UPDATE ON LEGAL DEVELOPMENTS IN STATE CONSTRUCTION CONTRACTING

The Undiscovered Country?

Design-Build, Design-Build Bridging, Public-Private Partnerships, Insurance, Auditing, False Claims Act, Termination for Convenience

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I. Introduction

The Undiscovered Country

"But that the dread of something after death,
The undiscovered country from whose bourn
No traveller returns, puzzles the will
And makes us rather bear those ills we have
Than fly to others that we know not of?"

Shakespeare's Hamlet: Act 3, Scene 1, Lines 85-89

To Build or Not to Build—That Is The Question?

The three new project delivery methods in North Carolina and additions to the State's General Conditions are like "undiscovered countries" described by Shakespeare, in that, **we really do not know what awaits us on the other side until you actually go through the delivery methods or have the appellate courts settle the issues regarding the enforcement of the changes to the State's General Conditions**.

Will the end results be Good, Bad or Ugly?

Will those journeys bring rewards or painful lessons learned?

As a result of the unknown, State owners, if they have a choice, may choose to go through the slings and arrows of outrageous fortunes and bear with the project delivery methods they know and have used.

Nevertheless, the General Assembly has expressed its intent that the State use these new delivery methods when the circumstances justify their use.

II. Definitions for Design-Build and Design-Build Bridging

G.S. § 143-128.1B(a):

(1) Design-build bridging. – A design and construction delivery process whereby a governmental entity contracts for design criteria services under a separate agreement from the construction phase services of the design-builder.

(2) Design-builder. – An appropriately licensed person, corporation, or entity that, under a single contract, offers to provide or provides design services and general contracting services where services within the scope of the practice of professional engineering or architecture are performed respectively by a licensed engineer or licensed architect and where services within the scope of the practice of general contracting are performed by a licensed general contractor.

G.S. § 143-128.1A. Design-Build Contracts.

(b) A governmental entity shall establish in writing the criteria used for determining the circumstances under which the design-build method is appropriate for a project, and such criteria shall, at a minimum, address all of the following:

(1) **The extent to which the governmental entity can adequately and thoroughly define the project requirements prior to the issuance of the request for qualifications for a design-builder.**

(2) The time constraints for the delivery of the project.

(3) **The ability to ensure that a quality project can be delivered**.

(4) **The capability of the governmental entity to manage and oversee the project, including the availability of experienced staff or outside consultants who are experienced with the design-build method of project delivery**.

(6) The criteria utilized by the governmental entity, including a comparison of the advantages and disadvantages of using the design-build delivery method for a given project in lieu of the delivery methods identified in subdivisions (1), (2), and (4) of G.S. 143-128(a1).

Design-Build Requirements

(c) A governmental entity shall issue a public notice of the request for qualifications that includes, at a minimum, general information on each of the following:

(7) Other information provided by the owner to potential design-builders in submitting qualifications for the project.

(8) A statement providing that each design-builder shall submit in its response to the request for qualifications an explanation of its project team selection, which shall consist of either of the following:

a. **A list of the licensed contractors, licensed subcontractors, and licensed design professionals whom the design-builder proposes to use for the project's design and construction**.

b. **An outline of the strategy the design-builder plans to use for open contractor and subcontractor selection based upon the provisions of Article 8 of Chapter 143 of the General Statutes.**

DB bridging adds the following additional information:

(7) **The thirty-five percent (35%) design criteria package prepared by the design criteria design professional**.

(10) A statement providing that each design-builder shall submit in its request for proposal a sealed envelope with all of the following:

a. The design-builder's price for providing the general conditions of the contract.

b. The design-builder's proposed fee for general construction services.

c. The design-builder's fee for design services.

Design-Build Firm Selection

(d) Following evaluation of the qualifications of the design-builders, **the three most highly qualified design-builders shall be ranked**. If after the solicitation for design-builders not as many as three responses have been received from qualified design-builders, the governmental entity shall again solicit for design-builders. If as a result of such second solicitation not as many as three responses are received, the governmental entity may then begin negotiations with the highest-ranked design-builder under G.S. 143-64.31 even though fewer than three responses were received. If the governmental entity deems it appropriate, the governmental entity may invite some or all responders to interview with the governmental entity.

§ 143-128.1B. Design-build bridging contracts.

(c) On or before entering into a contract for design-build services under this section, the governmental entity shall select or designate a staff design professional, or a design professional who is independent of the design-builder, to act as its design criteria design professional as its representative for the procurement process and for the duration of the design and construction. … The design criteria design professional shall develop design criteria in consultation with the governmental entity. The design criteria design professional shall not be eligible to submit a response to the request for proposals nor provide design input to a design-build response to the request for proposals. **The design criteria design professional shall prepare a design criteria package equal to thirty-five percent (35%) of the completed design documentation for the entire construction project.**

§ 143-128.1B. Design-Build Bridging Contracts.

(c) … The design criteria package shall include all of the following:

(1) Programmatic needs, interior space requirements, intended space utilization, and other capacity requirements.

(2) Information on the physical characteristics of the site, such as a topographic survey.

(3) Material quality standards or performance criteria.

(4) Special material requirements.

(5) Provisions for utilities.

(6) Parking requirements.

(7) The type, size, and location of adjacent structures.

(8) **Preliminary or conceptual drawings and specifications sufficient in detail to allow the design-builder to make a proposal which is responsive to the request for proposals.**

(9) Notice of any ordinances, rules, or goals adopted by the governmental entity.

§ 143-128.1B. Design-Build Bridging Contracts.

(e) Following evaluation of the qualifications of the design-builders, the governmental entity shall rank the design-builders who have provided responses, grouping the top three without ordinal ranking. … From the grouping of the top three design-builders, ***the governmental entity shall select the design-builder who is the lowest responsive, responsible bidder based on the cumulative amount of fees provided in accordance with subdivision (d)(10) of this section and taking into consideration quality, performance, and the time specified in the proposals for the performance of the contract***. Each design-builder shall certify to the governmental entity that each licensed design professional who is a member of the design-build team, including subconsultants, was selected based upon demonstrated competence and qualifications in the manner provided by G.S. 143-64.31.

