



[Older Newsletters](#)

Volume 4, Issue 6
November/December
2018

[Mergers & Acquisitions](#)

[Change Orders](#)

[Public Records for
Claims](#)

[Free Webinar –
Successful Contracts](#)

[Design-Build](#)

[Apparent vs Actual
Authority](#)



Buying an Existing Construction Operation? Do Your Due Diligence

[Marion T. Hack](#), Partner, and [Michelle Beth Rosenberg](#), Associate, [Pepper Hamilton LLP](#)

While mergers and acquisitions have been a hot market for some time in other industries, in recent years, venture capitalist and private equity firms have been actively involved in the acquisition of construction operations in the United States. In handling these acquisitions, M&A counsel, in their due diligence, should remember to track one of the most important assets of the construction operation — its contracting license.

There appears to be a misunderstanding that any license held by a corporation can be easily transferred to the new owners or new acquiring company. But this is not the case in many states. Indeed, for the most part, a contractor’s state license is not transferable from one entity to the next without taking the appropriate measures. Thus the sale of a company could put the very assets being sold at risk unless proper due diligence and preparation is done **before** the sale to make sure there is a continuation of the license.

Contractors’ Licenses Are Not Transferable in Several States

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In California, all contractors must be licensed, and contractors’ licenses are not transferable. See Cal. Bus. & Prof. Code § 7026. Accordingly, a new license is required whenever a business entity changes (such as sole owner to corporation, sole owner to partnership, partnership to corporation, etc.) or when specific changes occur within the business structure. Moreover, licenses are associated with a business entity and not the individual qualifier.

Therefore, licenses are not transferable from one business to another, even if the qualifying individual is the same for both. See Cal. Bus. & Prof. Code § 7075.1. A corporate license number is issued exclusively to an individual corporate registration number assigned by the Secretary of State. If this registration number changes, a new contractor license number will be required for the new corporation. If a corporation dissolves, merges or surrenders the right to do business in California through the Secretary of State, the contractor license must also be canceled. The Contractors State License Board must be notified of any change to the license status within 90 days of the change. See Bus. & Prof. Code § 7083.

In Nevada, contractors must also be licensed, and contractors’ licenses are similarly nontransferable. Nev. Rev. Stat. § 624.700. Licenses may be issued to individuals, general partnerships, limited partnerships, corporations, limited liability companies or joint ventures. Nev. Rev. Stat. §§ 624.240; 624.250. Again, the license belongs to the entity rather than the qualifying individual. If a new entity is created, a new contractor’s license is required.

In Arizona, a contractor’s license is generally required for projects totaling more than \$1,000. See Ariz. Rev. Stat. § 32-1123. A sole proprietorship (individual), a partnership, a limited liability company or a corporation may apply

for a contractor's license if it has a regularly employed person with the necessary experience, knowledge and skills who serves as the qualifying party. Again, the license belongs to the business and not the qualifying individual and therefore may not be transferred from one business entity to the next. A corporation or a limited liability company must be registered with the Arizona Corporation Commission and in good standing with that agency before submitting an application for a contractor's license. The corporation or the limited liability company must remain in good standing in order to renew its contractor's license. Engaging in contracting without a license is prohibited. Ariz. Rev. Stat. § 32-1151. This section forbids unlicensed persons from offering to contract, a ban enforced by punishment as a misdemeanor under section 32-1164A(2). *City of Phoenix v. Superior Court*, 909 P.2d 502 (Ariz. Ct. App. 1995).

This is just an example of the various licensing requirements. Many states, such as Tennessee, Florida, Virginia, Oregon, New Mexico and Georgia, have similar licensing requirements. What is lesser known are the penalties for failing to have a license at all times during performance of the work. Thus, it is very important for the license status of the acquired corporation to remain in full effect from the date of closing.

Penalties for Contracting Without a License

If a new license number is going to be obtained for a contractor on an existing project, one must be cognizant of the timing of assignability of all contracts that are currently being performed by the merging or old entity. The assignment of a contract must occur so as to avoid any gap in the license because, in several states, contracting without a license has extreme consequences. Those consequences include losing the right to sue for payment for performed work, being ordered by a court to disgorge amounts already paid for work performed, and even potential criminal liability.

