

# SENATE BILL REPORT

## SB 5936

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As of February 01, 2006

**Title:** An act relating to the preservation of claim rights of a contractor, subcontractor, or supplier on construction contracts.

**Brief Description:** Limiting the effect of construction contract provisions affecting the claim rights of contractors.

**Sponsors:** Senators Kastama, Rockefeller and Esser.

**Brief History:**

**Committee Activity:** Government Operations & Elections: 2/22/05, 1/31/06.

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### SENATE COMMITTEE ON GOVERNMENT OPERATIONS & ELECTIONS

**Staff:** Mac Nicholson (786-7445)

**Background:** Construction contracts may contain mandatory protest and claim 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.

In 2003, the State Supreme Court had occasion to interpret such a clause 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. However, the court found that while MMJ did submit several letters claiming it was owed additional compensation, MMJ did not submit a formal claim as required in the contract.

The court ultimately upheld dismissal of the case on a summary judgment motion. The court noted that as a general matter of contract law, procedural contract requirements must be enforced absent either a waiver by the benefitting party or an agreement between the parties to modify the contract. The court rejected MMJ's argument that when an owner has actual notice of a contractor's claim, that notice excuses compliance with mandatory contractual claim provisions. Rather, the court held that actual notice is not an exception to contract compliance and that a waiver of a contract provision must be made by the party benefitting from the provision.

The dissent in *Mike M. Johnson* agreed that actual notice is not an exception to contract compliance. However, the dissent asserted that the real issue is whether the county's actual notice plus its direction to the contractor to proceed amounted to compliance with the contract by the contractor or waiver of the notice requirement by the county. The dissent asserts that

the rule should be that when an owner directs a contractor to do work outside the original contract, and then observes the work being done, the owner cannot then rely solely on technical non-compliance with a claim provision to deny reasonable compensation, especially when the owner has not been prejudiced by the non-compliance.

Some public agencies use construction contracts that contain protest and claim provisions that may allow a contractor to pursue a claim even though the contractor has failed to make the required notice. These provisions state that failure to give the required notice constitutes a waiver of the contractor's rights unless the contractor can prove the owner's interest was not prejudiced in any way.

**Summary of Substitute Bill:** Any clause in a construction contract that purports to waive, release, or extinguish the claim rights of a contractor to damages or an equitable adjustment based on failure to submit claim notice or claim related documentation in a specified time frame or form is enforceable to the extent that the party failing to receive such notice was prejudiced. This provision does not apply to contractual requirements that a claim be submitted within a certain time frame following the completion or termination of a contract as a condition precedent to mediation, arbitration, or judicial relief.

The contractor has the initial burden to make a prima facie showing that the public owner was not prejudiced by the failure to submit notice as required by the contract. If a prima facie showing is made, the burden shifts to the owner to prove that it was prejudiced. Prejudiced means being deprived of the opportunity to mitigate cost, time, or both cost and time impacts caused by the event giving rise to the claim.

Any clause in a contract that attempts to waive the provisions of the bill is void and unenforceable as contrary to public policy.

**Substitute Bill Compared to Original Bill:** The substitute adds the requirement that the contractor make an initial prima facie showing that the public owner was not prejudiced by the failure to submit notice as required by the contract and shifts the burden to the owner to prove that it was prejudiced. The substitute bill also defines the term prejudiced.

**Appropriation:** None.

**Fiscal Note:** Not requested.

**Committee/Commission/Task Force Created:** No.

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

**Testimony For:** (2005) Contractors will be driven out of business unless this bill is passed. The Mike M. Johnson case imposed a death penalty on contractors who don't comply with complex and technical notice and claim requirements. Without the bill, contractors will have to incur additional costs because they will have to bring in attorneys to make sure that notice provisions are met. Owners are making notice and claim provisions hyper-technical and difficult to comply with in the hope that contractors will fail to meet them and therefore cannot seek additional compensation. Contractors who don't meet technical notice and claim provisions are prevented from being compensated for their work even where the owner directs

the contractor to go ahead with the work. The bill just re-establishes a more equitable solution.

(2006) The Mike M. Johnson case reversed a standard that required an owner to be prejudiced when notice wasn't received in the form required in the contract. Construction projects are fluid and dynamic, and the court swung the pendulum too far in the direction of owners. Owners are denying legitimate claims because the contractor didn't comply with onerous notice provisions. Prejudice has been defined in the bill, and the burden is on the contractor to prove the owner wasn't prejudiced. The Department of Transportation currently operates this way, and other public owners should as well. Prior to the MMJ case, reasonable notice and claim requirements were where you expected to find them in contracts; after MMJ, the provisions have been scattered throughout contracts, making them difficult to find. Notice provisions are being designed to trip-up contractors. The federal standard in contracts requires prejudice, and the state should do likewise.

**Testimony Against:** (2005) The Mike M. Johnson case just upheld 90 years of case law and provided that contract notice provisions are enforced absent waiver. The bill operates to eliminate summary judgment in all cases which will force the owner to go to trial to establish prejudice. Prejudice is undefined in the bill and passage of the bill will spawn litigation regarding what prejudice is and how it is proved. Notice provisions are in the contract in advance and contractors can negotiate different terms. The notice and claim provisions provide a way for the owner to manage the project for the public, including keeping the project on budget and on schedule. Taking away that power is bad policy. Existing law prevents an owner from demanding and observing extra work and then failing to compensate, so there is no risk that a contractor will not be paid for such work.

(2006) Ports didn't have a prejudice standard in contracts before MMJ and they don't have one now. The interest of public owners is to pay promptly and contracts have standard notice provisions. Contracts are consistent now, and passing the bill would generate confusion. Public owners don't use notice and claim provisions as a "gotcha", rather it is the responsibility of the public owner to make sure claims for additional money are submitted in an appropriate manner. Contractors should bear the risk of failure to communicate, not the owner. Prejudice as defined in the bill is a narrow definition and doesn't take into account money that may have been spent on later projects based on figures from the earlier project. Contractors shouldn't be absolved of mistakes. Notice and claim provisions eliminate the surprise element that would come as work is completed. Poorly managed contractors should bear burden of mistakes, and contractors are just looking for an escape with this bill.

**Who Testified:** PRO (2005): Michael Transue, Associated General Contractors; Paul Cressman and Bruce Cohen, Short, Cressman and Burgess; Andy Ward, Valley Electric. (2006): Michael Transue, Associated General Contractors; Bruce Cohen, Short Cressman and Burgess; Douglass Roach, Howard S. Wright Construction.

CON (2005): Dick Prentke, Perkins Coie; Pete Wall and Lorraine Wilson, Tacoma Public Schools; Linda Shilley, Port of Tacoma. (2006): Janet Quimby, Port of Tacoma and Washington Public Ports Association; Peter Camp, City of Everett; Graehm Wallace, Perkins Coie on behalf of Washington State School Construction Alliance; Chris Hirst, Preston, Gates and Ellis.