

# CONSTRUCTION LAW

SEPTEMBER 2006

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*A special supplement to The Connecticut Law Tribune*



## POTENTIAL MINEFIELD

# New Ethics Rules A Trap For Unwary Contractors

Office of State Ethics charged with task of implementing ethics reform

By **WILLIAM S. WILSON II**

Now that the news of political scandals has faded and new ethics-related legislation is in place, the newly formed Office of State Ethics (OSE) faces the daunting task of administering, investigating and enforcing the new laws.

The new framework creates a potential minefield for an unwary construction contractor and will affect nearly all current and potential public work for the State of Connecticut performed by both resident and non-resident contractors alike.

After over a year of extensive activity aimed at reforming the state contracting process in both the legislative and executive branches, Public Acts, 05-287 and 05-183 were signed into law effective July 1, 2005. Combined, these two Public Acts repealed and replaced nearly all of the relevant Code of Ethics statutes (C.G.S. §§ 1-79

through 1-89) and created new far-reaching laws (C.G.S §§ 1-101mm through 1-101rr).

The OSE is a new independent state agency and successor agency to the State Ethics Commission. The governing body within the OSE is the Citizen Ethic's Advisory Board (CEAB) which consists of nine members, all of whom are currently in place.

The OSE consists of a legal division and an enforcement division. The legal division provides legal advice to the CEAB and represents the CEAB in all matters in which the CEAB is a party. The enforcement division investigates complaints brought to or by the CEAB. Ten judge trial referees will be made available to the OSE to carry out its duties.

## Landmine

The potentially largest landmine for contractors is C.G.S. § 1-101nn. The provisions in this statute apply to construction contracts having a cost of more than

\$500,000 (identified as a "large contract"). Connecticut General Statute Section 1-101nn prohibits any party seeking to be pre-qualified under C.G.S. § 4a-100, or actually performing or seeking to perform a large contract from:

- Soliciting any information from a public official or state employee that the contractor knows is unavailable to other bidders for that contract with the intent of obtaining a competitive advantage;

- Intentionally, willfully or recklessly charging the state for work not performed or goods not provided. This includes submitting "meritless change orders" in bad faith with the sole intention of increasing the contract price without authorization, and submitting false invoices or bills; or

- Intentionally or willfully violating or attempting to circumvent state competitive bidding and ethics laws.

Any contractor found in violation of any provision of C.G.S. § 1-101nn may be deemed a non-responsible bidder by a state agency (apparently without a hearing) and also, after an OSE finding, subject to severe

civil and criminal penalties.

To ensure adequate dissemination of the new laws, state agencies must provide a summary of state ethics laws to all contractors seeking a large contract. The contractor must affirm in writing that it has received the summary and that key employees have read and understand the summary and agree to comply with the ethics laws.

The contractor must obtain the same written affirmations from all its subcontractors and consultants for the contract and provide them to the state agency. Failure to do so in a timely manner is cause for termination of the contract.

## Investigation Procedure

A new procedure is in place for investigating any alleged violations of C.G.S. §§ 1-79 through 1-89 and 101nn (ethics code). An investigation can be initiated by the OSE or upon the complaint of any person signed under penalty of false statement. Notice of an investigation must be provided to the party being investigated. No complaint can be made later than five years after the violation is alleged to have been committed.

An investigation may be conducted by either two assigned CEAB members or by

■ See **OSE EMPOWERED** on PAGE 8



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# Lawyers Dole Out \$10B In Reconstruction Loans

Post-Katrina, attorneys work day and night to disburse SBA loans

By **MIRIAM ROZEN**  
ALM Media

In a physically unremarkable, one-story corporate building near Texas' Dallas-Fort Worth International Airport, 430 lawyers toil. In their stadium-like office, a bulletin board displays photos of refurbished homes and businesses and thank you notes sent from hurricane victims who obtained loans from the U.S. Small Business Administration Disaster Assistance Processing and Disbursement Center.