In addition, most contracts contain nonassignability provisions. Therefore, before any change in the corporate structure, the parties to each contract should agree that each of the current contracts will be reassigned to the new entity. The assignment must occur after the new entity is properly licensed so as to avoid any gap in the license.

In California, even a lapse of a license for one day has dire consequences. Indeed, a contractor forfeits compensation for all work performed under a contract when the contractor is unlicensed for **any period** during that contract. See Cal. Bus. & Prof. Code §§ 7031(a), 7031(b); *Judicial Council of California v. Jacobs Facilities, Inc.*, 191 Cal. Rptr. 3d 714 (Cal. Ct. App. 2015). In *Jacobs Facilities, Inc.*, although the contractor (Jacobs) was properly licensed when it began work on the contract, as part of a corporate reorganization, Jacobs transferred employees responsible for performing work under the contract to another wholly owned subsidiary. *Id.* at 718. In the process, the new subsidiary obtained a contractor's license, and Jacobs's license expired. *Id.* However, Jacobs remained as the signatory on the contract until nearly a year after the new subsidiary was formed, at which time the parties entered into an assignment of the contract. *Id.* The court held that Jacobs violated California State Licensing Law when it continued to act as the contracting party after its license had expired. *Id.*

Even though the other contracting party was aware of Jacobs's lack of license, Jacobs was prohibited from asserting bad faith or unjust enrichment as a defense to forfeiture. *Id.* at 724. Indeed, forfeiture of all compensation for work performed by an unlicensed contractor is held to apply regardless of the equities, preventing contractors from asserting equitable defenses. See *MW Erectors, Inc. v. Niederhauser Ornamental & Metal Works Co.*, 115 P.3d 41 (Cal. 2005). The intent behind the statute providing for forfeiture of all compensation for work performed by an unlicensed contractor is to discourage persons who have failed to comply with licensing law from offering or providing their unlicensed services for pay. See Cal. Bus. & Prof. Code §§ 7031(a), 7031(b).

Similarly, in Arizona, New Mexico, Florida, Georgia, Nevada and Tennessee, unlicensed contractors are barred from filing suit to recover monies for work performed. See *Sanders v. Foley*, 945 P.2d 1313 (Ariz. Ct. App. 1997) (unlicensed contractors may not bring suit to recover for work performed.); *Fleming v. Phelps-Dodge Corp.*, 496 P.2d 1111 (N.M. Ct. App. 1972) (unlicensed contractor was precluded under a licensing statute, which expressly prohibited unlicensed contractors from bringing actions on contracts for which a license was required, from recovering damages for a breach of the contract); *Boatwright Const., LLC v. Tarr*, 958 So. 2d 1071 (Fla. Dist. Ct. App. 2007) (construction company that was not licensed as a contractor in Florida was prohibited from bringing suit against an owner to recover monies for work performed); *Baja Properties, LLC v. Mattera*, 812 S.E.2d 358 (Ga. Ct. App. 2018) (homebuilding company's lack of a contractor's license barred its claims against property owners for breach of contract and *quantum meruit* and claim of lien, despite argument that statutory exemption allowed a property owner to act as his own contractor and to use unlicensed contractors); *Tom v. Innovative Home Sys., LLC*, 368 P.3d 1219 (Nev. Ct. App. 2016) (statute requiring proof that a contractor was duly licensed serves as an absolute bar on the recovery of contract claims brought by unlicensed contractors.); *Kyle v. Williams*,

98 S.W.3d 661 (Tenn. 2003) (trial court did not err when it held that a contractor who had not maintained a valid license throughout the entire contract period was deemed unlicensed and in violation of Tenn. Code Ann. § 62-6-103(b), and was therefore limited to recovery of the documented expenses proven by clear and convincing evidence).

Due Diligence Checklist

In undergoing a change in the corporate structure or entity, here is a brief checklist to ensure the new entity maintains its license:

1. Investigate the target acquisition's license status in all states of operation, and assess whether the licenses are in good standing.
2. Consider including a representation and warranty in the acquisition documents that the licenses have been and remain in good standing and an indemnity protection if the status of any of those licenses creates issues after closing.
3. Determine the appropriate steps for creating a new entity or change in the corporate structure, such as applying through a state registrar or a secretary of state.
4. Determine whether the entity (new or changed) must have its own license.
5. Take appropriate steps for obtaining a new license number, including steps for using an existing qualifier (if one exists).
6. Ensure all contracts can be assigned to the new entity, and be cognizant of the timing of the assignment.

