

PORTER & HEDGES, L.L.P.

— [Business is personal



Managing Change Orders



Presented to:

Houston Contractors' Association

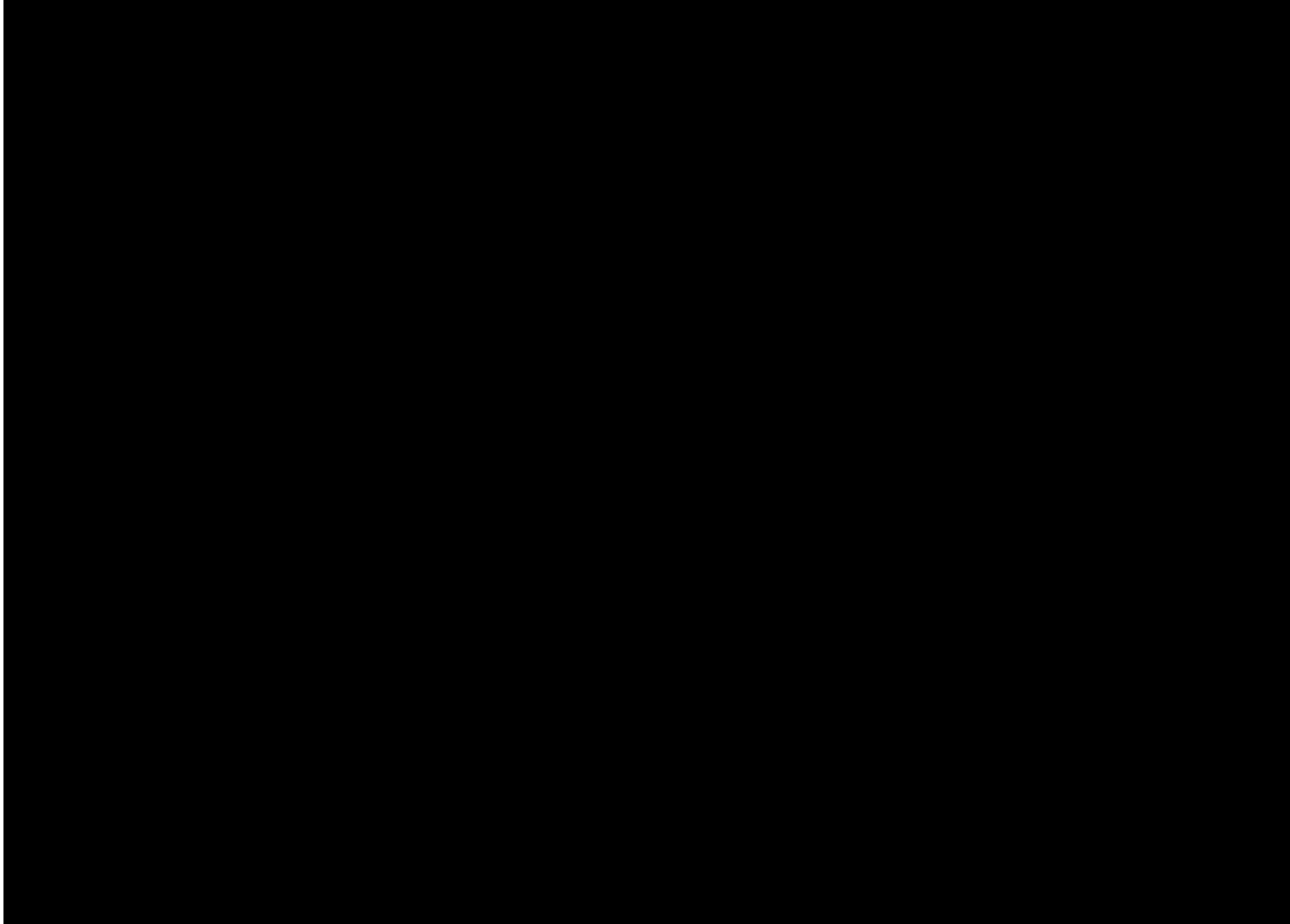
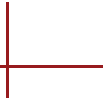
Presented By:

Allison J. Snyder

Timothy ("Tim") C. Ross

Houston, Texas
April 11, 2012

PORTER HEDGES LLP
1000 Main Street, 36th Floor
Houston, Texas 77002



Overview of Contract Law

Contract Formation

Under Texas law, the elements of a contract are:

- (1) an offer;
- (2) acceptance in compliance with the terms of the offer;
- (3) a meeting of the minds;
- (4) a communication that each party has consented to the terms of the agreement;
- (5) execution and delivery of the contract with an intent that it become mutual and binding on both parties; and
- (6) consideration.

