovery.

Hartford disputed IBM's claim by arguing that IBM's revision to the subcontract amounted to a new contract. The court recognized that, ordinarily, a surety can be discharged when its principal has entered into a new contract or alters a contract beyond it original scope. However, assuming the claimant can meet the elements for recovery, this defense is not available when the surety has contracted for an uncertain obligation. The court reasoned that a Miller Act surety normally issues its payment bond before the general contractor has identified its subcontractors and executed subcontracts for the project. Thus, the surety does not rely on the subcontract amount, scope or payment terms, and it cannot be prejudiced by a change in the subcontract terms.

Hartford, in fact, issued its payment bond to Richards before Richards executed a subcontract with IBM. Hartford did not rely on the terms and conditions of the Richards/IBM subcontract, and therefore Hartford was not prejudiced by modification of the payment terms. The payment bond supplied by Hartford expressly waived notice of modifications or change orders. Accordingly, the court denied Hartford this defense.

Hartford also argued that IBM breached a duty of fair dealing by failing to notify Hartford of Richard's payment problems. The court stated that a surety can be discharged when a subcontractor engages in fraud or unfair dealing. However, payment bond claimants ordinarily do not have an obligation to notify the surety of its principal's financial difficulties. IBM was not required to notify Hartford when it extended Richards' payment terms. There was no evidence of fraud or unfair dealing, and Hartford was not prejudiced because IBM did not know that Richards would never pay. When Richards did not pay, IBM notified Hartford promptly.

Additional Insured Endorsement Does Not Cover Party's Own Negligence

To manage construction risks, owners and contractors frequently seek to be named as additional insureds under the liability policies of their lower tier contractors (the "named insureds"). However, being named an additional insured does not guarantee that a party will be covered for any and all insurable risks which may arise on a construction project.

Being named an additional insured places the party in a direct contractual relationship with the named insured's insurer. The terms of that relationship are governed not only by the language of the additional insured endorsement but also by the terms of the underlying liability policy. Numerous variations of additional insured endorsements and liability policies abound. For instance, the Insurance Services Offices, Inc. ("ISO") has issued three different standard forms of the additional insured endorsement. Accordingly, a party seeking to be named as an additional insured should carefully review the language of the additional insured endorsement as well as the terms of the underlying liability policy to ensure that its expectations for coverage will be met.

That being said, some general statements regarding additional named insured coverage may be made. Being named as an additional insured will generally protect a party from liability based upon the acts of the named insured and for the party's vicarious liability arising out of the named insured's actions. However, being named as an additional insured may not protect a party from liability based upon its *own* actions.

For instance, in *G.E. Tignall & Co., Inc. v. Reliance National Ins. Co.*, 102 F.Supp.2d 300 (D. Md. 2000), a general contractor was hired to perform renovations on a school building. After lead paint was discovered on the site, the general contractor hired a subcontractor to abate the hazardous material. The general contractor was named as an additional insured on its subcontractor's liability policy under an endorsement which provided coverage to the general contractor "but only with respect to liability arising out of your ongoing operations performed for that insured" where the term "your" was defined as the named insured alone. Id., at 305.

A student at the school brought suit against several defendants, including the general contractor, seeking damages for lead poisoning. Notably, the suit did not name the subcontractor as a defendant. The general contractor tendered the suit to the subcontractor's insurer. The insurer denied coverage and refused to defend the general contractor against the suit. In response, the general contractor brought a declaratory judgment action seeking a declaration that the insurer owed the general contractor both a defense and coverage.

The court concluded that the language of the additional insured endorsement provided the general contractor with coverage only for liability arising out of the subcontractor's work and for claims alleging acts or omissions by the general contractor in supervising the subcontractor's work. Since the suit by the student did not allege any liability "arising out of" the subcontractor's work or the general contractor's supervision of the subcontractor's work, the court granted summary judgment in favor of the insurer.

In *Boise Cascade Corp., Inc. v. Reliance National Indemnity Co., Inc*., 99 F.Supp.2d 87 (D. Me. 2000), the court reached a similar conclusion but based upon the language of the construction contract instead of the terms of the additional insured endorsement. While the existence of coverage remained at issue throughout the case, the owner alleged it was named as an additional insured on the general contractor's liability policy. Several of the general contractor's employees were injured after toxic gas was negligently released by the project owner's employees. The injured employees brought suit against the property owner, who sought coverage as an additional insured under the general contractor's liability policy. After the insurer denied coverage, the property owner brought suit against the general contractor and its insurer.

