

A RESEARCH PERSPECTIVE  
ISSUED BY THE  
NAVIGANT CONSTRUCTION  
FORUM™

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CONSTRUCTION FORUM™  
Building on the lessons learned in  
construction dispute avoidance and resolution.™



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### CONSTRUCTION

#### JAMES G. ZACK, JR.

Executive Director  
Navigant Construction Forum™

[navigant.com](http://navigant.com)

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## PURPOSE OF RESEARCH PERSPECTIVE

Subsequent to the preparation and issuance of the Navigant Construction Forum™ research perspective entitled **Trends in Construction Claims and Disputes**<sup>1</sup> the Navigant Construction Forum™ continued looking for new trends. In the two years since publication of the previous report the Navigant Construction Forum™ has found a number of additional trends concerning construction claims on government contracts. The purpose of this research perspective is to identify and discuss briefly the various trends observed.

This research perspective will discuss the basic causes of construction claims on public contracts. Additionally, the research perspective will identify and discuss claims being filed against both contractors and design professionals; some recent restrictions on recovery of claims against the government; some changes in government contract administration that impact contractors working on government contracts; and changes in judicial relief – both legal and practical – that contractors should be aware of and deal with when making claims against the government.

The Navigant Construction Forum™ cannot predict where these trends are going or what impact they will ultimately have on the construction industry. Our purpose in publishing this research perspective is to make construction industry stakeholders aware of these recent developments especially if they are working on government contracts.

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1. James G. Zack, Jr., Trends in Construction Claims and Disputes, Navigant Construction Forum™, Boulder, CO, December 2012.



## INTRODUCTION

There have been numerous studies of cost overruns on government contracts over the past few years. Among the more recent studies is a policy analysis released by the Cato Institute in September 2015 entitled **Federal Government Cost Overruns**.<sup>2</sup> This study rests on a number of other studies that all reach similar conclusions, including the following.

- “Digging the Dirt at Public Expense: Governance in the Building of the Erie Canal and Other Public Works”<sup>3</sup>;
- “Underestimating Costs in Public Works Projects: Error or Lie?”<sup>4</sup>;
- “Survival of the Unfittest: Why the Worst Infrastructure Gets Built and What We Can Do About It”<sup>5</sup>.

Like the many other studies cited above this study concludes that:

“Cost overruns on large government projects are pervasive. The problem appears to stem from a mixture of deception and mismanagement, and it has not diminished over time...It is true that cost overruns and other inefficiencies are a risk on all types of large projects, whoever undertakes them. But the federal government’s track record on major project management is particularly poor, and many federal agencies do not learn from past mistakes.”

Another recent study, **VA Construction – Actions to Address Cost Increases and Schedule Delays at Denver and Other VA Major Medical Facility Projects**<sup>6</sup> reviewed the cost and schedule history of four major medical facility projects and determined that cost increases on these project ranged from 66% to 427% and project delay ranged from 14 months to 86 months but noted that the Denver project was still under construction and was already 14 months delayed from the initial estimated completion date as of

the time of the GAO report. At the time of the preparation of this research perspective, the Denver project is currently projected to complete in January 2018, adding an additional 32 months of delay bringing the total project delay to nearly 4 years.<sup>7</sup> This study concluded that these cost increases and project delays resulted from (1) scope modifications and (2) unanticipated events both of which resulted in contract modifications (change orders). While not specifically called out in this GAO study, many of the change orders on these projects resulted from settlement of various construction claims – directed and constructive changes, delays, differing site conditions, etc.

Another recent construction study, **Climbing the Curve – 2015 Global Construction Project Owner’s Survey**<sup>8</sup> reached found the following –

- 53% of project owners suffered one or more underperforming projects in the previous year. For energy and natural resources and public sector respondents the figures rose to 71% and 90% respectively.
- Only 31% of respondents’ projects in the past 3 years came within 10% of budget.
- Just 25% of respondent’s projects in the past 3 years came within 10% of their original deadlines.
- And, 69% of respondents said “poor contractor performance” is the single biggest reason for project underperformance.

These results correspond roughly with the findings set forth in **Mitigation of Risk in Construction: Strategies for Reducing Risk and Maximizing Profitability**<sup>9</sup> in which it was concluded that:

- 84% of respondents had experienced project delay on previous projects and the average project delay was 24% more than the initial planned project duration.
- 86% of respondents experienced cost overruns with the average overrun being 19%.
- 76% of respondents experienced claims with the average percentage of claimed cost being 11% of original contract cost and the average claim being approximately US\$3.1 million.

A report entitled **Analysis of Construction Projects with Federal Agencies and the Causes of Disputes**<sup>10</sup> specifically researched claims on 107 federal government construction contracts and reached the following conclusions.

2. Chris Edwards and Nicole Kaeding, *Federal Government Cost Overruns, Tax & Budget*, No. 72, Cato Institute, Washington, D.C., September 2015.

3. Stanley L. Engerman and Kenneth L. Sokoloff, *National Bureau of Economic Research, Working Paper 10965*, December 2004.

4. Bent Flyvbjerg, Mette Skamris Holm and Soren Buhl, *Journal of the American Planning Association* 68, No.3, 2002.

5. Bent Flyvbjerg, *Oxford Review of Economic Policy* 25, No. 3, 2009.

6. U.S. Government Accountability Office, GAO-15-564T, April 24, 2015.

7. “VA Hospital Delayed Until Early 2018 But New Contract In Place to Finish Facility”, *Denver Post*, November 2, 2015.

8. KPMG International, *Global Construction Survey*, March 2015.

9. McGraw Hill Construction, Navigant Consulting and Pepper Hamilton LLP, SmartMarket Report, November 2011.

10. Construction Financial Management Association and Sage Consulting Group, September 2015.

- Contractors are at least partially exonerated from responsibility more than half the time and in 16% of the cases “...all negative or disappointing project outcomes were effectively attributed to the public agency.”
- The larger the project, the more likely the public agency prevails.
- On average, the claimed damages sought equaled 6.9% of the original contract amount.
- Disputes with certain public agencies are less likely to be resolved in favor of contractors. More specifically, in disputes involving the U.S. Army Corps of Engineers (“the Corps”) contractors recovered all claimed costs in only 11% of the cases studied and partially recovered claim damages in only 38% of the cases. At the other end of the spectrum, in cases involving the U.S. General Services Administration (“GSA”) contractors recovered all claimed costs 38% of the time and recovered some claimed damages in 69% of the cases studied.
- Infrastructure related disputes are unlikely to be resolved in favor of the contractor. Contractors recovered all claimed costs in only 7% of the cases studied and partially recovered claimed costs in 14% of the cases.
- Design/build contracts had no significant advantage over design-bid-build contracts in terms of producing better legal outcomes for contractors. Contractors prevailed 32% of the time in cases using design/build contract and 45% of the time on design-bid-build projects.
- Defective, uncoordinated or inaccurate specifications and/or drawings frequently represent the source of claims.
- The most common cause of disputes is the denial of a cost adjustment due to an unforeseen problem or issue that arose during the execution of the work.
- The frequency of lawsuits increases in the midst of a recessionary economic environment.
- Claims from contractors are most likely to be denied due to a lack of adequate evidence regarding the basis of their claims or defenses.

The most recent survey concerning disputed issues on government construction contracts is entitled **Challenges and Issues of Government Construction Contracting – 2015 Survey Report**<sup>11</sup>. The survey divided government contracts into five distinct phases and determined the following issues related to each phase.

- **Procurement**
  - Quality of technical specifications
  - Completeness of drawings
  - Responsiveness to Requests for Clarification (“RFC”)
- **Startup and Mobilization**
  - Availability of partnering opportunities
  - Cooperation and responsiveness in processing start up documentation
  - Construction
  - Working relationship with the owner or the owner’s representative
  - Responses to and resolution of Requests for Information (“RFI”)
  - Timely review of shop drawings and submittals
  - Adequacy of the owner’s contract administration procedures
- **Claims and Change Order Management**
  - Turnaround time concerning change orders and time extension requests
- **Project Closeout**
  - Dealing with punchlists
  - Warranty issues
  - As-built drawings
  - Final payment

This survey concluded with the following statements.

“Comparing the federal government respondents with overall findings tells a bit of a different story. Federal contractors clearly have a different issue set on most of the activities of the first four out of five categories chosen for this survey, with generally lower levels of satisfaction. For project close out, federal contract ratings were not much different than overall ratings for public

11. ConstructionPro Network, *Construction Week*, Vol. 4, Issue 48, December 11, 2015.

construction. ... The survey revealed no major revelations. At worst, it highlights some areas that traditionally have been sources of complaints. At best, it provides government procurement officials with data to support efforts to make improvements in the construction contracting process.”

## CAUSES OF CONSTRUCTION CLAIMS

The National Cooperative Highway Research Program (“NCHRP”) published *Synthesis Highway Practice 105*<sup>12</sup> that looked into the common causes of claims based on various practices leading to claims and disputes. These practices are the following.

