



Cameron S. Hamrick

Recovery Act Stimulus Funds: New Opportunities and Complexities

By Cameron S. Hamrick, Joanna K. Horsnail,
and Rebekah C. Scheinfeld



Joanna K. Horsnail

On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (the Recovery Act),¹ which includes \$787 billion in funding intended to provide a stimulus to the U.S. economy. This total amount includes \$212 billion in tax incentives and \$575 billion in funds that will be expended through a combination of direct federal spending and grants and loans to states, local governments, and private nonprofits. These moneys will spur a broad array of construction projects, including transportation and other physical infrastructure, federal facilities, energy-efficiency improvements, environmental cleanup, and affordable housing.

The Recovery Act also extends or expands several existing municipal bond programs and provides for new bond financing programs intended to stimulate development and construction opportunities. The Build America Bonds program gives governmental issuers several options with respect to issuing tax credit and federally subsidized bonds in 2009 and 2010 in lieu of traditional tax-exempt bonds. It creates a Recovery Zone Bond program

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Rebekah C. Scheinfeld



Edward B. Gentilcore

The Conflict Between Arbitration Agreements and the Enforcement of Mechanics' Lien Claims

By Edward B. Gentilcore

Welcome to the land of mechanics' liens, where the statutes are as diverse as the makeup of the states in our nation that have them. This is a place where, in many, if not most instances, both strict compliance and strict construction rule the day, putting the statutes at odds with situations

that they were not designed to encounter. Consider another prevalent aspect of the construction landscape: Although some parties and even the available form documents are moving away from mandatory arbitration, arbitration agreements continue to be used with

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Message from the Cochairs



**Patrick J.
Greene**



**Charlotte
Wiessner**

We are proud and excited to be a part of ever-expanding committee publications, including our website on which we plan to increase substantive and committee-related content. Our thanks go out to Ed Salanga and Dave Kurtz for their wonderful stewardship of *Construct!* and to Tina Paries and Ray Garcia for their continuous efforts to take our website to the next level. We also thank our case note editor Mark Kiser and our regional case note editors for their efforts. But we need your help, so please get involved—submit an article or noteworthy news posting (recent case, recent enactment, etc.) to our website coordinators.

The committee has been active in sponsoring and presenting CLE programs and networking opportunities for our members.

In January 2009, together with the ABA Forum on the Construction Industry, the committee sponsored a two-day meeting in Bonita Springs, Florida, devoted to insurance coverage, claims, and litigation unique to the construction industry. The Construction Litigation Committee created and staffed four substantive programs for the event, which

was attended by over 400 ABA members. The event was conceived while Jim Landgraf was cochair of the Construction Litigation Committee and served as program cochair.

At the ABA Section of Litigation Annual Meeting in April 2009, our committee successfully cosponsored and produced speakers and content for two out of the three programs in the Employment Track: "Workplace Safety: Keeping Out of Harm's Way," "Out of the Papers and Out of the Courts," and "Avoid Getting ICE'd: What In-House Counsel and Companies Need to Know about Immigration, I-9s, and E-Verify."

At the Annual Meeting of the Forum on the Construction Industry, our committee produced a plenary program: "When Green Turns to Red and LEEDs to a Summons and Complaint: Potential Liability on Green Projects," and a substantive breakfast on "When the Surety Does Not Stand in the Shoes of the Principal."

At each of these events, the committee sponsored Dutch treat dinners at which committee members could meet and network with fellow members.

Thanks go to our programming subcommittee cochairs, Drew William and Anna Torres, as well as Charlotte Wiessner, Jim Landgraf, Cliff Shapiro, and Ed Gentlicore, our committee liaison for coordinating these efforts.

We urge all members to plan to attend and fully participate in our upcoming programs.

New members welcome! If you have friends or colleagues who might be interested in our Construction Litigation Committee, please encourage them to join and get involved.



Michael A. Branca

Federal False Claims Act "Corrected and Clarified" to Expand Contractor Liability

By Michael A. Branca and William W. Thompson Jr.



William W. Thompson Jr.