This list is often shortened to three traditional elements:

- (1) an offer; (2) an acceptance; and (3) consideration.

Critical Parts of Construction Contracts

Purpose - to list and explain each party's expectations and duties in an effort to balance risks and prevent future misunderstandings.

In order to fulfill these purposes, a construction contract should address, at a minimum, the following items:

- (1) Price and Payment Schedule;
- (2) Description of Labor and Materials and Scope of Work;
- (3) Completion Deadlines and Definitions of Completion;
- (4) Authority to Bind; and
- (5) Documents Constituting the Agreement

Contract's Scope of Work

- Virtually every construction contract will address the “scope of work.”
- The precise meaning of “scope of work” is important, because payment for changes is available only if the contractor performed work beyond, or different from, that specified in its contract.
- In order to determine whether a particular task is within the scope of work or constitutes a change, a party must look to the contract documents.

Overview of Contract Law

Requirement of a Writing

- Construction contracts, like other commercial agreements, often contain a provision that requires all subsequent modifications to the contract to be in writing
- Try to get modifications *IN WRITING* in order to avoid, or at least minimize, disputes regarding the existence and scope of any contract modifications
- You should expect a court or an arbitrator to enforce the provision requiring the change order to be in writing

Requirement of a Writing

It is the general rule that a provision in a construction contract stating that changes, alterations or deviations must be ordered in writing, **is valid and binding** upon the parties and, therefore, so long as such a provision remains in effect, no recovery can be had for the alterations done without a written order in compliance therewith.

D.H. Overmyer Co. v. Harbison, 453 S.W.2d 368, 370 (Tex. Civ. App.-El Paso 1970, no writ); *see also Uhler v. Golden Triangle Dev. Corp.*, 763 S.W.2d 512 (Tex. App.-Forth Worth 1989, writ denied) (contractor could not recover under contract for extras which were not agreed to in writing); *Kittyhawk Landing Apt. III v. Anglin Constr. Co.*, 737 S.W.2d 90 (Tex. App.-Houston [14th Dist.] 1987, writ ref'd n.r.e.) (same).

Exceptions to Written Change Orders

Exceptions To The Written Change Order Requirements:

- Quantum Meruit
- Waiver
- Breach of Contract
- Oral Contract
- Promissory Estoppel

Quantum Meruit

- *Quantum meruit* is an equitable remedy that allows the contractor to recover the reasonable value of labor, services, and materials provided when there is no specific contract covering the work.
- When recovery is premised on *quantum meruit*, the crucial inquiry is whether the alleged extra work was required of the contractor by the original agreement.

Quantum Meruit

- *Black Lake Pipe Line Co. v. Union Constr. Co.*
- *Angroson, Inc. v. Indep. Comm., Inc.*

Elements of a quantum meruit claim include proof of:

1. valuable services that were rendered or materials furnished;
2. for the person sought to be charged;
3. which services and materials were accepted by the person sought to be charged, used, and enjoyed by him;
4. under such circumstances as reasonably notified the person sought to be charged that the plaintiff was expecting to be paid by the person sought to be charged.

Waiver

- Texas courts define the concept of waiver as follows:

A waiver takes place where one dispenses with the performance of something which he has a right to exact, and occurs where one in possession of any right, whether conferred by law or by contract, with full knowledge of the material facts, does or forbears to do something, the doing of which or the failure or forbearance to do which is inconsistent with the right or his intention to rely upon it. Waiver, of course, is a matter or question of intention.

Waiver

Evidence of waiver, generally:

- (1) an express renunciation of a known right;
- (2) silence or inaction, coupled with knowledge of the right, for such an unreasonable period of time as to indicate an intention to waive the right; or,
- (3) conduct of the party knowingly possessing the right of such a nature as to mislead the other party into an honest belief that the waiver was intended or assented to.

Waiver

Texas Constr. Assoc., Inc. v. Balli

Chambless v. J.J. Fritch

Tribble & Stephens Co. v. Consolidated Serv.