While the court did not completely dispose of the property owner's claims, the court concluded that the contractual requirement to name the project owner as an additional insured did *not* require the general contractor to insure the property owner against the property owner's own negligence. In reaching this conclusion, the court cited precedent from the United States Court of Appeals for the First Circuit holding that unless a contractual requirement clearly and unequivocally requires a named insured to cover an additional insured for the additional insured's own negligence, such contractual requirements should be strictly construed against providing such coverage.

Certainly these two decisions do not reflect how every court will decide the issue of whether an additional insured endorsement provides coverage for the negligence of the additional insured. However, these decisions demonstrate three important points to consider in negotiating for additional insured coverage. First, a party seeking to be named as an additional insured should review the language of both the additional insured endorsement *and* the underlying policy. Second, the language of the construction contract requiring that the party be named as an additional insured can be broadly worded to require coverage for the party's own negligence as well as coverage for the actions of the named insured alone. Finally, a party seeking additional insured coverage should obtain its own separate liability coverage to avoid being left in a position where additional insured coverage does not provide the desired level of protection.

Often, a question arises as to what insurance is primary -- the additional insured coverage or the party's own liability policy. Which policy will be deemed primary depends upon whether the policies contain "other insurance" provisions and the particular language of those provisions. For instance, if the policy under which additional insured coverage is claimed contains an "other insurance" provision rendering that policy excess insurance and the party's own liability policy does not contain a similar "other insurance" clause, the party's own policy may be viewed as the primary source of coverage. Accordingly, a party seeking additional insured coverage should examine both its own policy and the policy on which it seeks to be named as an additional insured for "other insurance" provisions. Moreover, the party should review local law on the issue of coordinating coverage between different policies since the laws on this subject vary between jurisdictions.

International Arbitration - - No Due Process Right to Attend Hearing

In *Empresa Constructora Contex Limitada v. Iseki, Inc.*, 106 F. Supp. 2d 1020 (S.D. Cal. 2000), a California federal court determined that a United States contractor's due process rights were not violated by its inability to have a party representative present at a foreign arbitration hearing.

Iseki, a United States corporation based in San Diego, entered into a subcontract with a state-owned general contractor on a sewer main project in Valparaiso, Chile. Problems on this high profile public works project received intense scrutiny, resulting in criminal charges filed in Chile against Iseki. A dispute arose between Iseki and its subcontractor, a privately owned Chilean company. Arbitration proceedings were held in Santiago, Chile, according to the terms of the subcontract, and an award was entered in favor of Iseki's subcontractor. In this action filed by the subcontractor to enforce the arbitration award, Iseki alleged that it was not able to properly defend itself in the arbitration hearings because it was afraid that company executives sent to Chile would be arrested. In essence, Iseki argued that the project's failure had become a big scandal in Chile, that it was made a scapegoat, and that the criminal charges prevented it from defending itself in Chile.

The court determined that Iseki had not been prejudiced and its due process rights had not been violated, because Iseki had been represented by counsel in twelve hearings over two years, Iseki had the right to cross-examine all of the plaintiff's witnesses, the arbitrators had heard every witness Iseki offered, the arbitrators did not refuse to admit any documents offered by Iseki, and Iseki had even appealed the arbitrator's decision to the Chilean courts. Accordingly, the alleged inability of its executives to be present at the arbitration hearings was not a valid basis for challenging the arbitrator's award.

This case highlights the finality of foreign arbitral awards, and the rare success of attacks based on procedural fairness. It also highlights the peril of agreeing to arbitrate disputes in the foreign country where the project is located. Often, it is wise to negotiate an arbitration clause that requires the arbitration to be conducted in English, in a neutral country, before a panel chaired by an arbitrator from a neutral country.

Our attorneys have conducted numerous international arbitrations involving projects on several continents. If you have an international construction project and would like to discuss international issues, please contact one of the attorneys listed in this newsletter.