The staff attorneys are working as fast as they can, on day and night shifts, to disburse some \$10 billion in federal government loan money to victims of Hurricanes Katrina and Rita.

Burton E. Warner, who oversees the massive operation, says his attorneys have disbursed some \$2 billion and closed more than 156,000 cases. With 99,000 cases still open, he hopes the lawyers will issue the remaining \$8 billion in the next six months.

"We're trying to get rid of it [the money]," says Warner, center counsel for the U.S. Small Business Administration Disaster Assistance Processing and Disbursement Center (SBA-PDC).

Congress created the SBA-PDC as part of the SBA by passing the Small Business Act of 1953. Lawmakers assigned the SBA-PDC the task of issuing low-interest federal loan money to homeowners, renters and businesses located in any geographical area that the president or the SBA administrator declares a disaster area in the wake of hurricanes, floods, earthquakes, wildfires, tornadoes and other natural events.

Hurricane Katrina hit the Gulf Coast on Aug. 29, 2005, and Hurricane Rita hit southeast Texas and southwest Louisiana on Sept. 24, 2005.

## Centralized Operations

In September 2005, the SBA-PDC began centralizing its national operations at a campus near D-FW airport, in connection with a previously-scheduled reorganization plan.

But to cope with its sudden and vastly increased responsibilities in the wake of Katrina, the SBA-PDC needed to start hiring lawyers at a rate of 40 a month, say Warner and Celia Horner, a supervising attorney who oversees the lawyers' hiring and training.

With only 21 lawyers on staff at the time Katrina hit, the SBA-PDC is now, with its ranks still swelling, undoubtedly the fastest-growing legal department in the state.

"We've never been this large before," says Horner.

To jumpstart the rebuilding of and relocations within a hurricane-ravaged area, SBA-PDC lawyers are supposed to approve—as quickly as possible—borrowers' title documents, building permits and construction documents, so that the federal government is assured of its loans' collateral.

For the lawyers, the process begins after the SBA approves applicants for loans. Lawyers must approve the issuance of checks to loan applicants as construction or relocation takes place.

Katrina's colossal damage meant that the SBA-PDC had to beat the bushes to find attorneys willing to take temporary legal jobs under conditions that, at first glance, appear factory-like.

The SBA-PDC requires that its lawyers work 10-hour shifts, six days a week, either from 6 a.m. to 3 p.m. or from 3 p.m. to sometimes as late as 2:30 a.m. Each lawyer either works on closing loans or supervises other attorneys and paralegals who are closing loans.

## No Frills

On the job, the lawyers sit among a vast sea of cubicles in a 60,000-square-foot space with no frills. Even the name

plates are temporary: made of construction paper, they change each shift, since day lawyers must share their desks with the night crew.

Horner says the SBA-PDC searched nationwide for lawyers licensed in any state. About 60 percent of the SBA-PDC's attorneys are freshly minted law school graduates, most of them from north Texas and Oklahoma institutions, Warner says. The other 40 percent, which makes up most of the more recent hires, are experienced attorneys, many of whom have done real estate-related work. Some lawyers even left retirement to help out.

Prior to taking the SBA-PDC jobs, many of the veteran lawyers lived in other parts of the country. They have temporarily relocated to north Texas for the work.

The SBA-PDC pays the lawyers between \$45,000 and \$63,000 a year based on federal pay scales, since the new hires qualify as temporary federal workers. But, because they are temps, the SBA-PDC lawyers receive no health or retirement benefits. The SBA-PDC does offer lawyers who did not already reside in north Texas stipends for temporary housing and automobile rentals. They also receive \$47 a day for meals.

In March, Leena Peedikaparampil moved from Houston to work as a temporary lawyer with the SBA-PDC. Working at the

**SBA** lawyers  
are supposed to  
approve—as  
quickly as possible—  
borrowers' title  
documents.

■ See **RECONSTRUCTION** on PAGE 8

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## SUFFER THE CONSEQUENCES

# Can Consequential Damages Be Waived Mutually?

No Connecticut cases on point with regard to bad faith exception

By **RICHARD C. ROBINSON**

The latest version of the American Institute of Architects (AIA) General Conditions contains a provision in which the contractor and owner mutually waive their rights to consequential damages against the other. AIA 201 1997 General Conditions § 4.3.10.

