CONSTRUCTION IN BRIEF

Vol. 3 Issue 02 Summer 2004

Steel Price Increases:

IS THERE SUPPORT TO SEEK AN ADJUSTMENT?

Surging steel prices over the past year have many contractors struggling to avert a financial crisis. They are caught in a squeeze between their bid price, and the actual price they must pay for almost all products that contain steel. Contributing to the crisis is greater world-wide demand for steel which has resulted in diminished supply for domestic contractors. Also, a weak U.S. dollar has caused exports to be cheaper for foreign buyers and imports higher for domestic consumers.

Contractors are asking whether they may be entitled to an adjustment in their contract price and, if not, whether they can refuse to perform. Many contractors also want to know what they can do in the future to avoid being squeezed by volatile pricing conditions. Both are good questions.

With respect to an adjustment of an existing contract, two arguments can be made. First, the legal doctrine of commercial impracticability excuses a contractor from performing the contract work if it can demonstrate that an unexpected event occurred, and that performance would cause extreme and unreasonable difficulty, expense, injury or loss. Unfortunately, increases in materials costs alone are probably not enough to establish that performance is commercially impracticable because the contractor generally assumes the risk of such increases in a lump sum contract. If, however, the price increase has been so severe that fulfilling the contract would actually cause you to sustain a loss, the law may provide relief.

A second legal theory to consider is known as the frustration of purpose doctrine, which occurs when the objective of the contract has been destroyed by unforeseen circumstances that are beyond the contractor's control. Courts recognize that a legitimate purpose for entering a contract is to earn a profit. While contractors are deemed in most cases to assume the risk of price fluctuations, that assumption may be suspended where rising prices would cause you to incur a loss.

Nevertheless, you should not assume that you will be excused from performing. In all but the most extreme cases where performance would be truly disastrous to your company, you should expect that you are required to fully perform your contract. You may, of course, attempt to pass the costs on and make these arguments during such discussions. Most owners are well aware of the financial squeeze that rising steel prices have caused, and are increasingly willing to discuss price adjustments.

There are a few things that you can do to attempt to limit your exposure in contracts that you are or will be negotiating. You should consider requesting a price escalation clause in the contract for steel, metal, copper or related products with volatile pricing. Such a clause may provide that the contractor will absorb a price increase up to a certain percentage, and that the owner or general contractor will pay for any other additional costs. In effect, you and the owner or general contractor would be sharing the risk of a price increase.

The prudent contractor will also look to its

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CONSTRUCTION IN BRIEF

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STEEL PRICE INCREASES

-- COVER STORY CONTINUED --

suppliers to determine what deals it can make to limit its exposure to price volatility. Although in the current market some steel suppliers may not be willing to negotiate their terms and conditions, others might. If you have a good relationship with your supplier, you should attempt to lock in pricing at the time you become bound to perform. If this does not work, you may consider attempting to purchase a futures contract, under which you would agree to purchase the steel at a specified price by a certain date. Whether the price is higher or lower on the date of purchase, you will benefit because you will be able to submit a bid based upon a fixed price for the steel and avoid the potentially devastating effects of the current price volatility.

The current conditions in the steel market have the potential to damage even the best contractors. No one is immune; however, the savvy contractor will recognize the risks and be proactive in either negotiating changes or providing for volatility. It will also learn from these current conditions and use these lessons in other materials and equipment markets where there is price fluctuation.

-- Edward Seglias, *Esquire*
-- Timothy J. Woolford, *Esquire*

A NOTE FROM THE EDITORS

Welcome to the Summer 2004 Edition of ***Construction in Brief.*** This publication serves to bring you practical advice for issues that may be of concern to your business. Given the changing economy, this is a good time to review the business practices that are highlighted in this issue. The topics covered in this edition include a checklist of important provisions to consider when reviewing your contracts, some approaches to steel price increases, and highlights of the new Department of Labor overtime regulations.

As always, we welcome you to submit suggestions for future articles that may be of interest to you, either by regular mail or e-mail at: ***jcopley@cohenseglias.com.*** Remember, if you have a specific legal concern, we recommend that you consult with counsel so that you may receive the best advice. Have a great summer! See you next issue.