BARW Congratulates

New NAWIC Officers

Michele Smith, Bradley Arant Rose & White, LLP has been elected President of the Greater Birmingham Chapter of the National Association of Women In Construction. Sue Mulroy, BE&K, has been elected President-Elect. Other officers include Linda Westendorf, Brasfield & Gorrie, Vice-President, Susan Colvin, Superrock Block Co., Recording Secretary, Marcia Hastings, Masonry Arts, Corresponding Secretary, and Deborah Crane, M. J. Harris Co., Treasurer. Newly-elected members of the Board of Directors include Nolanda Bearden of Gresham Smith & Partners, Allison Hoover of Brasfield & Gorrie, Jennifer Wallace of McCrory, Inc., and Sandra Wallwork of Brasfield & Gorrie.

Gary Harrington of Brasfield & Gorrie has been named 2000 NAWIC Employer of the Year. Marcia Hastings of Masonry Arts was named NAWIC's Member of the Year. Rhonda Grounds of M. J. Harris was chosen as NAWIC Rookie Member of the Year.

About Bradley Arant

Bradley Arant Rose & White LLP was organized in Birmingham, Alabama around 1900. The firm presently has over 170 lawyers with offices located in Birmingham, Huntsville and Montgomery, Alabama and Washington, D.C. The firm represents a variety of local, regional, national and international organizations and is committed to understanding and responding to the needs of its clients.

The firm has a diversified civil practice including environmental law, labor and employment, health care, employment benefits, construction, litigation, general corporate, partnership and business entity law, mergers and acquisitions, banking, bankruptcy and creditor rights, tax, estate planning, energy, trade regulation, international trade, securities, municipal finance, real estate, governmental affairs, white collar crime, intellectual property and antitrust. The breadth of our practice not only permits us to serve the diverse needs of our regular clients but also gives us the depth and degree of practice emphasis required to assist new clients facing complex legal issues or transactions. Our depth allows us to focus on specific industries, like construction.

We are committed to providing the highest standards of legal service. In recognition of this commitment, many of our lawyers have been selected for membership in professional organizations that recognize outstanding attorneys in particular fields, including the American Law Institute, the American College of Trial Lawyers, the American College of Tax Counsel, the American College of Trust and Estate Counsel, the International Association of Defense Counsel, the American College of Construction Lawyers, the American College of Bond Counsel, the American College of Bankruptcy, the American College of Mortgage Attorneys, the Alabama Law Institute, the Southern Federal Tax Institute, the American Tax Policy Institute and the American Bankruptcy Institute. Two of our lawyers have been members of the Product Liability

Advisory Council. We have more lawyers listed in the most recent edition of *The Best Lawyers in America* than any other Alabama law firm. Since 1923, the *Martindale-Hubble Law Directory* has selected our firm to serve as the reviser of its *Alabama Law Digest*.

We also seek to improve the legal system. Throughout our history, our lawyers have been actively involved in local, state and national bar associations, in legal education and in other professional activities. Members of the firm have served as presidents of the Alabama, Birmingham and Huntsville-Madison County Bar Associations and have been elected chairs of the major practice sections within the Alabama Bar, including, in recent years, Litigation, Health Law, Labor Law, Tax, Real Property, Probate and Trusts and Environmental Law. A number of attorneys from the firm have been, or are, on the adjunct faculty at the University of Alabama School of Law, the Cumberland School of Law and other law schools. Three of the firm's lawyers are members of the International Bar Association, and the firm is a member of the American Law Firm Association ("ALFA"), an international law firm group. Two former partners have served as federal judges.

We also are committed to improving government through the preparation and implementation of essential legislation at the state level in the areas of municipal finance, education and tax reform. One of our late partners drafted the legislation that allowed Alabama to be one of the first states in the country to offer industrial revenue financing. Another partner was appointed by the Governor to chair the most comprehensive tax reform proposal ever considered by the Alabama legislature. Members of the firm also have served on committees charged with drafting and revising numerous business and property laws, including the Alabama Business Corporation Act, the Alabama Limited Liability Company Act, the Alabama Uniform Partnership Act (1996), the Alabama Uniform Commercial Code, the Alabama Condominium Code, the Alabama Probate Code and Alabama's trademark and trade secret laws. Recently, the firm published a handbook that explains Alabama's governmental ethics laws.