In its decision in *Allison Engine Co. v. United States*,¹

the U.S Supreme Court limited—but did not eliminate—the circumstances in which a contractor or subcontractor on a federally funded project may be liable under the federal False Claims Act. Generally speaking, the False Claims Act is violated when (1) a contractor knowingly presents a false claim to the federal government for payment or approval, or (2) knowingly makes a false record or statement to get a false or fraudulent claim paid by the government.² Now Congress has passed and President Obama has signed a new law that overrules *Allison Engine* and rewrites important sections of the False Claims Act.

On May 20, 2009, President Obama signed the Fraud Enforcement and Recovery Act of 2009 (FERA).³ Embedded in FERA are amendments to the False Claims Act that significantly expand the circumstances in which contractors and subcontractors may be liable for false claims. Because Congress believed that decisions like *Allison Engine* were not only erroneous but also greatly weakened the effectiveness of the False Claims Act, it used FERA as a vehicle to correct and clarify the False Claims Act.⁴ Below is a discussion of how FERA most significantly affects contractor and subcontractor liability.

Extension of the Act's Coverage

FERA extends the False Claims Act to claims (including progress payments) under any contract or grant funded or partially funded by the federal government, whether or not the government directly approves the claims. This provision effectively overturns *Allison Engine* by not requiring direct

presentment to the federal government for liability to arise. Instead, a contractor may be liable even if it submits a claim to a third-party recipient of government money or property such as a state agency or grantee. Congress noted that removing the presentment requirement makes the False Claims Act internally consistent, because it defines "claim" to include any payment request for which the government provides all or part of the amount requested or will reimburse a *third party* for any amount paid.⁵

It is important to note that FERA does not set any minimum amount of federal funding for the False Claims Act to apply. To the contrary, the new law states that the act applies whenever the government provides "any portion" of the money or property for which a claim has been made.

The elimination of the presentment requirement will have broad application to contracts and grants that are funded in whole or in part by the American Recovery and Reinvestment Act of 2009 (popularly known as the "Stimulus Act"). In enacting FERA, Congress was specifically concerned that the more than \$1 trillion that has been appropriated to stimulate our economic system would be "dispensed through contracts with non-governmental entities, going to general contractors and subcontractors working for the Government. Protecting these funds from fraud and abuse must be among our highest priorities as we move forward with these necessary actions."⁶ Stimulus Act-funded contracts had already been targeted for special ethics oversight. Now contractors will face the additional risk associated with potential False Claims Act liability for ethics lapses.

Elimination of the Intent Requirement

FERA replaces the False Claims Act requirement that the contractor intended to defraud the government with the requirement that the contractor's false claim was simply "material" to the decision to pay the claim. This provision of FERA also addresses *Allison Engine's* ruling that an intent to defraud the government was necessary for liability under the second basis for false claims liability, that is, the use of a false record or statement to get a false claim paid. According to the Supreme Court's holding in *Allison Engine*, a contractor's false record or statement had to have been intended to defraud the government. Under the False Claims Act, as amended by FERA, a contractor's false record or statement must simply be "material" to the decision to pay the claim.⁷ This means the false record or statement must "have a natural tendency to influence" or be "capable of influencing" the payment decision. Intent has thus been effectively eliminated from the False Claims Act.⁸

Liability for Failure to Return Overpayments

FERA exposes contractors to False Claims Act liability if they knowingly fail to return overpayments to the government, even if no false claim or statement has been made. Before this provision was enacted, contractors were liable if they used false records or statements to conceal, avoid, or decrease obligations to pay the government,⁹ known as making "reverse" false claims. FERA imposes liability if a contractor simply conceals, avoids, or decreases its obligation to pay, regardless of whether a claim has been submitted. FERA

defines "obligation" specifically to include the retention of an overpayment. Even if a contractor is the innocent recipient of an overpayment, the amount of the overpayment must be returned to the government or the contractor risks liability under the False Claims Act. It should also be noted that, under a provision of the Federal Acquisition Regulation enacted in November 2008, contractors may be suspended or debarred for failing to disclose significant overpayments on government contracts.