Prior Breach of Contract

Board of Regents of the University of Texas v. S & G Constr. Co.

It was the duty of the Board of Regents to provide the necessary plans and specifications under the terms of the contract. Its effort here to raise the spectrum of the change-order provision begs the question. Its breach set in motion the resulting tide of damages which the change-orders could in no way have fully stemmed. The Board cannot now escape the results of its failure by such diversion. Consequently, we hold that such a failure to provide “correct plans and specifications and additional instructions and detail drawings as were necessary to carry out the work called for in the contract . . .” was a breach of the contract resulting in the damage to appellee [contractor] found by the jury.

N. Harris Cty. Jr. College Dist. v. Fleetwood Constr.

Oral Contract

Buxani v. Nussbaum

Note difference in measure of recovery:

Quantum Meruit: reasonable value of services and materials provided

vs.

Oral Contract: agreed-on price or an amount figured by the procedure set forth in the original contract for valuing additional work.

Promissory Estoppel

No Texas courts have addressed this exception.

Similar to waiver, quantum meruit.

Confirming Oral Directives

Dear _____,

This is to confirm your oral direction of [date] to perform the following work: [describe]

Based upon your representation that we will be adequately compensated, we will immediately start to perform the extra work and will expect our contract price to be increased by \$[amount].

[or]

This work is not included in our contract price and we will expect a prompt change order increasing our contract amount by \$[amount].

[or]

This work is not included in our contract price and we will immediately undertake to perform it on the assumption that there will be an equitable adjustment in the contract price.

Very truly yours,

Trusting Construction Co.

Modification of Construction Contracts

Common Factors Leading to Modification

- (1) changes in scope caused by owner changes;
- (2) differing site conditions;
- (3) substitutions;
- (4) value engineering;
- (5) defective plans and specifications;
- (6) incomplete design; and
- (7) schedule delays.

Change Orders in General

A change order is the written instrument which states that the owner, architect, and/or contractor agree on a change in the work and the degree to which the contract time and price will be adjusted.

- Puts parties to a construction project on notice
- Establishes cost, time change
- Complies with contract

Authority to Enter into Binding Change Orders

Vitally important to know which individuals are (and, more importantly, which individuals are not) authorized to agree to change orders.

Barron v. Golden Triangle Constructors, Inc.

Authority to Enter into Binding Change Orders

Consider the following in a subcontract:

“Extra” work, or “claims” invoiced as “extra” work, or “claims” which have not been issued as a written change order by _____, will not be authorized for payment nor shall become a part of the subcontract. **DO NOT PERFORM ANY EXTRA WORK WITHOUT A PROPERLY EXECUTED CONSTRUCTION CHANGE DIRECTIVE AND/OR CHANGE ORDER FROM _____, signed by the Project Manager or officer of _____.** Superintendents of _____ are not authorized to give verbal or written change orders.

Public Statutes Governing Change Orders

Texas Local Government Code (contracts with cities and counties)**§ 252.048 Change Orders**

- (a) If changes in plans and specifications are necessary after the performance of the contract is begun or if it is necessary to decrease or increase the quantity of work to be performed or of materials, equipment, or supplies to be furnished, the governing body of the municipality may approve change orders making the changes.
- (b) The total contract price may not be increased because of the changes unless additional money for increased costs is appropriated for that purpose from available funds or is provided for by the authorization of the issuance of time warrants.

Texas Local Government Code

§ 252.048 Change Orders

- (c) If a change order involves a decrease or an increase of \$50,000 or less, the governing body may grant general authority to an administrative official of the municipality to approve the change orders.
- (d) The original contract price may not be increased under this section by more than 25 percent. The original contract price may not be decreased under this section by more than 25 percent without the consent of the contractor.

Texas Government Code (contracts with state agencies)

§ 2166.257 Contract Payment Administration

- (a) On receipt of notice and itemized statements from the commission, the comptroller shall:
 - (1) account for prior expenditures on behalf of a project as expenditures from the project's appropriation, based on the amount of those expenditures certified by the commission; and
 - (2) reserve from a project's appropriation an amount estimated by the commission to be sufficient to cover contingencies over the amounts obligated by contract or otherwise for:
 - (A) planning, engineering, and architectural work;
 - (B) site acquisition and development; and
 - (C) construction, equipment, and furnishings contracts.