LESSONS LEARNED BY OTHERS WHO NAVIGATED THROUGH THE UNDISCOVERED COUNTRIES OF DESIGN-BUILD

Design Build	
Advantages	Disadvantages
Single entity responsible for design and construction	Minimal owner control of both design and construction quality
Construction often starts before design completion reducing project schedule	Requires a comprehensive and carefully prepared performance specification
Transfer of design and construction risk from owner to the DB entity	Potentially conflicting interest as both designer and contractor
Emphasis on cost control, which may defined early in the DB process	No Party responsible to represent owner's interest
Requires less owner expertise and resources	High bid costs/fewer bidders
Potential for better design and construction coordination because the A/E is partnered with the contractor	Diminished open competition on product, material and equipment selection
Owner no longer involved in disputes between design team and contractor, that is, owner no longer liable to contractor for design errors and omissions	D-B has an incentive to complete project faster and less expensively, which may result in lower quality of materials and work

LESSONS LEARNED BY OTHERS WHO NAVIGATED THROUGH THE UNDISCOVERED COUNTRIES OF DESIGN-BUILD

Design Build	
Advantages	Disadvantages
Less change orders	Owner does not benefit from independent advice from design team during design and construction phases
Contractor input during design process	Not always the best price. The use of D-B may cost significantly more than other delivery methods, if owner's program is not well defined upfront and the owner's contract does not adequately allow owner to protect its interest through audit and review of DB's cost estimating to minimize change orders and scope busts
Impacts on project timeliness and costs are reduced because second procurement process is eliminated, reduction in design errors and omissions, more opportunities for value engineering when contractor is part of design process, and use of performance specifications by owner	Pitfall-program accuracy may cause changes, increased costs and delays. Program evolution frequently occurs during construction and may overlook the end users of the project.
DB good for medium to large DOT projects or complex DOT projects	DB not a good delivery method for small DOT projects such as road resurfacing

LESSONS LEARNED BY OTHERS WHO NAVIGATED THROUGH THE UNDISCOVERED COUNTRIES OF DESIGN-BUILD

- The significant differences that State owners need to pay attention to between D-B and D-B Bridging is that D-B will allow the State owner to select and negotiate the contract price with the highest qualified D-B firms, but State owner gives us significant control over the design of the project.
- If the State owner selects D-B Bridging it retains greater control over the design of the project, but will be forced to select the lowest responsible D-B firm and the disadvantages associated with selecting lowest bidders.
- D-B Bridging may expose the State owner and the Bridging designer may be liable for errors and omission in the 35%, which the D-B Firm may use for claims and/or requests for time extensions.

LESSONS LEARNED BY OTHERS WHO NAVIGATED THROUGH THE UNDISCOVERED COUNTRIES OF DESIGN-BUILD

- Owner will needed trained and capable contracting staff responsible for administrating design-build projects, including procurement and contract personnel (including legal and accounting/auditing staff).
- Owner must make sure there are sufficient and capable design-build firms in their respective market to ensure competition and better pricing..
- The owner’s contracting documents with D-B Firm must include terms and conditions that make the D-B Firm accountable for: project schedule; quality of design and engineering; labor; materials; means and methods; projects costs; warranties; and compliance with owner’s performance and program requirements.

LESSONS LEARNED BY OTHERS WHO NAVIGATED THROUGH THE UNDISCOVERED COUNTRIES OF DESIGN-BUILD

- The owner's contract documents should consider incorporating and/or addressing: a standard of care for the design and engineering work of the D-B fFrm; unknown/unforeseen conditions (allocating the risks); owner directed changes; interpreter of contract documents and order of precedence (i.e., owner should have a sufficient detailed performance specifications); owner should reserve some authority to review/approve final design and/or determine quality, test and/or inspect the construction as it progresses (especially above ceiling, behind wall, fireproofing/firestopping, life safety, etc.), owner review/approval of submittals; and to incorporate such owner quality assurances in project schedule); verifying project costs (including design, engineering, accounting, legal, auditing, etc.); time extensions for abnormal weather delays; review and approval of key project team members of D-B Firm; require weekly reporting requirements that reports on the information typically provide on State Construction Projects; include right to attend all regular project meetings; require DB firm to give owner electronic access to electronic project records; and such other requirements that will give owner access to the communications between designer and contractor.

- The owner's contract documents should shift the risk of delay caused by design errors and omission to the DB firm. However, the owner must make sure that its performance specification and/or bridging design are sufficiently detailed and had obtained thorough input from the end user (including life cycle, operational needs, future maintenance and use of the occupied space) to minimize owner directed changes that may open the door to time extension requests and delay claims by D-B Firm.

LESSONS LEARNED BY OTHERS WHO NAVIGATED THROUGH THE UNDISCOVERED COUNTRIES OF DESIGN-BUILD

- USDOT's Final Report on D-B recommended bridging so that owner has its preliminary design (no more than 30%) is incorporated into the RFP for the DB contract.
- SCO and owner must increase and invest in the expertise and experience of agency staff and owner staff in D-B project delivery as well as retain such trained staff.
- State of California's lessons learned (Legislative Analysis Report Feb. 3, 2005) on using the D-B delivery method stated that "Good Project Definition" is needed before awarding Design-Build Contract, which is consistent with USDOT's recommendation for "bridging" included in the North Carolina statutes.
- State of California's lessons learned from its counties indicated that Design-Build was "Best Suited for Straightforward Projects." Most agencies stated that DB was best suited for projects of conventional design and construction such as office buildings and parking garages. Projects that were more complex or specialized, such as jails and hospitals were less suitable for DB because of unique design preferences.

LESSONS LEARNED BY OTHERS WHO NAVIGATED THROUGH THE UNDISCOVERED COUNTRIES OF DESIGN-BUILD

- **Unlike construction management at risk contracts, the legislation authorizing the use of DB, DBB and P3 project delivery requirements did not impose any fiduciary duty on the DB firm or P3 developer that would have required them to essentially act in the best interests of the State owner in delivering these projects under these new methods of delivery.**

  N.C. Gen. Stat. § 143-128.1(c) (“The construction manager at risk shall act as the fiduciary of the public entity in handling and opening bids”); *Green v. Freeman,* 367 N.C. 136, 141, 749 S.E.2d 262, 268 (2013) (Though difficult to define in precise terms, a fiduciary relationship is generally described as arising when "there has been a special confidence reposed in one who in equity and good conscience is bound to act in good faith and with due regard to the interests of the one reposing confidence"); (quoting *Dalton v. Camp,* 353 N.C. 647, 651, 548 S.E.2d 704, 707 (2001)); *see also Meinhard v. Salmon,* 249 N.Y. 458, 464, 164 N.E. 545, 546 (1928) (describing fiduciaries as being held to a standard "stricter than the morals of the market place" and adding that "[n]ot honesty alone, but the **punctilio** of an honor the most sensitive, is the standard of behavior"). **Fiduciary relationships are characterized by "confidence reposed on one side, and resulting domination and influence on the other**." *Dalton,* 353 N.C. at 651, 548 S.E.2d at 708 (quoting *Abbitt v. Gregory,* 201 N.C. 577, 598, 160 S.E. 896, 906 (1931)) …

III. To P3 or not to P3?

If a State owner has no money or very little money (i.e., 50% of less the cost of construction), then a public-private partnership may be a viable delivery method to pay for the construction of the future building project, **if that project is capable of generating a consistent stream of income that would attract developers**.

