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UNDERSTANDING CONTRACTOR RIGHTS & RISKS *on Owner-Suspended Projects*



As a result of the “Great Recession,” many project owners are faced with disappearing financing, no prospect of filling their buildings, and little hope of selling their units during construction. So, these owners “suspend” construction indefinitely.

While every suspended project has its own story, each is now part of an inexhaustible list of construction project suspensions in a downward-spiraling economy.

Since suspension is less of a *possibility* and more of a *probability* these days, contractors are left asking: “Exactly what are our rights and risks? And, what expenses are recoverable as damages?” The answers are not as simple as they first appear.

In the midst of a suspension, contractors must evaluate their contracts and the interpretation of certain contractual provisions in order to determine what expenses and damages were incurred, what documentation is required, and the total amount of potential expenses and damages that can be recovered.

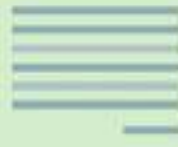
This article provides guidance for CFMs on how to accurately identify and document those expenses and damages.

WHAT IS A SUSPENSION?

As opposed to a contract termination or a delay in a contractor’s work sequence and schedule, *a suspension is a contractually allowable delay* at the beginning or during the course of a project’s construction.

As such, a “suspension of work clause” in a contract between an owner and a contractor is a *compensable delay* authorized by most contracts.

For most construction contracts, in order for an owner to invoke the suspension of work clause, a written notice of the suspension (Suspension Order) must be provided to the contractor.



Upon receipt of a Suspension Order, a contractor is required to stop all work and take reasonable steps to mitigate its expenses and damages during the suspension.

In many cases, a contractor that is ordered to suspend work on a project (where the contract contains a suspension of work clause) would not automatically be able to terminate the contract and would be required to continue to perform work upon the project's reinstatement. Any refusal to do so would be considered a breach on the part of the contractor.

A SIMPLE TWIST OF LANGUAGE: THE EFFECT OF CONTRACT TERMS ON SUSPENSION

Today, most construction contracts give the owner the right to suspend all or part of the work on a project for the owner's convenience. However, the implications of the suspension, how long the suspension can last, and what a contractor can seek to recover for additional expenses and costs depends on the language in each contract's suspension provision.

AIA Contract Documents

Many contractors use the standard AIA specifications as part of their project contracts. As such, when projects are suspended, it's likely that most contractors will deal with provisions similar to those found in the AIA Documents.

The suspension sections in AIA Document A201, General Conditions of the Contract for Construction (AIA A201) state:

"§14.3.1 The Owner may, without cause, order the Contractor in writing to suspend, delay or interrupt the Work in whole or in part for such period of time as the Owner may determine.

"§14.3.2 The Contract Sum and Contract Time shall be adjusted for increases in the cost and time caused by suspension, delay or interruption as described in Section 14.3.1. Adjustment of the Contract Sum shall include profit."

Through this language, an owner is allowed to suspend the construction of a project "for such period of time as the Owner may determine." Also note that the contract language does not limit the owner's suspension to a "reasonable" period of time.

In fact, it appears that the owner's suspension could last as long as the owner wishes, *as long as the contractor is compensated for the cost of the suspension in accordance with AIA A201 §14.3.2.* (However, there are some exceptions that are beyond the scope of this article.)

ConsensusDOCS

The AGC, in conjunction with other industry groups, has also developed a series of standard form contract documents (ConsensusDOCS) for use in the construction industry.

The suspension section within the ConsensusDOCS 200 Standard Agreement and General Conditions Between Owner and Contractor (Where the Contract Price Is a Lump Sum) states:

"§11.1.1 Owner Suspension. Should the Owner order the Contractor in writing to suspend, delay, or interrupt the performance of the Work for such period of time as may be determined to be appropriate for the convenience of the Owner and not due to any act or omission of the Contractor or any person or entity for whose acts or omissions the Contractor may be liable, then the Contractor shall immediately suspend, delay or interrupt that portion of the Work as ordered by the Owner. The Contract Price and the Contract Time shall be equitably adjusted by Change Order for the cost and delay resulting from any such suspension."

This language allows a project owner to suspend a construction project for an appropriate period of time for the owner's convenience. *Similar to the AIA A201, it appears that in ConsensusDOCS 200, the owner's suspension could last as long as the owner wishes, if the contract price and time are equitably adjusted.*

FAR §52.242-14

Federal construction contracts are most often governed by the Federal Acquisition Regulations (FARs). FAR §52.242-14 addresses the suspension of federal construction projects and states:

"(a) The Contracting Officer may order the Contractor, in writing, to suspend, delay, or interrupt all or any part of the work of this contract for the period of time that the Contracting Officer determines appropriate for the convenience of the Government.