While committed to excellence, we are sensitive to the need to control costs. We understand that the value of what we do is measured by the results. To provide more timely and cost-effective service to our clients, we have invested heavily in state-of-the-art voice and data technology. As a result, we are easily accessible to our clients – whether by e-mail, phone, facsimile, or video conference. A large menu of off-the-shelf and custom applications for litigation support, budgeting, planning, communications, legal research and financial analysis is available to our attorneys to provide them with access to the tools they need to best serve our clients' needs. Because notebook computers are available to all attorneys and legal assistants, the firm's computer network capabilities are available at any location that can be reached by telephone.

Lawyers' Activities

Sept. 22, 2000	Axel Bolvig made a presentation to the Birmingham chapter of the Construction Financial Managers Association. The topic was the new Alabama law making purchases on public contracts exempt from sales and use taxes. He has also given this presentation to clients at in-house seminars.
Oct. 2000	Nick Gaede published an article dealing with the new FIDIC design-build form known as the "Silver Book." *See*, Gaede, "The Silver Book: An Unfortunate Shift From FIDIC's Tradition of Being Evenhanded and of Focusing on the Best Interests of the Project," Vol. 17, Part 4. International Construction Law Review (Oct. 2000)
Oct. 25-26, 2000	Stanley Bynum attended the Complex Surety Litigation Seminar in Philadelphia which covered many of the issues that we see in our Surety work.
Oct. 27, 2000	Joel Brown, Donna Crowe, Rodney Moss and Mabry Rogers presented a seminar sponsored by Lorman: "Construction Management/ Design Build." The seminar was held in Birmingham and was well received.
Oct. 30, 2000	Rodney Moss attended Leadership in the New South - Governor's Leadership Conference.
Dec. 8, 2000	Wally Sears and David Hymer will make a presentation at the Construction Superconference in San Francisco titled, "The Role of the Internet in the Discovery Process."
Dec. 14, 2000	Mabry Rogers, Axel Bolvig and Joel Brown will present a seminar for NBI titled "Construction Law: What Do You Do When. . .?" This will be held in Birmingham.
March 8, 2001	Mabry Rogers, Wally Sears, Jim Archibald and Joel Brown and will present a Lorman Seminar on Public Contracting in Alabama. This will be held in Birmingham.

Disclaimer and Copyright Information

The lawyers at Bradley Arant Rose & White LLP, including those who practice in the construction and procurement fields of law, monitor the law and regulations and note new developments as part of their practice. This newsletter is part of their attempt to inform their readers about significant current events, recent developments in the law and their implications.

This newsletter is a periodic publication of Bradley Arant Rose & White LLP and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have. For further information about these contents, please contact your lawyer or any of the lawyers in our group whose names, telephone numbers and E-mail addresses are listed below; or visit our web site at www.barw.com.

A. H. Gaede, Jr.	(205) 521-8323	ngaede@barw.com
Stanley D. Bynum	(205) 521-8000	sbynum@barw.com
E. Mabry Rogers	(205) 521-8225	mrogers@barw.com
Gary C. Huckaby (Huntsville)	(256) 517-5140	ghuckaby@barw.com
Andrew J. Noble, III	(205) 521-8342	anoble@barw.com
Walter J. Sears	(205) 521-8202	wsears@barw.com
H. Harold Stephens (Huntsville)	(256) 517-5130	hstephens@barw.com
Michael D. McKibben	(205) 521-8421	mmckibben@barw.com
David G. Hymer	(205) 521-8289	dhymer@barw.com
Axel Bolvig, III	(205) 521-8337	abolvig@barw.com
J. David Pugh	(205) 521-8314	dpugh@barw.com
James F. Archibald	(205) 521-8520	jarchibald@barw.com
Douglas E. Eckert	(205) 521-8519	deckert@barw.com
Rodney L. Moss	(205) 521-8251	rmoss@barw.com
Arlan D. Lewis	(205) 521-8131	alewis@barw.com
Joel E. Brown	(205) 521-8416	jbrown@barw.com
Donna M. Crowe	(205) 521-8418	dcrowe@barw.com
Stacey A. Thurman	(205) 521-8086	sthurman@barw.com
Robert Campbell	(205) 521-8702	rcampbell@barw.com
David W. Owen	(205) 521-8333	dowen@barw.com

Note: The following language is required pursuant to Rule 7.2 Alabama Rules of Professional Conduct: *No representation is made that the quality of the legal services to be performed is greater than the quality of the legal services performed by other lawyers.*