2015 | VOLUME 4

Construction In Brief

A quarterly publication brought to you by COHEN SEGLIAS PALLAS GREENHALL & FURMAN PC

Up in the Air:

Drones and the future of the construction job site

By Edward Seglias and Robert John O'Brien

Unmanned aerial vehicles, commonly referred to as "drones," are appearing more and more frequently in the skies over construction project sites.

Drones typically operate from a handheld device, such as an iPhone, and can be connected to a Wi-Fi network. The physical design utilizes four to eight rotary blades, which allow for fairly fluid vertical movement and aerial stability. Such stability — the ability to hover or remain in place for an extended period of time — can prove particularly beneficial for surveying a job site. For example, drones can be used to capture images of the work from above and then transmit the information to one of a number of mapping software programs, which are, in turn, used to analyze and monitor all phases of a project, from site preparation to completion.

Beyond surveying the site, drones are being used by companies to view or inspect work that is either highly elevated or located in difficult to reach areas. Drones also are proving to be a valuable marketing tool, by allowing for impressive aerial footage or video of job sites, which can be shown to clients and potential clients. In the near future, drones may even be used for physical transportation of equipment and project materials. Indeed, multinational corporations, including Amazon and Google, have famously begun discussing the use of drones to transport and deliver goods to their respective customers.

Drones and drone technology truly possess the potential to fundamentally change the construction industry. However, the legal framework under which drones operate is still in flux.

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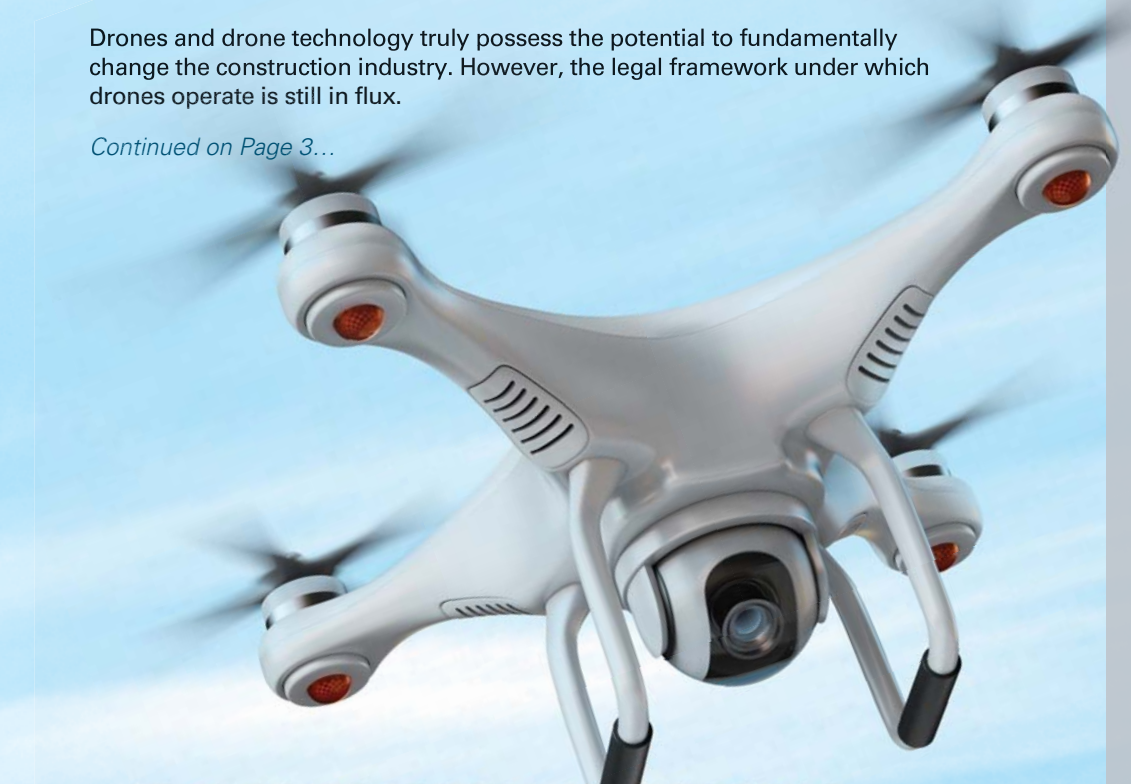

IN THIS ISSUE

Contributors:

What's New

Brief Note:

Greetings from the Editorial Team at Construction In Brief. With winter fast approaching, we invite you to take advantage of some useful tips in this issue on minimizing risks and loss on a project. We also are sharing a new decision from the Delaware Supreme Court affecting how contractors can recover interest on disputed change order requests, and don't miss the fascinating article on the future use of drones at construction sites.

