

CONSTRUCTION CLAIMS ADVISOR *Weekly E-Letter*

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Editor's Notes

"Good fences make good neighbors." Despite Robert Frost's intent when he penned the adage, it is no guarantee. Consider this classic example given to law school students: A man decides to build a wall on his property and does what any good neighbor would do – he informs his next-door neighbor, who refrains from agreeing or disagreeing with the plan. Once the wall is up and both neighbors are benefitting from it, the man asks his neighbor to help pay for the wall. When the neighbor refuses, the man takes him to court and sues for compensation on the basis of quantum meruit. He argues that there was an implied agreement that the neighbor would help pay for the wall. The court will generally rule in favor of the man who built the wall. Why? Because the neighbor is receiving the benefit of something for which he has not paid. This week's first

case is another lesson in quantum meruit, or fair value. The contractor fixed alignment flaws on a hydroelectric refurbishing project, but did not follow the contract's change order procedures when it engaged in the extra work. Even though the municipality received the benefit of the work, it was not required to pay the contractor because the court determined that the contract precluded the contractor's quantum meruit rights.

Also this week, we present cases on extended home office overhead costs and the justifications for a frivolous lien procedure.

If you haven't yet visited WPL Publishing's newest website, go to www.constructionadvisorstoday.com. This week, editor Bruce Jervis writes about claims administration, a tedious, though necessary part of the construction process.

Case Summaries

CHANGE ORDER CLAUSE PRECLUDES "FAIR VALUE" RECOVERY

Pennsylvania Electric Coil, Ltd. v. City of Danville

Overview

A federal appeals court has ruled that under Virginia law, a contractual change order procedure precludes a contractor's recovery for extra work on a fair value or "quantum meruit" basis.

Background

The City of Danville, Va., awarded a contract to Pennsylvania Electric Coil Ltd. (PEC) to refurbish three hydroelectric units on the Dan River. The fixed-price contract contained the following Changes clause:

"The City, without invalidating any construction contract, and without notice to any surety, may order changes in the work within the general scope of the contract consisting

(Continued on page 2)

Electric Coil v. Danville (cont.)

(Continued from page 1)

of additions, deletions, or other revisions, providing that the total amount added or eliminated does not exceed twenty-five percent (25%) of the total contract price or \$10,000, whichever is greater. All such changes in the work shall be authorized by change order and shall be executed under the applicable conditions of the contract documents.”

The 25 percent cap on total changes is mandated by Virginia public contract law.

As the work progressed, PEC requested and received a number of change orders for extra work. Later in the project, PEC complained that all three units were out of alignment, a condition not contemplated by the contract. There was extensive correspondence between PEC and the city engineer regarding problems in the field caused by the misalignment. But, PEC never expressly requested a change order addressing the situation.

PEC completed the project and submitted a final invoice, which included the extra cost of work necessitated by the alignment problem. The city declined to pay that amount. PEC filed suit for breach of contract and quantum meruit.

With regard to the quantum meruit claim, PEC argued that the city was equitably obligated to pay the fair value of the extra work because the city benefited from the work, accepted the work, and

knew that PEC expected to be paid for the work. A federal district court granted summary judgment in favor of the city. PEC appealed the denial of its quantum meruit claim.

The Ruling

The U.S. Court of Appeals for the Fourth Circuit said Virginia law is well settled on this matter. When a construction contract contains a provision establishing a procedure for obtaining change orders authorizing extra work, that provision is the exclusive remedy for obtaining payment for extra work. The contractor cannot recover under a theory of quantum meruit. *Main v. Department of Highways*, 142 S.E.2d 524 (Va. 1965).

“Under *Main*, quantum meruit relief is not available to PEC because there is a valid, enforceable contract that governs the parties’ rights and lays out a change order procedure requiring PEC to obtain approval from a designated person with authority to execute agreements on behalf of the City. PEC’s own actions regarding [the earlier change orders] demonstrate that it knew of and was able to follow this change order procedure.... PEC has not disputed the validity of the change order procedure. Nor has it supplied a reason for its failure to continue complying with the provision as work on the units progressed. Like the plaintiffs in *Main*, PEC failed to follow the prescribed method outlined in the parties’ contract to obtain approval and payment for extra work – a method with which it was not only familiar, but which it had in fact utilized.”

“PEC’s own actions regarding [the earlier change orders] demonstrate that it knew of and was able to follow this change order procedure....”