Texas Government Code

§ 2166.257 Contract Payment Administration

(b) The money reserved under Subsection (a)(2) may be used only if:

- (1) the design professional or contractor recommends and justifies the proposed contingency expenditures by submitting a change order request;
- (2) the proposed change order request is approved by the design professional;
- (3) the proposed change order request is approved by the using agency and the agency makes a formal request for the allocation of money from the contingency reserve; and
- (4) the director of facilities construction and space management appointed under Section 2152.104 investigates the nature of the change order and concurs in the necessity of the proposed expenditure or refuses to concur not later than the 15th day after the date of receiving the request.

Texas Government Code

§ 2166.257 Contract Payment Administration

- (c) If the director of facilities construction and space management refuses to concur in a proposed contingency expenditure, the using agency may appeal to the commission. The commission's findings are final. The commission shall adopt rules on the procedures for an appeal under this subsection.
- (d) If an approved change order results in a reduction of construction cost, the amount of the contingency reserve shall be increased by the amount of the reduction.
- (e) The comptroller shall issue warrants to pay progress payments and final payments on construction under this chapter on the commission's written approval.

Advice for Dealing with Public Entities

- A contractor should thoroughly investigate all city charter and code provisions in order to determine proper lines of authority in approving change orders because it is very difficult to recover against a public body in the absence of an approved written change order by an authorized representative of the public body.
- The contractor is in a Catch-22 because to wait for formal approval of a public change order can seriously delay a project.
- Although most public bodies will honor their commitments, and although legal theories are available to attempt recovery for extra work, contractors must understand and assess the risks of proceeding without formal approval.

The AIA Change Order Process

Introduction

- The American Institute of Architects (“AIA”) Construction Contract forms all contain Change Order provisions.
- The forms essentially provide that changes in the Work may be accomplished after the execution of the Contract, without invalidating the Contract, by Change Order, Construction Change Directive, or order for a minor change in the Work.

Dealing with Change Order Problems

It has become all too commonplace on complex commercial construction projects, for a contractor to find himself in a very uncomfortable position at the end of the project.

Assume the project in issue is a twenty-floor hospital renovation project. The contract has an original contract price of \$20,000,000.00. The project is scheduled to last for 2 years. Six months into the project, the owner and architect issue a letter requesting that the contractor submit a price to change two floors, which were originally designed as administration offices, to two floors of patient care rooms. The contractor submits his change proposal price of \$1,500,000.00 prior to beginning any of the changed work. The architect and/or owner reject the contractor's price, issue a CCD and instruct the contractor to proceed with the changed work.

The contractor begins the changed work. The contractor also continues to negotiate the price of the work with the architect. What is the basis for reaching the price of the CCD work? Typical AIA contract language says that the CCD can be calculated on one of the following bases: (1) lump sum; (2) unit price; (3) cost-plus a fee; or (4) if there is a disagreement, the architect shall determine the amount based on reasonable expenditures, including costs of labor, materials, rental cost of equipment, insurance and bonds, and additional costs of supervision and field office personnel directly attributable to the change.

If the CCD is resolved, then a change order is signed and the change order enters the regular billing process. If the architect makes a determination of the undisputed portion of the CCD, then that amount can be placed in the monthly pay applications. In some instances, the architect doesn't render a decision until after the Project is completed. In other instances, the architect may decide that no additional compensation has been justified. In any event, with few exceptions, the contractor is not permitted to stop if the architect's decision is not acceptable to the contractor.

If a CCD is issued, the contractor must proceed unless the work in question is so far beyond the scope of the contract as to be a “cardinal” change. A truly fundamental change in a construction contract can trigger the Cardinal Change Doctrine.

A cardinal change is an alteration in the construction work so drastic that it effectively requires the contractor to perform duties materially different from those originally agreed to. Although change orders and cardinal changes both concern alterations and modifications to an agreement, a cardinal change is a drastic change that allows the contractor to refuse to proceed with the changed work.

How does a contractor know when a change is a cardinal change? Realistically, the case law on cardinal changes is unpredictable and the decisions are rare. The only prudent way for the contractor to protect itself is to address the definition of cardinal change at bid time through exclusions and in the contract provisions relating to change orders and construction change directives.