Stay warm and have a happy holiday season!

Ashling
Co-Editor-in-Chief

Kate
Co-Editor-in-Chief

Jennifer
Associate Editor

By Kerstin Isaacs

New Faces

Please join us in welcoming Partner **Carol Sigmond** to the Firm's New York Office! Carol brings extensive construction experience including litigation of construction disputes in both the public and private sectors as well as experience in contract preparation, mediation, suretyship, bid protests, appeals, and arbitration. Carol is the current President of the New York County Lawyers Association.

We also are happy to welcome back former Summer Associates **Gary Repke** and **Jacqueline Ryan** to the Firm's Philadelphia office.

Gary Repke joins the Construction Group as an Associate and will focus his practice on construction litigation, assisting clients with research and preparation of motions and briefs in various construction-related matters. Gary served as a judicial intern for the Honorable Mae A. D'Agostino in the US District Court, Northern District of New York. He is a graduate of Albany Law School.

Jacqueline Ryan joins the Federal Contracting Group and focuses her practice on government contracts and construction litigation, assisting clients in matters involving contracts, bid protests, claim drafting and litigation in the federal courts. She is a graduate of Temple University Beasley School of Law and has served as an intern in the Philadelphia Mayor's Office.

2016 Best Law Firm

Best Lawyers has become one of the leading surveys worldwide ranking more than 11,000 law firms, 120 practice areas and 178 regions. The rankings are based on a rigorous evaluation process that includes the collection of client and lawyer evaluations and exhaustive peer review from leading attorneys in their field.

We are proud to announce that Cohen Seglias has once again been ranked a "Best Law Firm" by U.S. News and World Report and Best Lawyers® in the areas of Arbitration, Construction Law and Litigation, and Labor & Employment Law.

Four Cohen Seglias attorneys have been included in the 2016 edition of The Best Lawyers In America® in five different practice areas:

George Pallas
Litigation – Construction

John Greenhall
Construction Law

Marc Furman
Employment Law Management & Labor Law Management

Judge Gene Cohen
(Ret.) Arbitration

Holiday Toy Drive

The Firm continues its annual toy drive bringing holiday joy to less fortunate children locally and nationally through toy donations and monetary contributions to charities including Toys for Tots, the Support Center for Child Advocates, and the Allegheny County Department of Human Services Holiday Project. The Firm will match all contributions. For more information go to www.cohenseglias.com.

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Up in the Air

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By Edward Seglias and Robert John O'Brien