- **Contractor Practices**
  - Inadequate investigation before bidding
  - Unbalanced bidding
  - Bidding below cost and/or over optimistic estimating.
  - Poor planning and use of wrong equipment
- **Owner Practices**
  - Changes in plans and specifications during construction
  - Inadequate bidding information
  - Inadequate time for bid preparation
  - Excessively narrow interpretation of plans and specifications
  - Restrictive specifications
  - Contract requirements for socioeconomic objectives
- **Causes Associated with the Contract Documents**
  - Exculpatory clauses
  - Mandatory advance notice of claims
  - Finality of field engineer’s decisions
  - Changed Conditions (Differing Site Conditions) clauses
  - Lack of periodic review of documents
- **Causes Associated with Contract Awards**
  - Diversity of State contract award rules
  - Treatment of bid mistakes

- **Causes Associated with Contract Administration**
  - Coordination of owner responsibilities
  - Interpretation of owner policy and practices
  - Attitude and style of contract administrators
  - Documentation of contract performance in field records
  - Owner program factors
- **Causes Associated with Claims Settlement Procedures and Practices**
  - Encouragement of project level settlements
  - Delegation of settlement authority to field supervisors
  - Effectiveness of field/headquarters consultation

A much more recent survey of claims and disputes, **Global Construction Disputes: A Longer Resolution**<sup>13</sup>, found the most common causes of construction claims and disputes to be the following.

- Incomplete and/or unsubstantiated claims
- Failure to understand and/or comply with contractual obligations by the Employer/Contractor/Subcontractor
- Failure to properly administer the contract
- Failure to make interim awards on extensions of time (“EOT”) and compensation
- Errors and/or omissions in the Contract Documents

Based on the author’s experience the most common causes of construction claims and disputes include the following.

- Defective plans and specifications – errors, omissions, ambiguities, conflicts and impossible or impracticable requirements
- Changed or differing site conditions
- Failure of the owner and contractor to promptly and properly address problems and time extension requests at the time of the delay event
- Failure of the owner and contractor to negotiate time extensions and delay and impact costs when change orders are issued
- Inability to mitigate the effects of delay
- Unusually severe weather
- Acts of government in its sovereign capacity
- Strikes or labor actions
- Acts of God or force majeure events

12. Transportation Research Board, *Construction Contract Claims: Causes and Methods of Settlement*, National Research Council, Washington, D.C., 1983.

13. EC Harris, *Global Construction Disputes Report 2013*, EC Harris / Arcadis, London, 2013.

14. *Preventing Black Swans: Avoiding Major Project Failure*, KPMG LLP, 2013.

One particularly interesting white paper released in 2013 listed the most common causes of claims on construction projects in the following manner:<sup>14</sup>

#### Owners

- **Scoping issues** – Project scope does not fully address organizational business requirements.
- **Inexperienced or unqualified project team** – Project team lacks appropriate skills and expertise to manage the project.
- **Poor estimating** – Project estimates are incomplete or insufficiently detailed for budgeting.
- **Lack of integrated budgeting and planning** – Project business requirements are not aligned with budget and execution plan.
- **Incomplete and fluid design** – Construction commences based on an incomplete design and project scope is continually in flux.
- **Lack of proactive risk management** – Project risks are not fully understood or vetted prior to project approval.
- **Unrealistic schedules** – Project delays during planning and approval result in compressed schedule milestones and unrealistic completion targets set by management.
- **Insufficient tools and project management infrastructure** – Project tools and infrastructure are not set up to effectively plan, deliver, track, and report performance.

#### Contractors

- **Poor estimating** – Overly optimistic bids, poor or outdated cost data, missed scope items, flawed assumptions regarding regulatory issues, constructability or labor and material price escalation.
- **Resource shortages and inexperienced or unqualified project team** – Lack of available craft or staff labor, inexperienced field supervisory personnel, and/or lack of qualified and experienced project management team members.
- **Unfavorable-contract** – Construction contract favors the owner in areas such as payment terms, change order pricing, reimbursement of general conditions, overhead and profit/fee, and penalties for nonperformance.
- **Lack of senior management support** – The project lacks support from senior management to address project issues and challenges in a timely manner, and manage key communications and negotiations with the owner.
- **Design issues** – Project design issues lead to inefficiencies, unrecoverable cost overruns, and schedule delays.

- **Overly aggressive schedule** – Overly aggressive schedules lead to inefficiencies in the field and unrecoverable overtime and premium time.
- **Lack of risk management to address unforeseen conditions** – Lack of proactive risk management techniques to identify and address project issues and risks.
- **Lack-of-project coordination and integration** – Projects are managed in silos with limited integration between the owner, architect/engineer, contractor and its subcontractors, and other project stakeholders.

In conclusion, Navigant Construction Forum™ summarizes the leading causes of construction claims at a high level in the following manner.

- Unrealistic time of performance requirements and/or construction schedules
- Unrealistic project budgets based on poor project planning and/or unrealistic bids
- Improper contractual risk allocation
- Improper contract administration
- Lack of proper implementation of a robust project controls system.

With this information as a background, let's now turn to government contract claims and how claims (both contractor and government claims) may change today's construction industry.

## CLAIMS AGAINST CONTRACTORS AND DESIGN PROFESSIONALS

One of the developing trends the Navigant Construction Forum™ has observed is the potential for claims filed against contractors by government owners for various reasons. A brief overview of some of these claims is set forth below.

### Department of Justice and Department of Labor Expand and Promote Worker Endangerment Initiative

In December 2015 the U.S. Department of Justice ("DOJ") and the U.S. Department of Labor ("DOL") jointly executed a Memorandum of Understanding ("MOU") concerning criminal prosecutions of worker safety laws.<sup>15</sup> Pursuant to this MOU, DOL may opt to make "...referrals of alleged violations, and related matters concerning compliance and law enforcement activity to ensure the health and well being of the Nation's workforce"

15. Memorandum of Understanding Between the U.S. Departments of Labor and Justice on Criminal Prosecutions of Worker Safety Laws, December 17, 2015.

to DOJ for potential criminal prosecution. The MOU provides that DOL may share information with DOJ, make criminal case referrals and jointly investigate violations of some statutes. The MOU specifically refers to violations of the following statutes –

- **The Occupational Safety and Health Act of 1970<sup>16</sup>**
- **The Mine Safety and Health Act of 1977<sup>17</sup>**
- **The Migrant and Seasonal Agricultural Worker Protection Act<sup>18</sup>**

As noted in *The National Law Review*<sup>19</sup>–

“...employers should assume that information regarding workplace safety investigations by OSHA will be looked at by federal prosecutors. The initiative is based on the belief that companies that have worker safety violations may also have violated environmental statutes, and thus could face the far more stringent criminal sanctions under the environmental laws.”

Also on December 17, 2015 the DOJ’s Deputy Attorney General issued a memorandum to all U.S. Attorneys concerning prosecutions of worker safety violations.<sup>20</sup> After commenting on existing sanctions for violations of the Occupational Safety and Health Act the memorandum contained the following statements.

“The Department is committed to ensuring every American’s right to a safe workplace. Currently, an average day in the United States is marked by 13 workplace fatalities, nearly 150 deaths from occupational diseases, and about 9,000 nonfatal injuries and illnesses. The Occupational Safety and Health Act of 1970 (“OSH Act”) provides criminal sanctions ... Perhaps because these penalties have never been increased, there are only a handful of reported criminal prosecutions under the OSH Act each year (e.g., three in 2013.)

Prosecutors can make enforcement meaningful by charging other serious offenses that often occur in association with OSH Act violations – including false statements, obstruction of justice, witness tampering, conspiracy, and environmental and endangerment crimes. With penalties ranging from 5 to 20 years’ incarceration, plus significant fines, these felony provisions provide additional important tools to deter and punish workplace safety crimes.

U.S. Attorney’s Offices are encouraged to consider criminal referrals from DOL and to work with ESC<sup>21</sup> in using all tools available under the U.S. Code to build strong workplace safety cases.”

It is entirely too early to determine the impact this increased workplace safety enforcement program will have on the construction industry. However, should the U.S. Attorney’s Offices across the country follow up aggressively on the Deputy Attorney General’s memorandum contractors are likely to face more substantial claims from the government for safety violations than they have experienced over the past 45 years. The Navigant Construction Forum™ also notes that since the OSH Act applies to all construction in the U.S. this new enhanced claim applies to both public and private projects.

