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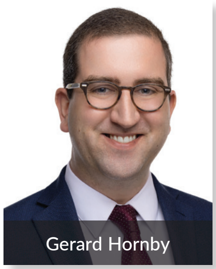
CONSTRUCTION LAW

In This Issue...

Compliance with notice provisions in a construction delay claim must be feasible


Gerard Hornby

A recent case handed down by the Eastern District of Kentucky reminds both construction litigators and parties alike that complying with the notice provisions in a project contract is in everyone’s interest and often a two-way street.

In *Triton Services, Inc., v. Century Construction, Inc.*, Century was hired as the general contractor for the construction of a new middle school, and Triton was subcontracted to complete and install the HVAC and plumbing systems. After things went sideways, the subcontractor brought suit against the general contractor. One of its claims was breach of contract in which the subcontractor alleged economic harm was caused by the general contractor’s repeated delay and mismanagement on the project.

In its defense, the general contractor looked to the contract, specifically Section 11(d), the “notice provision,” pertaining to delay claims that the subcontractor allegedly failed to satisfy, thereby barring its claims for damages arising from delay.

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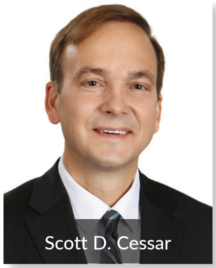
Covenant of good faith and fair dealing applied to pass-through agreements


Scott D. Cessar

Pass-through claims are claims by a party that has suffered damages, but does not have a contractual relationship with the entity that caused the damages. In the construction industry, subcontractors commonly have claims for additional costs based on actions or inactions by the owner. However, since the subcontractor is not in privity of contract with the owner, it has no direct cause of action against the owner other than perhaps, on a nongovernment project, a lien claim. In such cases, subcontractors may seek to pass the claim through the general contractor, who is in privity with the owner, to the owner. Indeed, many construction contracts require the subcontractor, in such cases of owner-caused damages, to pass the claim through the general contractor to the owner. And since the harm visited on a subcontractor by the owner usually also affected the general contractor, the subcontractor’s claim is packaged together with the general contractor’s claim, which is usually greater, for presentation to the owner and, if not resolved, litigation with the owner.

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Compliance with notice provisions in a construction delay claim must be feasible

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Section 11(d) required that a claim for delay of work must be **"presented within forty-eight (48) hours of the commencement of such delay."** The subcontractor failed to do this.

In its defense, the subcontractor argued that the notice provision only referred to requests for extensions of time arising from delays, rather than resolving disputes more generally. The subcontractor instead tried to rely on a different provision, Section 28(c), which only required that notice of a dispute be sent to the general contractor "within a reasonable time after the dispute has arisen."

The Court disagreed with the subcontractor and held that the 48-hours' notice provision applied. Even if the two provisions cover the same subject matter and thus create some redundancy, the Court may rely on a canon of construction:

> *"Where they are inconsistent, general terms and provisions in a contract ordinarily yield to specific ones, and the meaning of general words will be restricted by more specific terms; however, where both general and special provisions may be given reasonable effect, both are retained."*

So while Section 28(c) refers to dispute resolutions more generally, Section 11(d) specifically discusses delays and how derivative claims are to be preserved.

And this is where it got interesting. Just when it looked like the game was up for the subcontractor, the Court called into question the very feasibility of the subcontractor ascertaining the "commencement" of each discrete delay on the general contractor's part, given the nature and extent of the delays. In other words, it was unclear whether the subcontractor's satisfaction of the notice condition was frustrated or made effectively impossible by the general contractor. Of particular note for the Court concerning the sheer feasibility of compliance was the fact that the general contractor may have been too often absent from the site and that it left the subcontractors unorganized.

The Court at this stage was deciding a summary judgment motion filed by the general contractor. Considering the procedural posture, the Court found that the parties could both present conflicting evidence as to whether the subcontractor's delay claims were barred by Section 11(d) or not, and it therefore denied the motion.

The decision highlights the importance of paying attention to the timing mechanisms and notice provisions for delay claims in project contracts—for both parties. It emphasizes that not only must the party providing notice pay attention to its timing, but the receiving party must also be careful not to frustrate compliance with that condition.