The Bottom Line

The amendments to the False Claims Act brought about by FERA demonstrate that the movement toward stricter federal ethics requirements has gained even more momentum. With FERA's reworking of False Claims Act provisions, contractors and subcontractors assume an even greater risk of liability, and the importance of a robust and effective compliance program is further magnified.

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Endnotes

1. 128 S. Ct. 2123 (2008).
2. 31 U.S.C. § 3729(a)(1) and (a)(2).
3. Fraud Enforcement and Recovery Act of 2009, Pub. L. No. 111-21 (2009).
4. S. Rep. No. 111-10 (2009). The primary purpose of FERA, however, is to increase accountability for corporate and mortgage fraud. *Id.*
5. 31 U.S.C. § 3729(c) (2000).
6. S. Rep. No. 111-10, at 10 (2009).
7. Congress eliminated the words "to get," which were interpreted by the *Allison Engine* Court as connoting an intent that the false record or statement would lead to payment of a false claim. FERA substituted the words "material to" for the "to get" language.
8. FERA also eliminates the intent requirement for conspiring to submit a false claim. 31 U.S.C. § 3729(a)(3).
9. 31 U.S.C. § 3729(a)(7) (2000).

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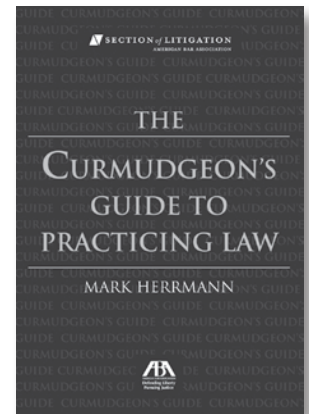
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**Stephen
Leys**

Getting Paid on Federal Projects: Basic Principles

By Stephen Leys

From cost principles to payment bonds, every young lawyer needs to have an understanding of how to get paid on a federal construction project and the issues that typically arise. This article covers those basics.

Cost Principles

Part 31 of the Federal Acquisition Regulation (FAR) code explains cost principles and procedures “for the pricing of contracts, subcontracts, and modifications to contracts and subcontracts whenever cost analysis is performed and the determination, negotiation, or allowance of costs when required by a contract clause.”¹ The role that cost principles have in contract administration depends on the type of contract that the contractor enters into with the government. In incentive-fee or cost-reimbursement contracts, the government uses the cost principles to determine “allowability” of costs. In fixed-price contracts, cost principles affect change order issues. While different cost principles are applicable depending on the governmental agency the contractor contracts with, this analysis focuses on construction and architect-engineer contracts.²

A contractor may be paid for a cost if it meets certain “allowability” standards. A cost is generally “allowable,” provided it complies with the following requirements: (1) reasonableness; (2) allocability; (3) standards promulgated by the Cost Accounting Standards (CAS) Board if applicable; (4) terms of the contract; and (5) any limitations set forth in FAR subpart 31.2.³ The first three are discussed below.

Reasonableness. A “cost is reasonable if, in its nature and amount, it does not exceed that which would

be incurred by a prudent person in the conduct of competitive business.”⁴ Necessarily, this standard is subjective,⁵ however, FAR 31.201-3(b) sets forth standards to judge whether a cost is reasonable, including (1) whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor’s business or the contract performance; (2) generally accepted sound business practices, arm’s-length bargaining, and federal and state laws and regulations; (3) the contractor’s responsibilities to the government, other customers, the owners of the business, employees, and the public at large; and (4) any significant deviations from the contractor’s established practices.

Allocability. Generally,

a cost is allocable to a government contract if it: (a) Is incurred specifically for the contract; (b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or (c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.⁶

The contractor is permitted some discretion in its cost allocation and is free to use its own accounting system,⁷ but its system must follow certain Cost Accounting Standards (discussed below) and properly allocate costs under FAR principles, as either “indirect” or “direct” costs.⁸ The government has also set forth certain “selected” costs for special treatment, which must comply with additional criteria under FAR 31.205.