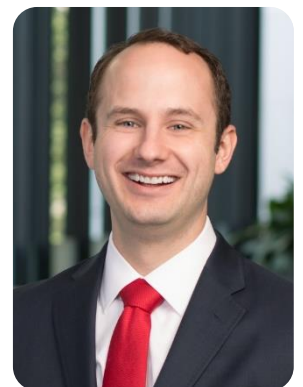
These steps should be part of any due diligence plan for the acquisition or corporate reorganization of a construction operation. The failure to ensure proper licensure can quickly turn a great deal into a great headache.

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[Back to Top](#)

Can't Get a Written Change Order? Document, Document, Document [Todd M. Heffner](#), Associate, [Smith, Currie & Hancock LLP](#)

Most construction contracts require that any changes to the work be made formally, in writing, via a change order, work directive, or similar written document. Frequently, however, changes to the work or extra work are communicated orally by the architect, engineer, or owner's representative, instead of in writing. What is the contractor to do in such a situation? The best option is follow the provisions of the contract and demand a written change order before performing changed work. Unfortunately, the realities of construction sometimes make it impossible to get the changes in the proper format in a timely manner. Savvy contractors will maintain schedule and produce written documentation of the change in lieu of a formal change order or directive. But many contractors will simply proceed with the changed work relying on the owner, architect, or engineer to do the right thing and stand by their oral instructions.



So what happens if changes are communicated orally and a dispute over the changes arises? The general trend is for courts to allow a contractor to recover for the extra work that was performed. But there are still certain jurisdictions and situations in which contractual requirements for changes to be in writing will be strictly enforced.

Even in jurisdictions where contractors have been able to recover, it is an expensive and time consuming challenge to convince a court to ignore the plain language of a contract.

Relying on the good will of the owner, architect, or engineer is rarely a good idea, even for contractors who have a long working relationship. If the work must proceed without formal authorization, it should be possible to obtain informal documentation. For example, the contractor can send an email to whoever is directing the work requesting clarification of what is to be done. The email chain will provide written evidence that that contractor did not proceed as a volunteer or consider the changed work to be in the original scope.

Even if the owner, architect, or engineer refuses to respond to an email request for clarification, the contractor can still create written documentation of the oral directive to perform extra work. This can be done initially by sending a long email documenting exactly what was directed and why it constitutes a change to the work. Any such email should be followed by a letter sent certified mail. Both email and letter should give the owner, architect, or engineer a limited time to disagree, e.g., "We will proceed with this work in x days unless you direct otherwise."

If the party directing the work is unwilling to send something informal in lieu of whatever the contract requires, the contractor must proceed very cautiously. Why the reluctance to put the changes in writing? Whatever the reason, this is not an enviable situation to be placed in as most contracts will also impose penalties if work is delayed or stopped. Along with producing its own written documentation, the contractor can point out that it was the owner who put the requirement for written documentation in the contract, while also noting that it is mutually beneficial to have a common understanding of the required work at the time the work is to be performed. Any misunderstanding is far easier to address contemporaneously rather than months or years after the work is complete. This issue also affects subcontractors. Subcontractors who rely on particular general contractors for repeat work will especially benefit from a conciliatory approach. Many subcontractors simply cannot afford to bring a lawsuit because there was misunderstanding about a verbal change to the work.

Another contract clause to be aware of in this context is what can generically be called an "anti-waiver" clause. An anti-waiver clause is one that claims to invalidate the waiver of any contract provision, unless the waiver is expressly in writing. In other words, an anti-waiver clause could require written confirmation that the verbal change at issue does not need to be provided per the terms of the contract. Generally speaking, anti-waiver clauses are no more effective than the changes clauses. The same legal principles that would allow a contractor to overcome not following a written change requirement are the same legal principles that would allow it to overcome the anti-waiver clause. That said, it is always better to follow the terms of the contract to the greatest extent possible. If this is impossible—document, document, document.