### **Increased Use of False Claims Act<sup>22</sup> Allegations as Counterclaims**

Another trend concerning government contract claims noted by the Navigant Construction Forum™ is the government’s increased use of the False Claims Act (“FCA”) as a counterclaim when contractors pursue claims to the U.S. Court of Federal Claims (“COFC”) following denial of their claim by the Contracting Officer. A well known construction litigation attorney recently noted –

“Among the recent trends I have observed in the government contracts arena is the increasing aggressiveness of the Department of Justice (DOJ) when it comes to pursuing claims brought under the False Claims Act ... Currently, there is much fear involved when it comes to going to the Court of Federal Claims because of the knee jerk reaction to assert a counterclaim that the Justice Department believes it may have with respect to the claim you are bringing.”<sup>23</sup>

16. 29 U.S.C. §§ 651 – 678.

17. 30 U.S.C. §§ 801 – 965.

18. 29 U.S.C. §§ 1801 – 1872.

19. <http://www.nationallawreview.com/article/doj-and-dol-expand-and-promote-worker-endangerment-initiative>, December 21, 2015.

20. Sally Quillan Yates, Deputy Attorney General, *Memorandum for All United States Attorneys – Subject: Prosecutions of Worker Safety Violations*, December 17, 2015.

21. Environmental Crimes Section of the Environment and Natural Resources Division (“ENRD”).

22. 31 U.S.C. §§ 3729 – 3733, 2012.

23. Joseph McManus, “Successfully Representing Contractor Clients in Government Contract Claims”, *Inside the Mind - Litigation Strategies for Government Contracts*, 2015 Edition, Thomson/Reuters, New York, 2014.

A **Briefing Paper** noted the following in regard to the use of false claim counterclaims –

“The U.S. Attorneys’ Manual instructs that “[e]very report of fraud or official corruption should be analyzed for its civil potential before the file is closed” and that, “[i]n the first instance, this review should be conducted by an Assistant United States Attorney or Departmental Trial Attorney assigned to the case” ... Trial attorneys are to file fraud based claims “[a]bsent a specific, detailed statement that there is a strong likelihood that institution of a civil action would materially prejudice contemplated criminal prosecution of specific subjects,” and unless there is some “doubt as to collectability or ... doubt as to facts or law.”<sup>24</sup>

This **Briefing Paper** went on to point out that the government’s use of false claim counterclaims under the FCA or fraud counterclaims under the Contract Disputes Act<sup>25</sup> (“CDA”)

“...can be a game changer for the Government because they create a potential upside for the Government to litigate the case to judgement. Counterclaims, therefore, have the capacity to dramatically alter the Government’s litigation risk analysis and, in turn, the relative settlement positions

held by the parties. Indeed, once filed, counterclaims have the ability to all but tie the hands of the DOJ trial attorney, precluding the attorney from settling a matter, and thereby locking the plaintiff into a lengthy, and correspondingly costly, contest.”

With respect to fraud claims under the CDA one author highlighted *Daewoo Engineering and Construction Co. Ltd. v. United States*<sup>26</sup> to illustrate the potential downside risk of a fraud counterclaim under the CDA.<sup>27</sup> In *Daewoo* the contractor submitted a certified claim to the government in the amount of \$64 million which included approximately \$50.6 million in unsubstantiated costs. The contractor apparently assumed that the claim would be settled via negotiation and therefore increased their claim amount in order to provide room to negotiate with the government. Regardless of the merits of the initial claim the government filed counterclaims under both the CDA and the FCA and entered a “special plea in fraud” under the CDA seeking forfeiture of Daewoo’s entire claim under the provisions of 28 U.S.C. §2514. When all was said and done, the U.S. Court of Appeals for the Federal Circuit ruled that Daewoo not only forfeited their **entire** \$64 million claim but also **owed the government** \$50 million **plus** FCA penalties.

The most recent development in the false claims arena may arise from the U.S. Supreme Court. On December 4, 2015 the Supreme Court granted certiorari<sup>28</sup> in *Universal Health Services, Inc. v. United States ex rel. Escobar*, an appeal from a First Circuit Court of Appeals decision.<sup>29</sup> The Supreme Court accepted two questions for review.

1. Whether the “implied certification theory”<sup>30</sup> is valid with respect to the False Claims Act; and
2. Whether the implied certification theory applies only where the defendant fails to comply with a statute, regulation, or contractual provision that expressly provides that compliance is a condition of receiving payment from the government.

24. Matthew H. Solomonson, “When the Government’s Best Defense is a Good Offense: Litigating Fraud and Other Counterclaim Cases Before the U.S. Court of Federal Claims”, *Briefing Papers Second Series, No. 11-12*, Thomson Reuters, November 2011.

25. 42 U.S.C. § 7103.

26. 65 Fed. Cl. 264 (2005).

27. Geoffrey T. Keating, Government Contracts – Feast or Famine, *Insight from Hindsight*, Issue No. 4, Navigant Construction Forum™, December, 2012, <http://www.navigant.com/NCF>

28. “Certiorari” is the name of a writ of review or reexamination of a lower court decision.

29. 780 F.3d 504 (1st Cir. 2015).

30. This is the theory that finds a False Claims Act violation for those who seeks funds from the government while in violation of a legal or contractual obligation, even when they have not expressly verified their compliance with that legal or contractual obligation.



The Supreme Court's ruling in *Universal Health Services* may result in far reaching changes to the scope of False Claims Act liability for contractors.

The Navigant Construction Forum™ believes that the employment of false claims allegations as counterclaims by government agencies will continue to grow going forward. The Navigant Construction Forum™ also notes that at the present time 31 states and 7 municipalities across the country have their own false claims statutes and most are modeled after the federal False Claims Act.<sup>31</sup> As a result, contractors working on public projects, whether federal, state or local, may face an increased risk of this type of counterclaim.

### Government Contract Compliance and the Fight Against Corruption

The Navigant Construction Forum™ has also observed that as government regulations in the U.S. have increased contractors are spending more on contract compliance. It too, has been noted that U.S. contractors working internationally are spending additional money to protect themselves against charges of corruption which have substantial sanctions for violations.<sup>32</sup>

With regard to issues concerning government contract compliance and global anti-corruption efforts a relatively recent construction industry survey, **Adapting to an Uncertain Environment – Global Construction Survey 2010**<sup>33</sup>, noted the following.

- 35% of engineering and construction companies in the Americas region have taken on **more** government compliance staff. Of those companies that have taken on more staff –
  - 39% instituted new processes to enhance accountability.
  - 19% increased government compliance personnel.
  - But, only 4% had either exited government business altogether or reduced the number of government contracts bid on.
- 46% of contractors say they do not have appropriate anti-corruption policies and procedures

54% of the respondents stated that they have appropriate policies and procedures.

- 28% said they had enhanced their corruption policies and procedures to comply with government regulations.

- 11% said they had implemented corruption policies and procedures to comply with regulations.
- Only 10% of the respondents say they are actively involved in implementing the Partnering Against Corruption Initiative (“PACI”) established by the World Economic Forum in 2004.
- And, only 4% of contractors said they would cease doing business in a country with a high perceived corruption score.

With respect to government contract compliance within the U.S. the **6th Annual Deltek Clarity GovCon Industry Study**<sup>34</sup> summarized their findings in the following manner.

“The audit swell is growing as we predicted. Last year, we noted early signs of the government beginning to dig into its backlog of audits. This year, they are going at it full force. As DCAA<sup>35</sup> focuses on that backlog, contractors are having to keep their books open longer and substantiate projects that occurred years ago. Many are holding funds in reserve in case of an audit finding, impacting profitability. To add to the picture, project leaders are also undergoing substantial audits up front, long before a project ever begins.

A tighter audit environment translates to more resources required for companies. As profits increasingly get eaten up meeting audit demands, fewer funds are available to pursue expansion. If this increased scrutiny is here to stay for the time being, figuring out how to efficiently manage the audit process will be critical for GovCon firms going forward.”

31. Pietragallo Gordon Alfana Bosick & Raspante LLP, *False Claims Act Resource Center*, [www.falseclaimsact.com](http://www.falseclaimsact.com)

32. Jay H. Perlman, *Constructing Anti-Corruption Compliance*, Navigant Construction Forum™, Boulder, CO, September 2015.

33. KPMG International, *Global Construction Survey 2010*.

34. November 2015.

35. Defense Contract Audit Agency.

Among the key findings of this industry study are the following.

- A jump in the number of Pre-Award and Incurred Cost Submission (“ICS”) audits shows DCAA is focused on scrutinizing all phases of projects. 58% of respondents said they had undergone a Pre-Award audit in the past two years – roughly double the percent of last year – while 6 in 10 firms experienced an ICS audit.
- Indirect Rates, Labor & Time Keeping and Internal Control Systems remain the top three audit issues for firms.
- Firms ranked ICS and DCMA<sup>36</sup> audits highest in terms of cost of compliance. The rise in DCMA audits suggests auditors are taking a closer look at the scope and quality of work being performed.

The Navigant Construction Forum™ believes that this trend in increased audit scrutiny will continue and likely even increase as long as there is a belief that there is a substantial amount of fraud, waste, abuse and corruption concerning government contracts.