Viewed from the contractor's perspective, the provision anticipates that the contractor might fail to perform or misperform in some fashion and thus become liable to the owner for breach of contract. The provision limits the owner's recoverable damages to direct damages, that is to those damages reflecting "the loss in value [to the owner] of the [contractor's] performance caused by [the] failure or deficiency [of the contractor's performance]. *Ambrogio v. Beaver Road Associates*, 267 Conn. 148, 155 (2003) (citing 3 Restatement Contracts § 347(a) (1981)).

The provision eliminates liability for consequential damages; that is for losses "that 'may fairly and reasonably be consid-

ered [as] arising naturally, i.e., according to the usual course of things from such breach of contract itself.'" *Id.*, quoting from *West Haven Sound Development Corp. v. West*



*Haven*, 201 Conn. 305, 319 (1986) (quoting *Hadley v. Baxendale*, 9 Ex. 341, 354, 156 Eng. Rep. 145 (1854)). The pertinent AIA section specifies some of the consequential

damages the owner is waiving. The list includes damages for rental expenses, loss of use, lost income, lost profits, extended financing expenses and damage to reputation.

An owner's consequential damages can conceivably be huge and grossly disproportionate to the contractor's profit. In *Perini Corporation v. Great Bay Hotel & Casino*,

glass façade. Significantly, the hotel and casino were continuously in operation throughout the work. By September 1984, Perini finished the façade and reached completion. The defendant, nevertheless, asserted a lost profits claim against Perini, an arbitration panel awarded it \$14,500,000, and the New Jersey courts upheld the award. Perini's fee on this job

**One would think** that contractors could now rest easy knowing that their liabilities on a job could no longer be disproportionate to their profits on that job. Think again.

129 N.J. 479, 610 A.2d 364 (1992), the plaintiff, Perini, was a construction manager on a project to partially renovate the defendant's large hotel and casino in Atlantic City. Perini's duties included supervising the various trade contractors, guaranteeing a maximum price and achieving completion by May 31, 1984. Perini failed to complete by May 31, 1984, but all that remained at that point was the installation of a \$400,000 ornamental, non-functional

was only \$600,000! Based on Perini, and other similar cases, the Associated General Contractors of America lobbied successfully for the mutual waiver of consequential damages provision in the current AIA General Conditions.

### Exception Swallows Rule

One would think that contractors could now rest easy knowing that their liabilities on a job could no longer be disproportionate to their profits on that job. Think again.

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Even though the mutual waiver language in the General Conditions is clear, unambiguous and includes no exceptions, owners' counsel are arguing for a common law exception, and as a practical matter, the exception for which they are arguing could potentially swallow the rule. Their claim is that court should not enforce the clauses limiting the recovery of consequential damages, if the contractor's performance was in bad faith.

There is some support for such an argument. In *Union Carbide Corporation v. Siemens Westinghouse Power Corporation*, 2001 U.S. Dist. LEXIS 19216 at p. 3, the Southern District of New York acknowledged that clauses limiting the recovery of consequential damages are valid and enforceable under Connecticut law, but further observed that these clauses may be disregarded if the party seeking to enforce them acted in bad faith. The authority cited for the proposition that this is Connecticut law is *International Connectors Indus. Ltd v. Litton Sys. Inc.*, 1995 U.S. Dist. LEXIS 5769, a Connecticut District Court case.

