

HOUSE BILL REPORT

ESHB 1765

As Passed House:

March 14, 2007

Title: An act relating to claims under a construction contract.

Brief Description: Changing provisions concerning limitation of claims under a construction contract.

Sponsors: By House Committee on Judiciary (originally sponsored by Representatives Lantz, Springer, Williams, Rodne and Moeller).

Brief History:

Committee Activity:

Judiciary: 2/9/07, 2/26/07 [DPS].

Floor Activity:

Passed House: 3/14/07, 95-1.

Brief Summary of Engrossed Substitute Bill

- Allows enforcement of a contractor's claim right under certain circumstances when the contractor has not complied with time or form requirements for submitting the claim.

HOUSE COMMITTEE ON JUDICIARY

Majority Report: The substitute bill be substituted therefor and the substitute bill do pass. Signed by 7 members: Representatives Lantz, Chair; Goodman, Vice Chair; Rodne, Ranking Member; Ahern, Moeller, Ross and Williams.

Minority Report: Do not pass. Signed by 2 members: Representatives Kirby and Pedersen.

Staff: Bill Perry (786-7123).

Background:

Construction contracts sometimes contain various provisions, including mandatory protest and claim clauses, covering unanticipated situations that may arise during the course of construction. Such protest and claim clauses generally require the contractor to follow

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specific notice requirements when seeking additional payment for extra work done and increased expenses incurred. Such clauses may be found in public works contracts as well as private contracts.

In a five-to-four 2003 decision, *Mike M. Johnson, Inc. v. Spokane County*, 150 Wn.2d 375, the Washington Supreme Court construed such a protest and claim clause to require strict adherence to a notice requirement. In *Mike M. Johnson*, a contract for sewer construction authorized the project owner, Spokane County, to order work changes within the general scope of the contract. The contract also provided that the contractor bore all risks associated with any mistakes in the location of utilities as shown on the construction project plans. The county submitted revised design plans and change orders, including proposed increases in the contractor's compensation and extensions of the construction deadlines. The contractor did not object to these changes. When the contractor began work under the change order, however, it encountered buried phone lines that caused delay. The contract contained specific and detailed procedures for the contractor to follow in making a claim for additional compensation for the delay caused by the underground phone lines. The contractor did not provide the required written notice and documentation, although it did send a letter stating that the phone lines were causing the contractor to incur additional expenses. The county notified the contractor that the letter did not satisfy the contract's notice requirements. The county's attorney informed the contractor that the county did not intend to waive any defense it might have against a claim by the contractor. The contractor never complied with the formal requirements of the contract for making a claim.

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 held that as a matter of summary judgment, the contractor did not meet the requirement of the contract for making a claim for additional payment. It likewise held that actual notice of the claim did not satisfy the contract, and the county's actions did not constitute a waiver of the county's right to assert the contractor's non-compliance as a defense to the claim.

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 would have ruled 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.

Standard form contracts used by some public agencies 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 by the contractor's failure.

Summary of Engrossed Substitute Bill:

Criteria are established for the enforceability of certain construction contract clauses. The affected clauses are those that waive a contractor's right to make a claim against a project owner if the contractor has failed to meet contract requirements for timeliness or documentation of the claim.

A waiver clause is enforceable if the contract requires claim notice to be submitted in writing within seven days of an event giving rise to the claim and also requires documentation to be provided within 30 days of the event. The notice and documentation are to be sent to the party specified in the contract for that purpose. The documentation must be provided in sufficient detail and in a format that allows the project owner to respond, including providing factual details about the claim, the contractual basis for the claim, prior communications about the claim, and cost and schedule changes required by the claim.

If a contractor fails to meet the notice and documentation requirements described above, the contractor may nonetheless be deemed to have complied with them if:

- the required notice is submitted within 15 days (instead of seven days);
- the required documentation is provided within 45 days (instead of 30 days); and
- the contractor proves by a preponderance of the evidence that the project owner was not prejudiced by the late compliance.

If a contract waiver clause requires notice in less than seven days, or documentation in less than 30 days, or requires more in the way of documentation than described above, then the clause is enforceable only if the project owner has been prejudiced by the contractor's failure to meet those more stringent requirements. The contractor has the burden of proving by a preponderance of the evidence that the project owner was not prejudiced.

Regardless of other requirements, all contract claims must be submitted within 30 days of substantial completion of a contract. However, neither this provision requiring notice within 30 days of substantial completion, nor the provisions of the act relating to clauses with more stringent requirements, apply to formal claim processes that are necessary for mediation, arbitration, or judicial relief following the completion or termination of a contract.

The act applies to contracts entered into on or after January 1, 2008.

Appropriation: None.**Fiscal Note:** Not requested.**Effective Date:** The bill takes effect 90 days after adjournment of session in which bill is passed.**Staff Summary of Public Testimony:**

(In support) This issue has festered since the *Mike M. Johnson* decision. That decision gives no incentive for project owners to modify their contracts. The dissent in the case rightly points out the injustice of allowing summary judgment when there has been a failure to comply strictly with hyper-technical requirements in a contract. The bill will allow disputes to be resolved on the merits.

Public works contracts are basically take-it-or-leave-it contracts. The *Mike M. Johnson* decision takes equity out of the claims process despite the fact that the construction process is fluid and dynamic and adjustments need to be made along the way. The bill will remove these onerous clauses from contracts, and bids will be reduced and taxpayers will save money. Since *Mike M. Johnson*, contractors are tending to avoid public works contracts. Dealing with the strict contract clauses results in a mountain of paperwork because contractors feel obligated to give notice on every little thing for fear of losing a claim right.

(With concerns) The bill reduces predictability and does not meet the need for timely notice with sufficient documentation to resolve construction claims.

(Opposed) The bill interferes with the freedom of contract.

The bill will make the claims process unworkable. Claims provisions are important because they provide early notice and a way to resolve problems. The current law gives predictability to the process. The bill will reward those contractors who are the worst at giving timely notice. It will prevent public agencies from managing public funds in a responsible manner. There has to be a way to resolve claims quickly and efficiently in order to stay within a budget.

The bill is not needed. The *Mike M. Johnson* case did not change what has been the established and settled law for 60 years. The bill is ambiguous with respect to what constitutes "consent" and with respect to who, in a complex building project, must give it.

Persons Testifying: (In support) Representative Lantz, prime sponsor; Michael Transue, Paul Cressman, and Douglas Roach, Associated General Contractors; and John Ahlers, Utility Contractors Association of Washington.

(With concerns) Pete Wall, Tacoma School District; and Bob Bourg, Department of General Administration.

(Opposed) Chris Hirst, Puget Sound School Coalition; John Hurley, Finance and Administration, The Evergreen State College; Richard Prentke, Perkins Coie LLP, and Washington State School Construction Alliance; Mitch Denning, Alliance of Educational Association; and Scott Bicklund, Port of Tacoma.

Persons Signed In To Testify But Not Testifying: None.