## Awards Against Design Professionals and Construction Contractors

In an unusual award against a design professional a jury in Pennsylvania awarded US\$5.5 million in damages for breach of contract, professional negligence and negligent misrepresentation in *Community College of Philadelphia v. Burt Hill, Inc. n/k/a Stantec Architecture and Engineering, LLC*, Case No. 120401889.<sup>37</sup> As noted in this commentary, the verdict is unusual as –

“The economic loss doctrine frequently bars third party tort claims, and also serves as a shield for a design professional against owner claims for negligence when there are purely economic losses that arise out of a contractual relationship.”

In *Community College* the owner was successful in convincing the jury that –

- Stantec used unlicensed designers and engineers on the project.
- Stantec fell behind in delivering complete contract documents according to the project schedule.
- Both parties placed too heavy of a reliance on the RFI process to find and resolve conflicts with the existing structure.

- All of which resulted in delays to the project, the need for concurrent operations and increased construction costs by nearly fifty percent over the original contract cost.

This case is unusual, as noted above, because the decision ignored the classic economic loss defense. But, it is also unusual in that a great deal of the decision was based upon schedule delay analysis showing that Stantec’s late delivery of design documents and the impact of the errors and omissions in those documents. These two characteristics resulted in a huge increase in the cost of the project and delaying project completion some 26 months behind schedule.

Another unusual award was confirmed by an Ohio Appellate case in *Davis v. Hawley General Contracting, Inc.*<sup>38</sup> While the case does not stem from a public works contract this case has implications for contractors working in States with statutes similar to Ohio’s. In this case Davis retained Hawley to perform corrective work on the foundation of their own home and create a walk in basement. The permit for this work required compliance with the homeowners’ association ordinances, building codes and State laws. Problems developed with the work after completion. Hawley made repairs but the repairs did not fix the problem.

“In the trial court case the judge awarded \$30,400 in damages for breach of contract. Davis appealed alleging that the failure to perform the work in a workmanlike manner violated Ohio’s Consumer Sales Practices Act (“CSPA”)<sup>39</sup>; that Hawley was personally liable because he failed to disclose his status as an agent of Hawley General Contracting, Inc. (“HGC”); and that Hawley and HGC were reckless in performing the work and were, therefore, liable to Davis for attorney fees. The appellate court ruled “... that a homeowner could recover statutory damages and attorney fees from both

36. Defense Contract Management Agency.

37. Shiva S. Hamidinia, “Jury Awards Against Design Engineering Firms – Lessons from the Trenches”, *Under Construction*, ABA Forum on Construction Law, Vol. 17, No. 3, Winter 2016.

38. 2015-Ohio-3798 (6th District).

39. Chapter 1345, Title XIII Commercial Transactions, Ohio Uniform Commercial Code.

the general contractor and individually from the owner of the general contractor for misrepresentations concerning work that failed to conform to statutory requirements. These damages were in addition to breach of contract damages awarded to fix the defects at issue.”<sup>40</sup>

The Navigant Construction Forum™ cannot predict how widespread this type of owner claim will become as it will depend entirely upon the Uniform Commercial Code of the State in which the project is executed. But some lessons to be learned from this case by contractors are the following.

- Be clear about the context in which the contract is signed. Anyone signing on behalf of a general contractor needs to make it clear that they are signing in a corporate capacity.
- Be careful what is said. Here, HGC should have verified the placement of the rebar before saying that it complied with building code.
- Do not become complacent. Always check to make certain that work conforms to all applicable code and ordinance requirements.
- Fix your mistakes. Had HGC fixed the defect on their own they would not have faced the additional damages awarded by the appellate court.

## Court Decision Sets New Standard for Construction Managers

In June 2014 a Massachusetts Superior Court ruled that –

“... in the CM@R<sup>41</sup> delivery method, the CM takes on additional duties and responsibilities for the project along with added risk ... the contractual indemnification language running in favor of the Owner ‘[trumped] the long standing Massachusetts common law principles to the effect that where one

party furnishes plans and specifications for a contractor to follow in a construction job ... the party furnishing such plans impliedly warrants the sufficiency for the purpose intended’ ... the court determined that the doctrine that requires the owner to ensure constructability of the plans and specifications (recognized across the country as the *Spearin* Doctrine) does not apply in the CM@R context where the CM takes on added roles and responsibilities, including design related roles and responsibilities.”<sup>42</sup>

This trial court decision effectively wiped out the *Spearin* Doctrine under CM@R contracts in Massachusetts and negated the broad indemnification provision of the construction manager’s contract with the Massachusetts Division of Capital Asset Management on behalf of the Massachusetts Department of Mental Health (the project owner). The construction manager appealed this decision to the Massachusetts Supreme Judicial Court.

On September 2, 2015 the Massachusetts Supreme Judicial Court reversed the decision of the trial court. In this decision the Supreme Judicial Court looked at three questions.<sup>43</sup>

- Whether the *Spearin* Doctrine applies to CM@R contracts.
- If so, did the parties in this case waive the *Spearin* Doctrine by virtue of the terms of the contract?
- If not, did the indemnity provision of the contract bar the CM’s claim against the owner?

With respect to the first issue the court held that

“... we are not persuaded that the relationships [between the parties under the CM@R and the design-bid-build project delivery methods] are so different

40. David J. Dirisamer, “Double Damages? Ohio Court Allows Additional Recovery for Failure to Comply with Code”, *The National Law Review*, <http://www.natlawreview.com/article/double-damages-ohio-court-allows-additional-recovery-failure-to-comply-code>.

41. Construction Manager at Risk.

42. Michael C. Zisa and Warren E. Friedman, “Alternative Project Delivery, Alternative Risks: Are Construction Managers More at Risk?”, *Surety Bond Quarterly*, Vol. 2, Issue 3, Fall 2015, discussing *Coghlin Electrical Contractors, Inc. v. Gilbane Building Co. and Travelers & Surety Co. of America*, No. 2013-1300-D (Mass. Sup. Ct. June 24, 2014) (Davis. J.)

43. Michael C. Zisa and Warren E. Friedman, “NASBP News Alert – Court’s Decision Sets New Standard for CMs”, <http://www.suretybondquarterly.org/2015/09/24/nasbp-news-alert>

that no implied warranty of the designer's plans and specifications should apply in construction management at risk contracts ... that the CM@R should bear all the additional costs caused by design defects."

The decision went on to explain that a CM@R may benefit from the implied warranty **only** where it has (1) acted in good faith reliance on the design and (2) acted reasonably in light of the CM@R's own design responsibilities. The court stated that

"... the greater the CM@R's design responsibilities in the contract, the greater the CM@R's burden will be to show, when it seeks to establish the owner's liability under the implied warranty, that its reliance on the defective design was both reasonable and in good faith."

Concerning the second issue, while the court recognized that the CM undertook significant design related responsibilities under this contract, the court found that the contract did **not** contain an express waiver of the *Spearin* Doctrine. The court stated that

"... plain language of the contract supports, rather than disclaims, the implied warranty." As a result, the court reversed the trial court decision and remanded the case for further proceedings.

"Thus, under its holding and supporting rationale, where the implied warranty applies, the CM could only recover additional costs from the Owner to the

extent that such additional costs were caused by the CM's reasonable and good faith reliance on the defective plans and specifications that resulted in a breach of the Owner's implied warranty, despite the CM's own contractual design responsibilities."

The authors of this **NASBP News Alert** conclude this "... appellate decision and its new standard poses a significant risk to CMs." They note that

"... this decision will likely have far reaching consequences and change the way CM@R agreements are understood and operate as, traditionally, CM@R agreements do not assume responsibility for design. Furthermore, the decision has created a new and different standard governing the *Spearin* Doctrine and an owner's responsibility for implied warranties in any construction contract where a contractor participates in or assumes some contractual responsibility for even a portion of the design process. Because the new standard is factually dependent, each contract and individual project circumstances will need to be reviewed, analyzed, and understood independently; and this alone creates added risks."

The Navigant Construction Forum™ believes that regardless of the outcome of the remanded case, this new standard has a strong potential to modify the liability CM@Rs assume when participating in the design process.



## RESTRICTIONS ON CLAIM RECOVERY

In addition to changes in claims against design professionals and contractors the Navigant Construction Forum™ has observed some changes resulting in restrictions on claims recovery that are impacting contractors.

### Change to the “Incurred Cost” Rule

Previously, if a contractor had incurred costs while executing work under a government construction contract such costs were presumed to be “reasonable”. However, as noted in in *Kellogg Brown & Root Services, Inc. v. United States*<sup>44</sup> this presumption of reasonableness no longer exists. Federal Acquisition Regulation (“FAR”) 31.201-3 now includes criteria for determining reasonableness of costs as set forth below.