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Conclusion

If a contractor complied with the contractual change order procedure and was wrongfully denied additional compensation, the contractor could sue for breach of contract. But, this would be an action within the contract, not outside the contract as with a quantum meruit claim.

United States Court of Appeals for the Fourth Circuit

Pennsylvania Electric Coil, Ltd. v. City of Danville

No. 08-1746
May 11, 2009

Case participants: For Pennsylvania Electric Coil, Ltd.: Chauncey Reynolds Keller, Jr.

For the City of Danville: Jeremy E. Carroll.

Before: Judges Niemeyer, King and Duncan.

Opinion by: The full court.

Outcome: Summary judgment in favor of project owner affirmed.

[Download the complete opinion from the *Construction Claims Online* website.]

Case Summaries (cont.)

MARK-UPS ON EXTRA WORK COVERED EXTENDED OVERHEAD

Wayne Knorr, Inc. v. Pennsylvania Department of Transportation

Overview

A Pennsylvania court has ruled that a contractor could not recover extended home office overhead for a period of owner-caused delay. Mark-ups on extra, force account work had already compensated the contractor for that cost.

Background

The Pennsylvania Department of Transportation awarded a fixed-price contract to Wayne Knorr Inc. to improve a section of two-lane state highway in Armstrong County by adding a third, truck-climbing lane. The contract required substantial completion within 368 days of notice to proceed.

Knorr encountered problems with slope instability in the area where the third

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If a contractor complied with the contractual change order procedure and was wrongfully denied additional compensation, the contractor could sue for breach of contract.

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Case Summaries (cont.)

(Continued from page 3)

lane was being added. PennDOT was slow to respond to the problem, forcing Knorr to alter the sequence of its work. PennDOT subsequently authorized the repair and stabilization of the slope, directing Knorr to perform the extra work on a time-and-materials, or “force account,” basis. The contract specifications stipulated mark-ups on all force account costs: 40 percent on labor, 25 percent on materials and five percent on equipment.

Knorr completed the project 116 days after the original completion deadline and filed a claim for its extra costs, including delay and disruption damages. The Pennsylvania Board of Claims determined that PennDOT was responsible for 72 days of delay on the schedule's critical path.

The board ruled that Knorr was entitled to force account compensation for the extra work it performed, as well as the delay and disruption it experienced. The contractor was awarded, on a force account basis, the increased costs it incurred in working out of sequence; moving crews and equipment from place to place. But, the Board refused to award Knorr the \$101,228 it claimed in extended home office overhead—those expenses were covered by the mark-ups on the force account direct costs. Knorr appealed.

The Ruling

The Commonwealth Court of Pennsylvania said the contract specifications clearly intended the mark-ups on force account work to compensate the contractor for any extended home office overhead it might incur. The mark-ups covered “all administration, general superintendence, other overhead, bonds, insurance, anticipated profit, and use of small tools and equipment for which no rental is allowed.” Separate recovery of home office overhead would be duplicative.

“Because Knorr’s expert utilized the mark-ups contemplated in [the specifications] in calculating Knorr’s delay damages, which include an allowance for extended home office overhead, Knorr could not also recover extended home office overhead costs as a separately delineated delay damage claim. No error is apparent in the Board’s decision to reject Knorr’s extended overhead claim, which would amount to a double recovery for Knorr.”

Conclusion

The contractor characterized this claim as one for “extended,” rather than “unabsorbed,” home office overhead. Unabsorbed overhead is defined as home office expenses not absorbed by a fixed-price contract at the anticipated rate because contract performance (and therefore contract billing) was extended over a longer period of time due to project owner suspension of the work. As with the extended overhead in this case, unabsorbed overhead cannot be recovered when the performance period was extended because of changed or extra work and the contractor was compensated for direct costs plus overhead. *C. B. C. Enterprises, Inc. v. United States*, 978 F.2d 669 (Fed. Cir. 1992).

“No error is apparent in the Board’s decision to reject Knorr’s extended overhead claim, which would amount to a double recovery for Knorr.”

Commonwealth Court of Pennsylvania

Wayne Knorr, Inc. v. Pennsylvania Department of Transportation

No. 1593 C.D. 2008
May 14, 2009

Case participants: For Wayne Knorr, Inc.: E. James Reynolds, Jr.

For PennDOT: Christopher F. Wilson.

Before: Judges McGinley, Simpson and Kelley.

Opinion by: Judge Simpson.

