Means & Methods™

Volume 4, Issue 1 | Newsletter of the Rees Broome Construction Law Group | Spring 2015

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Variation to the Lump Sum Contract: the Deductive Change Directive

By Andy Felice

On your current project and like many general contractors, you front end loaded your schedule of values, perhaps excessively. The project has been humming along as planned, with the owner paying all of your payment requests without objection. But now halfway into the project, the owner decides to delete some of the work, and in particular a detail that is only 25 percent complete. As allowed by the contract, the owner issues a deductive change directive in writing to delete the remaining work for this activity and demands a credit. *What should you do, and how much credit must you allow?*

First, if your contract includes both a partial termination for convenience ("TFC") and a changes clause, you must

Issue Highlights

- Variation to the Lump Sum Contract:
  the Deductive Change Directive
- The Law's Ticking Clock: Statutes of Limitations & Statutes of Repose
- About the Authors
- Profiles:
  Robert F. Flinn
  Robert J. Beagan
  Mathew D. Ravencraft

determine whether the deletion should be treated as a partial TFC for the owner or as a deductive change. Unfortunately, there is no bright line separating the appropriateness of one over the other, but the consequences can be significant. For example, whereas the TFC clause limits the amount of any termination settlement, the changes clause does not.

For federal contracts, which are governed by the Federal Acquisition Regulations (FAR), the contracting officer is tasked with determining whether the deleted work constitutes a deductive change or a partial TFC. If a contractor disputes the contracting officer's determination, courts and boards will examine the nature of the change to determine the applicable clause. Generally, boards look "to two tests in determining this issue: (1) was there a reduction in the scope of work without the substitution of other work?; and (2) was the reduction major rather than minor?" Accordingly, the deletion of relatively minor and segregable items of work is generally treated as a deductive change, and the deletion of a major portion of the scope of work without replacing it with new substitute work is governed by the TFC clause.

Where it is determined that the deleted scope or modified specification should be treated as a "change," the contract price is subject to a downward equitable adjustment, which is calculated by obtaining the difference between the reasonable cost of performing the contract work before and after the change. In essence, the government uses the same principles to determine deductive changes as it does to price additive changes. Depending on the circumstance, such deductive credits may include overhead and profit.

Where it is determined that the deletion should be treated as a "partial TFC," the contractor is free to negotiate any settlement amount, provided it is reasonable and the total payments to the contractor will not exceed the contract price for that work. The guidelines for such allowable costs, and reasonable profit, are outlined within FAR Part 31.

For unmodified versions of the standard AIA contract between owner and contractor, which include A201—2007 *General Conditions of the Contract for Construction*, there is no confusion as to which clause applies for deductive changes, because unlike the FAR, there is no *partial* TFC. The standard AIA TFC clause applies only when the owner terminates the entire contract. Accordingly, the changes clause would apply, and specifically § 7.3.8 applies to deductive change directives:

§ 7.3.8 The amount of credit to be allowed by the Contractor to the Owner for a deletion or change that results in a net decrease in the Contract Sum shall be **actual net cost** as confirmed by the Architect.

But what constitutes "actual net cost?"—and how is it calculated? According to the AIA Commentary, "Where the change results in a credit, the amount of the credit is determined by the cost that would have been incurred in executing the change by the contractor without decreasing the contractor's overhead and profit." In other words, "actual net cost" is simply the cost-to-complete, without any overhead or profit mark-ups, the remaining or deleted work. Generally, it would include only

the following costs:

- Labor;
- Materials, supplies and equipment;
- Rental costs of machinery and equipment, exclusive of hand tools, whether rented from the Contractor or others;
- Costs of premiums for all bonds and insurance, permit fees, and sales, use or similar taxes related to the Work; and
- Costs of supervision and field office personnel directly attributable to the deleted work.

The same calculation would normally apply if you were a subcontractor and have an agreement with the general contractor, which includes a provision that "flows down" the standard AIA A201 general conditions. However, if the owner's deductive change results in deleting all of the subcontractor's remaining work scope, the TFC clause would govern.