#### “31.201-3 – Determining Reasonableness.

1. A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business. Reasonableness of specific costs must be examined with particular care in connection with firms or their separate divisions that may not be subject to effective competitive restraints. No presumption of reasonableness shall be attached to the incurrence of costs by a contractor. If an initial review of the facts results in a challenge of a specific cost by the contracting officer or the contracting officer’s representative, the burden of proof shall be upon the contractor to establish that such cost is reasonable.
2. What is reasonable depends upon a variety of considerations and circumstances, including --
  - Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor’s business or the contract performance;
  - Generally accepted sound business practices, arm’s-length bargaining, and Federal and State laws and regulations;
  - The contractor’s responsibilities to the Government, other customers, the owners of the business, employees, and the public at large; and
  - Any significant deviations from the contractor’s established practices.”(Underscored provided.)

Thus, the Defense Contract Audit Agency (“DCAA”), the Court of Federal Claims, and the Boards of Contract Appeals no longer presume that incurred costs by a contractor are

reasonable on their face. All such incurred costs are subject to the reasonableness tests outlined in FAR 31.201-23. As a result, the Navigant Construction Forum™ believes that contractors must keep more documentation of costs and their rationale for expending such costs in order to meet the “reasonableness” criteria.

### Recoverability of Unabsorbed Home Office Overhead

The General Services Administration (“GSA”) contracted with H.J. Lyness to renovate a federal building in Cincinnati, Ohio. During the performance of the work, GSA had issues with the fire evacuation plan. Unable to resolve these issues, GSA terminated Lyness for convenience. Lyness and GSA could not reach agreement on the termination for convenience settlement and Lyness filed suit in the Court of Federal Claims. As the government had already admitted liability the only issue before the court was what damages were owed Lyness.

As part of the claimed damages Lyness sought recovery of unabsorbed home office overhead. Lyness asserted a specially crafted formula for calculating unabsorbed home office overhead for this case. The court denied the use of this formula and reaffirmed that only the original *Eichleay* Formula can be used to calculate unabsorbed home office overhead costs. Additionally, the court reiterated the basic three requirements for recovery of such damages.

- There must have been a government caused delay of uncertain duration at the start of the delay.
- The contractor must show that the government caused delay extended the original time of performance of the work or that, even though the contract was completed within the required time, the contractor incurred additional costs as they were prevented from completing earlier than required.
- The contractor must have been instructed to remain “on standby” and was therefore unable to take on other work during the delay period.

Following the line of thought expressed in *The Redland Company, Inc. v. U.S. the Court of Federal Claims*<sup>45</sup> denied recovery of unabsorbed home office overhead in *H.J. Lyness Constr., Inc. v. United States*<sup>46</sup> on the basis that because the contractor could not provide evidence that it was required to “remain on standby” the court did not believe that the government owed the contractor **any** unabsorbed home office overhead.

44. 107 Fed. Cl. 16, 39 (2012).

45. 2011 Ct. Fed. Cl. No.8-6066C, WL 1338188 (Fed. Cl. April 7, 2011).

46. 121 Fed. Cl. 287 (Fed. Cl. May 15, 2015).

As the Navigant Construction Forum™ noted in an earlier research perspective<sup>47</sup>

“After *P.J. Dick* some commentators had suggested that it would be very difficult to establish the “standby requirement “... because it is unlikely that a Contracting Officer will issue a suspension order containing a requirement that the contractor be ready to immediately resume full scale work with no remobilization period.”

The lesson for contractors – in the event a contracting officer suspends all work on a project but does **not** state that the contractor “...must remain on standby ready to resume work promptly upon direction from the government...” then recovery of unabsorbed home office overhead is seriously in doubt. One option is for the contractor to immediately write back to the contracting officer specifically asking if they are to “...remain on standby...” If the answer is “yes” then home office overhead damages may be recoverable. If the answer is “no” then the contractor is alerted to the situation and should seek other ways to reduce their damages.

If the Contracting Officer does **not** respond to this written request for guidance concerning standby or if the Contracting Officer confirms that the contractor is **not** required to remain on standby then the contractor should provide written notice to the Contracting Officer that they intend to remove all labor and equipment from the site within the next few days and intends to charge the cost of demobilization and remobilization of these resources and all impact costs of labor replacement to the government when the delay event is complete and the return to work order is given.

### Calculation of Field Office Overhead Costs

The Navy contracted with Watts Constructors for the relocation of a sewer lift station at the Camp Pendleton Marine Corps Base.

During performance of the work, Watts encountered a differing site condition. The Navy agreed that the condition encountered was a differing site condition but could not reach agreement with Watts on the recovery of the claimed field office overhead costs. The disagreement centered on whether such costs were “direct costs” as claimed by Watts or “indirect costs” as asserted by the Navy.<sup>48</sup> Watts appealed the Contracting Officer’s denial to the Armed Services Board of Contract Appeals (“ASBCA”).<sup>49</sup>

As the amount in dispute was only US\$41,000 Watts elected to proceed under ASBCA **Rule 12, Optional Small Claims (Expedited) and Accelerated Procedures**.<sup>50</sup> In a Rule 12.2 decision the Board acknowledged that a contractor has the option to treat field office overhead costs as either direct or indirect costs pursuant to FAR 31.105(d)(3) which reads as follows.

“(d)(3) Costs incurred at the job site incident to performing the work, such as the cost of superintendence, timekeeping and clerical work, engineering, utility costs, supplies, material handling, restoration and cleanup, etc., are allowable as direct or indirect costs, provided the accounting practice used is in accordance with the contractor’s established and consistently followed cost accounting practices for all work.”

The Board noted that while the contractor has this option, the contractor is required to treat field office overhead costs as either direct or indirect costs “...as long as they are charged consistently.”<sup>51</sup> The Board ruled that because Watts had initially elected to classify field office overhead as indirect costs they could **not** now classify such costs as direct costs in this claim appeal. As a result, the Board denied Watts’ appeal.

While FAR 31.105(d)(3) is not new, the Navigant Construction Forum™ believes that *Watts* should serve as a stark reminder to contractors working on government contracts to make the choice

47. James G. Zack, Jr., *Trends in Construction Claims & Disputes*, Navigant Construction Forum™, Boulder, CO, December 2012.

48. The difference between these two positions is, of course, whether the extended field office overhead costs resulting from the differing site condition would be subject to mark up as direct costs or not subject to markup when the costs are presented as indirect costs.

49. Watts Construction LLC, ASBCA No. 59602 (Jan. 26, 2015).

50. Rules of Armed Services Board of Contract Appeals, Revised 21 July 2014, 48 CFR Chapter 2, Appendix A, Part 2.

51. Citing Karen L. Manos, *Government Contract Costs & Pricing*, Vol. 2 § 87.D.3 at 316 (2nd Ed. 2004).

of how to treat field office overhead costs on both contract modifications (change orders) and claims carefully at the outset of the project as they will be required to live with this choice for the duration of the project.

### Narrowing of the Differing Site Condition Clause Coverage

Following the trend noted earlier by the Navigant Construction Forum<sup>52</sup> concerning Differing Site Condition (“DSC”) claims, the Court of Appeals in Washington continued the trend of rejecting contractor DSC claims on the basis that “... the Contract Documents contained no indication, express or implicit, as to the number of transitions ... A contract silent on subsurface conditions cannot support a changed conditions claim.”<sup>53</sup>

King County awarded a lump sum wastewater tunnel contract to a joint venture of Vinci Construction Grands Projects, Parsons RCI and Frontier-Kemper (“VPFK”). The contract contained a DSC clause entitling the contractor to an equitable adjustment should they encounter “materially different” conditions. The definition of “differing site condition” contained in the contract was identical to the definition in the federal DSC clause. The contract incorporated a geotechnical report showing the data from soil test borings taken every 300 – 400 feet along the tunnel alignment. The report identified 12 types of soil conditions that could be expected while tunneling. The contract also included the following language concerning the soils information provided.

“The Contractor may make its own interpretations, evaluations, and conclusions as to the nature of the geotechnical materials, the difficulties of making and maintaining the required excavations, and the difficulties of doing other work affected by geotechnical conditions, and shall accept full responsibility for making assumptions that differ from the baselines set forth in the geotechnical report.”

The contract also dictated means and methods of tunneling insofar as it specified the use of a slurry tunnel boring machine (“TBM”). Slurry TBMs require adjustment of pressure and slurry mix when soil conditions change which, in turn, requires that tunneling operations stop while the changes are implemented.

VPFK used their own geotechnical experts to assist in preparation of their bid. In interpreting the soils report VPFK attempted to predict the points at which they could expect to encounter transitions from one major soil type to another – or points where they would have to stop tunneling to adjust the TBM in order to advance into the next soil type. During tunneling VPFK discovered that the soil conditions changed more frequently than anticipated. This resulted in more TBM shutdowns which increased costs and delayed the work. VPFK filed a DSC claim. The County, in turn, filed a lawsuit against VPFK for breach of contract and VPFK counterclaimed on the basis of their DSC claim. The trial court rejected VPFK’s DSC claim through summary judgement and VPFK appealed.