-- Jason A. Copley, *Esquire*
-- Janet L. Treiman, *Esquire*
Editors, *Construction In Brief*

What's New

As our clients understand, ***Cohen Seglias*** is committed to helping them with all of their legal needs. We continually seek to bring issues of importance to their attention through various avenues, including this newsletter and seminars. Recently, many of our clients have been contending with the troublesome issue of increasing steel costs. Given the importance of this issue, the firm has presented a number of seminars to discuss the legal options available to the construction community. **Roy S. Cohen** spoke on this issue to the Southeastern and Western Pennsylvania branches of the National Electrical Contractors Association. **Edward Seglias** also spoke to the Associated Builders and Contractors, Delaware Chapter, the Delaware Contractors Association and the Mechanical Contractors Association of Eastern Pennsylvania about this topic. Finally, **Timothy Woolford** spoke about this issue to the Associated Builders and Contractors, Keystone Chapter.

Cohen Seglias also reaches out to the community to discuss other topics of importance. **Jason Copley** recently spoke to the Construction Financial Management Association about Strategies for Getting Paid. In addition, our attorneys continue to stay active in civic and trade associations. **Shawn Farrell** has been appointed as local counsel for the American Society of Heating, Air Conditioning Engineers, as well as the Greater Philadelphia Building Professional Association. **Edward DeLisle** has been selected to the Board of Directors of the East Falls Development Corporation.

Finally, we would like to introduce the newest additions to the ***Cohen Seglias*** family. **William Meyer** has joined our Construction Practices Group in the Pittsburgh office. **Joshua Kohner** returns to Pennsylvania after practicing in Atlanta for the last several years, and is working in the Construction Practices Group in our Philadelphia office. **Thomas Sweeney,** with experienced in commercial litigation, has joined our Business Practice Group in our Philadelphia office. Welcome aboard!


William Meyer


Joshua Kohner


Thomas Sweeney

-- Edward T. DeLisle, *Esquire*

THE NEW OVERTIME RULES:

HIGHLIGHTS AND PRACTICAL ADVICE

The Department of Labor has issued new regulations which change the rules that govern whether an employee must be paid overtime. The new regulations apply to virtually all employers and become effective on **August 23, 2004**.

Dispelling Common Misconceptions

Federal law requires that "non-exempt" employees receive time and one half their regular pay when working more than 40 hours in a given week. The law provides a complete overtime exemption for "white collar" employees. Many employers believe that a job title makes an employee exempt. Others believe that paying a fixed weekly salary makes an employee exempt. These misconceptions can be quite dangerous. To qualify for exempt status, three tests must be satisfied: (1) the compensation test; (2) the salary basis test; and (3) the job duties test.

1. The Compensation Test

The new regulations raise the minimum compensation level for white collar employees from $150 to $455 per week. This means that any employee earning annual pay of less than $23,660 is automatically entitled to overtime. The new regulations also create a highly compensated employee rule under which most employees who earn more than $100,000 per year will be exempt. However, the highly compensated employee rule does not apply to non-management employees in construction, such as carpenters, electricians and iron workers.

2. The Salary Basis Test

An employee will be considered “paid on a salary basis" only if he/she receives a fixed salary each pay period which cannot be reduced because of variations in the quality or quantity of work performed. The salary basis test requires an employer to adhere to certain "no docking rules." Under the new regulations, employers may make deductions in full day increments from an exempt employee’s salary for unpaid disciplinary suspensions of less than one week without violating the salary basis test.

3. Job Duties Test

An employee is exempt from overtime pay only if his/her "primary duty" consists of Executive, Administrative, or Professional work.

A. Executive Exemption

An Executive must manage an “enterprise” or a department of that enterprise and regularly direct the work of two or more employees. In addition, under the new regulations, an Executive must have the authority to hire or fire other employees or the Executive’s suggestions on the change in status of other employees must be given particular weight. This new requirement means that many employees who satisfied the Executive exemption under the old regulations will not do so under the new regulations.

B. Administrative Exemption

Administrative employees must exercise "independent discretion and judgment." This phrase has been the source of considerable confusion. The new regulations attempt to provide clarity by providing examples of occupations which involve independent discretion and judgment. The new regulations also discuss the requirement that an Administrator perform work that is directly related to the management of the employer’s business. This means that an Administrator typically does not have involvement in producing or selling the employer’s products or services.

C. Professional Exemption

Under the new regulations, Professionals come in two varieties: Learned and Creative. Learned Professionals have acquired advanced knowledge through specialized education. Creative Professionals perform work requiring originality in a recognized field of artistic endeavor.

