

## IS THE GRASS REALLY GREENER ON THE PUBLIC SIDE? TRANSITIONING FROM PRIVATE TO PUBLIC CONSTRUCTION

- Marc Brown, Vincent Cardella, and Brian Fern

### I. OVERVIEW

With private financing scarce, contractors are increasingly turning to publicly financed projects to help them weather the storm of economic downturn. Although the public sector certainly has not been immune to the challenges of the current economic crisis, public bond initiatives passed in better times and federal stimulus spending (The American Recovery And Reinvestment Act of 2009) have allowed the continued flow of public money for construction projects, at least in the near term. As a result, more construction firms are competing for public dollars. With the dearth of private construction forecasted to continue well into the future, and with private financing scarce, contractors are forced to seek out available sources of revenue in what is often times the only place still available, the public construction economy.

### II. OBTAINING PUBLIC WORK

#### *Public Pricing vs. Private Pricing*

Pricing structures differ greatly with respect to public versus private work. The owners of private projects develop and set the terms for their projects as they deem most appropriate and as a result these owners have great latitude in controlling project delivery, subject to whatever restrictions the owners' lender imposes. It is not at all unusual for a private owner to accept a higher price for a project from a well known contractor and to decline proposals from less expensive construction companies who lack the same reputation or previous experience with that owner. The reasons for owners selecting a more expensive contractor may be many, but the primary motivation for the owner is to choose the contractor who is most likely to deliver a revenue-generating project on time and in line with owner specifications.

By contrast, public owners seek out the lowest responsible bidder. This eliminates a contractor's ability to leverage its reputation in order to achieve more favorable pricing, and instead forces the contractor to rely on one thing – a competitive bid to secure the work. When the construction economy is robust, as we saw for several years prior to the current economic downturn, contractors bid jobs with significant margins. The conventional wisdom was, simply, "I do not need this job...but if I somehow get it, I will make a killing". When the economy is weak, however, the opposite dynamic takes place: the diminished amount of private and public work creates an environment where many more contractors submit bids, and as work begins to thin, those bids become increasingly more competitive as contractors shed profit margins to attempt to secure work to stay in business.

Having lived through difficult economies, many veteran contractors know that the best practice for their company is to pursue work with diligent pricing practices and careful job estimation even though the ensuing responsible bids will eliminate them from a great deal of public work. Hopefully they will have the financial strength to weather a temporary downturn in revenue and not submit to the temptation of "buying jobs" (submitting bids so low just to obtain work to maintain cash flow, rather than profit). Contractors who have not had the experience of living through down markets need to be educated on the potentially deadly effects of bidding work at what they know to be unrealistically low margins.

#### **Disclaimer**

This paper is for general informational purposes only. None of it constitutes legal advice, nor is it intended to create any attorney-client relationship between you and the author. You should not act or rely on this information concerning the meaning, interpretation, or effect of particular contractual language or the resolution of any particular demand, claim, or suit without seeking the advice of your own attorney.

### *Financial Strength and Cash Flow*

From an underwriting perspective, the balance sheet and cash flow history of a contractor primarily or exclusively involved in private work may be significantly different from one that is dedicated solely to work in the public sector. Construction surety underwriters are used to seeing balance sheets and income statements that differ from other types of businesses, in that revenue is subject to varying degrees of peaks and troughs. The term “lumpy” is often used to describe the temporary highs followed by low periods of both revenue and cash flow. For the private contractor, this difference is often much more pronounced. Dedicated private contractors, working with a handful of well-known owners, are much more attuned to waiting through periods of low revenue generation when they know they are the sole contractor being considered for a large project with a known owner. As such, underwriting the private project contractor now transitioning to public work may be significantly more difficult.

From the perspective of the contractor, the undertaking of large public projects for the first time will present its own unique financial challenges. Unlike negotiated private work, the payment terms for public projects are fixed. High mobilization costs comparable to initial payments, fixed retention amounts, and strict change order policies are just a few of the potentially serious financial challenges a contractor will face when undertaking public work. For considerably large projects, it is absolutely essential that a contractor have a detailed cash flow forecast that presents a realistic picture of the dollar-for-dollar payments and receivables throughout the life of not only the specific project pursued, but all other ongoing work as well. Sufficient working capital is a must.

### *Bonding*

Surety underwriters are well aware of the federal Miller Act (and state “little Miller”) legislation requiring bonds for public works. What underwriters should not assume is that all contractors, simply by nature of working in the construction industry, are aware of the process by which they and their company are evaluated for bond support by the surety, and how the surety further reviews specific projects submitted to the surety for bond support. Contractors moving from exclusively unbonded private work to bonded public work should be made aware – proactively – of what specific financial metrics are considered critical, how sureties evaluate both work history and future projects to be considered based on the company’s business plan, and what the surety will expect from the contractor if they are to form a long term relationship. The contractor needs to understand this is not a transactional business, that open communication with the surety through the construction bond agent is critical, and the more the surety underwriter understands and is in tune with the contractor’s business plan and anticipated future endeavors, the less likely it is for last minute difficulties to arise in project approvals that are seen to be excessively large, or “out of the box” in terms of scope or conditions.