In their ruling the Washington Court of Appeals summarized the basic elements of a successful DSC claim as follows.

- The contract documents included indications or representations of certain physical conditions at the site.
- The contractor reasonably relied on those representations when pricing their bid.
- Actual conditions in the field differed materially from the conditions indicated in the contract documents.
- The differing site conditions were **not** reasonably foreseeable by the contractor when preparing their bid.

The Appellate Court ruled that VPFK had failed on the first two points as the contract documents contained no express representations concerning the frequency of soil transitions along the tunnel alignment. They pointed out that the geotechnical report only indicated 12 different soil types. VPFK had argued in the lower court case that they anticipated no soil transitions when two adjacent test borings indicated the same soil conditions. VPFK stated that in situations like this they interpreted the boring data to mean the soil conditions would be consistent at least between these two borings, not requiring a change to the TBM. In the appellate case VPFK argued that the contract contained affirmative representations when the boring data leads to logical inferences. The Appellate Court rejected this argument. The Appellate Court also relied upon the contract’s disclaimer language in rejecting VPFK’s DSC claim –

52. Zack, *Trends in Construction Claims & Disputes*, December 2012.

53. *King County v. Vinci Construction/Parsons RCI/Frontier-Kemper, JV*, Case No. 70432-0-1, November 9, 2015. See also Joseph T. Imperiale and James M. Kwartnik, Jr., “Differing Site Condition Defense Rejected,” *AGC Law in Brief*, Vol. 1, No. 5, November 2015. See also, “Differing Site Condition Claim Fails to Meet Standards,” *Construction Claims Advisor*, Vol. 4, Issue 48, ConstructionPro Network, December 11, 2015.

“Here, the Contract Documents explicitly stated that bidders should make their own interpretations and conclusions about the conditions along the tunnel.”

The Navigant Construction Forum™ notes that the reasoning and outcome of *King County v. Vinci Construction/Parsons RCI/Frontier-Kemper, JV* is very similar to that in the *Appeal of NDG Constructors*<sup>54</sup>. In both cases contractors had very limited data available at the time of bidding and made what they believed were reasonable interpretations of the data provided by the owner. These interpretations turned out to be incorrect. But, what else can a contractor do? One article concerning *King County* concluded with the following.<sup>55</sup>

“These two questions are the crux of most differing site condition disputes. What did the contract documents affirmatively represent? And, were the contractor’s inferences or conclusions, when pricing its bid, reasonable?”

Based on these two questions the Navigant Construction Forum™ recommends that contractors –

- Document what they understand as “affirmative representations” during the bidding process; and,
- Document how they translated this understanding into the bid in order to show their reasonable reliance.

## CHANGES IN GOVERNMENT CONTRACT ADMINISTRATION

### Contractor Performance Assessment Reports System

FAR 42.15, Contractor Performance Information, requires that contractor performance evaluation information be collected and used by government procurement officials in future source selection evaluations in accordance with FAR Part 15. The outgrowth of this FAR requirement is the Contractor Performance Assessment Reports System (“CPARS”), a government wide data

collection system on all contractors. In essence, each contracting officer (or other designated official) is required to assess a contractor’s performance at least annually during a project and at the end of each contract. These evaluations are filed in the CPARS and are available to all other procurement officials and contracting officers.

Contractors that perform a good deal of federal construction work must be aware of this system as it may impact future government procurements especially those procured under the best value selection method where factors such as “past performance” are weighed along with the bid price in making the award decision. Among the list of contractor performance characteristics to be reported on under FAR 42.1501 are the following:

- Conforming to requirements and standards of good workmanship;
- Forecasting and controlling costs;
- Adherence to schedules;
- Reasonable and cooperative behavior and commitment to customer satisfaction;
- Integrity and business ethics; and
- Business like concern for the interest of the customer.

***The Guidance for the Contractor Performance Assessment Reporting System***<sup>56</sup> includes the following statement in Subsection 1.2, Purpose.

“It is imperative for the CPAR to include detailed, quality written information because each CPAR submitted to PPIRSRC is used to effectively communicate contractor strengths and weaknesses to source selection officials. The Contracting Officer should use information available in PPIRSRC and other sources of information outlined in FAR 9.105-1(c) to support responsibility determinations of prospective contractors.”

54. ASBCA No. 57328, August 21, 2012.

55. *Differing Site Condition Claim Fails to Meet Standards*, *Construction Claims Advisor*, Vol. 4, Issue 48.

56. December 2015 edition.



Senior Government officials and contractors may also use the information derived from the CPARS for their own management purposes.” (Underscoring provided.)

Thus, the mere existence of the CPARS may serve as a deterrent for contractors with respect to claims on government construction contracts. As one noted construction litigation attorney recently opined:

“... if you become known as a litigious contractor whose behavior is affecting the procurement officers you are dealing with, you may find yourself with a low CPARS rating—and that situation will often dictate a litigation strategy in terms of trying to get disputes resolved at the contracting officer level, rather than pushing them toward litigation. You can litigate the reasonableness of the rating with the board or with the Court of Federal Claims, but they have no jurisdiction to order the agency to change the rating. Thus, for example, if the rating is of concern, the contractor may want to consider also advancing an unrelated but fully supportable monetary claim and take them together to the court or board and seek to negotiate them both at the same time.”<sup>57</sup>

The Navigant Construction Forum™ notes that a review of the guidance documents related to CPARS does allow for a contractor to comment on draft CPARS evaluations proposed by a contracting officer but does **not** provide for an appeal from a bad performance rating should the contracting officer and the

reviewing official opt to disregard the contractor’s objections to the proposed assessment. The advice cited above appears to be the only option for a contractor who receives a negative performance rating.

## Contract Management Practices

A subtle but significant trend observed by the Navigant Construction Forum™ is the manner in which government construction contracts are managed. Due to budgetary restrictions and/or increased numbers of construction contracts issued annually by the government it is all too common to find that the Contracting Officer (“CO”) is located in Washington, D.C. while the construction project is located in Kazakhstan, Haiti, Germany, Afghanistan, China or elsewhere around the globe. Thus, on site contract management is handled by a Contracting Officer’s Representative (“COR”) rather than a senior and more experienced CO. The upshot of this change in contract management and administration is succinctly summarized below.

“Clearly, negotiation is the first stage in any government contracts claims matter—but it is important to keep in mind that times have changed in this area. For example, years ago, if you were working on an Army Corps of Engineers job, your contracting officer was likely to be a senior, crusty colonel, and in order to deal with a claim in that kind of environment, you would have needed to put together a highly coherent package. Essentially, your claim would be packaged with an introduction and a description of the contract, a description of what happened during the contracting process, and then a legal analysis as to why your client is entitled to money, followed by a detailed and comprehensive statement of costs/damages. You would have submitted

57. Joseph McManus, “Successfully Representing Contractor Clients in Government Contract Claims”.

this document to the contracting officer, and typically, the next step would have been to sit down with the colonel in a job site trailer and negotiate the claim to conclusion before you left the trailer.

These days, while the nature of contracting officers has changed in certain respects, it is still important to meet with the contracting officer and discuss a possible resolution. It may be that the contracting officer—unlike the crusty colonel of years ago—has little familiarity with what has actually happened during the course of the project because a contracting officer's representative (COR) was actually running the project. Therefore, in some cases, the contracting officer is hearing the true facts of the case for the first time at the claim stage. Alternatively, you can request mediation with the Armed Services Board at any stage of your claim. For instance, the client's claim may not have risen to the level of a Contract Disputes Act (CDA) certified claim; it may just be a Request for an Equitable Adjustment (REA). In such cases, the Board of Contract Appeals, at the request of the parties, can still assist you in getting your claim resolved.”<sup>58</sup>

The author of the above cited commentary is referring to the ASBCA Rules wherein the ASBCA will provide mediation services for a dispute if both parties jointly make such a request.<sup>59</sup>

The Navigant Construction Forum™ believes that mediation provided by a member of the ASBCA has both advantages and disadvantages, as follows.

- Advantages

- Mediation with the assistance of the ASBCA can take place prior to filing a certified claim under the CDA, thus saving time and avoiding the risk of a False Claim Act counterclaim.
- The services of the ASBCA mediator should cost considerably less than a private mediator.
- The ASBCA will assign one of the judges to act as a mediator, again saving time as the typical squabbling over which mediator to choose is avoided.
- The government agency is likely to listen to and follow the suggestions from a sitting judge from the ASBCA acting as a mediator.
- If the mediation is unsuccessful, the mediator will **not** be appointed as the judge in the follow on proceedings before the ASBCA; the mediator is precluded from providing any information to the judge assigned to the case; nor may either party subpoena the mediator or any of their notes or documentation from the mediation session.