Outcome: Board of Claims judgment affirmed.

[Download the complete opinion from the *Construction Claims Online* website.]

FRIVOLOUS LIEN PROCEDURE WAS MISUSED

S. D. Deacon Corporation of Washington v. Gaston Brothers Excavating, Inc.

Overview

A Washington court has ruled that a “frivolous lien” procedure should not be used to defeat a contractor’s claim without a hearing on the merits. The summary release of a mechanic’s lien should be granted only when there is no possibility of sustaining the lien.

Background

S. D. Deacon Corporation of Washington was the general contractor for construction of a fitness center in Seattle. Deacon requested quotations for site work from Gaston Brothers Excavating Inc., which submitted a bid of \$49,000 for the footing work. Three days later, Gaston submitted a bid of \$63,000 for a crushed glass moisture barrier.

Deacon sent a letter to Gaston agreeing to award a subcontract for \$112,000. Gaston started work. The subcontractor submitted a progress payment request, which reflected a total subcontract price of \$112,000. Deacon paid the requested amount, less 10 percent retainage. Deacon then sent Gaston a written subcontract agreement indicating a fixed price of \$63,000.

Gaston continued work despite the disagreement over price. Deacon made another payment of \$9,891 to the subcontractor. Deacon then issued a unilateral, deductive change order reducing the subcontract price to \$54,100, the precise amount Deacon had already paid to Gaston. Deacon refused to make further payment.

Gaston filed a timely mechanic’s lien on the project property for \$43,191. Deacon filed a motion for the summary removal of a frivolous lien, a procedure authorized by the Washington lien statutes, RCW 60.04.081. Deacon contended the lien was frivolous because

Gaston had been paid in full. A trial court agreed and released the lien. Gaston appealed.

The Ruling

The Court of Appeals of Washington said the frivolous lien procedure should not be misused to deprive a lien claimant of a hearing on the merits of its claim. A lien should be removed as frivolous only after a factual finding that it is devoid of merit and there is no possibility of sustaining the lien. No such finding existed in this case. And, said the court, there was ample evidence to the contrary.

To begin, the parties had a legitimate dispute regarding the subcontract price. Deacon now said that the second quotation of \$63,000 covered all subcontract work; its earlier reference to an \$112,000 subcontract was an error. Gaston pointed out that each of its two price quotations expressly referred to separate, discrete portions of the work.

Additionally, there were no invoices or other documentation supporting Deacon’s deductive change order reducing the price to the precise amount paid to Gaston. And, there was no accounting for the 10 percent retainage Deacon

A lien should be removed as frivolous only after a factual finding that it is devoid of merit and there is no possibility of sustaining the lien.

Court of Appeals of Washington, Division One

S. D. Deacon Corporation of Washington v. Gaston Brothers Excavating, Inc.

No. 61702-8-1
May 11, 2009

Case participants: For S. D. Deacon Corp. of Washington: John Todd Henry.

For Gaston Brothers Excavating, Inc.: Sage Andrew Linn.

Before: Judges Becker, Dwyer and Grosse.

Opinion by: Judge Becker.

Outcome: Summary removal of mechanic’s lien reversed. Case remanded.

[Download the complete opinion from the *Construction Claims Online* website.]

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Case Summaries (cont.)

(Continued from page 5)

withheld from the first progress payment. These factual disputes should have been given a full hearing. The lien should not have been removed in summary fashion.

Conclusion

Many state lien statutes include procedures for removal of a frivolous lien. The procedures are most commonly, and appropriately, used in situations in which the lienor has clearly failed to comply with the statutory requirements for maintaining a mechanic's lien. Removal does not address the merits of the underlying claim, only statutory compliance and the right to secure a potential obligation with a lien on the property.

The procedures [for removal of a frivolous lien] are most commonly, and appropriately, used in situations in which the lienor has clearly failed to comply with the statutory requirements for maintaining a mechanic's lien.

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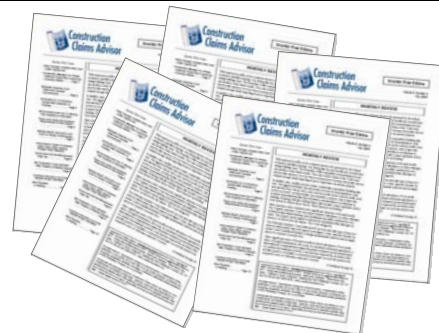
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