To P3 or not to P3?

§ 143-128.1C. Public-private partnership construction contracts

(a) Definitions for purposes of this section:

(1) Construction contract. – Any contract entered into between a private developer and a contractor for the design, construction, reconstruction, alteration, or repair of any building or other work or improvement required for a private developer to satisfy its obligations under a development contract.

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(4) Development contract. – Any contract between a governmental entity and a private developer under this section and, as part of the contract, the private developer is required to ***provide at least fifty percent (50%) of the financing*** for the ***total cost necessary to deliver the capital improvement project***, whether through lease or ownership, for the governmental entity.

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(8) Public-private project. – A capital improvement project undertaken for the benefit of a governmental entity and a private developer pursuant to a development contract that includes construction of a public facility or other improvements, including paving, grading, utilities, infrastructure, reconstruction, or repair, and may include both public and private facilities.

To P3 or not to P3?

§ 143-128.1C. Public-private partnership construction contracts

(b) If the governmental entity determines in writing that it has a **critical need** for a capital improvement project, the governmental entity may acquire, construct, own, lease as lessor or lessee, and operate or participate in the acquisition, construction, ownership, leasing, and operation of a public-private project, or of specific facilities within such a project, … If the governmental entity is a public body under Article 33C of this Chapter, the determination shall occur during an open meeting of that public body. … The development contract shall specify the following:

(1) The property interest of the governmental entity and all other participants in the development of the project.

(2) The responsibilities of the governmental entity and all other participants in the development of the project.

(3) The responsibilities of the governmental entity and all other participants with respect to financing of the project.

To P3 or not to P3?

§ 143-128.1C. Public-private partnership construction contracts

(c) The development contract may provide that the private developer shall be responsible for any or all of the following: (1) Construction of the entire public-private project.

(d) The development contract may also provide that the governmental entity and private developer shall use the same contractor or contractors in constructing a portion of or the entire public-private project. … For public-private partnerships using the design-build project delivery method, the provisions of G.S. 143-128.1A shall apply.

To P3 or not to P3?

§ 143-128.1C. Public-private partnership construction contracts

(m) This section shall not apply to any contract or other agreement between or among The University of North Carolina or one of its constituent institutions, a private, nonprofit corporation established under Part 2B of Article 1 of Chapter 116 of the General Statutes, or any private foundation, private association, or private club created for the primary purpose of financial support to The University of North Carolina or one of its constituent institutions.

IV. ARTICLE 34 - MINIMUM INSURANCE REQUIREMENTS

The work under this contract shall not commence until the contractor has obtained all required insurance and verifying certificates of insurance have been approved in writing by the owner. These certificates shall document that coverages afforded under the policies will not be cancelled, reduced in amount or coverages eliminated until at least thirty (30) days after mailing written notice, by certified mail, return receipt requested, to the insured and the owner of such alteration or cancellation. If endorsements are needed to comply with the notification or other requirements of this article copies of the endorsements shall be submitted with the certificates.

ARTICLE 34 - MINIMUM INSURANCE REQUIREMENTS

a. **Worker’s Compensation and Employer's Liability**

The contractor shall provide and maintain, until final acceptance, workmen's compensation insurance, as required by law, as well as employer's liability coverage with minimum limits of $100,000.

- The purpose of workers' compensation is to provide compensation for injuries and diseases developed during the course of employment. This compensation is provided to you regardless of whether you, your employer or someone else is at fault for your injuries or illness. In return, you may not file a lawsuit against your employer to collect compensation outside of the workers' compensation system, unless your employer injured you intentionally.

ARTICLE 34 - MINIMUM INSURANCE REQUIREMENTS

b. **Public Liability and Property Damage**

- The contractor shall provide and maintain, until final acceptance, comprehensive general liability insurance, including coverage for premises operations, independent contractors, completed operations, products and contractual exposures, as shall protect such contractors from claims arising out of any bodily injury, including accidental death, as well as from claims for property damages which may arise from operations under this contract, whether such operations be by the contractor or by any subcontractor, or by anyone directly or indirectly employed by either of them and the minimum limits of such insurance shall be as follows:

  Bodily Injury: $500,000 per occurrence

  Property Damage: $100,000 per occurrence / $300,000 aggregate

  In lieu of limits listed above, a $500,000 combined single limit shall satisfy both conditions.

  Such coverage for completed operations must be maintained for at least two (2) years following final acceptance of the work performed under the contract.

ARTICLE 34 - MINIMUM INSURANCE REQUIREMENTS

b. Public Liability and Property Damage

- **Contractor's general liability** will cover risks with regards to any bodily injuries or property damage caused by contractor’s negligence. It does not cover the contractor's property or equipment. This type of insurance usually protects against accidents and other defined occurrences/claims such fire, explosion, underground work or collapse that may be connected with the construction project.
- *Completed Operations Coverage*—The work/products (business risk) exclusions typically bar coverage for most property damage caused by construction accidents; however, the exclusion does not apply after turnover of the project to the owner. After completion, the products/completed operations coverage in many CGL programs may protect against bodily injury or property damage arising out of the completed work usually for two-years per standard industry CGL policy forms. Coverage will exist as long as the construction contractor continues to renew its policy.

ARTICLE 34 - MINIMUM INSURANCE REQUIREMENTS

c. **Property Insurance (Builder's Risk/Installation Floater**)

- The contractor shall purchase and maintain property insurance until final acceptance, upon the entire work at the site to the full insurable value thereof. This insurance shall include the interests of the owner, the contractor, the subcontractors and sub-subcontractors in the work and shall insure against the perils of fire, wind, rain, flood, extended coverage, and vandalism and malicious mischief. I
- f the owner is damaged by failure of the contractor to purchase or maintain such insurance, then the contractor shall bear all reasonable costs properly attributable thereto; the contractor shall effect and maintain similar property insurance on portions of the work stored off the site when request for payment per articles so includes such portions.

ARTICLE 34 - MINIMUM INSURANCE REQUIREMENTS

d. **Deductible:** Any deductible, if applicable to loss covered by insurance provided, is to be borne by the contractor.

e. **Other Insurance:** The contractor shall obtain such additional insurance as may be required by the owner or by the General Statutes of North Carolina including motor vehicle insurance, in amounts not less than the statutory limits.