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[Back to Top](#)

Let There Be Light: Contractors' Practical Use of Open Records Rights

[Michael C. Drew](#), Partner, [Jones Walker LLP](#)



Public open records rights are an important and effective tool for contractors to get access to critical documents and information on public projects to assist on bid protests, claims and litigation. This article addresses some of the impacts and issues associated with public records requests on public projects.

Public open record laws, also known as "freedom of information" or "sunshine" laws, acknowledge the need for government transparency and citizens' rights to access to government records. These laws are implemented through public records requests, with federal, state and local agencies designating record custodians to respond to such requests and produce relevant government records.

The challenge of obtaining documents for use in a public/private bid protest.

Bid protests present one of the main scenarios in which a contractor might want to obtain public documents. Public records requests are the main mechanism for obtaining procurement records to

determine if there is a basis for a protest and to support a protest. The ability to effectively rely on public records requests involves two important challenges: tight deadlines associated with bid protests and limited access to bidding documents that could be considered confidential and exempt from the sunshine laws.

On public projects, a disappointed bidder has only days, or at most a few weeks, from the date of contract award or from when the basis of the award became known to protest the award. On federal projects, a disappointed bidder must file its protest with the Government Accountability Office (GAO), within 10 calendar days after “the basis for the protest is known or should have been known, whichever is earlier” or within 5 calendar days of a debriefing.ⁱ In Louisiana, a bidder has fourteen days from the date of contract award to file a protest. In Georgia, that timeframe shrinks to 10 days under the State Purchasing Act. Not only do the time limits vary from state to state, but local government and individual agencies may have their own procedures and time limits, and the rules regarding the start date, end date, and calculation of deadlines (calendar vs. business days) vary.

Given the tight timetables to protest, it is critical to move quickly to determine whether to protest, and then to request documents per the applicable rules, coordinate with public agencies to obtain available records as soon as possible, and avoid disputes with the custodian of the public records sought to speed the protest process. Tight timelines can become even tighter if the information sought is potentially exempt from disclosure. Understanding the timeline and scope of a public records law can be critical to making a successful bid protest.

Access to Other Bidders’ Confidential Information

Public access to a procuring agency’s documents has led to an increasing conflict between the principle of ensuring open government versus the principle of protecting private information versus. In other words, when are documents created by a private entity deemed public and thereby subject to sunshine laws? The answer to this question differs widely from state-to-state, with some states having failed to address the issue at all. Contractors must understand the applicable standards in their respective states when competing for, protesting, performing, or asserting claims on public projects. Documents which a contractor would consider confidential may become subject to disclosure to competitors simply by providing them to a state agency.

By way of example, California has one of the more restrictive judicial tests for determining when “private” documents are deemed public: (1) whether the government has a contractual relationship with the company; (2) whether the government delegated work to the company but still retained the power and duty to monitor the performance of the work; and (3) whether the company is providing services to residents by way of a contract with the government. New York has a similar, but even more restrictive, 6 part test.

Conversely, Oregon has created a simple determinative test for this issue: Records are public any time a private entity is performing work at the request of a governmental (i.e. public) body. Similarly, all information or records a contractor submits to a federal agency are subject to public disclosure under the Freedom of Information Act (FOIA), subject to the assertion of an exemption for confidential or proprietary information (also known as a (b)(4) exemption).

These tests cut various ways and their application often leads to one party or the other being disappointed. For example, sunshine laws can either grant or shield access to vital records that will provide a crucial, if not exclusive, basis of a bid protest. But when viewed from a different angle, these laws have the potential to shine a light upon proprietary and sensitive confidential information that a company would not want to be made public for a number of competitive reasons. In fact, the idea of losing confidentiality can create the most fear for contractors bidding or working on public projects.

Exemptions to Public Access to Proprietary and Confidential Information

Most states broadly construe the meaning and application of the word “record” within the context of “public record” request (i.e. almost anything can be considered a “record.”). Thus, most states have focused on determining whether the record is “public” and thereby subject to production.