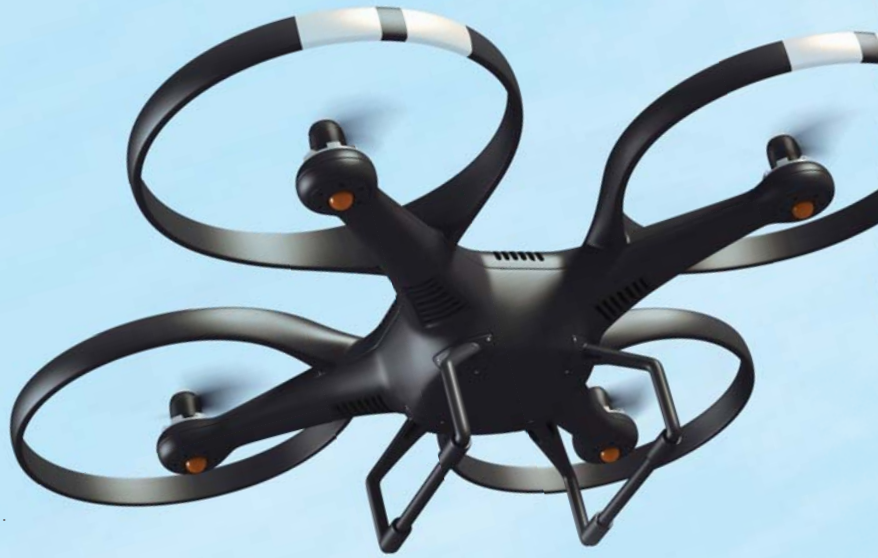
Governmental oversight and restrictions

Laws and safety regulations are starting to address this new use of drone technology. The Federal Aviation Administration ("FAA") is the governmental agency tasked with the safety and regulation of civil aviation. Presently, the FAA allows for the recreational, not commercial, use of drones weighing under 55 lbs., as long as the drones are not flown more than 400 feet above ground and not operated without permission near an airport or otherwise in a location that may interfere with air traffic.

As drones become more common and the technology continues to advance, the FAA is facing the realities of limited domestic airspace, public and personal safety, as well as privacy rights and concerns about drone use by groups with extremist or terrorist ties. Congress recently passed the FAA Modernization and Reform Act, which mandates that the FAA develop and promulgate rules and regulations for drones and their commercial or business use and operation. These FAA regulations should be finalized in 2016.

Although the commercial use of drones is not technically illegal, the FAA requires commercial drone operators to apply for and obtain a Section 333 exemption. The process to obtain this exemption is cumbersome and slow, but contractors should be aware that the FAA has demonstrated that it will not hesitate to levy significant (seven figure) civil penalties to those contractors who are discovered using drones on project sites without the necessary Section 333 exemption.

The FAA continues to develop and finalize its drone regulations, and from a legal standpoint, the use of drones by construction contractors is still in an uncertain state of limbo. Beyond remaining mindful of the FAA requirements and regulations as they are updated, construction contractors would be well-served to create and implement their own internal guidelines and policies with respect to the use of drones on the job site. For instance, drone operators should be required to go through a training protocol or process, and drone flight paths should be properly planned in advance and documented.



Other issues: insurance coverage

Another significant issue for contractors to consider in connection with the use of drones on the construction job site is the commercial general liability (CGL) insurance policy. It is unlikely that a contractor's CGL policy would cover accidents or damage to the drone or to property or, for that matter, to individuals for injuries caused by a drone crash or collision. Until drones become more common in the construction industry, contractors should obtain separate insurance coverage for their drones. Those contractors who have applied for and received the Section 333 exemption and plan on using drones on the job site should consult with an insurance broker and/or attorney to make sure they obtain the proper coverage.

More information coming…

Stay tuned in 2016 for news regarding how the FAA, the courts, and insurance companies respond to drones and the continued advancement of drone technology. If you are, or are contemplating, using drones on your job site, you should consult with an attorney to consider the legal issues associated with this new and developing technology.

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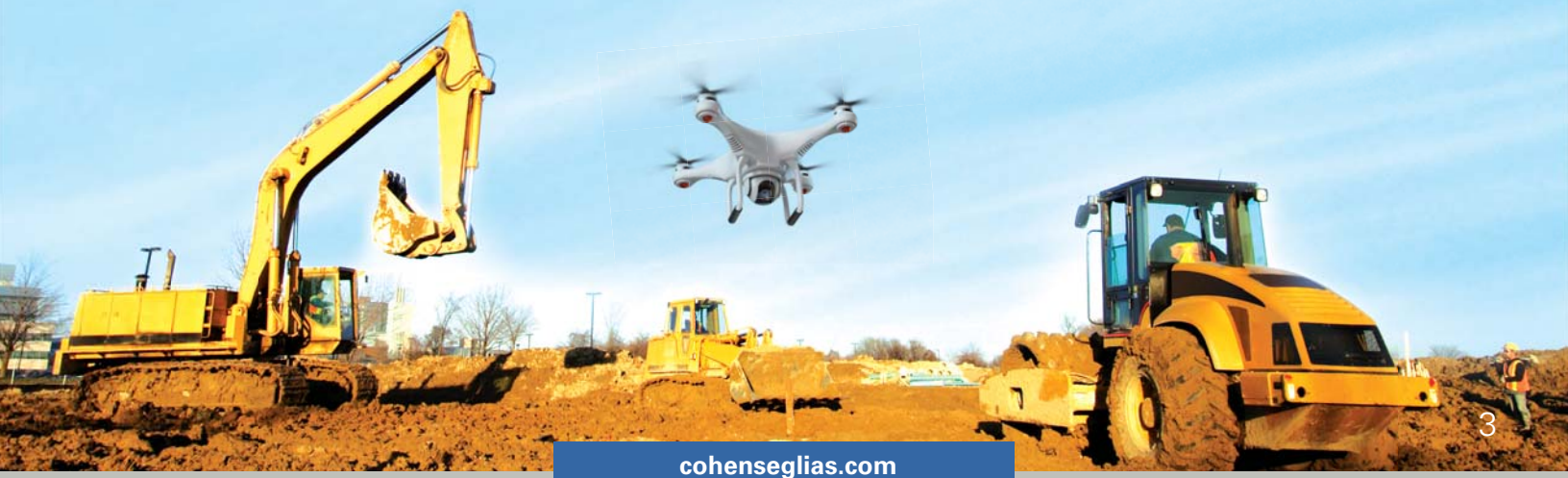