ARTICLE 34 - MINIMUM INSURANCE REQUIREMENTS

Traveler's Guide Through the Undiscovered Country of Insurance

- Article 34 Sets forth the **Minimum** Insurance requirements for a State construction project and these requirements may be changed through a supplemental general condition to this Article.
- **Contractual Insurance Terms and Conditions:** If State owner is going increase the amounts of insurance, then it should discuss any unique risk relating to the proposed project with end user, architect/engineer, NCDOJ Insurance Section and/or Department of Insurance if the State Owner does not have it own risk management personnel to perform a risk and insurance assessment.
- If requirements are set too high, insurer objections, additional premiums, or unnecessary contract costs may result.
- If requirements are too lenient, loss exposures may not be covered adequately.

ARTICLE 34 - MINIMUM INSURANCE REQUIREMENTS
(Traveler's Guide Through the Undiscovered Country of Insurance-continued)

Acceptability of Insurers: An insurance policy is only as good as an insurer's ability and willingness to pay claims. For this reason, the insurance provisions of the contract should include clauses reserving the right to:

- Make sure all insurers are approved the North Carolina Department of Insurance to sell insurance in the State. Most well-known and national insurers are licensed, but you certainly want to verify each insurer's status especially for larger or complex projects and more expensive.
- State owner should not assume that SCO will check and verify insurers during the contracting approval process.

ARTICLE 34 - MINIMUM INSURANCE REQUIREMENTS
(Traveler's Guide Through the Undiscovered Country of Insurance-continued)

Factors in Settling Appropriate Limits of Liability

- Construction cost;
- Project type and complexity;
- Size of contractor and architect/engineer;
- Types of services to be provided and related risks;
- Exposure to and magnitude of potential losses;
- Likelihood of third-party claims, such as losses caused by accidents in a commercial building in a major metropolitan area;
- Potential to cause significant service disruptions to utilities from the proximity to power, water, or industrial plants;
- Airport construction;
- Potential for catastrophic loss, for example, structure or tower crane collapse; Business interruption loss, such as profits lost because of office closure, plant shutdown, or delayed startup.

ARTICLE 34 - MINIMUM INSURANCE REQUIREMENTS
(Traveler's Guide Through the Undiscovered Country of Insurance-continued)

Evidence of Insurance All contracts should include a provision requiring evidence that insurance requirements have been met. Such a provision is important not only to verify the existence of insurance, but also to assure that liabilities assumed by the architect/engineer" or contractor under the hold harmless clause can be met. The type of evidence required may vary considerably from job to job:

- At the lowest end of the scale is a simple requirement that the other party provide a certificate of insurance (usually ACORD Form 25-S).
- The next level is a requirement for a certificate with specified attachments or endorsements.
- The highest level requires a certified copy of the policy, complete with all specified amendments.

- Proof of insurance should be confirmed as soon as possible, and before construction work begins. Insurance should be maintained throughout the course of the work and perhaps for a specific period after completion (tail and completed operations coverage, as mentioned above). Otherwise, establishing coverage for a construction related loss may be extremely difficult.

ARTICLE 34 - MINIMUM INSURANCE REQUIREMENTS

(Traveler's Guide Through the Undiscovered Country of Insurance-continued)

Audit issues: If owner did not request a particular type of insurance, then the premium costs should be included in contractor's overhead cost as part of its general conditions cost and should be a separate line item in the SOV that owner is paying for.

Audits may also disclose whether contractor and subcontractors are actually paying the premiums for insurance (and bonds) paid for by owner in change order. Contractors and subcontractors usually pass along insurance premiums in change orders to their insurers if they know their insurer will audit its payroll (e.g., workers' compensation and builders' risk coverage) at the end of the project. However, other insurers that do not audit the premiums during construction or after project completion (e.g., CGL or auto coverage), then the contractor and/or subcontractor may not pass along the cost of those premiums included in change order pricing and keep the premium. In other words, the State owner paid for insurance coverage it did nor receive, which may constitute a violation of the false claims act.

ARTICLE 34 - MINIMUM INSURANCE REQUIREMENTS
(Traveler's Guide Through the Undiscovered Country of Insurance-continued)

Insurance Claims During Construction: Property damage claims or professional malpractice claims against general contractors, construction managers, subcontractors, suppliers and design professionals may obtain may delay construction, if such claims are not resolved in a timely manner or the claims exceed the amount of insurance forcing one of the contracting parties to pay the uninsured portion of the claim or litigate the claim/

Article 34 imposes minimum insurance requirements and State owners are free to impose additional requirements in the supplemental general conditions to meet the needs on particular projects and can include, but is not limited to: requests for copies of the insurance policies the State owner will be paying for; require the contractor, construction manger and/or designer to provide copies of all communications between general contractor, construction manager, designer, D-B Firm, subcontractors, and/or supplier regarding all claims submitted under any required policy required by and paid for by the State owner (including copies of the claims submitted to any subject insurer); all insurer responses to the claims (including all communications by contractor, construction manager, D-B Firm, subcontractors and/or suppliers); include requirements that the additional insurance requirements are included in subcontracts and/or consultant contracts; produce copies of insurance policies to State owner upon receipt of a written demand from owner; all formal responses from subject insurers in response to any claim (e.g., acknowledgements of receipt of claims; reservation of rights letters; rejection of claim or approval of claim); and payment of claims).

The State owner may also add provisions in the supplemental general conditions that contractor's, CMR's or DB firm's failure to provide copies of any of the foregoing documents may make the contractor, construction manager or D-B Firm shall be solely liable for all delays, impacts and/or price escalation caused by the failure to resolve such insurance claims in a timely manner if such claims create schedule delays.

V. Update on Recent Changes to State's General Conditions
A. Significance of New Definitions m, x, y, z, aa, and bb

m. Liquidated damages, as stated in the contract documents, is an amount reasonably estimated in advance to cover the consequential damages associated with the Owner's economic loss in not being able to use the Project for its intended purposes at the end of the contract's completion date as amended by change order, if any, by reason of failure of the contractor(s) to complete the work within the time specified. **Liquidated damages does not include the Owner's extended contract administration costs (including but not limited to additional fees for architectural and engineering services, testing services, inspection services, commissioning services, etc.), such other damages directly resulting from delays caused solely by the contractor**, or consequential damages that the Owner identified in the bid documents that may be impacted by any delay caused solely by the Contractor (e.g., if a multi-phased project-subsequent phases, delays in start other projects that are dependent on the completion of this Project, extension of leases and/or maintenance agreements for other facilities).

