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# Construction Defects in Public

## Contracts

## DOECAA

## April 26, 2007

# Overview

- » Introduction
- » Allocation of Risk
- » Contractor's Duty of Strict Compliance
- » Owner's Right of Inspection
- » Doctrine of Economic Waste



# Overview

- » Owner's Remedies During Performance
- » Acceptance
- » Owner's Remedies After Acceptance



# Allocating Risk in the Acquisition Plan



# Design Specification

- » Precise instructions allow Owner maximum control over process
- » Allows award based solely on price
- » Increases Owner's liability for claims because Owner assumes responsibility for correctness and adequacy of design specifications



# Performance Specifications

- » Defines the functions the desired product will be capable of performing
- » Owner relinquishes control
- » Contractor assumes responsibility for product design and achieving the stated performance objectives



# Design-Bid-Build

- » Traditional delivery method for construction projects
- » Owner either designs project or contracts for design, then
- » Construction contractors bid on the design



# Design-Bid-Build (cont'd)

- » Owner bears the risk that drawings and specifications are defective (or shifts risk to A/E)





# Design-Build

- » Contractor responsible for both design and construction
- » Contractor assumes responsibility for deficiencies or defects in the design



# Allocating Risk by Pricing Arrangement



# Firm-Fixed-Price Contract

- » Contractor agrees to perform the job for a price fixed at time of award
- » Contractor assumes risks of increased costs
- » Contractor opportunity for profit is greater



# Cost Reimbursement Contract

- » Owner retains risk of increased costs
- » Contractor profit margin is fixed in the contract



# Allocating Risk by Contract Clauses

- » Contract clauses attempt to predetermine the risk allocation; e.g.,



# Changes Clauses

## » Changes Clause

- › Contractor entitled to equitable adjustment for Owner's changes to the work
- › No adjustment if work already is in the scope of the contract



# Differing Site Condition Clause

- » Contractor entitled to equitable adjustment when (1) physical conditions are materially different from those indicated in specifications, or (2) an unknown physical condition of an unusual nature interrupts the contractor's ability to perform



# Differing Site Condition Clause (cont'd)

- » No equitable adjustment if contractor knew or should have known of the discovered conditions





# Suspension of Work Clause

- » Contractor entitled to an adjustment in contract price as compensation for unreasonable Owner delays
- » No adjustment when delay due to contractor's fault or negligence



# Default Clause

- » Owner may terminate contractor's right to perform for default if contractor fails to prosecute the work with diligence or fails to complete on time
- » Improper termination for default converted to termination for convenience



# Contractor's Duty of Strict Compliance



# Contractor's Duty of Strict Compliance (cont'd)

- » Found throughout the Federal Acquisition Regulations (FAR)
- » Example: Inspection of Construction Clause, FAR 52.246-12(b):



# Contractor's Duty of Strict Compliance (cont'd)

- » “All work shall be conducted under the general direction of the contracting officer and is subject to Government inspection and test at all places and at all reasonable times before acceptance to ensure *strict compliance* with the terms of the contract.”



# Owner's Right of Inspection



# Owner's Right of Inspection

- » Contractor obligation to maintain effective inspection system to ensure compliance with specifications
- » Owner right to inspect the work as it is being performed to ensure strict compliance with specifications



# Owner's Right of Inspection (cont'd)

- » Contractual right at all places and at all reasonable times
- » Owner inspections are for the sole benefit of the Owner
  - › Do not relieve contractor of duty to inspect
  - › Do not constitute implied acceptance





# Owner's Right of Inspection (cont'd)

- » Under the FAR, contractor must provide facilities, labor and material Government needs to conduct inspections and tests
- » Owner can charge contractor for costs of reinspection if contractor wasn't ready or work failed first inspection



# Owner's Right of Inspection (cont'd)

- » Destructive Inspections (tearing out completed work)
  - › If found defective, contractor bears the expense of reconstruction
  - › If found to meet contract requirements, contractor receives equitable adjustment for reconstruction and delay



# Doctrine of Economic Waste



# Economic Waste (cont'd)

- » Strict compliance rule might not be enforced after work has been performed to avoid economic waste



# Economic Waste (cont'd)

- » FAR: Contractor required to replace or correct work that fails to conform to contract requirements “unless in the public interest the Government consents to accept the work with an appropriate adjustment in contract price.” FAR 52.246-12(f)



# Owner's Right of Strict Compliance

- » Owner's remedy for contractor's failure to strictly comply depends on
  - › Time in life of the contract when contractor is notified
  - › Relationship between cost of correcting defects and Owner's damages



# Strict Compliance (cont'd)

- » Before performance has begun
  - › Owner can reject shop drawings that deviate from contract requirements-- contractor assumes risk if he proceeds without approval
  - › Approval of drawings by Owner does not relieve contractor of risk of errors or omissions



# Strict Compliance (cont'd)

- » Owner can reject contractor's proposed method of work, even if result will meet Owner's needs (needs vs. requirements)
  - › Owner can reject proposed materials not in strict compliance
  - › Owner can reject contractor's proposed substitute materials