Cost Accounting Standards. A contractor may employ generally accepted accounting principles and

practices appropriate to the particular standard,⁹ unless CAS are applicable.¹⁰ CAS are applicable if there is a “Cost Accounting Standards” clause in the contract.¹¹ CAS clauses generally require that the contractor (1) disclose its cost accounting practices; (2) follow the disclosed practices consistently in estimating, accumulating, and reporting costs; (3) comply with CAS in effect as of the contract award date; and (4) agree to an adjustment of the contract price when the contractor fails to comply with CAS or its disclosed practices.¹²

Change Orders

Changes to the work under a federal construction contract raise numerous compensation issues for the contractor.

Change Order Authority

The government is bound only by the actions of its employees who have actual authority.¹³ Thus, the government agency is not required to provide extra time or cost to the contractor unless the government employee issuing the change order had actual authority (generally, the contracting officer).¹⁴ Although a nonbinding employee’s actions may be ratified,¹⁵ the contractor should not assume that exceptions will be made. The better course is to receive written direction from the contracting officer before performing the work.

Fixed-Price Change Orders

The fixed-price change order clause in a federal contract differs depending on whether the contract is a supply contract, an architect-engineer or other professional services contract, a non-architect-engineer services contract under which supplies are to be furnished, or a non-architect-engineer services contract under which supplies are not to be furnished.¹⁶

The supply contract change order clause allows the contracting officer to make changes unilaterally to the (1) drawings, designs, and specifications (even when the supplies are to be specially manufactured); (2) method of shipment or packing; or (3) place of delivery.¹⁷ Under paragraph (b) of the same section, the contractor is entitled to a contract price increase if the change causes an increase in the cost of performance and an extension, and the contractor is entitled to an extension of the completion date if the change increases the time required for performance. Conversely, the government is entitled to a decrease in “time to complete” or a decrease in the contract price if the change causes a decrease in the time required for performance or the cost of performance, respectively. If the contractor believes that it is entitled to additional time or money, it must submit the change order within 30 days of the date of receipt of the change order.¹⁸ If the contractor disagrees with the contracting officer’s assessment of the change order proposal, the contractor may make a claim under the “disputes” clause.¹⁹

The change order clauses for other types of fixed-price federal contracts function in a substantially similar fashion.²⁰ However, the change order clause may be much broader and permit the contracting officer to accelerate performance or change the method and manner of performance.²¹ Accordingly, the contractor should be wary of the change order clause included in the contract at the time of the bid and should determine how to handle change orders before beginning performance.

Change order clauses also exist for cost-reimbursement contracts.²² These clauses are similar to fixed-price change order clauses in that they provide authority to the contracting officer to issue a change order unilaterally.²³ Such clauses are generally superfluous as contractors are permitted to cease work once contract funds are expended. However, if the contract contains a “limitation of cost” clause,²⁴ the government is not obligated to reimburse

the contractor beyond the cost cap or the contract’s estimated cost in the contract schedule,²⁵ and the contractor may be called upon to complete the work. Under such cost caps, the contractor may still recover for additional work outside the original contract scope under the applicable cost-reimbursement change order clause²⁶ and may still seek reimbursement for cardinal changes.²⁷

Contractors should determine how to handle change orders before beginning performance.

Cardinal Changes

The contracting officer is only permitted to issue change orders within the general scope of the contract.²⁸ A change that falls outside the general scope of the contract is a cardinal change. While the contractor may technically refuse to do work that is outside the scope of the contract as a breach of contract, the contractor risks breaching the contract by refusing to perform. Furthermore, even if the contractor believes that the work ordered by the contracting officer is outside of the general scope of the contract, the contracting officer issuing the order does not and will likely compensate the contractor with a change order. Accordingly, a contractor should only assert a cardinal change as a last resort, after completing the work, and only if it is not compensated vis-à-vis the above change order process.