Significance of New Definitions m, x, y, z, aa, and bb (continued)

The following definitions were added to make sure contractors incorporated these closeout activities in their project schedules and to understand the State's process on obtaining beneficial occupancy.

x. **Commissioning** is a quality assurance process that verifies and documents that building components and systems operate in accordance to the owner's project requirements and the project design documents.

y. **Designer Final Inspection** is the inspection performed by the design team to determine the completeness of the project in accordance with approved plans and specifications. This inspection occurs prior to SCO final inspection.

z. **SCO Final Inspection** is the inspection performed by the State Construction Office to determine the completeness of the project in accordance with NC Building Codes and approved plans and specifications.

aa. **Beneficial Occupancy** is requested by the owner and is occupancy or partial occupancy of the building after all life safety items have been completed as determined by the State Construction Office. Life safety items include but not limited to fire alarm, sprinkler, egress and exit lighting, fire rated walls, egress paths and security.

bb. **Final Acceptance** is the date in which the State Construction Office accepts the construction as totally complete. This includes the SCO Final Inspection and certification by the designer that all punch lists are completed.

V. Update on Recent Changes to State's General Conditions
B. ARTICLE 51 – GIFTS

Pursuant to N.C. Gen. Stat. § 133-32, it is unlawful for any vendor or contractor (i.e. architect, bidder, contractor, construction manager, design professional, engineer, subcontractor, supplier, vendor, etc.), to make gifts or to give favors to any State employee.

A violation of this statute is a Class 1 misdemeanor criminal offense.

This prohibition covers those vendors and contractors who: (1) have a contract with a governmental agency; or (2) have performed under such a contract within the past year; or (3) anticipate bidding on such a contract in the future. For additional information regarding the specific requirements and exemptions, vendors and contractors are encouraged to review G.S. Sec. 133-32.

Note: There is a family, relatives and friends exception that requires disclosure of the gift to employee's agency head.

V. Update on Recent Changes to State's General Conditions
C. ARTICLE 52 – AUDITING-ACCESS TO PERSONS AND RECORDS

In accordance with N.C. General Statute 147-64.7, the State Auditor shall have access to Contractor's officers, employees, agents and/or other persons in control of and/or responsible for the Contractor's records that relate to this Contracts for purposes of conducting audits under the referenced statute.

The Owner's internal auditors shall also have the right to access and copy the Contractor's records relating to the Contract and Project during the term of the Contract and within two years following the completion of the Project/close-out of the Contract to verify accounts, accuracy, information, calculations and/or data affecting and/or relating to Contractor's requests for payment, requests for change orders, change orders, claims for extra work, requests for time extensions and related claims for delay/extended general conditions costs, claims for lost productivity, claims for loss efficiency, claims for idle equipment or labor, claims for price/cost escalation, pass-through claims of subcontractors and/or suppliers, and/or any other type of claim for payment or damages from Owner and/or its project representatives.

V. Update on Recent Changes to State's General Conditions
D. ARTICLE 53 – NORTH CAROLINA FALSE CLAIMS ACT

Session Law 2009-554 enacted the North Carolina False Claims Act ("NCFCA"), which became effective January 1, 2010, and was codified as N.C. General Statutes Sections 1-605 through 1-618.

NCDOJ has used the NCFCA in investigating and commencing civil action associated with Medicaid fraud.

However, NCDOJ has not yet prosecuted a civil action under the NCFCA for violations involving a State construction project.

Again, NCFCA is another "undiscovered country" that the State must go through to see what is on the other side and to develop lesson learned from which SCO, State Owners and State's agents-designers and CMRs must utilize to fulfill the legislative intent of the NCFCA to discourage contractors, subcontractors, CMR, DB firms and P3 developers from submitting false claims to the State of North Carolina and its agencies, institutions and universities.

DISCLAIMER: All State owners (and their representative agents) working on any State construction project, regardless of the delivery method, should familiarize himself, herself or itself with the entire FCA.

State owner's (and their representative agents on a project) should seek the assistance from the N.C. Attorney General's Office regarding suspected violation of the FCA, or if you have any questions regarding the FCA and its applicability to any requests, demands and/or claims for payment its submits to the State through the contracting state agency, institution, or university.

The purpose of the FCA "is to deter persons from knowingly causing or assisting in causing the State to pay claims that are false or fraudulent and to provide remedies in the form of treble damages and civil penalties when money is obtained from the State by reason of a false or fraudulent claim." (G.S. Section 1-605(b).)

A contractor's liability under the NCFCA may arise from, but is not limited to:

- Requests for payment, invoices, billing;
- Claims for extra work, requests for change orders, change orders, requests for equitable adjustment for concealed or unknown conditions;
- Requests for time extensions, claims for delay damages/extended general conditions costs;
- Claims for loss productivity, claims for loss efficiency, claims for idle equipment or labor, claims for price/cost escalation;
- Pass-through claims of subcontractors and/or suppliers;
- Documentation used to support any of the foregoing requests or claims; and/or
- Any other request for payment from the State through its contracting state agency, institution or university.

The NCFCA shall be interpreted and construed so as to be consistent with the federal False Claims Act, 31 U.S.C. § 3729, et seq., and any subsequent amendments to that act. (Section 1-616(c).)

FCA's Key Definitions:

- A "claim" is "[a]ny request or demand, whether under a contract or otherwise, for money or property and whether or not the State has title to the money or property that (i) is presented to an officer, employee, or agent of the State or (ii) is made to a contractor … if the money or property is to be spent or used on the State's behalf or to advance a State program or interest and if the State government: (a) provides or has provided any portion of the money or property that is requested or demanded; or (b) will reimburse such contractor … for any portion of the money or property which is requested or demanded." (Section 1-606(2).)

"Knowing" and "knowingly." – Whenever a person, with respect to information, does any of the following: (a) Has actual knowledge of the information; (b) Acts in deliberate ignorance of the truth or falsity of the information; and/or (c) Acts in reckless disregard of the truth or falsity of the information. (Section 1-606(4).) Proof of specific intent to defraud is not required. (Section 1-606(4).)

Illustrative Cases:

- For plaintiff U.S. to prevail on its 31 USCS § 3729(a)(1) and (2) claims, it had to demonstrate both that (1) statements or omissions were literally false at time they were made; and (2) defendant company actually knew of, was willfully blind to, or acted with "gross negligence plus" regarding falsity of those statements or omissions. United States ex rel. Longhi v Lithium Power Techs., Inc., 513 F Supp 2d 866 (2007, SD Tex). United States ex rel. Kirk v Schindler Elevator Corp. 606 F Supp 2d 448 (2009, SD NY).

- Liability under False Claims Act may properly be found when defendant submits claim for reimbursement while knowing that payment expressly is precluded because of some noncompliance by defendant. United States ex. rel. Mikes v Straus, 274 F3d 687 (2001, CA2 NY).