### *Public Work Prequalification Process*

A basic tenet of government contracting at the federal, state, or local level is that a contract can be awarded only to a responsible bidder. The responsibility requirement has been described in a variety of ways. For example, the Federal Acquisition Regulation (“FAR” or “FARS”) describes a responsible bidder as having adequate financial resources to perform the contract; be able to comply with the required performance schedule; have a satisfactory performance record; have a satisfactory record of integrity and business ethics; have the necessary organizational structure and experience to complete the work; have the necessary production, construction, and technical equipment and facilities (or the ability to obtain them); and be otherwise qualified and eligible to receive an award under applicable laws and regulations. State laws have similar requirements, and while the language varies the common thread is that to be “responsible” a bidder must possess technical capability, financial resources, and integrity.<sup>1</sup>

Traditionally, a determination of bidder responsibility is made following bid opening. In cases where the low bidder is deemed to be non-responsible, significant problems may arise. A contractor that has invested considerable time and effort in putting together a bid and is the low bidder is not likely to accept a finding of non-responsibility and simply walk away. A solution to the problems associated with the traditional procedure is to move the responsibility determination from after the bid opening to before the bid opening by prequalifying bidders. Prequalifying has several advantages, the most significant of which is that contractors that fail to pre-qualify find this out before they have become invested in the project. Under the traditional procedure, there is a certain amount of stigma attached to

being found non-responsible after being identified as the low bidder at a public bid opening, to say nothing of the time and effort spent in preparing the bid, collecting subcontractor prices, etc. A contractor that fails to prequalify does not have to reveal that fact to anyone, and saves substantial time and effort on a fruitless bid.<sup>2</sup>

Prequalification of Contractors is not generally mandated on federal projects pursuant to the FARS. However, in some instances federal agencies do have the discretion to prequalify bidders. For example, the Defense FAR Supplement (DFARS) provides in §236.272 (a): "Prequalification procedures may be used when necessary to ensure timely and efficient performance of critical construction projects". Some states have similar discretionary powers to prequalify contractors. One example is the state of California. California's Public Contract Code, §10160, 10163, 10165 and 10166 provide that a local or state public agency may require prospective bidders to submit prequalification questionnaires.

### *Bid Process*

Public contracts are awarded to the lowest responsible, responsive bidder. The "responsible" portion of the award standard means simply that the contractor possesses the "skill, judgment and integrity necessary to the faithful performance of the contract, as well as sufficient financial resources and ability." Contractors pursuing public contracts must be "reputable and qualified contractors regularly engaged in their respective lines of endeavor." Given the number of new players bidding for public dollars, questions of "responsibility" may become more commonplace. While the courts will allow a public body latitude to reject contractors it does not believe are responsible, this discretion is not unfettered. If a public body cannot articulate a legitimate reason for deeming a bidder not responsible, the aggrieved bidder may have grounds to challenge that determination.


A "responsive" bid, on the other hand, is one that substantially meets the requirements of the specifications applicable to the contract. Low bidders who have made mistakes in their bid form must satisfy the awarding authority that any deviation is minor in order to keep the work. While an owner may waive minor deviations, it is prohibited from waiving any material deviation. If a bid is not responsive, it must be rejected - the bidder does not have any opportunity to correct the mistake or supplement its bid. The result is that the owner must move on to the next lowest bidder.

### *Bid Challenges*

Firms that come in second on bid day occasionally seek to convince the public owner to disqualify the low bidder as nonresponsive to secure the work for themselves. It is important for the low bidder as well as the challenger to seek legal counsel to present their best case to the awarding authority. A disappointed bidder should immediately raise (in writing) any alleged bid irregularity with the awarding authority. This challenge must be initiated quickly as a public body is far less likely to reverse a prior award once it has entered into a contract with the low bidder. If the public body denies the aggrieved bidder's request, the bidder may maintain a formal challenge to the award. The method for initiating and prosecuting a formal bid challenge varies with each jurisdiction. In some situations the contractor challenging a bid should seek a temporary restraining order from the Courts, restraining the public body from issuing the award, entering into the contract, and/or issuing a notice to proceed (all dependent upon what stage the contract award process is in). Guidance from competent legal counsel is highly recommended in bid challenges.

### *Increased Competition*

The lack of private work has continued to drive more and more hitherto exclusively private contractors to pursue public work. Pressure on government entities to delay or even cancel public projects to offset shortages in revenue, even with stimulus spending on infrastructure, is resulting in a diminished pool of work, minor in some areas and extreme in others. But even if the number of public projects remains static (or declines), the increase in the amount of contractors now competing for that work is resulting in substantial declines in revenue as contractors see a fixed amount of work in the public domain spread out among many more companies. Contractors today face an enormous temptation to lower their bid submissions not only to cut out healthy profits, but well below what they would have seen as realistically safe just two years ago. It is not uncommon to see twenty or more bidders on projects that would have gained interest from only five or six bidders three or four years ago.



Obviously, the contractor being awarded the work under such conditions faces a mixed bag. On the one hand, the contractor is at least getting some work, and if everything on the job proceeds according to plan, the project will complete at break even or with some modest profit. As we've all seen, however, things rarely proceed precisely as anticipated, and contractors who choose not to build an allowance for potential added costs into their bid – for weather difficulties, supply problems, un-approved change orders, labor issues, and a myriad of other latent problems – do so at their own peril. It behooves contractors – and underwriters – to understand that the increase of just a few percentage points in cost on a larger job could endanger the contractor's entire balance sheet value, the contractor is better off – literally – doing nothing than entertaining bidding on such a project at the level required to realistically compete for the project.