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Covenant of good faith and fair dealing applied to pass-through agreements

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In these situations, the general contractor invariably controls the preparation, presentation, and prosecution of the combined claim. The general contractor will select experts, engage counsel, and interact directly with the owner and, if necessary, initiate and prosecute litigation.

For both general contractors and subcontractors involved in a pass-through claim situation, the best practice is to enter into a Pass-Through Agreement, which sets forth the parties' rights and responsibilities and addresses issues such as allocation of attorney and expert fees and litigation costs, routine information sharing, decision-making as to settlement, and allocation of settlement proceeds.

This is particularly important for subcontractors because their claim is usually smaller than that of the general contractor and subcontractors essentially find themselves riding the coattails of the general contractor. Some general contractors will actively involve and keep subcontractors abreast of developments in the prosecution of the joint claims; others will not and will pay token service to involving the subcontractor and then, after the case is settled or resolved, present the subcontractor with a breakdown showing the subcontractor's share of costs and of the recovery from the owner to be paid to the subcontractor. This latter situation likely will produce a disappointing result for the subcontractor.

A recent case from New York, *Rad and D'Aprile, Inc. v. Arnell Construction, Inc.*, demonstrates the worst-case situation of the general contractor abdicating its responsibilities to a subcontractor to whom it was entrusted with a pass-through claim. *Arnell* involved the circumstances of a classic owner-caused delay not barred by a no damage for delay clause: The project was delayed/impacted because the City of New York did not have title to the project site and, as such, the entire site was not available to the contractors for construction.

As such, the general contractor suffered delay damages as well as its subcontractor. Hence, the subcontractor passed its claim for delay damages through the general contractor, with the general contractor's like claim, to the City. The general contractor, however, failed to timely file an action against the City, resulting in the dismissal of the action, and the subcontractor's pass-through claim, and then the general contractor settled the claim without notice to the subcontractor and would not provide any compensation to the subcontractor from the settlement.

> *"Relying on the implied covenant of good faith and fair dealing, the court held that the general contractor's failure to timely file litigation and to settle the case without consulting with the subcontractor and not sharing any of the proceeds constituted a breach of this covenant."*

Subcontractor sued general contractor. General contractor sought to dismiss the action on a variety of grounds. The court denied the motion and, importantly, did not rely on a provision in the parties' contract, but relied on a covenant implied by common law in contracts. This covenant is known as the covenant of good faith and fair dealing which "embraces a pledge that neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract. It encompasses any promises that a reasonable person in the position of the promisee would be justified in understanding were included."

Relying on the implied covenant of good faith and fair dealing, the court held that the general contractor's failure to timely file litigation and to settle the case without consulting with the subcontractor and not sharing any of the proceeds constituted a breach of this covenant.

Although this holding is very common sense-based, it is important because the court relied on the implied duty of good faith and fair dealing to substitute and reach a just result where apparently express contractual duties of the general contractor to the subcontractor were absent.

Arnell thus teaches that the best practice is to draft a thorough Pass-Through Agreement that spells out the parties' obligations to one another and the consequences otherwise; but, however, the implied covenant of good faith and fair dealing works as a check on roughshod practices such as evidenced in *Arnell* in order to incorporate promises that reasonable persons would expect to be included.

Another takeaway/drafting suggestion from *Arnell* would be to include a provision in the Pass-Through Agreement that expressly states that the parties agree that they owe to one another the express duty of good faith and fair dealing. Such a provision would bolster the position of the subcontractor, and reasonable general contractors should not balk at its inclusion if, indeed, they are operating in good faith and because the duty is otherwise implied at law.

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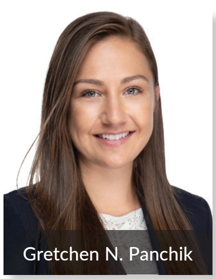
REAs may count as "claims" under the Contracts Disputes Act, according to a recent Federal Circuit decision


Gretchen N. Panchik

In *Zafer Construction Company v. United States*, the U.S. Court of Appeals for the Federal Circuit decided that a request for equitable adjustment (REA) by a contractor will be treated as a "claim" under the Contracts Disputes Act (CDA).