Yet, in that case, the court merely concluded that there was support in "the case law" for such a position. And the "case law" to which the court was referring comprised two federal cases applying New York law. *Long Island Lighting Co. v. Transamerica Delaval, Inc.*, 646 F. Supp. 1442, 1458-59 (S.D.N.Y. 1986) ("A defendant may be estopped from asserting a contractual limitation of consequential damages if the defendant has acted in bad faith."); and *County Asphalt Inc. v. Lewis Welding Engineering Corp.*, 323 F. Supp. 1300, 1308 (S.D.N.Y. 1970) ("Were the defendant guilty of bad faith, it might have been estopped

from asserting exculpatory contractual language."). Suffice it to say, neither these New York cases, nor the Connecticut District Court's *International Connectors* case creates Connecticut law.

#### No Connecticut Cases

The fact is that there are no Connecticut cases on point. Owner's counsel, nevertheless, make two arguments to demonstrate that the so-called bad faith exception is indeed Connecticut law. First, they argue that the waiver of consequential damages is analogous to a no-damage for delay clause, and that the Connecticut Supreme Court has ruled that a contractor cannot enforce a no-damage for delay clause if its bad faith

or willful, malicious or grossly negligent conduct caused the delay. *White Oak Corp. v. Department of Transportation*, 217 Conn. 281, 289 (1991).

A no-damage for delay clause, however, eliminates all damages for one type of violation. A waiver of consequential damages clause merely limits the damages available for violations. Arguably, the two clauses are insufficiently similar to warrant similar treatment.

Second, owner's counsel argue that exculpatory clauses are disfavored under Connecticut law. However, the cases they cite involve clauses that free their beneficiaries from liability. The waiver clause here merely frees its beneficiaries from a single

category of damages. There is no basis for asserting that Connecticut law disfavors contractual limitations on damages. Indeed, the Uniform Commercial Code expressly sanctions consequential damages exclusions unless they are unconscionable. C.G.S. § 42a-2-719.

As we noted at the outset, the consequential damage waiver here reflects the parties' agreement on the consequences that could befall one of them if the other breached, no matter how they happened to breach or their state of mind in breaching. It would be odd indeed if the court or an arbitrator could disregard this agreement simply because the breach reflected a particular level of culpability. ■

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## DOWNSTREAM DOLLARS

# Public Regulation Of Private Construction Contracts

What every construction lawyer should know about financing in the construction industry

By **SUSAN S. CHAMBERS and STUART JOHNSON**

Some time ago, Connecticut joined the growing number of states that have enacted "prompt payment" statutes regulating payment of funds on private construction projects. In 1999, the legislature enacted into law Public Act 99-153, "An Act Concerning Fairness in Financing in the Construction Industry" (effective Oct. 1, 1999) (Act). The Act is now codified, as subsequently amended, in Connecticut General Statutes §§42-158i, *et seq.*

The Act addresses important issues for construction project participants. Nevertheless, anecdotal evidence suggests that some segments of Connecticut's construction community have taken little notice of the Act. In addition, the Act has had limited treatment in the Connecticut

courts. The purpose of this article is to make construction lawyers more aware of the provisions of the Act and its impact on construction projects.

## Application Of The Act

The Act applies to contracts in the state



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exceeding \$25,000 entered into on or after Oct. 1, 1999 for construction, renovation or rehabilitation, except for public works contracts, contracts funded or insured by

HUD, or contracts for buildings intended for residential occupancy containing four units or fewer.

The "owner" under the Act is virtually any individual or entity (including a not-for-profit entity) "that is the owner of record or lessee of real property upon

**These** provisions are apparently intended to discourage payors from withholding funds—the life blood of any construction project—for improper purposes such as financing other projects, especially with the threat of a lawsuit at hand.

The Act mandates that all "construction contracts" contain payment provisions that require:

- the owner to pay any amounts due to any contractor, subcontractor or supplier (payees) in a direct contractual relationship



with the owner within 30 days after the date a written request has been made;

- the contractor to pay any amounts

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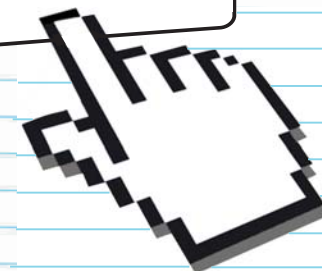
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due to payees within 30 days after the date the contractor receives payment from the owner that encompasses the labor or materials supplied by the contractor's payees;

- the contractor to include in each of its subcontracts a provision requiring each subcontractor and supplier to pay any amounts due within 30 days after the date the subcontractor or supplier receives a payment from the contractor which encompasses labor performed or materials furnished by such subcontractor or supplier. C.G.S. §42-158j.