### **III. CONTRACT ADMINISTRATION**

#### *Staffing/Personnel*

When a contractor is considering bidding on a public project it needs to pay special attention to several contractual requirements in establishing its estimate. One of the more significant areas where requirements can vary greatly between the private and public arena is project staffing. Public contracts can set very specific and sometimes onerous staffing requirements for the contractor in administration of the contract. Contractors need to take the cost of these administrative requirements into account when bidding the project and ensure that they have qualified personnel available to properly staff the project. These contract requirements may include special training, certifications, licenses, etc., for onsite personnel to have in order to be approved by the owner to work on the project. There may be significant cost and time impacts to the contractor if it needs to have existing staff obtain the required training or certification (if that is even an option). If the alternative is to hire on new employee(s) in order to meet these requirements they may come at a premium. Moreover, even if qualified personnel are available for hire they are unproven and subject to the learning curve that comes with all new employees.

Another staffing issue on a public project is the fact that many public contracts require a dedicated individual to perform certain roles on the site. The contract may require a dedicated safety officer or quality control representative and preclude that individual from performing any other functions such as project superintendent, project engineer, etc. This may vary from the contractor's normal operations and can have an impact not only on the general condition costs for the project but also on the company's overall staffing plans and bench strength.

#### *Record Keeping & Reporting Requirements*

Although all projects, public or private, may require the contractor to maintain project records and documents in addition to what that contractor may customarily keep, public contracts can be very specific about what forms are to be filed and how and when they are to be completed. Many public owners will require these forms to be completed as a prerequisite to approving and processing monthly payments, which makes it imperative for the contractor to be cognizant of what is required of it and its subcontractors. The contractor needs to ensure that it has the staff and systems available to keep these records current. Some of the record keeping documentation required may include, but not be limited to, the following:

- Certified Payrolls
- Women Owned Business (WBE)
- Minority Owned Business (MBE)
- QA/QC Reports/Logs
- Subcontractor/Vendor Lien Releases or Waivers
- Non-Conformancy Notices (NCN's) or Deficiency Logs
- Subcontractor Insurance Certifications
- As-built Drawings

Any deficiencies by the contractor in keeping these records and documents up to date can impact the timely processing of its pay requests, negatively impacting cash flow. In addition, this can strain relationships between the contractor and owner, as well as between the contractor and its subcontractors. The contractor needs to be vigilant in

obtaining all required documentation from its subcontractors in a timely manner in order to avoid entire payments being withheld due to the failure of one or two subcontractors to comply with the record keeping requirements.

### *Subcontractors*

Contractors that perform a large volume of private work, whether negotiated or hard bid, usually rely upon a proven group of subcontractors that they trust and have established a good working relationship with over time and work with from project to project. When considering a public project the contractor should be aware that there is a good possibility that it will not have the luxury to continue to work with the select group of subcontractors with whom it has established relationships. One reason for this is the fact that these subcontractors may not be familiar with the public market and won't be competitive in that arena. As previously discussed, public projects are typically bid and awarded based on price. In order for a contractor to be competitive bidding public work it will have to utilize the lowest, most responsive subcontractor bids when preparing its estimate regardless of whether there is a working relationship or not. Another reason why a contractor would be required to work with subcontractors it is unfamiliar with would be to meet contractual WBE, MBE, or DBE requirements. In these cases it would be very prudent for a contractor to do its due diligence to familiarize itself with the subcontractors performing this type work in the area, especially as it relates to the major trades. Most of the subcontractors that pursue this work are job result driven and there is no consideration to relationships or future work with the contractor and quite often the subcontractor's first loyalty may be to the public owner. Even if not required by the underlying prime contract, the contractor should consider requiring payment and performance bonds from all subcontractors whose contract value exceeds a certain threshold and/or is otherwise critical to the project. The more proactive the contractor is in understanding the subcontracting market in the public arena the better chance it will have at a successful project.


### *Contract Documents*

Public contracts tend to be very onerous in comparison to more widely accepted AIA forms or variations of the same that are used in the private sector. Additionally, administrators on public contracts are very familiar with the terms and conditions of their contract forms and are very hesitant to accept anything other than what is required by the contract terms. Any contractor moving from private to public work should carefully review the proposed contract language and familiarize itself with all the terms. Some of the more important terms that a contractor needs to fully understand in order to avoid costly impacts or disruptions to the project are as follows:

- Notice Provisions
- Payment Terms/Procedures
- Damage Provisions
- Change Orders
- Time Extensions
- Indemnification Clauses
- Testing & Inspections Certifications/Signoffs
- Closeout Documentation Requirements

The most critical contract provision for a contractor to become familiar with may very well be the notice provision terms. If the contractor is not aware of the notice provision requirements in the contract or fails to abide by them it may prejudice or waive its rights to seek an adjustment for cost, a time extension, or reimbursement for changes or impacts to the project caused by the owner or a third party. Many public agencies will not even begin an investigation into the merits of a contractor's claim unless it has first met the notice requirements in accordance with the contract terms. Contractors need to be vigilant in documenting any impacts or potential impacts to the project and cannot take a wait and see approach which may have worked for them in the past on private projects. Claims and change orders on public projects are discussed in greater detail later in this paper.