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THE NEW OVERTIME RULES:

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Safe Harbor Provision Expanded

Under the new regulations, even where an improper deduction is made from an exempt employee's salary, exempt status will not be lost if the employer: (1) has implemented a "clearly communicated" policy prohibiting improper docking; and (2) reimburses employees for improper deductions. The new safe harbor provision means that employers who implement an appropriate no docking policy may avoid additional overtime liability, liquidated damages, costs and attorneys' fees.

In conclusion, we suggest the following:

- Carefully review your company's no docking rules and implement an appropriate policy to take advantage of the safe harbor provision.
- Ensure that employees earning less than $23,660 per year are paid overtime when working more than 40 hours in a given week.
- Examine the job duties of "borderline" employees who do not receive overtime.
- Review your written job descriptions. These will be of critical importance in the event of an audit or litigation. If you do not have written job descriptions, start drafting them.

If you have any questions about the new overtime rules we recommend you consult with counsel.

-- Jonathan Landesman, *Esquire*

"BUSINESS PRACTICE GROUP" Q & A con't.

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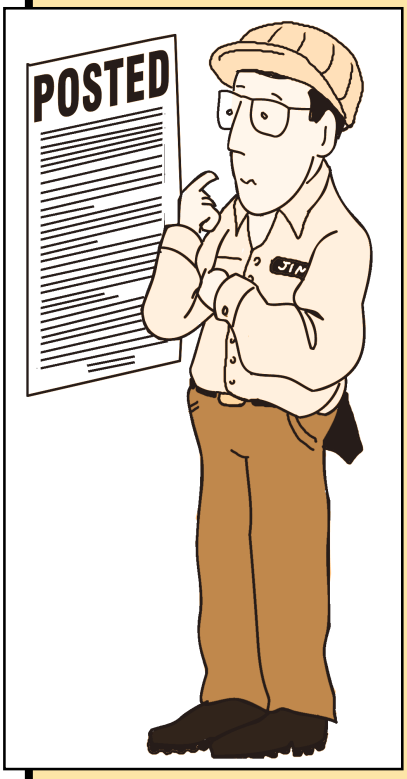
could completely defeat the preference claims or provide leverage for a more favorable negotiated settlement. These defenses include an "ordinary course of business" defense, which provides that a payment made on an ordinary business debt is not a preference so long as it was made in the ordinary course of business between the debtor and the client and was made according to ordinary business terms. This defense considers whether any coercive methods were employed to obtain payment and compares the timing of the preference payment to those payments historically made by the debtor to the client (for example, the debtor historically paid within 55 days and the payment at issue was made within 60 days). Another defense applies when there has been a "contemporaneous exchange for new value." In other words, the payment at issue was for goods or services provided to the debtor at or about the same time as the payment.

A third defense is the "subsequent new value defense" and it considers the amount of goods and services provided during a preference period (generally after the payments at issue) and compares it to the payments made during the preference period (the debtor makes a payment, but then receives on credit additional goods or services - the value of those goods and services are an offset against the earlier preference payment).

Our **Business Practice Group** will answer general business questions in this column each quarter. If any issues are raised of concern relating to your business, we recommend you consult with counsel.

-- Marian A. Kornilowicz, *Esquire*



POSTING OF LABOR RIGHTS

New regulations became effective on April 28, 2004 which require federal contractors and subcontractors with contracts exceeding $100,000 to post a notice informing employees that they have certain rights related to union membership under federal law. Organized labor strongly opposed the new regulations because the notice clearly states that employees cannot be forced to join a union and, in some circumstances, have the right to pay an agency fee instead of union dues.

Significantly, the new posting requirement does not apply to:

- **Contractors with fewer than 15 employees**
- **Contractor establishments or construction work sites where no union has been formally recognized by the prime contractor or certified as the exclusive bargaining representative of the prime contractor's employees**
- **Contractor establishments where state law forbids enforcement of union-security clauses ("right-to-work" states); or**
- **Work performed outside the United States that does not involve the recruitment or employment of workers within the United States.**

The new poster may be found on the web at

http://www.dol.gov/osbp/sbrefa/poster/main.htm
[scroll down to "The Beck Poster"]

MAINTAINING CONTRACT HEALTH

I was at my doctor's office recently for a routine physical. Despite being in good health, he spent some time reviewing my diet and exercise routine. When I asked why, he said, "Preventative medicine.., if you take these simple steps now, you most likely will avoid major health problems in later years." I thought to myself, this is exactly what I should be telling my clients with respect to contract drafting - SEEK PREVENTATIVE LEGAL ADVICE. If you do so, you may be able to avoid many litigation disputes.