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1 Steve Holmes, AGBCA Lexis 4, 90-1 BCA (CCH) 22,628 (1990).
2 See Appeal of Lionsgate Corp., 90-2 BCA (CCH) 22, 730 (Corps Eng'rs BCA Feb. 28, 1990).
3 See Nager Elec. Co. v. U.S., 194 Ct. Cl. 835 (Ct. Cl. 1971).
4 Appeal of G.M. Co. Mfg., Inc., 1957 ASBCA LEXIS 1129 (A.S.B.C.A. Dec. 26, 1957).
5 Appeal of Keco Indus., Inc., ASBCA No. 15131, 72-1 BCA 9262.
6 AIA 201 § 14.4.
7 AIA Document A201—2007 Commentary.

The Law's Ticking Clock – Statutes of Limitations & Statutes of Repose

By Alison Mullins

The time frame within which a legal claim can be brought is limited. The purpose behind these time limitations is to provide predictability and finality to liability exposure. The time limits also help ensure that claims are brought and can be resolved when evidence related to the legal claim is fresh and reasonably available. These time limitations are most often set forth in a Statute of Limitations and Statute of Repose.

Statutes of Limitations

A "Statute of Limitations" is a law that establishes a time limit for suing in a civil case based on when the claim "accrued." Statutes of Limitations are created by state law, and therefore, differ from state to state, not only in length, but also when the claim accrued. The issue of when a claim "accrues" for purposes of a statute of

limitations is important, as once the claim "accrues" the limitations period begins to run. Some statutes follow the "discovery rule" under which a limitations clock does not begin to tick until the plaintiff discovers, or reasonably should have discovered, the alleged injury giving rise to the legal claim. Other statutes follow the "occurrence rule" under which a limitations clock begins to run when the alleged wrongful act or omission occurs.

Statutes of Limitations also differ based on the type of claim the plaintiff is alleging. Below are examples of statues of limitations for claims common to the construction industry in local jurisdictions:

- District of Columbia
    - breach of contract, written or oral – 3 years
    - fraud – 3 years
    - discovery rule recognized
- Maryland
    - breach of written contract – 3 years
    - breach of contract, written under seal – 12 years
    - fraud – 3 years
    - discovery rule recognized
- Virginia
    - breach of written contract – 5 years
    - breach of oral contract – 3 years
    - fraud – 2 years
    - discovery rule *not* recognized

Please note that the above are only examples, and that legal actions often involve more than one cause of action for a single alleged injury, making the determination of which claims may be barred more complex.

Adding to the already complex analysis is the fact that in many jurisdictions, including DC, it is often possible to shorten a statutory limitations period by contract which will be enforceable in court. Further, if a contract provides for arbitration instead of litigation, it is important to note that statute of limitations issues and defenses will still apply.

Statutes of Repose

A "Statute of Repose" is a law that bars a suit for a fixed number of years after a certain act, even if this period ends before the plaintiff suffered any alleged injury. Below are examples of statues of repose common to the construction industry in local jurisdictions for claims against an architect, professional engineer, or contractor:

- District of Columbia – 10 year period beginning on the date the improvement was substantially completed
- Maryland –10 year period beginning on the date the entire improvement first became available for its intended use
- Virginia – 5 year period after the performance or furnishing of such services and construction

Conclusion

Keep your eye on the law's ticking clock. Determining the applicable statue of limitations can be tricky but should always be analyzed whether you are considering bringing a claim or defending a claim. The applicable statue of limitations defense most often is a complete bar to a person's right to pursue a legal action seeking money damages or other relief. If you have a claim, you want to ensure suit is timely commenced prior to the expiration of the limitations period. On the other hand, if a claim is brought against you a statute of limitations, or statue of repose, defense may get the case dismissed before the case is even really started saving you lots of money in defense costs.

About the Authors

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Andy is a shareholder at Rees Broome, PC, with more than 25 years of experience representing clients in a variety of construction-related matters. Andy can be contacted at 703-790-1911 or afelice@reesbroome.com.

Alison R. Mullins
Alison's practice focuses on all aspects of commercial dispute resolution, including alternative dispute resolution and litigation. She primarily represents professionals in the construction industry. Alison can be contacted at 703-790-1911 or amullins@reesbroome.com.