Tips For Minimizing Risk and Loss on a Project

By George E. Pallas and Kathleen M. Morley

As experienced contractors and subcontractors know, even the most carefully planned and skillfully bid projects can result in devastating losses and unanticipated overruns due to a large number of factors, many of which are not within their control. In such circumstances, the likelihood of disputes between the parties is high. When this occurs, the success of a contractor's claim will depend upon key steps it took – or did not take – before, during and after execution of its contract and throughout construction. Below are some basic tips and reminders of simple steps that contractors can take to help prevent and minimize risk and loss on a project:

1. **DO your homework.** Before submitting your bid, be sure to take the time to diligently review all available information, documents, plans and specifications to understand all conditions and obligations and obtain as much data as possible to inform your company's bid. Failure to do so can doom your job and profit potential before you even execute the contract. If you notice ambiguities or inconsistencies in the bid documents, or if you have questions or concerns about any of the information provided, be sure to document and raise those questions or concerns before you submit a bid.

2. **DO try to negotiate your contract.** If you are awarded a job, do not blindly accept and sign whatever contract is presented to you. Attempt to negotiate or, at a minimum, endeavor to identify unfavorable or restrictive contract terms before signing. Many contractors are under the mistaken belief that attempting to negotiate contract terms will result in the loss of a job; however, that scenario is highly unlikely. Consider having an attorney assist in the review and negotiation of the contract. Certain contractual provisions may be unenforceable or limited by operation of law and your attorney's knowledge of the law can be used as a bargaining tool in negotiations. Even if the entity you are contracting with refuses to negotiate or alter its terms, make a point to identify and understand restrictive and unfavorable terms so that you can tailor your actions accordingly during the course of the project. Here are a few critical provisions to look out for in this exercise:

- *Scope of work provisions* – you should demand very specific scope of work provisions and be weary of broad language that may be susceptible to differing interpretations for inclusion of additional work as part of your base scope.
- *Change order provisions* – make sure there is a clear provision in the contract outlining the process by which change orders are issued and approved.
- *Notice provisions* – be weary of overly restrictive notice provisions and strict compliance requirements that could bar claims. Try to negotiate less restrictive terms and entitlement in situations where the other party is aware of conditions giving rise to a claim.
- *No damages for delay clauses* – check for such a clause. Try to negotiate limitations on enforcement such as in circumstances where delays are caused by the other party.
- *Liquidated damages clauses* – see if there is a provision providing for the assessment of liquidated damages and understand the circumstances when they could be imposed.
- *Pay-if-paid clauses* – subcontractors should be weary of clauses that condition their right to payment on the contractor's receipt of payment from the owner. Try to negotiate the removal or modification of language shifting the risk of the owner's nonpayment to subcontractors.

3. **DO be proactive and prolific.** Make it routine practice to consistently and promptly notify parties "up the chain" in writing of any and all issues, conditions and problems that arise during construction – no matter how seemingly minor or insignificant. Do this even when there have been discussions or it seems clear that all parties are aware of a situation. In the event that litigation ultimately results, the party who has the best documentation generally prevails. Ensure that your staff is well-trained to maintain complete and well-documented project files in the event litigation ensues.