Modifications You Can Make

A few examples of common modifications to CCD provisions include:

- Define a cardinal change by setting a certain percentage of the base contract price, for example 20%, as a maximum amount of unresolved CCD's allowed.

This will allow the Contractor to refuse to work on any future CCD's until the pending CCD's have been resolved to below 20% of the base contract price.

- Incorporate industry pricing standards/manuals and multipliers into the CCD calculation methods.

Negotiation is much more likely to be successful if the standards for the calculation of CCD's are clearly laid out before a dispute even appears.

- Limit the number of days that can pass before a final decision is made by the Architect on the amount to be paid under the CCD.

Ask for decision deadlines based upon contractor's estimate of the amount of the CCD. The smaller the amount, the quicker the turnaround should be.

- Request that mediation or arbitration of pending CCD issues be added to the CCD provisions in the Contract. Request the right to require mediation or arbitration of CCD issues within thirty days of a written demand, even if before completion of the Project.

For example, the following language (*italics*) can be added to a typical CCD clause:

Upon receipt of a Construction Change Directive, the Contractor shall promptly proceed with the change in the Work involved and advise the Architect of the Contractor's agreement or disagreement with the method, if any, provided in the Construction Change Directive for determining the proposed adjustment in the Contract Sum or Contract Time.

Owner agrees that Contractor shall not be required to proceed with any further CCD's if the total amount of unresolved CCD work exceeds 20% of the amount of the original Contract price.

The Architect shall issue its final determination of cost and time impact for any CCD within twenty (20) days of the Contractors' submission of its estimated price for the performance of the work requested in the CCD.

Contractor and Owner shall have the right to request mediation of any unresolved CCD's within thirty (30) days of the Architect's final determination of the cost and time impact of any CCD. If the Mediation does not result in an agreement on the unresolved CCD, then Contractor and Owner shall have the right to demand Arbitration of the unresolved CCD issue in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association. If any such arbitration is requested prior to substantial completion of the Project, then the parties agree that such arbitration shall be on submission before one arbitrator and as set forth in the Fast Track Procedures of the Construction Industry Arbitration Rules of the American Arbitration Association, irrespective of the amount involved.

(See www.adr.org for a full description of these Fast Track procedures).

Liens for Change Order Work

A contractor or subcontractor who has not been compensated for labor and/or materials provided in the performance of change order work should file a lien or submit a bond claim.

Liens for Change Order Work

As a practical matter, change orders may not be finalized until the time limits for the required lien or bond notices, lien affidavits, and/or bond claims have passed. In addition, if a contractor's billing includes work within the contractor's scope plus extras, the payment for the entire amount can be upheld pending the issuance of a formal change order.

Liens for Change Order Work

For these reasons, it is prudent for a contractor to submit separate pay applications when seeking payment for both contract work and extras during the same period. This way, there should be no hold up on the payment for approved work and the contractor may only have to file a lien for the extra work, in order to protect his interests before the change order is issued.

Lien Releases/Lien Waivers

- Pending change orders should be excepted out of the release
- List separately or refer to “all pending change orders” – but do not leave blank
- Typical broad waiver language will attempt to release a contractor’s claim to change orders
- New statutory lien releases for private projects address this problem

EXAMPLE BROAD FORM WAIVER

This Waiver constitutes a representation by the undersigned signatory, for and on behalf of the firm or company listed below, that the payment referenced above, once received, constitutes full and complete payment for all work performed, and all costs or expenses incurred (including, but not limited to, costs for supervision, field office overhead, home office overhead, interest on capital, profit, and general conditions costs) relative to the work or improvements at the Project as of the date of this Waiver, except for the payment of retainage. The undersigned hereby specifically waives, quitclaims and releases any claim for damages due to delay, hindrance, interference, acceleration, inefficiencies or extra work, or any other claim of any kind it may have against the Owner, the Developer referenced as being responsible for payment in the Contract Documents, any tenant or lender on the Project, the General Contractor (if this Waiver is signed by a subcontractor or supplier), or any other person or entity with a legal or equitable interest in the Project, as of the date of this Waiver, except as follows:

Questions?



PORTER HEDGES LLP

ALLISON J. SNYDER

TIMOTHY ("TIM") C. ROSS

1000 MAIN STREET, 36TH

FLOOR

HOUSTON, TEXAS 77002

(713) 226-6000

asnyder@porterhedges.com

tross@porterhedges.com