Additionally, the practice of putting a public owner on notice for any potential impacts in order to insert a place holder or a reservation of rights to submit a claim for added costs or time at a later date are often no longer sufficient. Many public contracts require that certain time frames be met as far as notice of the claim as well as establishing the cost and impact of the claim. Oftentimes the final cost and impact of a changed condition may not be able to be established or even known until sometime in the future. It is always wise for a contractor to put an owner on notice



as soon as possible of a potential impact; however, justifying the total cost of the claim in the future may be challenging depending on the contract language. The best advice is to read the contract carefully and familiarize oneself with the terms and conditions, and follow them.

### *Scheduling*

Project scheduling requirements can differ greatly from private to public work contracts. The contractor needs to be sure that it has the personnel and software available in order to provide the schedule and periodic updates in accordance with the contract. Some public owners require resource and/or cost loaded schedules which require certain detail and software that the contractor may not be proficient with. Some public contracts require that the scheduling duties be performed by an outside consulting firm that has a certain level of expertise and experience in performing these tasks. Whether the contractor is required to outsource the scheduling activities or chooses to do it in-house, it must account for the costs in its estimate and be sure there is a qualified scheduler available with whom it is comfortable working.

If a contractor is not confident that it is capable of meeting the required scheduling duties with existing staff, then it would be best for it to seek outside support. A current updated project schedule is not only a critical tool in the successful management of a project, it is often a prerequisite for the release of progress payments. Additionally, any impacts to the "as planned" schedule will need to be documented and submitted to the owner when they are encountered in order for the contractor to seek an adjustment for any time and cost impacts. Failure of a contractor to understand the contractual requirements and be prepared to follow them in regards to project scheduling could prove to be detrimental, if not fatal, to the financial success of the project for the contractor.

### *Other Considerations*

When evaluating projects to determine if there is interest in pursuing the project (as well as in the preparation of the bid), there are some additional factors the contractor should consider:

- LEED Certification – Although both private and public owners appear to be embracing LEED Certifications on their new projects, public owners may be required to do so in order to meet new regulations and or obtain certain grants, loans, or tax incentives. Contractors need a clear understanding of their contractual obligations in relation to meeting established LEED standards and what the financial exposure is to their firm if in fact the owner does not receive expected savings or credits. Contractors bidding these projects need to ensure that they have the qualified staff and systems in place in order to meet these requirements. Additional training of staff and/or subcontractors may be required as well as requirements that onsite staff possess certain LEED certifications/designations.
- Substitution/Equals – Most public owners have very strict requirements regarding a contractor obtaining approval to make substitutions for specified materials even when the proposed product is shown to be equal or superior to the specified item. Many public contract administrators are very hesitant to accept a substitution and will stand behind the requirements of the contract versus approving a substitute and exposing themselves to potential criticism. Most public contracts have express and very limited time frames for a contractor to submit any proposed substitutions and in some cases they need to be submitted and identified with the contractor's initial proposal/estimate. The unavailability of a specified item or long lead times to procure an item could significantly impact a contractor's initial progress on a public project when the same could be avoided on a private project by the contractor obtaining a variance.
- Learning Curve – Regardless of how prepared a contractor is to move from private to public work there will inevitably be some learning curve associated with the change. This is the case moving from private to public as well as moving from one public agency to another or from one region or state to another. Contractors need to understand and allow for inefficiencies when starting up a project with a new owner, region, or contract administrator.

## **IV. CONTRACT COMPLIANCE/LANDMINES**

### *Public Owner Bankruptcies/Budget Concerns*

The present economic challenges that the United States is facing have had a very significant impact on many states, counties, and municipalities' abilities to balance their budgets and fund programs and projects. In the present public contracting arena it is important for public contractors to perform some due diligence to ensure that the public entity with whom they are contracting will have the funds necessary to pay the contractor.

There are several ways a contractor can look into the financial strength of a state, municipality or school district for whom it is intending to do work. For example, financial rating services such as "Moody's" provides ratings for many medium and large municipalities (as well as states) for bond offerings. In the electronic age in which we live, a few clicks on Google or other similar search engine sites can also provide significant information. At the very least, the contractor should request written confirmation from the owner that the project has been funded.

While federal government contracting appears to be the most stable from a financial standpoint at this point in time, many states and municipalities have not been so fortunate. In 2009, the city of Vallejo, California, declared bankruptcy. The city of Vallejo appears to be a microcosm of the financial challenges that the state of California and its various cities, towns and counties are experiencing. In 2009, as the state of California struggled with passing a budget, the state considered suspending ongoing projects. Additionally, the state seriously considered issuing "warrants" as payment for ongoing work. The warrants were simply IOU's to be redeemed at a later date when the state could make good on its financial obligations. In the present economic downturn, contractors pursuing public work must be ever vigilant to ensure that they are able to obtain payment for the work that they perform for public owners.