4. **DO NOT remain silent.** Similarly, it is imperative to always respond and document an objection to any correspondence or records that contain information or statements which you contest or believe to be inaccurate. It is very important to document in writing any such objection or disagreement and memorialize your position for the project record. In this regard, it is crucial that you

document your dispute of any assertion or implication by another party of your responsibility for a delay, problem or performance of deficient work.

5. **DO create a paper trail.** In this same vein, with respect to any affirmative claims for additional compensation, it is critical that you document all work and costs giving rise to a claim, and create a comprehensive paper trail to support future claims. Pay close attention to any contract provisions regarding claims or force account work, and be sure to compile all necessary backup documentation to support costs and claims in accordance with any contractual requirements.

6. **DO NOT miss deadlines or neglect claims procedures.** Be diligent about complying with all claim and dispute resolution procedures and deadlines to advance claims for additional work and costs – regardless of any ongoing settlement discussions or efforts to resolve claims or disputes between the parties.

7. **DO NOT be afraid to seek counsel.** Do not hesitate to enlist the assistance and involvement of counsel when construction is ongoing. Oftentimes, disputes and issues can be successfully resolved or avoided if addressed early. Counsel can assist in handling such issues before they develop into larger problems or more adversarial situations. An attorney can offer guidance and counsel from "behind the scenes" without the other side even being aware of counsel's assistance or involvement.

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Good News for Contractors Who Work on Delaware Public Projects

By Edward Seglias and Scott T. Earle

The Delaware Supreme Court recently held that a contractor performing public work in Delaware does not need to submit a payment application to recover pre-judgment interest on a disputed change order request and that interest will be calculated based on the rate expressly stated in the contract.

The facts of *Emory Hill & Company v. Delaware Technical & Community College* are as follows. Delaware Technical & Community College (the "College") and Emory Hill & Company (the "Contractor") were parties to a construction contract that set forth the rate of interest the College would have to pay for any disputed change order requests. During the course of the Project, the Contractor submitted a change order request, which the College denied. The College also refused to pay the contract rate of interest. Instead, the College argued that the interest was subject to the legal rate set forth in 29 Del. C. § 6516(d)(4)(d). The College further refused to pay any pre-judgment interest. In the litigation, the College took the position that the submission of a payment application in a form approved by the state was a condition precedent to the right to payment, and that the Contractor had no rights to payment because it never submitted a payment application.

The Delaware Superior Court rejected the College's arguments and found that the Contractor was the prevailing party in this dispute. After a trial on the merits, the jury found that the College wrongfully denied the change order request and awarded judgment in favor of the Contractor — at the interest rate set forth in the contract.

On appeal, the Delaware Supreme Court held that the legal rate of interest (2 percent above the prime interest rate as established by the Federal Reserve), set forth in 29 Del. C. § 6516(d)(4)(d), only applies in the absence of an express contract rate of interest. The statutory rate serves as a gap-filler when the contract documents are silent as to the interest rate. Therefore, state agencies are bound by the rate of interest the parties agreed to in the contract documents. Additionally, the Court found that it would be an exercise in futility for a contractor to submit a payment application if the state agency already denied a change order request.

What does this mean for a contractor working on a Delaware public project? Notwithstanding the statutory language of the state prompt pay provisions, there is no requirement to submit a payment application to obtain pre-judgment interest on a judgment obtained from a state agency's wrongful denial of a change order request. A contractor's submission of a change order request alone is sufficient to justify payment of that request, at the interest rate set forth in a contract.

Importantly, if you are working on Delaware public projects, be sure to check your change order requests, change orders, and contract to ensure that the public owner is paying you the correct interest rate on your change order work. If you have questions about necessary documentation to support a recovery on, or the proper valuation of, change order work, be sure to contact your attorney during the course of the Project to resolve these issues.