- Knowingly billing for worthless services, or recklessly doing so with deliberate ignorance, may be actionable under 31 USCS § 3729, regardless of any false certification conduct. United States v Smithkline Beecham Clinical Labs. 245 F3d 1048 (2001, CA9 Cal).

- Contractor's contention that claim could be fraudulent only if it rested upon false facts rather than on baseless calculation was without merit. Extrinsic evidence supported court's factual finding that contractor filed certified claim for $64 million despite contractor's contention that it only filed claim for $13 million; project manager had repeatedly testified that he had certified claim for $64 million, and his attempted recantation was not credible. Daewoo Eng'g & Constr. Co. v United States, 557 F3d 1332 (2009, CA FC).

"Material" means having a natural tendency to influence, or be capable of influencing, the payment or receipt of money or property. (Section 1-606(4).)

- In determining whether false statement is material under 31 USCS § 3729(a)(7), **inquiry focuses on potential effect of false statement when it is made, not on actual effect of false statement when it is discovered**; fact that government official may subsequently waive established fee does not negate "potential effect" of false record or statement. United States ex rel. Bahrani v Conagra, Inc., 465 F3d 1189 (2006, CA10 Colo).

Liability. – “Any person who commits any of the following acts ***shall be liable to the State for three times the amount of damages that the State sustains because of the act of that person***[:]

(1) Knowingly presents or causes to be presented a false or fraudulent claim for payment or approval.

- To allege a violation under this section of the state or federal FCA, plaintiff must allege that defendant (1) made claim to government, (2) that is false or fraudulent, (3) knowing of its falsity, (4) seeking payment from government. United States ex rel. Taylor v Gabelli, 345 F Supp 2d 313 (2004, SD NY).

(2) Knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim.

- To allege a violation under this section of the state or federal FCA, plaintiff must aver that defendant (1) created, used, or caused to be used, record or statement to government; (2) that is false or fraudulent, (3) knowing of its falsity, (4) to get false or fraudulent claim paid or approved by government; objective of this provision is to remove any defense that defendant did not personally submit false claim directly to government… United States ex rel. Taylor v Gabelli, 345 F Supp 2d 313 (2004, SD NY); United States ex rel. Harrison v. Westinghouse Savannah River Co., 352 F.3d 908, 913 (CA 4 2003).

(2) Knowingly makes, uses, or causes to be made or used, a false record or statement material to a false or fraudulent claim.

- For example, a subcontractor violates this section of the FCA, if subcontractor submits false statement to prime contractor intending for statement to be used by prime contractor to get Government to pay its claim. Allison Engine Co. v United States ex rel. Sanders, 128 S Ct 2123 (2008, US).
- Conversely, a subcontractor or another defendant makes false statement to private entity and does not intend Government to rely on that false statement as condition of payment will not constitute a violation of FCA. Allison Engine Co., 128 S Ct 2123.

(3) Conspires to commit a violation of subdivision (1), (2) (Section 1-607(a)(1), (2))

- The elements of a civil conspiracy in North Carolina are: (1) an agreement between two or more individuals; (2) to do an unlawful act or to do a lawful act in an unlawful way; (3) resulting in injury to plaintiff inflicted by one or more of the conspirators; and (4) pursuant to a common scheme. See Privette v. University of North Carolina at Chapel Hill, 96 N.C. App. 124, 139, 385 S.E.2d 185, 193 (1989).
- Accordingly, the FCA may be violated if two or more individuals agree to violation section 1 or 2 of the FCA that inflicts injury to the government as part of a common scheme or plan.

(7) Knowingly makes, uses, or causes to be made or used, a false record or statement material to an obligation to pay or transmit money or property to the State, or knowingly conceals or knowingly and improperly avoids or decreases an obligation to pay or transmit money or property to the State.

- To state claim under 31 USCS § 3729(a)(7), plaintiff must allege that defendant (1) made false statement or created and used false record, (2) with knowledge of its falsity, (3) **for purpose of decreasing, concealing, or avoiding obligation to pay government.** United States ex rel. Taylor v Gabelli 345 F Supp 2d 313 (2004, SD NY).
- Although False Claims Act does not define word "obligation," courts have found that defendant's obligation must be present duty to pay money or property that was created by statute, regulation, contract, judgment, or acknowledgment of indebtedness, as contrasted with "potential liability" or penalty. United States ex rel. Taylor, 345 F Supp 2d 313.

Section 1-607(a)(7) (continued)

- **Lessons to Learn**: Filing claims, verified claims and/or schedule analyses that are groundless or exaggerate reality with the purpose of concealing, decreasing or avoiding an obligation to pay the government, like liquidated damages, may constitute a violation of the False Claims Act even though it may not cause any actual damages to the government. Thus, this type of violation may not trigger treble damages, but will certainly allow an assessment of a civil penalty for each violation.

FCA Civil Actions – G.S. Section 1-608

- The Attorney General's Office is responsible for investigating any violation of NCFCA, and may bring a civil action against the Contractor under the NCFCA.
- Accordingly, contracting state agency, institution or university should refer all suspected FCA violations by the Contractor, subcontractors, construction managers at risk, DB firms, P3 developers and/or design professionals to the Attorney General's Office for civil investigation and civil action.
- The Attorney General's investigation and any civil action relating thereto are independent and not subject to any dispute resolution provision set forth in this Contract. (See Section 1-608(a).)

- Please note that the NC False Claim Act applies to all project delivery methods whether SCO's General Conditions Article 52 or not.

G.S. Section 1-608(c). Civil actions for false claims.

The Attorney General may retain a portion of the damages recovered for a State agency out of the proceeds of the action or settlement under this Article as reimbursement for costs incurred by the Attorney General in investigating and bringing a civil action under this Article, **including reasonable attorneys' fees and investigative costs**.

NCFCA

§ 1-615. False claims procedure.

(a) Statute of Limitations. - A civil action under G.S. 1-608 may not be brought (**i) more than six years after the date on which the violation of G.S. 1-607 was committed** or (ii) **more than three years after the date when facts material to the right of action are known or reasonably should have been known by the official of the State of North Carolina charged with responsibility to act in the circumstances**, but in no event more than 10 years after the date on which the violation is committed, **whichever occurs last**.

(c) Burden of Proof. - In any action brought under G.S. 1-608, **the State** or the qui tam plaintiff **shall be required to prove all essential elements of the cause of action, including damages, by a preponderance of the evidence.**

FCA and Contractors-Subcontractor, Corporation-Employee and Principal-Agent Relationships

- False Claims Act gave United States cause of action against subcontractor who caused prime contractor to submit false claim to government. See United States v Bornstein, 423 US 303 (1976).

  False claim presented to government contractor is claim "upon or against United States". United States v Lagerbusch, 361 F2d 449 (1966, CA3 Pa).