"(b) If the performance of all or any part of the work is, for an unreasonable period of time, suspended, delayed, or interrupted (1) by an act of the Contracting Officer in the administration of this contract, or (2) by the Contracting Officer's failure to act within the time specified in this contract (or within a reasonable time if not specified), an adjustment shall be made for any increase in the cost of performance of this contract (excluding profit) necessarily caused by the unreasonable suspension, delay, or interruption, and the contract modified in writing accordingly. However, no adjustment shall be made under this clause for any suspension, delay, or interruption to the extent that

performance would have been so suspended, delayed, or interrupted by any other cause, including the fault or negligence of the Contractor, or for which an equitable adjustment is provided for or excluded under any other term or condition of this contract.”

This suspension of work clause provides that the government, at its convenience, may require a contractor, by written order, to suspend or delay all or part of the construction on a project. The suspension can be for any period of time that the Contracting Officer determines is appropriate.

If the suspension is later lifted and the contractor submits a request for compensation, then the government must make an equitable adjustment in the cost of contract performance, as long as the suspension was: 1) for an *unreasonable* period of time and 2) *caused by an act or a failure to act* by the government.

Presumably under this language, if the suspension ran for a reasonable period of time, then the contractor would not be compensated for that portion of the delay. However, given the recent economic turmoil and the fallout of public funding, contractors need to know what constitutes an “act or a failure to act by the government” for purposes of recovery by the contractor under FARs.

In the case of *C.H. Leavell and Company v. United States*, 530 F.2d 878 (Fed. Cir. 1976), the court held that an equitable adjustment was available under the suspension of work clause for an unreasonable suspension since the cause was an appropriation cutoff. (So, in this case, the contractor was able to recover for the delay.)

WHAT COSTS CAN CONTRACTORS RECOVER?

In the midst of much speculation and interpretation, one thing is clear: *The price of suspension is not cheap.*

Consider what happens during the course of a suspension when material costs or labor rates change substantially. Each



of these increased costs could not have been foreseen at the time of contracting, and it's highly unlikely that the contractor would have been prepared for them.

But as previously mentioned, what a contractor can recover is governed by the contract language in the suspension of work provision of each contract. For example:

Time Extensions

First and foremost, almost all suspension of work provisions provide for some extension of time in order to complete the work. AIA A201 §14.3.2 and ConsensusDOCS 200 §11.1.1 specifically provide for an adjustment to the “Contract Time.” While FAR §52.242-14 does not specifically mention a time adjustment, it does not exclude one either.

Such a time extension should be, at a minimum, equal to the length of the suspension authorized by the change order or construction change directive. The contractor may also be entitled to additional time caused by demobilization and remobilization, once the project restarts.

CFM Tip: Work closely with your project team to ensure that your company is allowed the full time extension, including time to remobilize all subcontractors. More often than not, as a result of remobilization and restarting the project, the time-extension change order will be longer than the actual suspension delay.

Profit Recovery – Allowed

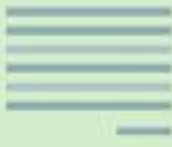
AIA A201 §14.3.2 specifically provides for the recovery of profits. And, while ConsensusDOCS 200 §11.1.1 does not specifically provide for profit recovery, its reference to a “Contract Price” adjustment makes recovery likely.

We recommend that profits be calculated using the additional costs incurred due to a typical delay. Generally, recovery is limited to a reasonable profit. This profit *may not* be the same amount incorporated into the original contract or bid amount. Instead, the risk involved is usually re-evaluated and used to recalculate the job's profits (i.e., the higher the risk, the higher the profit margin).

CFM Tip: Determine the historical reasonable profit for your company by examining its profit margin on similar projects over a 3-5 year period. Assess any additional risks or issues the suspension may have caused and the associated profit increase. This may support a higher profit recovery than in the contract.

Profit Recovery – Not Allowed

Unlike the AIA A201 and ConsensusDOCS 200 suspension provisions, FAR §52.242-14 *specifically excludes profit from*



recovery by the contractor. Thus, if contractors are delayed due to a suspension and prohibited from taking on additional work, it's possible that – even though they would be compensated for their time and *potentially* their overhead – their profit positions would be worse.

CFM Tip: Because of the FARs exclusion, contractors should carefully evaluate all aspects of a suspension and determine if there is another avenue available for profit recovery.

For example, if an owner suspends a contractor's progress and a change in performance provided by the contract occurs, then the contractor should allocate the claimed profit between the suspension of work clause and the changes clause in the contract. That way, it may be able to recover those profits attributable to the change in performance.

Price Escalations for Material

When a contractor is unable to order material due to a suspension in the critical path under a contract, it usually cannot take advantage of the prices used in its bid. If the contractor is unable to order its material as originally planned, and the cost for that material rises, then it should be able to recover the escalation in price. The difference between the contemplated price and the actual expense constitutes a legitimate and compensable element of these damages.

CFM Tip: Determine when materials were supposed to be ordered and obtain a competitive quote to document the price your company would have paid "but for" the suspension. Compare that quote to the actual cost after the project resumes; the difference is the amount of the cost reimbursement.