### *Prevailing Wages*


In 1934, the federal Davis Bacon Act was passed requiring contractors to pay the "locally prevailing" wages and benefits to workers on federal projects. The Act was designed to protect local construction companies from being undercut by cheaper outside labor. Most states have similar legislation. The Davis Bacon Act was amended in 1964 to include fringe benefits in the calculation of prevailing wages. Contractors that have worked exclusively in the private construction market can experience a real "eye opener" when they come to fully appreciate the added labor expense that often comes with working on public projects. Moreover, a public contractor must ensure that it is properly "classifying" its workers into the appropriate trade classifications. Additionally, there is often significant added paperwork that comes along with prevailing wage regulations to ensure compliance and enable federal, state or municipal auditors to confirm that the proper wages are being paid. Failure to pay the proper wages often results in significant fines and penalties.

Finally, public contractors who are acting as general contractors must be vigilant to ensure that their subcontractors are also paying prevailing wages. Laborers of a subcontractor on a public works project are usually able to file a claim on the general contractor's bond, which can create a scenario whereby the general contractor, under its indemnity obligations with the surety, must fund its subcontractors' prevailing wage obligations if the subcontractors did not do so.

### *Bond Substitutes for Lien Rights*

It should come as no surprise to most people that a general contractor, subcontractors, laborers, or others providing services on a public construction project cannot file a lien against the property in an attempt to recoup what is owed to them via a foreclosure action. Public policy dictates that as a whole we do not desire to have public buildings and public properties foreclosed upon. In most instances, the general contractor on a federal, state, or other public project is required to post payment and performance bonds.

The payment bond substitutes as security for subcontractors, laborers, and material suppliers who provide labor or provisions for the project. For a general contractor that is new to public construction and bonding, it can come as a very unpleasant surprise when the surety notifies the general contractor of a claim on the bond by a material supplier



to one of the general contractor's subcontractors who asserts it has not been paid for materials provided to the project even though the general contractor may have paid the subcontractor for the materials previously. The general contractor must be vigilant in obtaining proper lien releases from its subcontractors and their suppliers as the work progresses and utilize other methods such as joint checks to ensure that the general contractor is not required to pay twice.

#### *Claims Certification*

Another potential landmine for contractors new to public works projects are the various state "False Claims" statutes as well as the federal False Claims Act ("FCA"). The FCA<sup>3</sup> was originally passed in 1863 during the Civil War in response to overcharges and other abuses by defense contractors. In 1986 Congress substantially amended the FCA, broadening the availability of the statute to "enhance the government's ability to recover losses sustained as a result of fraud against the government."<sup>4</sup> In general terms the FCA imposes liability on any person or entity that knowingly presents a false or fraudulent claim to the United States government. The FCA imposes significant liability, including penalties and treble damages, on anyone or any entity that is found to have violated the FCA.

Following the broad 1986 amendments to the FCA, many states passed similar legislation. While each of the states' false claim legislation is a little different, the penalties and damages for filing a false claim can be significant, including debarment from bidding on public projects.

The public works contractor must not only be vigilant in the proper certification of its own pay applications and claims, but must also take extra care in certifying claims on behalf of its subcontractors. Many public owners either have legislation or contracts that mandate that all claims (and pay applications) be certified by the general contractor under penalty of perjury.

#### *Obtaining Additional Compensation for Change Orders and Claims*

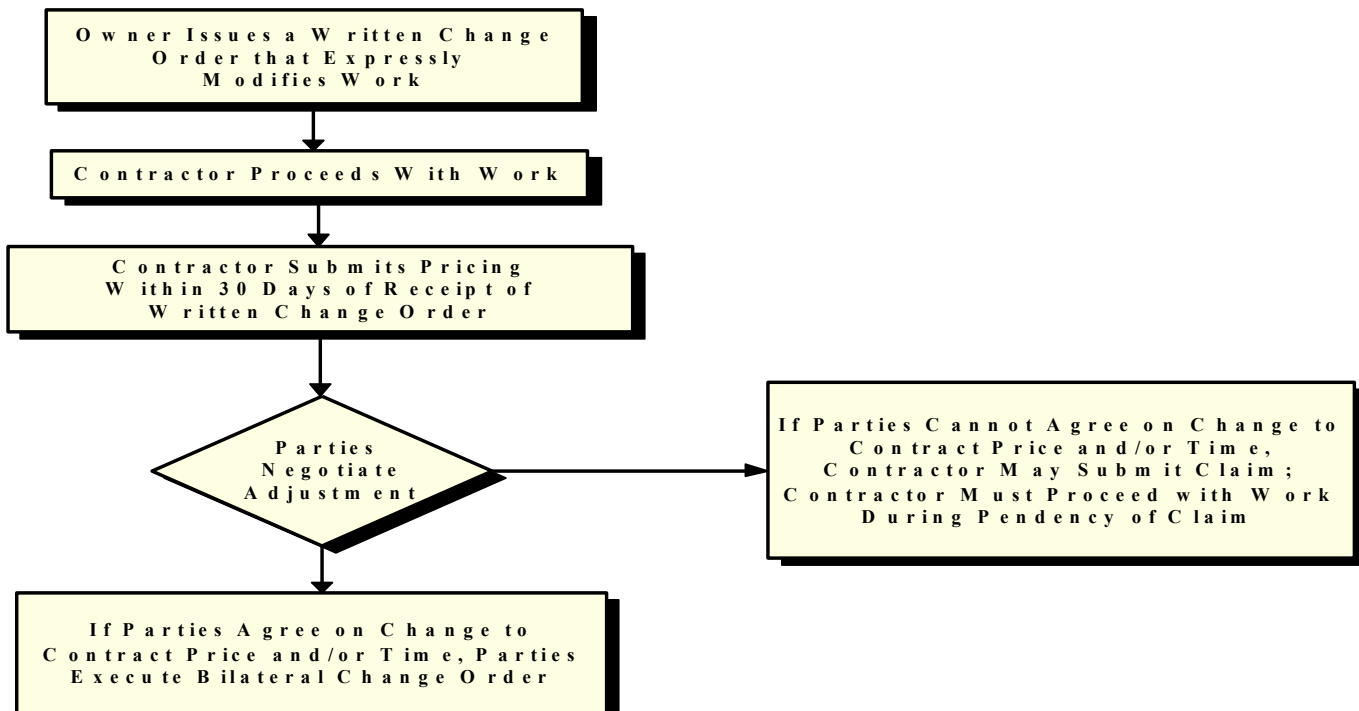
Construction is an inexact science and on larger projects there are often many changes throughout the course of a project. The basis for changes, and therefore change orders and claims, arise from many differing factors including: incomplete or inadequate specifications and drawings, differing site conditions, delays, weather, changes by the project owner to the scope of work, etc. To the extent the contractor is not the cause of the changed condition or delay or has not otherwise assumed the risk for same in its contract, the contractor will seek additional compensation for its additional costs, including home office overhead. In public construction contracts, more often than not, a contractor is required to jump through a myriad of hoops to perfect its right to receive additional compensation.