Louisiana has adopted what is known as the “functional purpose” test to determine whether a record is public. For example, personal emails sent through a state email account are not “public” even though they are transmitted on a public system. Likewise, official business conducted on a private phone or through a private email turns those records into “public records” even though they are neither created nor maintained on a public system. (Note, a public body cannot avoid its obligations under general sunshine laws by outsourcing its public responsibilities to a private firm). Thus, Louisiana focuses on the functional purpose of the record. However, this is not a universal test and it is important to know what constitutes a “public record” in your respective state.

Despite the potentially “public” nature of a record, information may need to be protected because of its sensitive financial or economic nature. For example, an offeror may submit proprietary pricing data when bidding on a project, the disclosure of which would place it at a competitive disadvantage. The same goes for records and information created by a private contractor during the course of executing a public/private contract. Similarly, a public body may attempt to recruit a company to a particular state and need to keep negotiations relating to that recruitment private. Many sunshine laws provide limited protection for these types of records, but only insofar as those activities involve confidential or proprietary information.

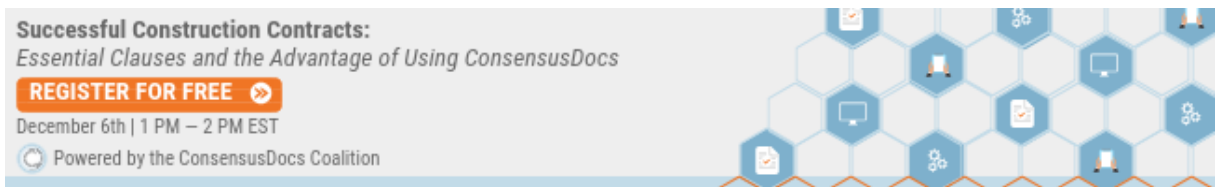
The federal FOIA provides a broader exemption and greater protections for confidential information, but in some states, this confidential or proprietary exemption is narrowly construed. Consequently, do not to assume that state sunshine laws comfortably or necessarily mirror the federal FOIA when it comes to protecting confidential data. Likewise, it is important to understand that the confidential information exemption is not limitless and that what you think are “private” records may be subject to disclosure.

Conclusion.

Overall, it is important not to make blanket assumptions that information will (or will not) be disclosed in relation to a public/private project. This is particularly true in relation to bid protests, which can present a number of issues. The rules impacting disclosure differ widely based upon which state or federal entities are involved in the project. Nevertheless, public records requests can serve as a valuable tool or a thorn in a contractor’s side when it comes to public projects. Therefore, it is important to always be aware of the applicable sunshine disclosure requirements before jumping into any project.

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[Back to Top](#)

A banner for a webinar. The text reads: "Successful Construction Contracts: Essential Clauses and the Advantage of Using ConsensusDocs". Below this is a red button with white text that says "REGISTER FOR FREE" and a right-pointing arrow. Underneath the button, it says "December 6th | 1 PM – 2 PM EST". At the bottom left of the banner, it says "Powered by the ConsensusDocs Coalition". The background of the banner features a grid of blue hexagons, some containing icons like a document, a gear, and a person.

Webinar Title: [Successful Construction Contracts: Essential Clauses and the Advantage of Using ConsensusDocs](#)

Webinar Description: Studies demonstrate that fair, best practice contracts, achieve superior construction project results versus the one-sided, outdated, and siloed clauses that lead to claims and litigation. What are the most important clauses that you should prioritize in negotiations to set a foundation for success, and which clauses to avoid? The two-main standard construction contract documents, AIA and ConsensusDocs, take different approaches in some areas and similar approaches in others. Learn how you can leverage the advantages in standard construction and architectural agreements to improve your bottom-line.

- Learn how utilizing proper risk allocation boosts party relationships, profits, and avoids claims and delays
- Spot some contract killer clauses and contractual best practices to prioritize
- Learn the differences and advantage between ConsensusDocs and the AIA A201.

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Presenters:

Robert P. Majerus – Vice President and General Counsel, Hensel Phelps



Robert (Bob) P. Majerus, is a graduate of Georgetown University with a Bachelor of Arts Degree and has a Law Degree from the University of Notre Dame. He joined Hensel Phelps in 2006 and serves as Vice President and General Counsel, Bob has overall responsibility for contractual and legal matters for the Greeley, Colorado-based organization. Prior to joining Hensel Phelps, Bob was a trial attorney for a private law firm.