  FCA civil penalties properly imposed against contractor who had stated four times that it had paid subcontractors when in fact it had not, had acted either knowingly or with reckless disregard of truth or falsity of claims submitted. Lamb Eng'g & Constr. Co. v United States 58 Fed Cl 106 (2003).

FCA and Contractors-Subcontractor, Corporation-Employee and Principal-Agent Relationships (continued)

- Corporate employer could not be held vicariously liable under 31 USCS § 3729 as result of misdeeds of low-level employee who, acting within scope of her employment, caused false claims to be filed with government unless government, could prove that employer authorized, ratified, or acted with knowledge of or reckless indifference to employee's misdeeds. United States v Southern Md. Home Health Servs., 95 F Supp 2d 465 (2000, DC Md).

- Government contractor's project superintendent's alleged concealment from government of employees' discovery and disturbance of asbestos in military housing during remodeling could be imputed to contractor for purposes of suit under 31 USCS § 3729(a), regardless of whether superintendent's superiors were aware of asbestos, where superintendent was working within scope of his employment, he submitted daily reports to contractor and government, and he served as liaison between contractor and government inspector, and, thus, acted with apparent authority. United States ex rel. Bryant v Williams Bldg. Corp., 158 F Supp 2d 1001 (2001, SD).

TYPES OF FCA CLAIMS

- Claim under False Claims Act is legally false only where party certifies compliance with statute or regulation as condition of governmental payment. United States ex. rel. Mikes v Straus, 274 F3d 687 (2001, CA2 NY).

- Claims of any kind that cannot be explained as mere inadvertence or innocent mistake can subject individual or firm filing claims with any agency of government to penalties under False Claims Act, even if claims are for small amounts. Use of False Claims Act to Target Hospitals, Comp. Gen. Dec. No. B-279893 (7/22/98), 1998 US Comp Gen LEXIS 420.
- Government claim against government subcontractor is stated under 31 USCS § 3729(a)(2), where complaint alleges false or fraudulent claims were submitted, notwithstanding that claims were not paid or approved. United States ex rel. Luther v Consolidated Industries, Inc., 720 F Supp 919 (1989, ND Ala).
- Claim is within purview of False Claims Act (31 USCS § 3729) if it is grounded in fraud which might result in financial loss to Government. Thevenot v National Flood Ins. Program, 620 F Supp 391 (1985, WD La).

TYPES OF FCA CLAIMS
(continued)

- FCA action properly asserted violations when payment requests' certification represented that work was performed in accordance with specifications, terms and conditions of contract, when defendant knew its work was not performed in accordance with contractual requirements. United States ex rel. Lemmon v Envirocare of Utah, Inc., 614 F3d 1163 (2010, CA10 Utah).
- 31 USCS § 3729(a)(2) is complementary to § 3729(a)(1), which is designed to prevent those who make false records or statements to get claims paid or approved from escaping liability solely on ground that they did not themselves present claim for payment or approval. United States ex rel. Totten v Bombardier Corp., 363 US App DC 180, 380 F3d 488 (2004, App DC).
- Company embellished series of molehills so it could present mountain of experience, facilities, and novelty to attract reviewers, with at least reckless disregard for truth statements at issue; company made false claims in violation of 31 USCS § 3729(a)(1) and (2) on contracts, so invoices based on contracts were "false claims" based on fraudulent inducement theory. United States ex rel. Longhi v Lithium Power Techs., Inc., 513 F Supp 2d 866 (2007, SD Tex).

TYPES OF FCA CLAIMS
(continued)

- Implied representation on invoice that work has been completed pursuant to contract requirements may constitute false claim for payment. BMY-Combat Sys. v United States, 38 Fed Cl 109 (1997).

  Intentional inflation of claim that is being made against U.S. government by contractor who is party to public contract is fraud for purposes of False Claims Act, 31 USCS § 3729. Daewoo Eng'g & Constr. Co. v United States (2006) 73 Fed Cl 547.

- FCA violated when contractor attempted to practice fraud against the United States in the proof, statement, and establishment of equitable adjustment claim, by deliberately inflating its demand for increased material costs allegedly incurred as a result of government-caused delay. UMC Electronics Co. v. United States, 43 Fed.Cl. 776 (1999, U.S. Federal Claims).

LESSONS ON LIABILITY FROM FCA CLAIMS

- If the violation of the FCA does not result in actual loss sustained by the State, then the violation exposes contractor, subcontractor, designer, and/or supplier to civil penalties.
- If the violation of the FCA results in actual financial losses to the government then the claimant is liable for civil penalties and treble damages (double damages if claimant cooperates with government's "unofficial" investigation within 30 days of receiving notice from government of the investigation).
- **Make every effort not to go on a journey through this undiscovered country because you do not know and have no control over the imposition of civil penalties, award of treble damages, exposure to paying the government the costs of litigation (i.e., investigation and discovery costs), the government's attorneys' fees as well as not recovering your own attorneys' fees.**
- You are better off being proactive and challenging your subcontractors, contractors as well as your own employees to substantiate claims, certifications of payment applications, pricing of change orders, provide substantiated critical path schedule analysis, and billing against SOVs and change orders. If you suspect or discover potential false claim violations you have to make a business decision as to which will be costlier prosecuting a potential false claim, covering up a false claim, demanding payment of the same, withdrawing the claim, or identifying the potential false claim and correcting any adverse impact to the State.

LESSONS ON LIABILITY FROM FCA CLAIMS (continued)

- Contractors, construction managers, B-D Firms and/or designers must be vigilant (i.e., not act with a reckless disregard or intentional ignorance) on pass-through claims and its potential FCA liability that they may be exposed to if the makes no attempt to verify or substantiate a subcontractors/supplier claims with respect to entitlement (liability of the government), causation and accuracy of the damages claimed. Contractors should be extremely caution with their own claims and pass-through claims that are intentionally or reckless inflated for purposes of negotiating a settlement.
- Entities contracting with the State and negotiating contracts under Article 3D of Chapter 143 of the North Carolina General Statutes must be very careful not overstate qualifications, work experience, “similar” projects to avoid FCA liability for fraudulently inducing the State to enter into the subject contract and, thereafter, performance and/or management issues arise because of the lack of the required experience and qualifications, or the experienced project team represented in the proposal or interview does not show up after the notice to proceed had been issued by the State.

Acquiescence or Knowledge of Government of FCA Violation is Probably Not A Good Defense

- Government's knowledge of fraud does not necessarily absolve contractor from liability under False Claims Act. In particular, Government's inspection and acceptance of product do not absolve contractor from liability for fraud under False Claims Act. Varljen v Cleveland Gear Co., 250 F3d 426 (2001, CA6 Ohio).