- Disadvantage

- If the matter is **not** pending before the ASBCA under its CDA jurisdiction, any settlement reached may **not** be paid out of the Judgment Fund<sup>60</sup> which calls into question whether the agency has sufficient appropriated funds to pay the settlement.

The Navigant Construction Forum™ believes that the strategy above may well be the most effective approach to resolving a request for equitable adjustment, avoiding the need to prepare, submit and defend a certified claim under the CDA.

## CHANGES IN JUDICIAL RELIEF

### Judicial Review

While a contractor may seek judicial review of a Contracting Officer's denial of a claim by appealing to the ASBCA, the CBCA, the Court of Federal Claims or the Court of Appeals for the Federal Circuit the workload before these tribunals is astronomically high. It was recently reported that –

58. Joseph McManus, "Successfully Representing Contractor Clients in Government Contract Claims".

59. Rules of Armed Services Board of Contract Appeals, Revised 21 July 2014, Addendum II, 48 CFR Chapter 2, Appendix A, Part 2.

60. The Judgment Fund is a permanent, indefinite appropriation available to pay judicially and administratively ordered monetary awards against the United States. The Judgment Fund is also available to pay amounts owed under compromise agreements negotiated by the U.S. Department of Justice in settlement of claims arising under actual or imminent litigation, if a judgment on the merits would be payable from the Judgment Fund. The statutory authority for the Judgment Fund is 31 U.S.C. 1304.

“The ASBCA, U.S. Court of Federal Claims, and the U.S. Court of Appeals for the Federal Circuit each publish annual reports that provide statistics regarding each tribunal’s activity and caseload during a given fiscal year (“FY”). The ASBCA and the Federal Circuit both ended FY 2014 with a substantially higher number of pending cases than the number at which they started the year: the ASBCA had a net increase of 173 pending appeals as of September 30, 2014, and the Federal Circuit had a net increase of 114 pending appeals. Both tribunals ended FY 2014 with more than 1,000 pending cases. Unlike the ASBCA and the Federal Circuit, the U.S. Court of Federal Claims **decreased** its number of pending cases by 110, but the Court nevertheless has well over 1,000 pending cases.”<sup>61</sup>

This same article pointed out that judicial vacancies are adding to this backlog. It was noted that the one vacancy on the Court of Appeals for the Federal Circuit was filled in July, 2015 bring that panel back to full strength. However, the article noted that the Court of Federal Claims still has 5 vacancies and there were no appointments to the ASBCA or CBCA.

Thus, when considering an appeal from a Contracting Officer’s claim denial a contractor must consider both the cost and the amount of time it will take to appeal a decision and obtain a judicial determination. As one of the author’s previous managers used to frequently point out, in pursuing a claim into formal legal action, the contractor must always remember the old adage – “Is the juice worth the squeeze?” Appealing a claim to a Board or Court is a lengthy and expensive process. And, as noted by the recent Construction Financial Management Association study<sup>62</sup> depending upon what agency the contractor is filing a claim against the chances of recovery are not always great.

## Defining the Claim

An unusual judicial decision issued on February 12, 2015 parsed the jurisdictional question to harmonize two rules in order to deal with claims arising from construction of a Coast Guard project.<sup>63</sup> In this case, the contractor completed work late and the Coast Guard assessed liquidated damages (“LDs”). The contractor disputed the assessment of LDs arguing that the LDs clause was unenforceable and inappropriate due to delays to the work caused by changes made to the work by the Coast Guard. The CO denied the request for remission of the LDs and the contractor filed suit in the Court of Federal Claims.

While the suit was in litigation the contractor filed a second claim for cost damages associated with the changes made to the work and the delay arising from these changes. The CO denied this second claim and the contractor sought to amend its claim pending in the Court of Federal Claims. The Court ruled for the Coast Guard holding that:

- The LDs were enforceable;
- The contractor did **not** provide written notice of the alleged changes (the second claim) and thus were **not** entitled to additional compensation; and,
- The Court did **not** have jurisdiction over the claim for additional time.

The contractor appealed this decision and the Court of Appeals for the Federal Circuit affirmed all three rulings. The Court ruled that CDA gives jurisdiction to the Court of Federal Claims only for claims which have been submitted to the CO and upon which the CO has provided a final determination. The Court also noted that once a claim is in litigation the CO has no authority to decide on the claim. Therefore, the Court concluded that the Court of Federal Claims had jurisdiction over the claim for damages resulting from government issued changes. The Court determined that this was a new claim **not** already in litigation and therefore the CO still had authority to render a decision on this claims. However, the Court denied recovery to the contractor on the basis that they had **not** filed written notice of constructive change to the government within the 20 day timeframe of the Changes clause. The Court went on to decide that the Court of Federal Claims had no jurisdiction over the delay claim arising from such changes as this issue was already in litigation when the delay claim was filed (as a result of the appeal concerning the remission of LDs).

61. Gibson, Dunn & Crutcher LLP, [2015 Mid-Year Government Contracts Litigation Update](#), July 29, 2015.

62. [Analysis of Construction Projects with Federal Agencies and the Causes of Disputes](#), September 2015.

63. *K-Con Building Sys., Inc. v. United States*, 778 F.3d 1000 (Fed. Cir. Feb. 12, 2015). See also, Gibson, Dunn & Crutcher LLP, [2015 Mid-Year Government Contracts Litigation Update](#).

The Navigant Construction Forum™ suggests that when deciding whether to file a claim ensure that **all** elements are included in the initial claim filing and seek legal advice to make certain that all elements of the claim are properly included. The risk, as noted in *K-Con*, is that if the CO denies the claim and the contractor files an appeal with the Court of Federal Claims which is broader than the claim filed with the CO for a decision, the Court may well determine that they lack jurisdiction over that portion of the claim **not** previously submitted to the CO.

### Timeliness of Appeal

Some good news arose out of a decision issued on February 23, 2015 by the Court of Federal Claims.<sup>64</sup> Rudolph & Sletten filed a certified claim with the National Oceanic and Atmospheric Administration (“NOAA”) CO in August 2013. Within the 60 day timeframe mandated by the CDA, the CO advised the contractor that due to the complexity of the claim the final decision would not be issued for nine months from the date of the letter to the contractor – that is July 15, 2014. On July 8, 2014 the CO notified the contractor that he would need another eight months to prepare and issue a final decision – delaying issuance of the final determination until March 2015.

Shortly after receipt of the second letter the contractor filed suit in the Court of Federal Claims. NOAA filed a request for dismissal on the basis that the Contracting Officer had not yet issued a final determination.

“The Court ... denied the motion to dismiss, holding that the government is allowed only one extension for issuing a contracting officer’s final decision, and that extension must be set within 60 days of receiving the certified claim. Because the July 8, 2014 extension was both a second extension and set outside of the 60-day period, it was not effective and Rudolph & Sletten was authorized to treat it as a ‘deemed denial.’”<sup>65</sup>

This favorable decision was overshadowed by the following:

“The Court did, however, stay the proceedings for 30 days and remand the matter to the contracting officer to provide one last opportunity to issue a final decision. Notably, 30 days from the Court’s order was within the March 2015 revised deadline set by the contracting officer, casting a shadow over the contractor’s victory.”

The Navigant Construction Forum™ notes, however, that the Court of Federal Claims is as willing to hold the government to the timeframes set forth in the CDA as they are to hold contractors to the timeframes set forth in the contract documents. Thus, contractors need to track the timeframes concerning claims and be prepared to act on the “deemed denial” date unless the CO sets forth a reasonable extension of time within the CDA’s 60 day timeframe. Additionally, contractors should bear in mind that the government is allowed only one extension for issuing a CO’s final decision.

### Jurisdiction Over Appeals of Contract Claims

In a highly technical decision the ASBCA rejected a contractor’s claim on the basis that the claim did not set forth a “sum certain”.<sup>66</sup> The claim arose out of a contract to repair a runway at a Navy station. Donovan, the prime contractor, subcontracted with Costello to perform a portion of the work. Costello submitted a request for equitable adjustment (“REA”) to Donovan in the amount of \$559,764. Donovan forwarded the claim to the CO. In the letter transmitting Costello’s claim, Donovan also advised the CO that they would add a claim for recovery of associated costs incurred by Donovan using the following wording.

“Of the \$559,764.00 that Costello is claiming, Donovan is herein stating that Donovan has or will have approximately

64. *Rudolph & Sletten, Inc. v. United States*, 120 Fed. Cl. 137 (Feb. 23, 2015). See also, Gibson, Dunn & Crutcher LLP, [2015 Mid-Year Government Contracts Litigation Update](#).

65. Gibson, Dunn & Crutcher LLP, [2015 Mid-Year Government Contracts Litigation Update](#).

66. *Appeal of J.P. Donovan Construction, Inc.*, ASBCA No. 55335, 2010 WL 2899029, (July 16, 2010).



\$65,000.00 of additional direct and administrative costs that should be added to this Costello requested amount.” (Underscoring provided.)