In 2008, the Army Corps of Engineers entered into a $40 million contract with Zafer to design and build water systems on the Bagram Air Base in Afghanistan. Zafer sought a $6.7 million REA in 2014 after completing the contract, citing to delays and modifications to the contract.

Following years of unsuccessfully attempting to settle, Zafer sought to convert its REA to a formal claim in 2018. The Federal Circuit decided that the 2014 REA was enough to let the Army Corps know that Zafer was seeking a final decision on extra payments it had requested. This ruling reversed the Court of Federal Claims' decision siding with the Army Corps, which held that Zafer's cause of action accrued no later than August 2011, meaning that a claim needed to be filed no later than 2017.

Despite the Army Corps' argument to the Federal Circuit that the claim was untimely because most of the alleged conduct occurred more than six years before the claim was filed, the Court rendered the REA a timely claim under the CDA and remanded the case back to the Court of Federal Claims.

The Federal Acquisition Regulation defines a "claim" as "a written demand or written assertion by one of the contracting parties seeking, as a matter of right, the payment of money in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to this contract." In addition, if the claim exceeds $100,000, the contractor must certify that (a) the claim is made in good faith, (b) the supporting data are accurate and complete, (c) the amount requested accurately reflects the contractor adjustment for which the contractor believes the government is liable, and (d) the certifier is authorized to certify the claim.

An REA is a request to the contracting officer that seeks an equitable increase to the contract price.

Claims have more stringent requirements than REAs. Claims include the requirement that the claimant show "what the contractor desires by its submissions is a final decision." There is no magic wording required to request a final decision, and the Court indicated that an REA can count as a claim if it meets the related regulatory and statutory requirements.

Zafer argued that its 2014 REA made a request for a final decision, discussing "at length" what the company believed was the money owed to it by the Army Corps and that Zafer wanted the contracting officer to make a decision regarding entitlement to that money. The Army Corps argued that the "clear signals" from the REA showed that Zafer only wanted to negotiate a contract proposal, not have a final decision rendered.

The framework that the Federal Circuit used here to render its decision was to look at whether the content and the context surrounding the submission of the REA put the contracting officer on notice that the REA was a claim requesting a final decision based on a "common sense" approach. The Court found that Zafer "implicitly request[ed] a final decision" by pointing to government-prompted changes and delays, requesting an amount certain of payment, and explicitly describing the REA as encompassing all claims incurred as a result of the delays.

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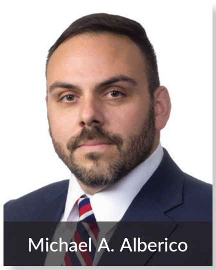
Do subcontractors now have to guarantee their quote?


Michael A. Alberico

A recent case out of the Court of Appeal of Louisiana, Fourth Circuit, *Alfred Conhagen, Inc. of Louisiana v. Ruhrpumpen, Inc.*, held a contractor who relies on a quoted price by a subcontractor in the bidding process can successfully pursue a claim against the subcontractor for detrimental reliance and negligence if that subcontractor later increases his quoted price.

> *"The subcontractor who honestly quotes jobs should have no fear of the* Conhagen *holding. In the unfortunate event the quote is wrong through no fault of its own, it too can pursue a cause of action against the individual lower on the contractor hierarchy."*

In *Conhagen*, the general contractor assembled a build team to create a bid for a NASA pump project. The general contractor hired a mechanical subcontractor to provide a high-pressure water pump system. The mechanical subcontractor retained a design engineering service, which sourced a quote from a separate entity for a pump package. The pump package entity initially quoted the design engineer $734,480 to construct the proposed bid but produced a final quote after the bid was obtained approximately $1 million higher at $1,793,360. The initial quote was underbid because it did not contain the correct motor or fluid coupling for the pump. The design engineer had received two other quotes for the pump in addition to the pump package entity's initial quote. The pump package entity's initial quote was the lowest, so the design engineer went with that firm.