Profiles

ROBERT F. FLINN

Mr. Flinn is counsel in the Tyson's Corner office of Rees Broome, P.C. He has forty years of experience in commercial litigation, primarily involving construction contracts, zoning and real estate development. He served four years as an Assistant County Attorney for Fairfax County during which he concentrated in zoning and site plan litigation. Since 1979, he has been in private practice concentrating in construction and zoning law. He has extensive experience representing owners, general contractors, subcontractors and suppliers in drafting and negotiating contracts and resolving disputes by litigation and arbitration. He also has extensive experience representing parties in litigation with local governments arising out of zoning and site plan disputes. He has tried numerous cases in the state and federal courts of Virginia, Maryland and the District of Columbia.

Professional Credentials

B.A. University of Tennessee, 1970
J.D. Marshall-Wythe School of Law, College of William & Mary, 1973
Barred in state and federal courts in Virginia, Maryland and the District of Columbia and U.S. Supreme Court
Member, Construction Law Section, Virginia State Bar
Member, Associated Builders & Contractors, Inc., Northern Virginia Chapter

Publications

The AIA Document A201 General Conditions, Construction Briefings Collection (No. 88-9)
Construction Manager Liability to Contractors, Construction Briefings Collection (No. 84-5)
Indemnification, Construction Briefings Collection (No. 86-7)
Mechanic's Liens and Payment Bonds in Virginia, Maryland and the District of Columbia
The Top Ten Pros and Cons of Arbitration
Zoning, Subdivision and Site Plan Laws in Virginia
The Virginia Public Procurement Act
The Perils of Unsigned Subcontracts
The Miller Act

ROBERT J. BEAGAN

Mr. Beagan is counsel in the Tyson's Corner office of Rees Broome, P.C. He has over thirty-five years of experience in commercial litigation, primarily involving eminent domain, construction and real property disputes. He is also engaged as counsel to clients involved in commercial and residential real estate development. He has served as a Commissioner for the Circuit Court of Fairfax County for more than twenty years and has extensive experience representing government entities and public service corporations in eminent domain matters. He has been involved in the Metro Silver Line construction for both Phases I and II and in the I-495 Hot Lanes project. His practice is focused on state and federal courts in Virginia and he is counsel in reported cases from the Supreme Court of Virginia and the U. S. District Court for the District of Maryland.

Professional Credentials

B.A. Georgetown University, 1972
J.D. Columbus School of Law, Catholic University of America, 1977
Barred in state and federal courts in Virginia and U.S. Supreme Court
Member, Construction Law and Real Property Sections, Virginia State Bar
Martindale Hubbell "AV" Rated

Publications

Mechanic's Liens and Payment Bonds in Virginia, Maryland and the District of Columbia
The Virginia Public Procurement Act

MATHEW D. RAVENCRAFT

Matt Ravencraft is counsel in the Tyson's Corner office of Rees Broome, P.C. He has more than twenty-seven years of experience in commercial litigation, primarily involving real property disputes, construction contracts and eminent domain matters. He has extensive litigation experience, including bench and jury trials in the state and federal courts of Virginia involving the following subject areas:

- construction litigation and arbitration involving contracts, subcontracts, payment bonds, performance bonds, mechanic's liens, delay claims, wrongful terminations, differing site conditions, acceleration, lost productivity and claims for extended field and home office overhead expenses.
- landlord-tenant litigation, including actions for unlawful detainer (eviction proceedings), disputes over tenant build-out costs and tenant alterations, subleases, holdover tenants, lease acceleration clauses and lease guarantees.
- real property litigation, including partition proceedings, easement encroachments, zoning and land use issues and enforcement of restrictive covenants.
- business torts, including civil conspiracy claims, conversion, breach of fiduciary duties, fraudulent conveyances and actions by creditors.
- condemnation litigation representing condemning authorities in highway and public utility eminent domain proceedings.

In addition to his commercial litigation practice, Matt has substantial experience in the preparation, negotiation and review of construction contract documents, commercial leases, purchase and sale agreements, commercial loan and financing documents and other documents in connection with commercial real estate transactions.

Professional Credentials

B.A. Washington & Lee University, with honors, 1984
J.D. T.C. Williams School of Law, University of Richmond, 1987
Barred in state and federal courts in Virginia
Member, Construction Law and Real Property Sections, Virginia State Bar

Publications

Commercial Leases: A Summary of the Laws and Drafting Considerations Governing Commercial Leases in Virginia
Mechanic's Liens and Payment Bonds in Virginia, Maryland and the District of Columbia
The Virginia Public Procurement Act

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