I wish I could tell you that if you include certain words in your contract that no one can sue you. But advice like that, although given, is incorrect. Contracts must be read in their totality. If one section of the contract conflicts with another, often courts will find that the section that more specifically deals with the issue in dispute is controlling. Alternatively, a court could find the contract to be ambiguous and construe the document against its drafter. The only hard and fast rule I can provide is that you should have your lawyer review any contract that you are going to sign. The cost for a qualified construction attorney to review your contract will be nominal in most cases in comparison to the time and expense of going to court.

"...you may be able to avoid many litigation disputes."

That being said, here is a check list of items you should consider when reviewing your contract:

- One of the more important issues that should be addressed at the start of the project is insurance. Who is required to obtain insurance, what type of insurance is necessary and how much coverage is required? You may be surprised to learn how many architectural companies do not carry "Errors and Omissions" coverage. Under certain circumstances, this may result in the insurance company for the engineer paying for an inordinate amount of the damages caused by an error. This could result in higher insurance costs to the engineer.

- The indemnity provision in any contract should be closely reviewed. For example, the typical indemnity provision in a contract for the engineer provides that the engineer will indemnify the owner and its agents against claims. Remember the architect and construction manager are agents of the owner. If at the end of a bad project, the architect and construction manager are sued, should the engineer indemnify? The indemnity provision should make clear that the engineer shall indemnify the owner and its agents only for the engineer's negligent acts or omissions.

- Dispute resolution clauses should be reviewed. You should consider: whether you want to make going to mediation mandatory before filing suit; whether arbitration or a court is acceptable; what should be the interest paid on any outstanding contract balances; and if the losing party is obligated to pay attorney's fees and costs to the winning party. All of the above choices have cost and timing considerations that should be understood.

- The contract should also set forth clearly and concisely the scope of work to be performed and the information that is being relied upon to complete the work. For example, if the general contractor hires an engineer to layout the location of a classroom on a new school project, and the engineer relies upon verbal information obtained from the architect, to determine the location of the classroom - can the architect be sued if the locations provided by the engineer are wrong?

These are just some of the many issues that should be considered when entering into a contract. Simply stated, the contract should memorialize the intentions of the parties and each of the sections within the contract should be internally consistent to effectuate that goal. There is no magic phrase that can accomplish this task. Speak to a qualified construction attorney who can answer your questions.

-- Shawn Farrell, *Esquire*

The Business Practice Group Answers Questions

Q: A company which has conducted business primarily in the Commonwealth of Pennsylvania and is planning to substantially expand its operations to New Jersey asks whether it should form an entity in New Jersey to do this work or whether it should simply file papers authorizing itself to conduct business in New Jersey?

A: For liability purposes alone, lawyers would always consider creating a new entity, an affiliate or subsidiary for an existing client which is planning to engage in new business activities or expand into new geographical areas. With a new entity, the existing company is not placed directly at risk for any potential liabilities arising from a failed venture. Other issues to consider would be the licenses required by the new operations (e.g., state trade licenses), additional bookkeeping and accounting costs, including tax preparation fees, the transferability of any permits, bonding capacity, etc., to such an affiliate or subsidiary, the impact on existing financing, and the likelihood that the new operations might be sold independently of the original company.

Q: A company's customer goes into bankruptcy. The company faces the prospect of a large write-off for the goods or services provided to the customer. Then, to add insult to injury, the business is sued in bankruptcy for the payment it received from its customer in the ninety-day period prior to the filing of the bankruptcy petition. Does the business simply write a check and avoid legal fees or are there real defenses to this preference action?

A: Immediately writing a check is generally a mistake. By establishing the concept of "preference payments," Congress sought to treat all unsecured creditors of a debtor equally. It established a presumption that any creditor which was paid in the 90-day preference period received more than what similar creditors will receive in the bankruptcy. Therefore, the preference must be returned and the creditor must share in the bankruptcy distributions.

However, the bankruptcy code provides for a number of defenses which

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Questions regarding a specific legal matter? We recommend that you speak with a CohenSeglias attorney:

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CSPG&F