For a contractor to be successful in obtaining additional compensation, it must be able to not only establish entitlement, but quantum. The successful contractor must have systems in place that enable it to produce a paper trail that reflects the basis for the claim or change order, including who requested or directed the work. In addition, it must have a sufficient cost system that allows the contractor to track the additional costs relating to the changed work.

Using the federal model as an example, the process that the contractor must follow to enable it to obtain additional compensation for change order work is fairly complex. First, a written directive for additional work within the general scope of the contract must be issued by a government representative having actual authority (usually the contracting officer). Below is a diagram that expresses the process for a fixed price contract under FAR 52.243-4.



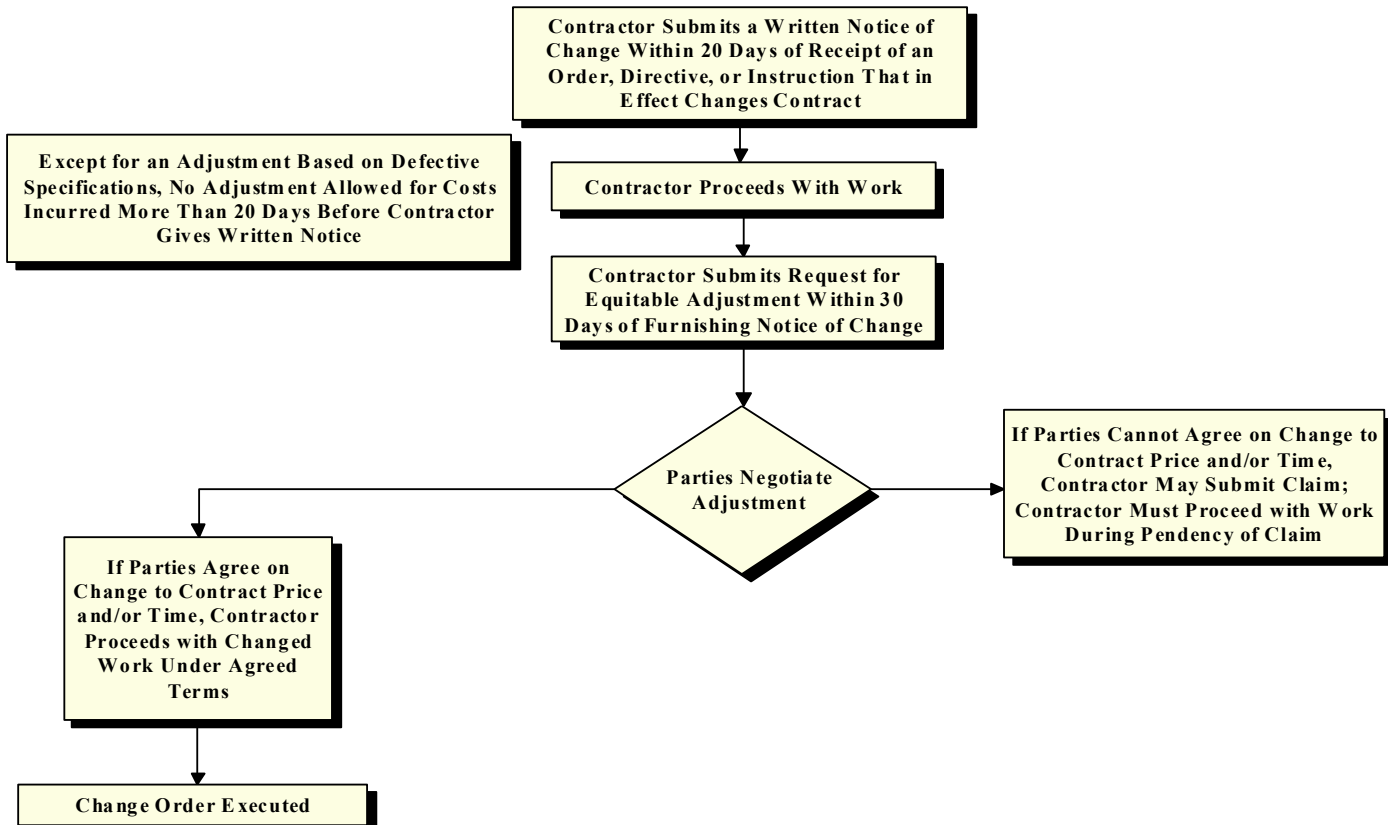
## C H A N G E S C L A U S E ( F A R 5 2 . 2 4 3 - 4 ) ( F i x e d - P r i c e , E x p r e s s C h a n g e s )