# Strict Compliance (cont'd)

- » Contractor duty to correct defective work
  - › Contractor shall replace or correct defective work discovered during contract performance
  - › If Owner discovers defect, Owner must give contractor an opportunity to correct it



# Owner's Remedies If Contractor Fails To Correct Defective Work

- » Accept the work with appropriate adjustment in contract price
- » By contract or otherwise, correct the work and charge cost to contractor



# Remedies If Contractor Fails to Correct (cont'd)

- » Terminate for Default contractor's right to proceed
- » Assess liquidated damages



# Acceptance With Price Adjustment

- » Based on concept of fair competition in Government contracting
- » Acceptance without price reduction would not be fair to bidders who had bid on the contract specifications



# Acceptance With Price Adjustment (cont'd)

- » Price is reduced by contractor's change in cost of performance (rather than damages to the Government)
- » Contractor relinquishes any savings it might have gained from its failure to comply with the specifications
- » When difference in performance is slight, doctrine of substantial performance applies



# Corrections at Contractor's Expense

- » Notice requirement
  - › Owner must give contractor opportunity to correct the work
  - › Contractor must have failed to do so within a reasonable time



# Termination For Default

- » When contractor fails to prosecute the work with diligence or fails to complete the work in time, Government may terminate for default contractor's right to continue performing the contract



# Termination for Default (cont'd)

- » Upon termination, contractor must return advance or progress payments to Government
- » Contractor liable for Government's reprocurement costs
- » Government not required to issue cure notice, but it is encouraged





# Termination for Default (cont'd)

- » Contracting officer must ensure Government has not waived completion date
- » Contracting officer must ensure that delay is not excusable, either because of
  - › Owner delays
  - › Interference by other contractors
  - › Acts of God



# Termination for Default (cont'd)

- » Improper Termination for Default can be converted to Termination for Convenience



# Liquidated Damages

- » Included in contract when actual damages for contractor delay would be difficult to determine
- » LDs cannot be used to punish contractor, must be realistic assessment of damages suffered because of delay in completion



# Liquidated Damages (cont'd)

- » LDs must be a reasonable forecast of the harm the Government would suffer from late completion of a construction project
- » In federal government contracting, doctrine of substantial completion bars Government from assessing LDs



# Acceptance



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# Acceptance

- » Acceptance is final and conclusive
- » Terminates Owner's rights to utilize the remedies it had available during contract performance
- » Owner has limited rights after acceptance



# Owner's Remedies After Acceptance



# Latent Defects

- » “Defects that existed at the time of acceptance and that could not have been ‘discovered by observation or inspection made with ordinary care’”
- » Discovery of latent defect overcomes finality of acceptance





# Latent Defects (cont'd)

- » If defect is *patent*, and was actually known to the Government or was discoverable by the Government by reasonable inspection methods, the Government's acceptance of the work containing patent defects is conclusive
- » Owner cannot require contractor to correct patent defects at contractor expense



# Latent Defects (cont'd)

- » Government bears burden of proving *latent* defect existed at time of acceptance
- » Upon timely discovery of latent defect, Government revokes acceptance
- » Upon successful revocation of acceptance, Government's remedies during contract performance become available again



# Warranty

- » Two types of warranties
  - › Express warranties
  - › Implied warranties



# Express Warranty

- » Written warranty with specific terms included in the contract
- » Typical elements of express warranty
  - › Scope--conditions covered
  - › Time limitation
  - › Notice requirement



# Express Warranty (cont'd)

- » Typical elements (cont'd)
  - › Requirement for Owner to provide contractor reasonable time to correct the defect
  - › Owner right to self-help at contractor's expense if contractor fails to perform



# Express Warranty (cont'd)

- » Express warranties are strictly construed
  - › E.g., notice by “contracting officer”
  - › E.g., consequential damages not included unless so stated in warranty



# Implied Warranty

- » Judicially created to allow owner's post-acceptance rights
- » E.g., work will be performed in workmanlike manner; work will be reasonably fit for its intended purpose
- » Falling into disfavor because of predominance of commercial forms



# Implied Warranty (cont'd)

- » To invoke implied warranty
  - › Reasonably prompt notice
  - › Defect must be contractor's responsibility
  - › Owner must not have caused or contributed to the defect
  - › Owner must show contractor's error was most probable cause of failure





# Contractor's Claim for Defective Specifications



# Contractor's Claim for Defective Specs (cont'd)

- » When Government supplies the specifications, it impliedly warrants the specifications are correct, adequate and feasible
- » If Government design is defective, Government has breached implied warranty of specifications



# Contractor's Claim for Defective Specs (cont'd)

- » Government liable for only design specifications, such as
  - › designating particular type of material or component to be used
  - › depicting required method of performance or particular process
  - › specifying particular equipment



# Contractor's Claim for Defective Specs (cont'd)

- » Government-specified test causes unexpected problems
- » Specifications unusually difficult to use



# Contractor's Claim for Defective Specs (cont'd)

- » Performance specifications give the contractor discretion in achieving the end result called for in the contract
  - › Government not liable for contractor's increased costs in achieving performance requirements unless requirements impossible or commercially impracticable





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Questions

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