If the payors fail to comply with these prompt payment requirements, the affected payees "shall set forth" their claim against the payor by registered or certified mail. C.G.S. §42-158j(b)(1). The same process is to be followed with respect to failures by the contractor and downstream payors to make payments. Ten days after receipt of notice, the payor is liable for interest on the amount due at a rate of one percent per month.

In addition, upon demand by a payee, the payor must place funds in the amount due, plus interest, in an interest bearing escrow account, provided that the payor may refuse to do so if the party making demand has not substantially performed the contract.

Payors cannot withhold funds because of a dispute between other contractors. Payors found to have acted unreasonably are liable for payment of the withheld funds, plus interest and attorneys' fees. Payors found to have withheld payments in bad faith, are further liable for "ten per cent damages." C.G.S. §42-158j(4).

Repeated failure to comply with the Act's payment provisions may violate CUTPA (Connecticut Unfair Trade Practices Act, C.G.S. §42-100a *et seq.*).

If the owner fails to pay amounts due to the contractor, payees can serve a demand upon the owner (with a copy to the contractor) for payment. If the owner still fails to pay the amount due, payees have a direct right of action against the owner in superior court. The owner's obligations are, however, limited to the amount then owed by the owner to the contractor.

#### Improper Purposes

These provisions are apparently intended to discourage payors from withholding funds—the life blood of any construction project—for improper purposes such as financing other projects, especially with the threat of a lawsuit at hand.

Your clients may wonder whether they can waive the Act's payment provisions by contract. Although the authors are unaware of any case addressing this issue, based on the history of the Act the answer is likely "no." An earlier version of C.G.S. §42-158j(a) had been prefaced by the phrase: "Unless otherwise agreed by the parties..." This language has since been deleted, lending support to the idea that the Act's requirements may not be waived.

The Act contains additional provisions your clients may not know about, including the following:

- Contractors and subcontractors, by the

terms of a contract or otherwise, may be required to waive their rights to file mechanic's liens or make payment bond claims before work is performed and/or payments received. The Act renders any such waivers void. See *Alstom Power, Inc. v. Balcke-Durr, Inc.*, 269 Conn. 599 (2004) (prospective waiver void because contract was entered into after effective date of the Act). However, the Act does not prohibit subordination of a

**Your clients may wonder whether they can waive the Act's payment provisions by contract ... Based on the history of the Act the answer is likely "no."**

C.G.S. §42-158m.

- The owner must post in a conspicuous

mechanic's lien to a mortgage or security interest.

- Retainage is capped at 7.5%. C.G.S. §42-158k.

- The Act voids provisions requiring that disputes be adjudicated in or under the laws of a state other than Connecticut.

place at the work site information for filing a mechanic's lien or making a payment bond claim. C.G.S. §42-158n.

- Under C.G.S. §42-158o, sureties are not obligated to pay certain interest, costs, penalties or attorney's fees imposed on the principal of the bond by identified statutes, unless the bond expressly states that the surety is obligated to pay these items.

The Act is apparently designed to minimize construction project disputes by regulating certain traditionally problematic areas. Whether the Act really benefits construction projects and the industry as a whole remains to be seen. ■



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# OSE Empowered To Hold Hearings, Compel Witnesses

■ From **NEW ETHICS RULES** on PAGE 2

an ethics enforcement officer.

In conducting an investigation, the OSE has been empowered to hold hearings, examine witnesses, and to receive oral and documentary evidence. The OSE can compel witness attendance at a hearing and the production of any documents the OSE deems relevant in any matter under investigation. To this end the OSE can use the services of the state police.