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Miller Act Claims and Dispute Resolution Procedures

By Michael H. Payne and Michael A. Richard

Federal government construction contractors know that the Miller Act requires them to furnish a payment bond for the benefit of subcontractors. Many contractors are familiar with the process by which subcontractors may seek payment under a surety's payment bond in federal court when there is a payment dispute, in the form of a Miller Act claim. What many contractors do not know is how their subcontractors' Miller Act rights affect the dispute resolution procedures included or incorporated in their subcontracts. Indeed, many contractors on federal projects who thought they were protected against unnecessary courtroom litigation by strong contractual dispute resolution procedures have discovered that their subcontractors can short circuit some of these procedures by means of a Miller Act lawsuit against the contractor's surety. To avoid this result, contractors need to know what alternative dispute resolution procedures are enforceable to prevent litigation of Miller Act claims and which ones are less likely to be enforced.

First, the good news: contract clauses that require arbitration between the contractor and the subcontractor are enforceable in the face of a Miller Act claim. When a subcontractor attempts to avoid its obligation to arbitrate its dispute with the contractor by filing a Miller Act claim against the bond, the federal district courts generally allow the contractor to intervene and compel arbitration. The actual Miller Act claim will not be sent to the arbitrator, as this is between the subcontractor and the surety, but will be stayed (suspended) by the court while the contractor and the subcontractor arbitrate the payment dispute. Even though the Miller Act claim is stayed, it will usually be resolved by the outcome of the arbitration because the surety is typically only liable to the same extent the contractor is liable. For payment disputes between contractors and subcontractors, the Miller Act does not provide a means for the subcontractor to avoid arbitration.

> The Miller Act is meant to protect subcontractors against nonpayment — not enable them to avoid participating in the dispute resolution procedures they agreed to in a subcontract.

So if arbitration is enforceable, what's the problem? The problem is that an arbitration clause in the subcontract does not apply to claims against the federal government. In fact, the only way to recover funds from the federal government on behalf of a contractor or a subcontractor is by following the procedures established in the Contract Disputes Act ("CDA"). When a subcontractor has a claim that implicates the federal government, the subcontractor must submit the claim to the contractor to be passed through to the government. Yet, rather than pursuing a pass-through claim, some subcontractors attempt to recover their losses through a bond claim rather than from the federal agency that is actually responsible. In these situations, instead of cooperating with the subcontractor in the presentation of its claim to the federal government, the contractor may get stuck litigating the subcontractor's Miller Act claim to avoid paying damages that are the responsibility of the federal government.

Contractors on federal projects typically address this problem by having a two-tiered dispute resolution procedure. For subcontractor claims that are purely against the contractor, the subcontract includes an arbitration clause. For subcontractor claims that implicate the federal government, however, the subcontract includes a pass-through clause that requires the subcontractor to follow CDA resolution procedures set forth in the prime contract. This is where trouble arises: unless the pass-through clause is written specifically to incorporate the dispute resolution procedures set forth in prime contract, the federal district courts may refuse to enforce it.

Federal district court judges are reluctant to order a subcontractor to submit a pass-through claim for multiple reasons, including: a concern that the subcontractor did not understand or intend to limit its remedy to a pass-through claim against the government; the court's lack of jurisdiction over the federal government to ensure adequate and timely consideration of the subcontractor's claim; and the court's inability to force the contractor to cooperate with the subcontractor in the presentation of its pass-through claim to the government. All of these concerns, however, can be overcome by carefully drafted subcontract language. The subcontract should, if possible, set forth the dispute resolution provisions of the prime contract verbatim. It also should obligate the contractor to participate and cooperate in the pass-through

contractor to participate and cooperate in the pass-through claims process. It should reference the sections of the CDA that guarantee that the government will timely consider properly submitted claims. Finally, it should include a clause, known as a liquidating agreement, which clearly waives the subcontractor's right to recover any damages from the contractor other than what the contractor and surety may recover from the federal government on the subcontractor's behalf.

The Miller Act is meant to protect subcontractors against nonpayment — not enable them to avoid participating in the dispute resolution procedures they agreed to in a subcontract. If a subcontract is drafted correctly, federal district courts will frequently order the subcontractor's Miller Act claim stayed pending resolution of the subcontractor's pass-through claim against the federal government. Careful attention to the subcontract language prior to execution is necessary to achieve this result. If you are a general contractor performing federal construction work and have questions about the language of your subcontract, you should contact an attorney to be sure you are properly shielded from unnecessary and costly litigation.