If a contractor is working on a federal project under a cost reimbursement form of a contract and the owner has provided a directive for additional work, the contracting officer must provide an "estimated cost of the change work" and then the contractor has 30 days to seek an adjustment to the estimate. The contractor is not required to perform beyond the original estimated contract value until a change order is finalized.

Oftentimes a contractor on its own initiative believes it is entitled to additional costs. Below is a diagram that describes the process under FAR 52.243-4 for constructive changes on a fixed price contract, where the contractor initiates the request for a change order.

## CHANGES CLAUSE (FAR 52.243-4) (Fixed-Price, Constructive Changes In The Work)



As represented in the diagrams above, the process for successfully obtaining compensation for changes to the work can be quite complex. The contractor must be careful to provide timely notice as required under its contract or other federal, state, or municipal specifications, closely follow the claim procedures, and carefully track its costs. Failure in any of these areas may cause the contractor to waive an otherwise valid claim for additional compensation.

### *Dispute Resolution*

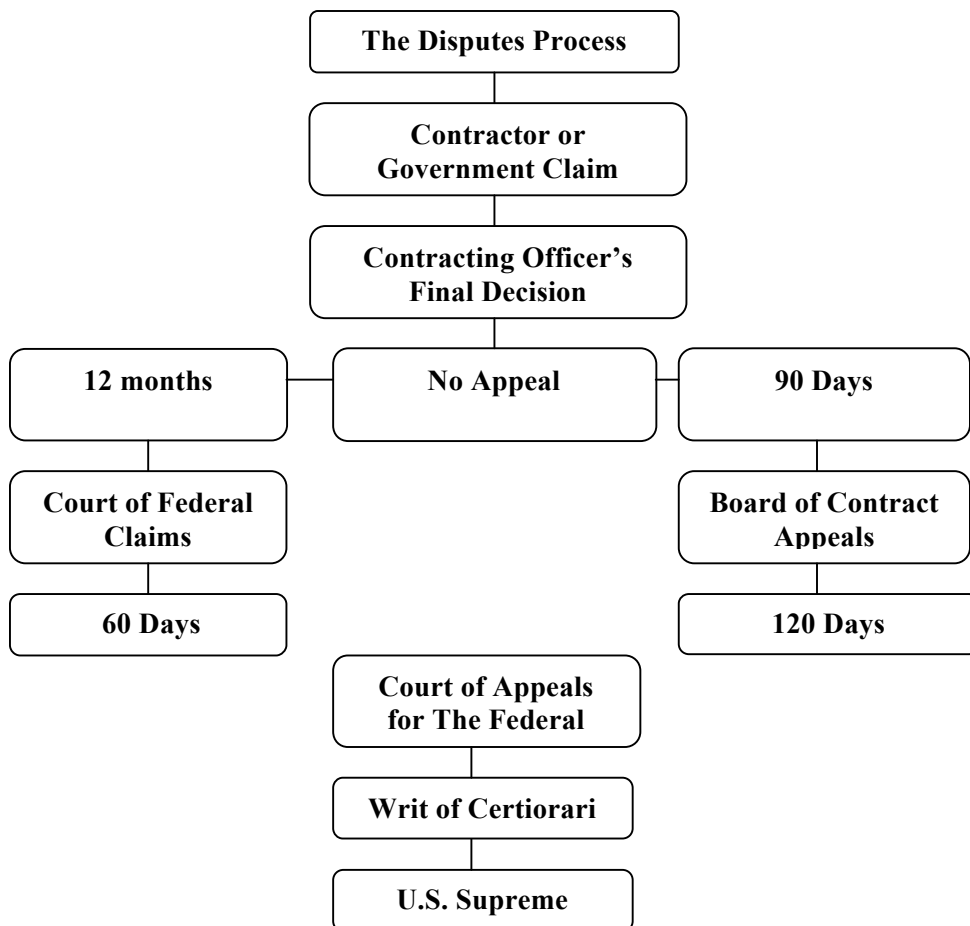
When changes occur or claims are made relative to a construction project, the parties oftentimes are able to resolve the dispute through negotiations. A negotiated resolution is the preferred method of dispute resolution as it is much less costly and time consuming. However, the parties to a construction contract often are unable to agree to a resolution relative to the pricing of a change order or a claim. Most construction contracts have a dispute resolution provision that outlines how disputes will be resolved if the parties cannot resolve them amongst themselves. These dispute resolution processes can be very simple or very complex. Oftentimes the dispute resolution clause of the contract initially requires that the parties meet and confer and try to come to a settlement. If that does not resolve the conflict, a third party neutral or mediator is often mandated. From that point it usually goes to a more formal arbitration or litigation mode.