- However, there may be occasions when government's knowledge of, or cooperation with, contractor's actions is so extensive that contractor could not, as matter of law, possess requisite state of mind to be liable under Act. Shaw v AAA Eng'g & Drafting, Inc., 213 F3d 519 (2000, CA10 Okla).
- Lessons to Be Learned from Case: Owners and designer’s be proactive and also utilize interim audit process to detect potential fraudulent active.

FCA PENALTIES

- Each individual false claim or statement triggers False Claims Act's civil penalty. United States ex rel. Schwedt v Planning Research Corp., 313 US App DC 200, 59 F3d 196 (1995, App DC).
- Owners, designers, contractors and subcontractors may be jointly or severally liable for FCA penalties and treble damages if there is a civil conspiracy and/or knew of the false claims submitted to the government. United States v Bornstein, 423 US 303 (1976); United States v Board of Education, 697 F Supp 167 (1988, DC NJ).

- The minimum penalties should be imposed for violations amount to reckless disregard, while the maximum penalties should be imposed for actual knowledge (e.g., bid rigging) or deliberate ignorance. United States ex rel. Ervin & Assocs. v Hamilton Sec. Group, 370 F Supp 2d 18 (2005, DC Dist Col); United States ex rel. Miller v Bill Harbert Int'l Constr., Inc., 501 F Supp 2d 51 (2007, DC Dist Col).

FCA Damages

- Government is entitled to recover treble damages under False Claims Act only if it can demonstrate that it sustained actual damages or financial loss. Commercial Contrs. v United States, 154 F3d 1357 (1998, CA FC); Commercial Contrs. v United States, 154 F3d 1357 (1998, CA FC).
- No damages need be shown in order to recover civil penalty under 31 USCS § 3729. United States ex rel. Hagood v Sonoma County Water Agency, 929 F2d 1416 (1991, CA9 Cal); Varljen v Cleveland Gear Co., 250 F3d 426 (2001, CA6 Ohio)
- False Claims Act damages typically are liberally calculated to ensure that they afford government complete indemnity for its injuries. United States ex rel. Roby v Boeing Co., 302 F3d 637 (2002, CA6 Ohio).
- **Because each case under False Claims Act involves unique types of damage to government, formula for calculating damages must be created for each case that will provide government with its damages directly caused by filing of false claim.** BMY-Combat Sys. Div. of Harsco Corp. v United States, 44 Fed Cl 141(1999); United States ex rel. Roby v Boeing Co., 73 F Supp 2d 897 (1999, SD Ohio).

FCA Damages
(continued)

- In civil action under False Claims Act, the **measure of damages is generally determined to be difference between what government actually paid on fraudulent claim and what it would have paid if there had been fair, open, and competitive bidding**, and trier of fact must deduce from all evidence presented what fair market value was of goods and services provided in order to calculate actual damage…. United States v Killough, 848 F2d 1523 (1988, CA11 Ala).
- **Damages under False Claims Act, flowed from false statement, and, ordinarily, measure of government's damages under FCA was amount that it paid out by reason of false statements over and above what it would have paid if claims had been truthful. United States v Mackby, 339 F3d 1013 (2003, CA9 Cal).**

- **In determining damage to be awarded, sum total of all improper material furnished can be used in measuring amount of government's loss. United States v American Packing Corp., 113 F Supp 223 (1953, DC NJ).**

FCA Damages
(continued)

- **Explicit provision for double damage remedy prescribed by Congress is mandatory, and court lacks authority to modify imposition of treble damages**. See United States v McLeod, 721 F2d 282 (1983, CA9 Wash).
- **Where government has provided funds for specified good or service only to have defendant substitute non-conforming good or service, court may, upon proper finding of False Claims Act liability, calculate damages to be full amount of grant payments made by government after material false statements were made.** United States ex rel. Feldman v van Gorp, 697 F3d 78 (2012, CA2 NY).
- Some courts require the treble damages to be awarded under False Claims Act to use a net trebling approach because neither statutory language nor any policy favored gross trebling under, that is, calculate the net loss to the government then multiply by 3. See, United States v Anchor Mortg. Corp., 711 F3d 745 (2013, CA7 Ill).

FCA Damages
(continued)

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- Some courts require the treble damages to be awarded under False Claims Act to use a net trebling approach because neither statutory language nor any policy favored gross trebling under, that is, calculate the net loss to the government then multiply by 3. See, United States v Anchor Mortg. Corp., 711 F3d 745 (2013, CA7 Ill).

V. Update on Recent Changes to State's General Conditions
B. ARTICLE 54 – TERMINATION FOR CONVENIENCE

Owner may at any time and for any reason terminate Contractor's services and work at Owner's convenience. Upon receipt of such notice, Contractor shall, unless the notice directs otherwise, immediately discontinue the work and placing of orders for materials, facilities and supplies in connection with the performance of this Agreement.

Upon such termination, Contractor shall be entitled to payment only as follows: (1) the actual cost of the work completed in conformity with this Agreement; plus, (2) such other costs actually incurred by Contractor as are permitted by the prime contract and approved by Owner; (3) plus ten percent (10%) of the cost of the work referred to in subparagraph (1) above for overhead and profit. There shall be deducted from such sums as provided in this subparagraph the amount of any payments made to Contractor prior to the date of the termination of this Agreement. Contractor shall not be entitled to any claim or claim of lien against Owner for any additional compensation or damages in the event of such termination and payment.

Undiscovered Country Traveler's Guide: under federal construction law-a wrongful default termination of a contractor will automatically be converted the termination for convenience. As a result of this new provision, owners as well as designers advising owners, must use caution and care when issues arise on a project that raise an issue of terminating the contract. A termination whether for default or convenience involves both a business/financial analysis as well as legal analysis. A bad contractor should not be rewarded with a termination for convenience because you may make that bad contractor another State owner's problem if there was no negative contractor evaluation or default. A default termination or a takeover of work offers better protection to owner and surety remains liable to complete the project under the performance bond.

It must be stressed that the contractor terminated for convenience is entitled to actual cost of work completed in conformity of the contract, which means that Articles 19, 20 and 23 have to be addressed if there were such changes, claims or requests for time extensions pending at time of termination. In this situation, the Owner can require contractor to prove actual cost it incurred for any alleged delays and not use any proffered per diem calculations of general condition costs, which may have no relationship to the actual costs of delay that contractor paid for as reflected in its accounting records. Owner must also determine whether contractor owes owner credit for unused allowances and unearned insurance and bond premiums.

CONCLUSION

With Proper Planning, we do not have to dread on what is on the other side of the new undiscovered countries in State Construction Contracting

QUESTIONS & ANSWERS