



Changes to Change Orders

Those in the construction industry know too well that an owner frequently orders changes to a project after a contract is signed. Changes may be necessary, for example, if the purpose or need for the project has changed, if unforeseen conditions or design errors and omissions are encountered or if the owner simply changes its mind.

Contractors bear significant risks if circumstances require them to perform extra work before a formal change order is agreed upon and executed, since they often supply the bulk of the project's materials and supplies. Unless a written change order is quickly issued, contractors may have to use their working capital to pay for these supplies as well as employees' wages, benefits and overhead costs – with no guarantee of payment. The burden to essentially finance changes to

the job is exacerbated if the owner has a policy of not agreeing to any change orders until the contractor completes the project and multiple incidents of extra work accumulate, requiring more capital to fund operations.

Some states – including California, Colorado, the District of Columbia, Maryland and West Virginia – have recently passed legislation and/or enacted regulations to ameliorate the burdens and risks contractors bear on public construction projects when changes are ordered. Some contractor trade groups have proposed that states should adopt statutes to regulate the change order process, not only in the public context, but also for private construction agreements.

Legislating the change order process may be a trend, but notably the approaches that states are taking on this issue widely vary. Many of the proposed and enacted statutes have shortcomings. Two recently enacted statutes from Maryland and California illustrate the types of approaches states are taking to add fairness to the change order process.

Maryland

Maryland passed its State Procurement Change Order Fairness Act in 2016, which modified existing law relating to state procurements.



Maryland state law already included certain contractor-friendly statutes pertaining to procurement contracts, including a provision that required payment within 30 days after the day on which the payment became due under a contract.

The State Procurement Change Order Fairness Act provides additional protection for contractors, specifically relating to change orders. Principally, it prohibits a state entity or “procurement unit” from requiring a prime contractor on a state construction project to begin work under a change order until the procurement officer for the state issues a written change order. The written change order must specify whether work is to proceed, in compliance with the terms of the contract, on an agreed-to price, force account, construction change directive or time and materials basis.

Similar protections exist under the Act for subcontractors. The prime contractor cannot force a subcontractor to begin work unless conditions are met, and the prime contractor must give a copy of the written change order to a subcontractor within five days of receiving it and notify the subcontractor of the amount to be paid based on the work the subcontractor is going to perform.

The Act applies to more state entities than Maryland’s preexisting procurement provisions. Numerous state agencies, including the Maryland Stadium Authority and public four-year universities, were exempted from preexisting provisions. The Act’s only exemption applies to construction contracts for public schools.

The ultimate protection the Act may provide contractors from certain change order disputes is limited. Notwithstanding the Act’s indication that the state may not compel a prime contractor to perform work until a written change order is provided, the Act does not prohibit the state from compelling a prime contractor to perform certain work if the state determines that the work is required by the original contract, i.e. that the work is not a change order. In that instance, the prime contractor has to resort to submitting a claim or dispute to the state through its procurement officer.

Obtaining a written change order for Maryland state procurement contracts can be time intensive, require several intermediary approvals and can take up to three to five weeks to complete. The Act, unfortunately, does not expedite the process.

California

Whereas Maryland has sought to statutorily protect contractors at the front end of change order work – by not requiring contractors to perform work without a written change order – California has sought to protect contractors at the back end through modified dispute resolution requirements.

Prior to the passage in 2016 of Assembly Bill (AB) 626, there was no requirement in California for state agencies to pay contractors for work performed outside of an original contract. The state could

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make contractors wait months or longer for payment, which was a particular hardship on small businesses. Although California has previously required that change orders for public work contracts be issued in limited circumstances (when actual site conditions differ from what was originally described to bidders or from what is ordinarily encountered in the particular type of work in the particular locality), California has not required change orders when extra work is necessitated for other reasons. Contractors have been forced to secure payment by making formal claims, the procedures for which have varied among state agencies.

AB 626 provides protection to contractors who perform extra work on state



projects by streamlining dispute resolution procedures among state agencies and setting deadlines for state agencies to pay undisputed portions of claims. The law defines claim as a demand by the contractor for one or more of the following: a time extension for relief from damages or penalties for delay, payment of money or damages arising from work done, pursuant to the contract for a public work or payment of an amount disputed by the public. A claim for compensation for extra work fits within this definition.

If a claim is made, the state entity must review it within 45 days and provide written statement identifying what portions are disputed and undisputed. Payment for any undisputed portion must be made within 60 days. If any portion of the claim is disputed and denied, then the state entity and contractor must meet and confer. The law also provides a mechanism for subcontractors to make a claim through the contractor.

Like Maryland's Change Order Fairness Act, California's AB 626 does not completely protect contractors. Numerous

state entities with large public works contracts are exempted from AB 626, including the Department of Transportation, Department of Water Resources, Department of General Services, Department of Parks and Recreation, and its High Speed Rail Authority. The University of California and California State University are some of the few notable state agencies that are subject to the law. Further, even if this law does apply to a particular project, it does not guarantee timely payment, particularly if the state disputes significant portions of a claim. Finally, complying with the law imposes administrative and potential legal costs on the contractor (as well as the state) to monitor potential claims, prepare claims and participate in dispute resolution meetings.

Limited Protection

No matter how the particular legislation is structured, legislation affecting change orders on contracts is unlikely to completely protect contractors when performing change order work.

For one, as evident in the approaches

taken by California and Maryland, states seem inclined to exempt certain parties from these laws. For another, complying with the law can impose additional administrative burdens. Finally, laws are unlikely to completely guarantee timely payment for changes, particularly if the state and contractor dispute whether the particular work constitutes "change order" work.

Still, limited statutory protection for contractors (at least from the contractor's perspective) is better than no protection. For this reason, due to continued pressure from contractor associations, states are likely to continue to consider and pass legislation affecting change order work in the coming years. ♦

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