

SENATE BILL REPORT

SB 5788

As Reported by Senate Committee On:
Law & Justice, February 16, 2017

Title: An act relating to construction contracts.

Brief Description: Concerning construction contracts.

Sponsors: Senators Brown, Padden and Takko.

Brief History:

Committee Activity: Law & Justice: 2/14/17, 2/16/17 [DPS, DNP].

Brief Summary of Substitute Bill

- Allows a contractor to obtain an equitable adjustment of a construction contract even if the contractor did not strictly comply with claim notice requirements in the contract, to the extent the owner was not harmed by the contractor's failure to comply.

SENATE COMMITTEE ON LAW & JUSTICE

Majority Report: That Substitute Senate Bill No. 5788 be substituted therefor, and the substitute bill do pass.

Signed by Senators Padden, Chair; O'Ban, Vice Chair; Angel and Wilson.

Minority Report: Do not pass.

Signed by Senators Pedersen, Ranking Minority Member; Darneille and Frockt.

Staff: Shani Bauer (786-7468)

Background: Construction contracts may contain mandatory claim notice provisions to address certain situations that may arise during the course of construction. Such clauses generally require the contractor to follow specific notice requirements when seeking additional payment for increased expenses incurred. Such clauses may be used in public works contracts as well as private contracts.

Courts have generally taken two approaches in the enforcement of notice provisions.

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

The Prejudice Standard. In federal cases, the courts have generally limited enforcement of claim notice provisions to situations where "fairness demands." A number of state courts follow the federal principle, holding that notice clauses should not be enforced absent evidence that the party seeking to enforce the notice provision was materially prejudiced by not receiving it. In this line of cases, courts have found that the failure to comply with technical notice provisions in the contract will not bar a contractor from compensation if the person seeking to enforce the notice had actual or constructive notice of the conditions underlying a claim and the opportunity to investigate.

Strict Enforcement. Other courts, including Washington, strictly enforce the express terms of a contract as written, absent a waiver by the party who is to receive notice. In 2003, the state Supreme Court addressed this issue in *Mike M. Johnson, Inc. v. Spokane County*, 150 Wn.2d 375. In that case, Mike M. Johnson (MMJ) was the contractor in a sewer construction project. During construction, MMJ encountered buried phone lines that halted work while the utility conflict was resolved. The contract contained specific and detailed procedures for claims of additional compensation, time extensions, and changed conditions. MMJ submitted several letters to Spokane County claiming it was owed additional compensation, however, MMJ did not submit a formal claim as required in the contract. The court upheld dismissal of MMJ's claims on summary judgment, holding that even when an owner has actual notice of a contractor's claim, that notice does not excuse noncompliance with mandatory contractual claim provisions.

Summary of Bill (First Substitute): A contractor, subcontractor, or supplier may be entitled to equitable adjustment based on a claim despite the failure to submit a claim notice or claim-related document in a specific time frame or form required by the contract, to the extent the interests of the person seeking to enforce the notice are not prejudiced by the failure to comply with the notice provisions.

Construction contract means any contract or agreement for the construction, alteration, repair, addition to, subtraction from, improvement to, or maintenance of, any building, highway, road, railroad, excavation, or other structure, project, development, or improvement attached to real estate, including moving and demolition in connection therewith.

Claim means any demand or assertion by a party to a construction contract seeking, as a matter of right, adjustment, or interpretation of contract terms, payment of money, extension of time, or other relief with respect to the terms of the contract. The term includes other disputes and matters in question between the parties arising out of, or relating to, the contract. The claimant has the responsibility to substantiate a claim.

EFFECT OF CHANGES MADE BY LAW & JUSTICE COMMITTEE (First Substitute):

- Shifts the burden to the contractor to show that the owner was not prejudiced by the contractor's failure to follow the claim notice provisions in the contract prior to obtaining an equitable adjustment for the claim.

Appropriation: None.

Fiscal Note: Available.

Creates Committee/Commission/Task Force that includes Legislative members: No.

Effective Date: Ninety days after adjournment of session in which bill is passed.

Staff Summary of Public Testimony on Original Bill: *The committee recommended a different version of the bill than what was heard.* PRO: There are many situations where a contractor has conversations with the owner about a delay and believes that they have the acquiescence of the owner, only to find when it comes time to file a change order that they are denied due to the failure to follow strict notice provisions of the contract. This is unequitable and is a situation that should be remedied.

The current rule is not good for contractors or public agencies. As a recent example, when installing a septic line, there are unforeseen circumstances in the excavation. The contractor will call the inspector and the inspector goes back to the engineer. The contractor has a very short timespan to provide the contracting party with notice of the problem and an estimate to fix the problem. At the end of the day, the contractor is required to perform the additional work for free because it cannot provide an estimate of the cost prior to doing the work.

This bill simply seeks to ensure that compensation for changes to a contract are based on fairness and merit. Since the MMJ decision, the merits of a claim can take a back seat to the technical requirements of the contract. The contractor must submit mounds of paperwork or lose the right to fair compensation, even if the owner was aware of the changed circumstance and approved the work going forward. This is one reason why small businesses do not survive and places contractors and owners in adversarial positions.

Since the court decision, notice requirements have gotten more and more burdensome and now are almost impossible to comply with. This bill is modeled after the Department of Enterprise Services contract and several other states. The prejudice standard is a fair way to balance the needs of both parties.

CON: The current language of the bill is not workable, but there is potential for middle ground. Public works contracts are arcane but notice provisions are important for public policy. Changed site conditions frequently occur with underground work. In a recent example, a contractor found bedrock when they started excavating. A change order was submitted for \$250,000. With adequate notice, the Port went forward and got another bid for \$25,000.

Under this language, a contractor could potentially provide notice at any time, even at the end of a contract. It is unclear how the contracting party would show material prejudice and is unfair that this party has the burden of proof. Protecting owners from unsubstantiated and untimely claims is a good thing. This bill compromises an owner's ability to require a contractor to provide notice. Working with the Associate General Contractors to modify the contract is preferable to legislation.

Public works contracts have to be awarded to the lowest bidder. Agencies already face low ball bidders who come in with a whole bunch of change orders. The desired result is to get

the stakeholders together and formulate something that will address egregious problems. This bill needs to be more surgical and focused.

OTHER: It is important to balance the needs of merit and notice. Notice is important for an owner to make decisions. DES has language in its current contract that notice is enforceable to the extent that prejudice can be shown. There is no adverse effect from having this language in the contract. DES will work with other parties to come up with amended language.

Persons Testifying: PRO: Senator Sharon Brown, Prime Spnsor; Brett Hill, Ahlers & Cressman; Tomacah Hancock Knapp, Scarsella Bros.; Nancy Munro, Associated General Contractors; Mary Lehrdahl, DBE Electric.

CON: Eric Johnson, WA Public Ports Association; Juliana Roe, Washington State Association of Counties; Jane Wall, Association of WA Cities; Craig McDaniel, WA Department of Transportation; Richard Prentice, Perkins Coie; Joe Daniels, WA Association of Water/Sewer Districts.

OTHER: Bill Frare, Department of Enterprise Services.

Persons Signed In To Testify But Not Testifying: No one.