Bob is admitted to the Arizona, Washington and Alaska bar Associations. He is Chair of the Documents Committee of the Associated General Contractors of America (AGC) and is a member of the AGC Building Division Leadership Board.

To meet his strong pledge to give back to the community, Bob is actively involved in supporting local, regional and national organizations with a commitment of his time and personal contributions.



Brian Perlberg – Executive Director and Senior Counsel, ConsensusDocs

Brian Perlberg is Executive Director & Senior Counsel for ConsensusDocs, a coalition of 40 leading construction organizations dedicated to drafting best practice construction contracts. Mr. Perlberg is the lead staff person responsible for the content of ConsensusDocs 100+ standard contracts that guide the A/E/C industry. He is also in-house counsel for the AGC of America for all construction law and contract matters. In addition, Mr. Perlberg serves on the ABA Forum on the Construction Industry Steering Committee for the Contract Documents, National Construction Dispute Resolution Committee (NCDRC) of the Arbitration Association of America (AAA), the Construction SuperConference Board, and WPL Publishing Advisory Board.

[Back to Top](#)

Design-Build Contract Tools

[Kevin F. Peartree](#), Partner, [Ernstom & Dreeste LLP](#)

Much has been made of the virtues of design-build project delivery. More than a few dry research papers have analyzed and demonstrated that a design-build project can take less time to complete for perhaps less money, than traditional design-bid-build. Design-build is particularly adept at controlling the growth of costs and schedule over the life of a project.

There are many factors that make this possible. Critical among them are how the parties structure their relationships and how they promote the best practices that can achieve time and cost savings. The right contract form and language alone will not guarantee the desired outcomes, but it can put the design-builder, designer and owner in a position to succeed. The ConsensusDocs family of design-build standard contract documents is one highly effective tool for the job. Developed by a coalition of industry associations, the ConsensusDocs seek to advance the best interests of the project as a whole, and not any one constituency.



When Does the Design-Builder Enter the Picture?

A staple of many construction industry presentations is the graph depicting the increasing impact of design changes and the decreasing ability of project participants to positively impact project costs and performance over the course of a construction project. The parties' ability to control overall project costs is highest in the feasibility and conceptual planning stages, and decreases as the project evolves. At the same time, the cost of design

changes is lowest in those stages and increases significantly as the project progresses through design drawings, construction drawings and into the construction phase. The earlier the design-builder – wedding design and construction expertise – is involved in the project, the greater the possibility to realize cost savings and control.

The ConsensusDocs provide for the earliest possible involvement of the design-builder in the development of the project. The ConsensusDocs 400 Preliminary Design-Build Agreement engages the design-builder to develop design through schematics so that an owner can make a go/no go decision on the project. The design-builder can assist with the development of the owner's project and project criteria, providing information and concepts that can positively impact the cost and time of construction. ConsensusDocs 410, the full design-build agreement between owner and design-builder, can accomplish the same.

Design Development and Management.

In a design-build project, the owner gives up a certain amount of control once it has established its program for the design builder. The design professional, in many cases, gives up its direct contract with the owner and instead subcontracts with the design builder. The design-builder gives up the protection from design liability it enjoyed under the traditional approach to construction. To make these new relationships work, the parties must approach the project as a team. If a design-build project team is serious about managing the development of design and controlling project costs, it will insist upon clear and robust communication.

As the project design evolves from schematics through design development documents and to construction documents, the ConsensusDocs employ a progressive sign-off with owner approval required at each level of design, and each level of documents becoming by definition Contract Documents. Critically, at each level of design, the ConsensusDocs 400 agreement requires the design-builder to "identify in writing all material changes and deviations" that have taken place from the prior level of design reviewed with and approved by the owner. This approach not only ensures that the owner's original objectives are met, but promotes a comprehensive exchange of ideas, concerns, and a discussion of design and construction approaches that best achieve time and cost savings. The better the quality of these communications, the better the opportunities for realizing project success.

When Price is Set.