Relying on the pump package entity's initial quote, the general contractor bid and won the NASA project. The contractors and engineers began working on the design. Sometime during this process, the pump package entity realized the initial quote was too low given the cost of motors. Despite this realization, it remained silent for multiple months and misrepresented to the team that it had not yet determined a cost for the motor. Finally, after additional time had passed, the pump package entity came forward with the new, final quote $1 million more than the initial. As a result of the increase in price, the pump was eventually built by the mechanical subcontractor for $1,672,040, approximately $100,000 less than the true quote but approximately $900,000 more than the original quote.

The quote increase resulted in the mechanical subcontractor spending more money to construct the pump. The mechanical subcontractor then brought a petition for damages against the design engineering service and the pump package entity for negligence and detrimental reliance. Following motion practice and two bench trials after a remand, the trial court rendered a judgment in the mechanical subcontractor's favor for $927,560.30 against the pump package entity for detrimental reliance and negligence and the design engineering service for negligence.

The design engineering service and pump package entity appealed the liability findings, among other things. The pump package entity claimed lack of privity with the mechanical engineer to defeat the detrimental reliance claim. The Appellate Court upheld the detrimental reliance claim, determining there was a relationship between the mechanical engineer and pump package entity that could give rise to liability. Specifically, the mechanical engineer relied upon the pump package entity's original quote, given the communications between the two entities regarding the pump and its sourcing. The Appellate Court further held public policy favored the implication of liability because imposing liability on certain companies was beneficial "so that those companies would be more diligent in composing their reports" that "would benefit not only the contracting party, but also those persons who, due to current business practices, are expected to receive and rely upon the contents of the report."

The Appellate Court also upheld the negligence findings, reasoning the pump package entity breached its duty when it grossly underbid the project, given its substantial pecuniary interest in being selected as the pump supplier and when it communicated inaccurate and misleading information in its original quote. The Appellate Court also found the design engineering service's arguments unpersuasive, as the design service's duty was to vet pump package pricing discrepancies, which it failed to do.

Applying this ruling to the industry, contractors rely on quotes provided to them by subspeciality contractors in forming their budget and profits prior to the bidding process. If a subspeciality contractor misquotes a project, all the contractors about that sub feel the financial impact due to delays and increased material costs. Detrimental reliance (or promissory estoppel) and negligence are common causes of action. The contractors atop the contractor hierarchy after the *Conhagen* case now utilize these causes of action to recoup costs after suffering financial harm due to a misquote by subcontractor.

The subcontractor who honestly quotes jobs should have no fear of the *Conhagen* holding. In the unfortunate event the quote is wrong through no fault of its own, it too can pursue a cause of action against the individual lower on the contractor hierarchy. Conversely, the subcontractor who consistently underbids a project without justification with the hope of making up the shortfall through change orders and renegotiated prices must be wary.

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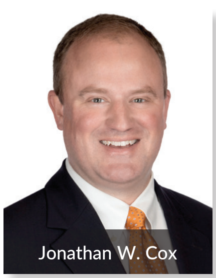
Commercial Property Assessed Clean Energy (C-PACE) gaining momentum in Pennsylvania for financing improvements to commercial real estate


Jonathan W. Cox


Scott R. Dismukes


Daniel Clearfield


James A. Diamond

Eckert Seamans provides industry-leading experience to clients by assisting them in implementing innovative financing strategies to reduce the costs of capital. One strategy that provides low-interest, long-term, fixed-rate financing is Commercial Property Assessed Clean Energy (C-PACE), which is meant to fund the costs of clean energy improvements to commercial real estate. Loans are typically priced at a spread over the 10-year Treasury rate and fixed for the term, which typically matches the useful life of the improvements being financed and is often 20 to 30 years. The financing typically covers 100 percent of the costs of the improvements, so long as minimum loan-to-value ratios are satisfied for the property, leveraging the owner's existing equity in the property.