The CO denied the claim and Donovan appealed to the ASBCA. On appeal, the ASBCA noted that a valid claim under the CDA must set forth a “sum certain”. The ASBCA noted that this language means that the claim is not subject to such qualifying language such as “approximately”. When a claim describes the claim as approximate and never states a sum certain then this requirement of the CDA has not been met. Even though the “approximate” language applied only to Donovan’s portion of the claim since this was not a separate claim the entire claim was rejected.

The Navigant Construction Forum™ recommends that when a contractor is preparing a claim for submission to the government, they prepare the damages carefully and be very cautious in drafting the claim document and transmittal letter so as to avoid the counterclaim that the claim does not set forth a “sum certain”.

### Sovereign Act Defense

The ASBCA issued a decision on September 22, 2015 which addressed the issue of sovereign acts versus changes to the project or force majeure events.<sup>67</sup> The Air Force awarded a contract to Garco Construction, Inc. (“Garco”) to construct housing on a base in Montana. Garco subcontracted some of the work to James Talcott Construction, Inc. (“Talcott”). Talcott had performed work on the base over a number of years and frequently employed pre-release convicts on its crews.

After award of the contract to Garco the base commander started enforcing a policy prohibiting pre-release convicts on the base. Garco, Talcott and the Air Force disagreed over whether this was enforcement of an existing policy or imposition of a new policy. Fourteen months after enforcement of the policy commenced, the base commander issued a formal memorandum actually implementing the base access restriction.

Talcott claimed that the base access restriction prevented it from utilizing its normal labor pool which, in turn, delayed its work and increased its cost. Garco sponsored Talcott’s claim to the Air Force. The CO denied the claim contending that the

base access restriction was a “sovereign act” implemented to maintain security at the base. The CO also took the position that the Air Force was merely enforcing a longstanding policy. Garco and Talcott countered with the argument that if this was an established policy, why had it **not** been enforced in the past? They also took the position the Air Force must have waived the existing policy.

One commentator on this case noted the following.

“The board defined a “sovereign act” of the government in the context of a government contract. A sovereign act is public and general in nature. It is not directed at a particular contractor. It is intended to improve public health or safety. It is not intended to nullify or abridge rights under a particular contract. And, it provides no economic advantage to the government under a contract.

In this case, said the board, there was no question that the base commander’s formal memorandum barring pre-release convicts from the base was a sovereign act of the government. The board had already granted partial summary judgment in favor of the Air Force on that question. The more difficult issue was the 14 months between enforcement of the policy and issuance of the memorandum.

The board said there was evidence the policy had been in place for years. It acknowledged, however, that the Air Force failed to consistently enforce the policy in

<sup>67</sup>. *Appeal of Garco Construction, Inc.*, ASBCA Case No. 57796, September 22, 2015.

the past. But these decisions were made by lower level personnel, not the base commander. Only the base commander had authority to waive the policy, so there had been no waiver by the Air Force.

The board concluded that the commander's enforcement of the policy barring pre-release convicts from the base was a sovereign act of the government, even prior to the issuance of the formal memorandum. There had been no waiver of the policy. There could be no recovery for the delay, disruption or increased labor costs allegedly caused by enforcement of the policy.”<sup>68</sup>

The Navigant Construction Forum™ notes that the policy at the center of this dispute was initially issued on November 18, 2003 and amended on July 26, 2005 but not enforced until the spring of 2007 some months **after** the contract award date of August 3, 2006. Notwithstanding the lengthy period of time between issuance and enforcement of this policy, the ASBCA concluded that:

“The Air Force's enforcement of its base access policy commencing on or about the spring of 2007 was a sovereign act. To the extent JTC suffered as a result of the denial of access to its desired workers, the Air Force is not liable in monetary damages. The appeals are denied.”

The ASBCA noted that the contractor “... might have been able to specifically request additional time to perform as a result of the sovereign acts.”<sup>69</sup> However, based on the decision of the ASBCA it appears that the contractor did **not** request a time extension, only cost damages.

The Navigant Construction Forum™ notes that when contractors are considering bidding on a government contract located on a government installation, it would be prudent to confer with the installation's security officer to determine the installation's access policy and if it is restrictive, factor this into the bid price.

## CONCLUSION

This research perspective outlines some of the changes to the landscape of construction claims on government contract claims. A majority of construction claims result from a project failure or impact either on the part of the government, the contractor or both. The Navigant Construction Forum™ has learned from experience that many of these project failures or impacts result from a lack of communication between the project stakeholders including the government, the design professionals and construction managers, and the contractor and their subcontractors, vendors and suppliers. This lack of communication often results from senior management of all stakeholders not receiving “unfiltered information” concerning the project, its risks and problems and its status until a dispute arises. One of the author's senior construction managers from years past used to comment that “Bad news delivered early is useful information. Bad news delivered late is a disaster!”

With this in mind the Navigant Construction Forum™ researched practices that enhance project communications as a way to reduce or mitigate project failure and impacts. A white paper issued in 2013 has an excellent listing of tools and techniques for getting unfiltered information (i.e., enhancing project communications) for both owners and contractors intended to prevent project failure.<sup>70</sup>

68. *Restricted Base Access Was a “Sovereign Act”*, *Construction Claims Advisor*, Vol. 4, Issue 44, ConstructionPro Network, November 13, 2015.

69. *Appeal of Troy Eagle Group*, ASBCA No. 56447, 13 BCA ¶ 35,258 at 173,060.

70. *Preventing Black Swans: Avoiding Major Project Failure*, KPMG LLP, 2013.

## Owners

- Periodic project assessments.
- Project readiness assessments prior to start of construction - a phase gate process.
- Utilize advanced schedule analytic techniques for periodic schedule analysis.
- Monthly/quarterly project cost reconciliations prepared by finance or accounting.
- Establish a project steering committee at project inception.
- Surprise management attendance at weekly project meetings.
- Utilization of earned value cost and schedule performance indexes.
- Independent validation and reporting of budget variance projections.
- Tracking contingency draw vs. project completion percentage.
- Report and update the top 10 project risks on a weekly or biweekly basis.

## Contractors

- Management/deal committee review for all project bids or contracts that deviate from target metrics.
- Shadow estimates prepared by estimating teams from other business units or regions for all high risk projects.
- Include labor escalation provisions for all projects with potential resource shortages
- Active senior management project participation via attendance at weekly project meetings among the owner, the design professional and the contractor or other key meetings.
- Actively participate in the design process via design assist or integrated project delivery.
- Include higher contract contingencies and ability to utilize time and material ("T&M") overtime on projects with aggressive schedules.
- Report and update the top 10 project risks on a weekly or biweekly basis including having subcontractors independently report their top 5 risks.
- In-flight project assessments conducted by other project teams for all major projects.
- Collocate the project team with the owner team.
- Review earned value metrics and all potential change orders with senior management on a weekly or biweekly basis.

## NAVIGANT CONSTRUCTION FORUM™

Navigant (NYSE: NCI) established the Navigant Construction Forum™ in September 2010. The mission of the Navigant Construction Forum™ is to be the industry's resource for thought leadership and best practices on avoidance and resolution of construction project disputes globally. Building on lessons learned in global construction dispute avoidance and resolution, the Navigant Construction Forum™ issues papers and research perspectives; publishes a quarterly e-journal (*Insight from Hindsight*); makes presentations globally; offers webinars; and offers in-house seminars on the most critical issues related to avoidance, mitigation and resolution of construction disputes. Copies of the Navigant Construction Forum's™ white papers, research perspectives and all issues of **Insight from Hindsight** may be found and downloaded from the Navigant Construction Forum's web page <http://www.navigant.com/NCF>.

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Navigant is the leading provider of expert services in the construction and engineering industries. Navigant's senior professionals have testified in U.S. Federal and State courts, more than a dozen international arbitration forums including the AAA, DIAC, ICC, SIAC, ICISD, CENAPI, LCIA and PCA, as well as ad hoc tribunals operating under UNCITRAL rules. Through lessons learned from Navigant's forensic cost/quantum and schedule/programme analysis on more than 5,000 projects located in 95 countries around the world, Navigant's construction experts work with owners, contractors, design professionals, providers of capital and legal counsel to proactively manage large capital investments through advisory services and manage the risks associated with the resolution of claims or disputes on those projects, with an emphasis on the infrastructure, healthcare and energy industries.

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## **FUTURE EFFORTS OF THE NAVIGANT CONSTRUCTION FORUM™**

In the first quarter of 2016, the Navigant Construction Forum™ will issue another research perspective analyzing construction industry issues. Further research will continue to be performed and published by the Navigant Construction Forum™ as we move forward. If any readers of this research perspective have ideas on further construction dispute related research that would be helpful to the industry, you are invited to e-mail suggestions to [jim.zack@navigant.com](mailto:jim.zack@navigant.com).