Labor Costs

Labor costs include wages (plus burden) for the contractor's employees who perform work on the project. Owners should be prepared to compensate the contractor for labor and material costs that are directly associated with the suspension (e.g., protecting the property during the time of suspension and additional demobilization and remobilization).

CFM Tip: Ensure that all time tickets, daily reports, and/or field work orders are properly coded for the work performed during the suspension period to ensure that the labor and additional material costs (with the continually agreed-upon mark-up) can be submitted to the owner.

Most contract bids are predicated on a calculation of hourly labor rates, which account for rates existing at bid time, the number of hours expected to be billed, and foreseeable increases in a given period.

So, if a suspended contractor is forced to stay on a project for longer than originally expected, and the cost for labor increases beyond its original calculation as a result, then it should be entitled to wage escalation costs (i.e., the difference between the planned and actual expenditures).

Note: Some prevailing wage rate classifications are locked in for the duration of the work, while others are locked in for a specific period of time and may not be affected by a suspension.

Moreover, during periods of a suspension, it might be necessary to retain workers or supervisors because it's not feasible to dismiss them – even though no work is being performed. In such cases, contractors have been permitted to recover these idle labor costs.

CFM Tip: The labor rate increase is fairly easy to document; however, the necessity of retaining and paying workers on the supervisory team may be more difficult to justify. If your company is required to retain and pay its project staff, document the inability to absorb them on different projects or to dismiss them based on specialized knowledge, skill sets, etc.

Equipment Costs

If a suspended contractor has idle equipment, but finds that it's impractical to transport and use that equipment on another job, then it may recover these costs. But, because idle equipment does not suffer any wear and tear, courts frequently allow contractors to recover only 50% of the ConsensusDOCS Schedule rate.¹

Conversely, contractors should recover the actual costs of rented equipment. However, they must mitigate their damages and return rented equipment during a suspension when feasible and economical under the circumstances.

CFM Tip: Maintain accurate lists of your company's equipment installed at all jobsites. If the equipment at a suspended job cannot be used on other projects, calculate the ConsensusDOCS rate or the allowable rate used by local or state agencies. In addition, be sure to return all rented equipment immediately.

Overhead Costs for Government Contracts

One of the largest and most contested issues in the realm of government contracts is a contractor's ability to recover overhead costs after the suspension of a government project. This is an important issue, since contractors will often claim that they were forced to stand by for extended periods of time and, therefore, were unable to take on additional work due to the uncertainty of their government contract.

Courts have determined that, in order to recover overhead costs, a contractor must prove that:

- 1) There was a suspension and that it was caused by the government;
- 2) The contractor was required to wait and be on standby; and
- 3) The contractor could not have taken on other work.²

Overhead Costs for Non-Government Contracts

Home office overhead is an incurred indirect cost that is usually spread over all contracts (e.g., accounting and payroll services, general insurance, heat, electricity, taxes, etc.).

CFM Tip: Calculate the potential unabsorbed home office overhead that resulted from the suspension and then discuss with senior management whether or not a claim should be submitted to the project owner.³

Other Costs

More obvious costs that a contractor should be able to recover include direct jobsite expenses (such as the cost for phone lines, additional or increased insurance, and extra bond premium expenses). Less obvious costs include impairment of bonding capability and loss of profits from impairment of capital.

CFM Tip: Obtain and organize all jobsite expenses. Ask your risk management group or outside insurance broker to determine if insurance and/or bond premiums have increased as a result of the suspension. Document (by correspondence with the broker) the increased amount and assess the loss of profits due to frozen capital.

PRESERVE ALL STATUTORY RIGHTS

Once a contractor is faced with an actual suspension of a project, it's important to preserve all rights and remedies. In most states, the remedies available to contractors include recording a mechanic's lien and bond claim (by subcontractors) as long as the contractor complies with all statutes related to preliminary notice requirements.

However, on public works improvements, there is no right to a mechanic's lien and only subcontractors have the ability to make a claim on a payment bond.

For additional information on the importance of proper project documentation, read "Protect Your Construction Claims: Proper Documentation – A Must!" by Jeffrey D. Firestone and Andrew J. Natale.

CONCLUSION

The construction industry is an important part of our state and national economies. In order to continue to be successful, contractors must have a clear understanding of their rights and risks under various contracts once a project is suspended.

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Endnotes:

1. *L.L. Hall Construction Company v. the United States*, 379 F.2d 559 (1966).
2. *West v. All State Boiler Inc.*, 146 F.3d 1368 (Fed.Cir. 1998).
3. *Eichleay Corp.*, ASBCA No. 5183, 60-2 B.C.A. 2688, (1960), *aff'd on recon.*, 61-1 B.C.A. 2894 (the "Eichleay Formula" for overhead cost calculations).



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