The Commonwealth of Pennsylvania joined 30 other states in approving a property-assessed clean energy program in 2018 (see Act 30 of 2018). C-PACE is gaining momentum in Pennsylvania, where 19 counties as of this writing have enacted enabling legislation to implement the program. The Sustainable Energy Fund (SEF) serves as the program administrator for all C-PACE programs outside of the City and County of Philadelphia, where the Philadelphia Energy Authority (PEA) oversees loan reviews and approvals. SEF has developed a comprehensive set of documents and resources to implement the program at the county level.

There is an active and competitive capital market for C-PACE loans because they are secured by a first lien special assessment on the improved property. In essence, the property owner agrees to tax itself through an annual special assessment equal to the debt service on the loan. The lien of the special assessment runs with the land and cannot be discharged until the C-PACE loan is satisfied. Because the C-PACE lien has priority over other encumbrances of record by statute, any financial institution holding a lien, mortgage, security interest in, or other encumbrance on the real property must be provided notice of the C-PACE lien and must consent to the lien. Mortgage lenders benefit from the improvements through an increase in the overall value of the property and are willing to consent to the loans because statutory protections prevent C-PACE loans from being accelerated. Therefore, the risk to a mortgage holder is limited to the payment of the annual special assessment. This risk can be mitigated by the mortgage lender by requiring an escrow agreement for the annual special assessment payments and other assurances so that any protective advances the mortgage lender may need to make to avoid enforcement of the lien of a special assessment will be reimbursed.

While C-PACE programs share a common foundation, the model varies across states. In Pennsylvania, the program concentrates on energy efficiency and alternative and renewable energy improvements to commercial real estate. This focus area includes multifamily, residential rental properties following an amendment to the program authorized under Act 43 of 2022. Clean-energy improvements are broadly defined under the statute to include the installation of alternative and renewable energy systems, water conservation measures, retrofitting an existing building to meet high-performance building standards, and installing equipment to facilitate or improve energy conservation or energy efficiency, including heating and cooling equipment.

At Eckert Seamans, we understand the expertise needed to counsel counties, municipalities, borrowers, developers, lenders, and mortgage holders through the myriad of issues facing such projects. We offer a full range of programming, including program implementation; negotiating loan documents and lender consent issues; real estate, zoning and landlord-tenant issues; federal tax issues, and public utility issues.

For more information on Eckert Seamans' multi-practice C-PACE team, please contact any of the following attorneys:

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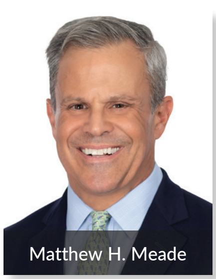
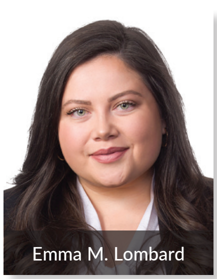
DHS's Cybersecurity and Infrastructure Security Agency seeking guidance on critical infrastructure cyber reporting


Matthew H. Meade


Emma M. Lombard

On September 12, 2022, the U.S. Department of Homeland Security's Cybersecurity and Infrastructure Security Agency (CISA) issued a Request for Information (RFI) in an effort to obtain feedback from the public on aspects of proposed regulations for cyber incident reporting by critical infrastructure entities.

This ongoing endeavor stems largely from a wave of cyberattacks on critical infrastructure entities in 2021, including those that made national news against SolarWinds and Colonial Pipeline.

As a result, in May 2021, President Biden signed Executive Order 14028, titled "Improving the Nation's Cybersecurity," which outlines ways to protect federal networks, remove barriers to sharing threat information, and establish stronger incident detection and response tactics.

In March of this year, President Biden signed into law the Cyber Incident Reporting for Critical Infrastructure Act of 2022 (CIRCIA), which primarily requires "covered entities" to report "substantial" cyber incidents to CISA within 72 hours of their occurrence, and to report any ransom paid to a threat actor within 24 hours of payment. It also directs CISA to implement rules that further define certain provisions.