Any alleged code violation may be brought by the OSE before a judge trial referee (JTR) for a probable cause hearing. If the JTR determines probable cause exists for a code violation, the CEAB will initiate additional hearings to determine whether a violation has actually occurred.

These hearings will be held before a different JTR whose role is limited to ruling on issues concerning the rules of evidence, which will be the same as for judicial proceedings.

A code violation conviction requires the concurring vote of six members of the CEAB present and voting. The CEAB will publish its reasoned decision, which can be appealed to the superior court.

If the JTR does not find probable cause of a code violation, the complaint and investigation remain confidential. If the JTR finds probable cause exists, the finding

and the entire record of the investigation become public, except the OSE may temporarily postpone going public for the purpose of reaching a stipulation agreement or settlement.

## Penalties

Code violators are subject to penalties, including a civil fine up to \$10,000 for each violation. Any person found to have intentionally violated any provision of the ethics code is subject to criminal penalties ranging from a Class A misdemeanor up to a Class D felony.

The attorney general may also bring a civil action against any contractor who knowingly acts in its own financial interest, or knowingly receives a financial advantage resulting from a violation of C.G.S. §§ 1-84 (which prohibits any person from providing a "gift" to any public official or state employee)—or a violation of C.G.S. § 1-101nn—to recover any financial benefit that accrued to the contractor as a result of the violation, and to impose additional damages in an amount not to exceed twice the amount of actual damages.

The foregoing is only a general summary of the new laws. It is imperative that a contractor be aware of all the requirements that affect everything it submits to the state. Otherwise, the consequences can be severe. ■

# Reconstruction

■ From **LAWYERS DOLE OUT** on PAGE 3

agency has turned out to be a surprisingly pleasant experience, Peedikaparampil says, so she has extended her service. Her temp legal job was supposed to end in July. However, she realizes the time will come when the hours and the intensity of the work will cause her to burn out.

A South Texas College of Law graduate, Peedikaparampil says she worked for a title company in Houston and for a bankruptcy firm before getting laid off last winter. A friend who works at the SBA-PDC told her the agency was hiring.

## Odd Hours

"The hours are odd," says Peedikaparampil, who works the night shift. "But the best thing about it is you are actually helping people and they are pretty grateful for the assistance."

Initially, she shared her agency-issued car with an SBA-PDC temp attorney who was a Katrina evacuee. The former co-worker returned to New Orleans several months ago, Peedikaparampil says.

Andrew Ottaway, who started working the night shift at the SBA-PDC earlier this summer, previously owned a title company in west Texas. The title business didn't bring in enough money, so Ottaway, a 1983 University of Houston Law Center graduate, sold it several years ago and opened a solo practice in Granbury, Texas.

But the demands of a litigation schedule

took its toll on his family, Ottaway says, so he started thinking about the SBA-PDC as a way to ease out of his solo practice. His father-in-law had worked for the SBA-PDC giving out disaster loans in the 1970s and 1980s, Ottaway says.

Since he works the night shift at the SBA-PDC he still has time to finish cases he had previously accepted. The night-shift hours also leave him time to help out with his two teenage sons while his schoolteacher wife works.

Ottaway views his SBA-PDC lawyering as its own kind of teaching assignment. "You have people who have to learn about the lending process, and you have to teach them," he says. In a commercial loan, Ottaway notes, a mortgage broker holds a borrower's hand and tutors him or her through the process. But with the SBA-PDC, the lawyer must do that work, as well as represent the government's interests.

Warner, who is a 17-year veteran with the federal agency, started his legal career as a temp lawyer with the SBA-PDC right out of law school. The first disaster victims he encountered were affected by Hurricane Hugo, a destructive Category 5 storm that hit Puerto Rico, St. Croix and the Carolinas in September 1989.

But nothing compares with Katrina, Warner says, in terms of loan dollars allocated for rebuilding. Katrina stands alone as a disaster that required a more Herculean effort than ever before: Since Katrina, the SBA-PDC has issued 20 percent of the disaster loans it has issued in its entire 53-year history. ■



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