Project owners strive for cost certainty, at least as much as that is possible on any construction project. Project budgets are but part of a company's broader corporate concerns and mission. The owner's project representatives often must answer to company leaders and boards. In design-build, the owner feels the pressure, and in turn pressures the design-builder, to establish a guaranteed maximum price as early as possible. At the same time, the design-builder wants to have the design and scope of work sufficiently developed before it commits to a final GMP or price. In the ConsensusDocs 410, the design-builder prepares and submits a GMP proposal "[a]t such time as the Owner and Design-Builder jointly agree". In contrast, other industry standard design-build forms establish a more fixed benchmark for the GMP proposal. What the ConsensusDocs approach hopes to achieve is both a balancing of the owner's and design-builder's interests. What the approach promotes is a discussion between the two of exactly when design, scope and cost estimates have been developed to the agreed point that the time is right to set a GMP. That discussion provides yet another opportunity to identify issues and opportunities for cost and time savings and controls.

Contingencies.

A useful tool in controlling unforeseen project costs are contingencies. In ConsensusDocs 410, the design-builder's GMP proposal includes contingencies for "further development of the Design-Build Documents consistent with Owner's Program. Such further development does not include changes in scope, systems, kinds and quality of materials, finishes, or equipment, all of which, if required, shall be incorporated by Change Order."

In addition, the GMP Proposal includes a separate Design-Builder's Contingency. This contingency is "a sum mutually agreed upon and monitored by Design-Builder and Owner to cover costs which are properly reimbursable as a Cost of the Work, but are not the basis for a Change Order." The Design-Builder's Contingency is not to be used "for changes in scope or for any item that would be the basis for an increase in the GMP." The design-builder controls this contingency, but provides the Owner with a monthly accounting of charges with each payment application. These contingencies provide the means to address the kinds of issues that invariably arise on construction projects without negatively impacting the GMP.

"The right tool for the right job." That adage is just as true when deciding upon the right contract form to use. The right contract language can be an effective tool in achieving time and cost savings and overall project success. Choose the right tool and use it well.

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**This article was originally published in [Design Cost Data Magazine](#).

[Back to Top](#)



Contractors Beware: Completing Work Directed Only by a Contracting Officer's Rep is at Your Own Risk

[Alexandra E. Busch](#), Associate, [Peckar & Abramson, P.C.](#)

Can an agent with apparent but not actual authority bind its principal? The answer depends on whether the transaction is between private parties or involves the federal government. Practitioners who represent parties in private construction disputes are likely aware of the rule that apparent authority can generally bind the principal in a private transaction. But, a unique aspect of federal procurement law is that the federal government may typically only be bound by representatives with actual authority – whether that authority is express or implied.

When contracting with the federal government, contractors must act with the understanding that the government does not recognize apparent authority. This awareness will help contractors to avoid completing work for which they may not ultimately be compensated. The general rule when the federal government is the project owner is that only the contracting officer (“CO”) has the authority to bind the federal government. This means that contractors risk nonpayment when they perform work that has not been directed by the CO or an individual who has actual authority to bind the government. An understanding of the different types of authority is critical to avoiding disputes about work that may be outside the scope of the contract.

I. Brief Overview: Authority of Agents to Bind the Government

An agent of the federal government must have express actual authority or implied actual authority to bind the government. Apparent authority is not sufficient. COs have express actual authority to bind the government in a transaction and are appointed by the principals of government agencies, as required by statute. This binding authority is often referred to as the CO’s “warrant.” The limits of the CO’s warrant are memorialized on a Standard Form 1402, Certificate of Appointment, which can be made available to the contractor. The CO may also delegate his/her authority to a contracting officer’s representative (“COR”). It is the contractor’s responsibility to determine the limits of the CO’s authority, and a contractor who completes work at the direction of an agent without confirming that agent’s authority does so at the contractor’s own risk.

A government agent may bind the federal government under the theory of implied actual authority, as well. “Actual authority is implied when such authority is an integral part of the duties assigned to the particular government agent.” Implied authority is grounded in the federal government’s actions and intent, so a government agent may have implied authority when the agent’s actions and statements are appropriate and/or essential to the performance of his/her duties. For example, the Court of Federal Claims has held that a government agent has implied authority to contract as is “appropriate and/or essential to the performance of the agents [sic] duties” where an agent who possessed delegated discretionary authority to manage, allocate, and distribute funds guaranteed reimbursement by the government. In contrast, implied actual authority will not be present when the government agent’s action is contrary to the explicit terms of the contract, such as when the contract contains a provision that exclusively reserves contracting authority to the CO.