The primary question that CIRCIA leaves unanswered is who qualifies as a "covered entity," as its definition within the Act is "an entity in a critical infrastructure sector, as defined in Presidential Policy Directive 21, that satisfies the definition established by the Director in the final rule issued pursuant to section 2242(b)." Presidential Policy Directive 21 identifies the following 16 critical infrastructure sectors: Chemical; Commercial Facilities; Communications; Critical Manufacturing; Dams; Defense Industrial Base; Emergency Services; Energy; Financial Services; Food & Agriculture; Government Facilities; Healthcare & Public Health; Information Technology; Nuclear Reactors, Materials, & Waste; Transportation Systems; and Waste & Wastewater Systems. Because CIRCIA's definition incorporates by reference a rule that CISA has yet to propose or finalize, whether an entity within any of the foregoing critical infrastructure sectors will be subject to CIRCIA's mandatory reporting requirements cannot be determined. The current definition is broad enough to include entities of all types in both the public and private sectors.

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DHS's Cybersecurity and Infrastructure Security Agency seeking guidance on critical infrastructure cyber reporting

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CIRCIA further requires CISA to consider the following three factors in formulating its definition of "covered entity":

a. the consequences that disruption to or compromise of such an entity could cause to national security, economic security, or public health and safety;
b. the likelihood that such an entity may be targeted by a malicious cyber actor, including a foreign country; and
c. the extent to which damage, disruption, or unauthorized access to such an entity, including the accessing of sensitive cybersecurity vulnerability information or penetration testing tools or techniques, will likely enable the disruption of the reliable operation of critical infrastructure.

H.R. 2471 § 2242(c)(1).

Regarding the substantive provisions of the proposed regulations, the RFI seeks feedback on the meanings of "covered cyber incident," "substantial cyber incident," "supply chain compromise," and any other terms that "would improve the regulations and proposed definitions for those terms." The RFI also asks what constitutes a "reasonable belief" that a covered cyber incident has occurred to trigger the 72-hour reporting deadline. Seemingly in an attempt to gauge the impact of any proposed regulation, CISA has requested feedback on the number of entities likely to be covered by the reporting, as well as the number of covered cyber incidents likely to occur either in total, or by industry, along with the number of ransom payments likely to be made on an annual basis.

As to the procedural provisions, the RFI seeks comments on the policies, procedures, and requirements for incident reporting. Specifically, the RFI poses several questions regarding how costly compliance with existing reporting requirements is, how reporting under the new regulations should work, and what method should be employed for calculating the reporting timeline.

This RFI is an ideal opportunity for organizations to offer feedback and potentially shape the scope of the proposed regulations. CISA is hosting a series of public listening sessions, including one newly announced session in Washington, D.C., and accepting responses to the RFI until November 14, 2022. Despite the potential length of the public rulemaking process, companies should begin preparing for these regulations now by reviewing and updating their incident response plans. Potentially covered entities should monitor the rulemaking process to ensure that they are equipped technically and organizationally to meet CIRCIA's obligations. Eckert Seamans will continue to monitor the rulemaking process.

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Construction Law Group NEWS

Victory

Christopher Opalinski and **Timothy Grieco** recently won a significant victory, following a three-week virtual bench trial in federal court in Pittsburgh, for our client that specializes in the dismantling of complex industrial structures. The court found in our client's favor in connection with its claims and awarded to it a multimillion-dollar verdict and held that our client is entitled to an award of prejudgment interest, which could total an additional several million dollars.

> *"Scott Cessar was named "Lawyer of the Year" in Pittsburgh for Construction Litigation in the 2023 Best Lawyers® rankings."*

Accolades

Scott Cessar was named "Lawyer of the Year" in Pittsburgh for Construction Litigation in the 2023 Best Lawyers® rankings. Between **Scott Cessar** and **Christopher Opalinski**, they have shared "Lawyer of the Year" honors in six of the last eleven years. **Scott Cessar** was profiled in the *Pittsburgh Business Times* for his achievement.

The 29th edition of *The Best Lawyers in America®* and *Best Lawyers®: Ones to Watch* reports also named **Christopher Opalinski** as a top attorney in Construction Litigation.

Following these reports, our Construction Litigation group earned a national ranking in the *U.S. News – Best Lawyers®* **"Best Law Firms" 2023** list. Our Pittsburgh office maintained its Tier 1 position.

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