Michael H. is the Chair and Michael A. is an Associate in the Firm's Federal Contracting Practice Group. They can be reached at (215) 564-1700, mpayne@cohenseglias.com and mrichard@cohenseglias.com.

Q&A:
Avoiding Risk Management Mistakes

Jonathan A. Cass
Chair of the Insurance Coverage and Risk Management Group

In counseling clients on insurance coverage and risk transfer issues, we frequently see clients unknowingly enter into construction contracts that expose them to potentially avoidable and sometimes uninsured risks. Generally, these mistakes can be avoided if clients understand the risks and how to avoid them.

Q: Is there one thing that your construction clients do when entering into contracts that keep you awake at night?

A: If I was to pick one, and there are many, it is entering into contracts without fully understanding the contractual indemnification obligations they are assuming and the insurance requirements to which they are agreeing. It is crucial for general contractors (GCs) who are contracting with owners, and subcontractors (SCs) who are contracting with GCs, to understand what the indemnity and insurance provisions in the contract actually mean from a business-risk stand point. I always recommend that clients, at a bare minimum, have these provisions reviewed by their insurance professional to determine (a) whether they are assuming an uninsured risk by agreeing to the indemnity provision; and (b) whether their current insurance program complies with the insurance requirements. Ideally, contracts should be reviewed by both an attorney and insurance professional. If the insurance professional is unwilling or unable to do so, you need a more sophisticated and capable professional. It is important to review these provisions when they are part of a bid package and to discuss any problematic requirements with the owner prior to submitting the bid. It is often difficult to negotiate changes in these requirements after the bid has been accepted.

Q: Have you seen changes in the indemnification and insurance provisions that are being required by owners and GCs?

A: Sophisticated owners and GCs understand how important it is to shift the risks associated with a construction project to those who are actually doing the work. An owner wants to shift that risk to its GC and the GC, in turn, wants to shift that risk to its SC. In construction, risk transfer rolls downhill. Effectively transferring that risk starts with a solid form contract that contains (a) a comprehensive and enforceable indemnification provision; and (b) insurance requirements that ensure that all contractors have appropriate insurance coverage for the work they are performing, including additional insurance requirements for the owner and GC. Generally, large GCs and experienced owners have the most comprehensive (meaning lengthy and burdensome) indemnification provisions and the most detailed insurance requirements. If it has been a few years since you had your form contracts reviewed by counsel (or if you have never done so), we would recommend that you do so to make sure that your form contract provides you with as much protection as possible. We often see form contracts that appear to have been "cut and pasted" together and that are not only missing key provisions, but have provisions that are incomprehensible and incomplete.

Q: Why is this risk transfer so important to contractors?

A: Construction projects can be dangerous – expensive property gets damaged and people get badly injured (or even killed). Maintaining a safe project site is critical. But even at the safest sites, accidents happen. By effectively shifting the risk of responding to these property damage and personal injury claims down the contracting chain to the responsible party — for example, from GC to SC — the GC can minimize the expense to its own general liability carrier. Fewer, less expensive claims means better loss ratios and lower premiums, all of which can give a GC a competitive advantage in the marketplace. Similarly, for the SC who has assumed that risk (by agreeing to indemnify a GC for injury claims brought by the SC's employees), the SC needs to make sure that the risk it has assumed is insured. If not, the SC is assuming an exposure that could financially cripple, if not bankrupt, the company.

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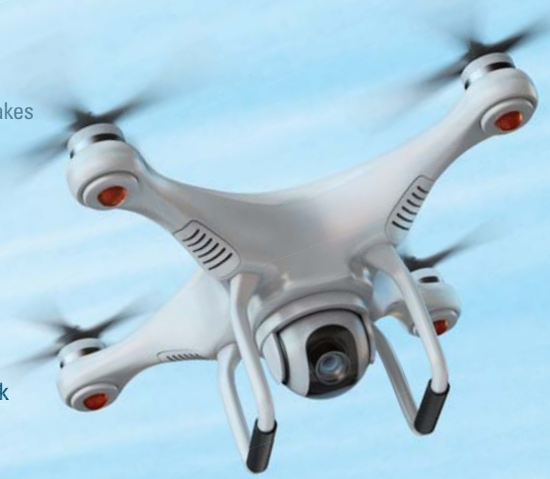

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