Notwithstanding that implied actual authority can bind the federal government, the mere appearance that an agent has authority is not enough to show that an agent has contracting authority. This is a unique distinction from private transactions in which a principal may be bound by the apparent authority of its agent. Contrary to implied authority, which arises from the government’s actions and intent, apparent authority is grounded in contractor reliance regardless of the government’s intent. Accordingly, a contractor must be confident it is taking direction from an agent with actual authority (express or implied) to avoid nonpayment of completed work.

II. *Baistar Mechanical, Inc. v. U. S.*, 128 Fed. Cl. 504 (2016)

The Court of Federal Claims recently reiterated the unique rule about authority to contract in the context of federal procurement law. In 2011, *Baistar Mechanical, Inc.* (“Baistar”) executed a contract with the federal government to

provide maintenance and snow removal services to a retirement community. The contract expressly provided that only a CO was authorized to bind the government to a change in the specifications, terms, or conditions of the contract. Baistar alleged, inter alia, that the government failed to compensate Baistar for services it performed outside of the scope of the contract. When the CO denied Baistar's requests for equitable adjustments to the contract, many of which were directed by the contracting officer's representatives ("CORs"), Baistar filed suit to recover on its requests for equitable adjustment.

In Counts I, III, and IV of its complaint, Baistar asserted that it performed maintenance services outside the scope of the contract at the direction of the CORs, and Baistar claimed that it should have been compensated for such work under theories of implied-in-fact contract, constructive change, and breach of contract theories. The Court of Federal Claims rejected Baistar's positions and granted the government's motion to dismiss Counts I, III, and IV of Baistar's complaint regarding the services performed outside of the scope of the contract. The Court reasoned that the CORs did not have the necessary authority to bind the government because the language of the contract reserved such authority for the CO.

The Court of Federal Claims did, however, acknowledge a possible exception to this general rule regarding Baistar's claim for out-of-scope snow removal services because the snow and ice potentially created an emergency situation. In Count V, Baistar alleged that the CORs directed Baistar to provide snow removal services outside the scope of the contract. Baistar asserted that the COs authorized the out-of-scope snow removal work because the COs were copied on the e-mail orders from the CORs and took no steps to prevent Baistar from performing the alleged out-of-scope work. Although Baistar did not contend that any government agent with actual authority ordered the snow removal services, the Court of Federal Claims denied the government's motion to dismiss Baistar's claim for payment on the out-of-scope snow removal work. The Court's rationale was that although this work was also directed by CORs without authority to bind the government, the presence of snow and ice posed a potential threat to the residents and the order may therefore fall within an exception to the requirement that a government agent possess actual authority in order to authorize out-of-scope work. Notably, the Court acknowledged that "[t]he emergency exception to the actual authority requirement is limited and has been construed narrowly."

III. Best Practices for Clients to Manage Risk

Appearance is not everything when contracting with the federal government. A major concern when performing work that falls outside the scope of the contract is whether the contractor will be compensated for such work. When doing business with the federal government, the contractor may take some steps to manage expectations and the risk of nonpayment because it is incumbent on the contractor to determine which agents have the authority to bind the federal government. When the contractor receives direction from a government agent, it should determine whether the directive is within that agent's authority. One way to check an agent's authority is for the contractor to request to review the CO's warrant or the COR's written delegation. Without this inquiry, the contractor risks nonpayment and increases the likelihood of the inception of a dispute.

To further manage risk, contractors should avoid relying on the narrow exceptions to actual authority, such as the emergency exception. Likewise, contractors should not rely on casual dealings and prior governmental course of conduct, especially in a situation in which the government has warned the contractor to wait until the execution of a formal agreement. Contractors who do not employ risk management strategies complete out-of-scope work at their own risk.

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ⁱ Within 5 calendar days of a debriefing that is requested and required, whichever is later.