On federal projects the Contract Disputes Act (CDA) of 1978, 41 U.S.C. Sections 601-613 governs the process for dispute resolution. The CDA was intended by Congress to:

- A. Help induce resolution of more disputes by negotiation prior to litigation;
- B. Equalize the bargaining power of the parties when a dispute exists;
- C. Provide alternate forums suitable to handle the different types of disputes; and
- D. Ensure fair and equitable treatment to contractors and government agencies.

In the federal forum if the parties are unable to reach a settlement on a claim then the claim is submitted to the contracting officer for a "Contracting Officer's Final Decision". The Contracting Officer's Final Decision is binding and conclusive unless it is timely appealed. If the contractor desires to appeal the Contracting Officer's Final Decision, then it has two tracks available to it: either through the Court of Federal Claims or the Board of Contract of Appeals. The diagram below outlines this process:

### Contract Disputes Act Flow Chart





Regardless of the dispute resolution process that is required of the contractor in a federal, state, or municipal contract setting, the contractor must be very familiar with the process, the timelines, its options, and ensure that it follows the requirements precisely. As expressed visually in the diagram above outlining the Federal Contract Disputes Act process, the process can take a significant amount of time and resources.

### *Warranties*

Another area where contractors (and their sureties) must weigh the risk of performing public construction is the length of warranties that they are bound to under their contracts. Private construction contractors are used to having fairly short warranty periods that usually do not extend for more than one year overall. First and foremost, the contractor should refer to the contract and any general or special conditions or specifications that are incorporated into the contract and ascertain the specific warranty obligations that it has as a general contractor. One issue that commonly arises in the area of warranties related to equipment and materials is whether or not the general contractor must simply provide (i.e. assign) a warranty from the manufacturer (i.e., a 20 year product warranty for roofing materials) or whether the general contractor is itself on the hook to warrant the equipment or materials. Whenever possible a general contractor should attempt to shift the risk of warranties to its subcontractors and product suppliers. In addition to defined warranties, a contractor must be mindful of latent defect liability. In many jurisdictions in the United States, contractors (and their sureties) are liable for latent defects that are discovered many years after the contract warranties have expired. For example in the state of California, California Civil Code §337.15 allows for latent defect claims against a contractor and its surety up to 10 years after substantial completion of the project.

### *Damages*

There are primarily three types of damages that can be sought under a construction contract:

- Liquidated Damages – Stated per diem damages.
- Actual Damages – Those that compensate the aggrieved party for all loss sustained by it as a result of the breach. Can include “direct” and “consequential” damages.
- Consequential Damages – Those that compensate for loss or injury not directly attributable to the breach but, rather, flow indirectly from one or more consequences of the breach.

Generally speaking, a contractor is better off with a fixed liquidated damages provision as opposed to an unknown actual or consequential damages provision. Additional information regarding liquidated and consequential damages can be obtained by reviewing the following articles posted in Compass: “Limiting Exposure for Consequential Damages” and “Liquidated Damages: Are they the Owner’s Sole Source of Recovery For Delay Damages?”.

### **Conclusions**

Contractors face significant challenges in moving from private to public construction. While it is entirely possible for contractors to be successful in pursuing a majority of work in the public sector, there are six primary areas of consideration that must be carefully addressed before pursuing public projects:

Contractors must adjust to the reality of lower – perhaps much lower – margins. Organizationally, the company must be “right sized” for what will most likely be substantially reduced profitability;

The contractor must establish a strong relationship with its surety and understand that its success will depend in part on maintaining this as a long term relationship rather than as transactional business.

Contractors must have sufficient internal accounting and scheduling resources to enable them to comply with rigorous public contract requirements for processing pay applications and pursuing claims.

Contractors must have project management personnel who are familiar with the public contract codes and public contract specifications relevant to the public entity with which they are working.

Contractors must have access to qualified legal counsel familiar with federal and state law and local regulations, including what may be onerous contract or bid form provisions, and can offer advice as needed.

Contractors should have an accounting firm specializing in construction accounting and be able to provide not only financial statements but contract schedules for completed and uncompleted work using Percentage of Completion accounting.

*Other Resources Available in Compass*

- [PUBLIC CONTRACTING ESSENTIALS AFTER THE AMERICAN RECOVERY AND REINVESTMENT ACT OF 2009](#). Z. Taylor Schultz, Esq., Seyfarth Shaw, LLP
- [GOVERNMENT CONTRACTING PROGRAMS FOR SMALL DISADVANTAGED BUSINESSES](#). Cameron Blackey and Mary Alice McNamara
- [FEDERAL GOVERNMENT CONSTRUCTION CONTRACTING](#). Watt, Tieder, Hoffar & Fitzgerald, LLP

---

<sup>1</sup> Prequalification in Government Construction Contracts, W. Samuel Niece. Construction Weblinks, July 28, 2008

<sup>2</sup> Ibid.

<sup>3</sup> False Claims Act, 31 U.S.C. Sec. 3729-3733.

<sup>4</sup> 1986 U.S.C.C.A.N. 5266