Constructive Changes

If the contractor is not given a formal order under a changes clause, the contractor may be able to assert a constructive change, which may, for example, include the contracting officer (1) interpreting a clause in the contract that increases the cost; (2) failing to comply with its performance obligations under the contract; (3) providing defective specifications; or (4) accelerating the work.²⁹ However, to recover for a constructive change, the contractor will need to prove that (1) the government’s act causing the contractor to incur additional costs can be traced to someone with actual authority; (2) the extra work exceeded the requirements of the contract; and (3) the contractor gave the proper notice to the government, if so required, that it believed that the government action constituted a constructive change.³⁰

Value Engineering

While the government is technically entitled to a deductive change order if a change causes a decrease in the cost of performance,³¹ the value engineering clause permits a contractor to share in savings resulting from its suggestions resulting in a reduced cost of performance.³² This includes (1) the savings generated on the contract being performed; (2) concurrent contract savings; (3) future contract savings; and (4) collateral changes, such as savings by the government from the value engineering.³³ To recover for such value engineering, the contractor must submit a change proposal that includes a comparison between the existing contract requirement and the proposed change.³⁴ The proposal should be clearly labeled as a value engineering proposal so that it properly identifies the contractor’s intentions to share in any savings realized under the proposal to the contracting officer.

Claims under the Disputes Clause

The “disputes” clause under the Contract Disputes Act of 1978 sets forth a procedure for the contractor to claim

Extraordinary Contractual Relief

Under a seldom-used provision, some federal agencies are permitted to grant extraordinary contractual relief outside of the contract “without regard to other provisions of law relating to the making, performance, amendment, or modification of contracts, whenever he deems that such action would facilitate the national defense,”¹ even if prohibited by statute.²

Twelve federal agencies have been authorized to grant such contractual relief: (1) the Department of Defense; (2) the Department of the Treasury; (3) the Department of the Interior; (4) the Department

of Agriculture; (5) the Department of Commerce; (6) the Department of Energy; (7) the General Services Administration; (8) the National Aeronautics and Space Administration; (9) the Department of Transportation; (10) the Tennessee Valley Authority; (11) the Government Printing Office; and (12) the Federal Management Agency.³ This authority, in turn, has been delegated by some of the above to Contract Adjustment Boards.⁴

Extraordinary contractual relief may include advance payments or contract adjustments such as (1) contract amendments without

consideration; (2) correction of mistakes; and (3) formalization of informal commitments.⁵

Endnotes

1. 50 U.S.C. § 1431. *See also* 48 C.F.R. § 30.
2. *See* 48 C.F.R. § 50.400.
3. Exec. Order No. 10,789, 23 Fed. Reg. 8897 (Nov. 14, 1958).
4. *See* 48 C.F.R. § 50.202.
5. 48 C.F.R. § 30.302 et. seq. For further discussion of extraordinary contractual relief, see Stephen W. Feldman, *Government Contract Guidebook* (4th ed. 2008), sections 21:12–21:16.

relief under the contract, while work continues on the project.³⁵

Claims Subject to the Disputes Process

All contractor claims and government claims “relating to” the contract are subject to the disputes process.³⁶ A claim is a written demand by one of the contracting parties seeking the payment of moneys in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or “relating to” the contract.³⁷ Contractor claims of more than \$100,000 in value must be certified.³⁸ Proper contractor claims include claims against “an executive agency” for “any express or implied action” and reach to “(1) the procurement of property, other than real property in being; (2) the procurement of services; (3) the procurement of construction, alteration, repair or maintenance of the real property; or (4) the disposal of personal property”;³⁹ however, there are myriad other exclusions,⁴⁰ and an attorney should be consulted to assist with the claim.

The Disputes Process

The federal agency may initiate the disputes process by transmitting a government claim to the contractor, and a contractor may initiate a

claim by presenting the claim to the agency’s contracting officer. While the government’s official policy is to “try to resolve all contractual issues in controversy by mutual [settlement] agreement at the Contracting Officer’s level,”⁴¹ the contracting officer has the power to decide the issue unilaterally.⁴²

Deadlines for the Contracting Officer’s Decision and for the Claimant’s Appeal

From the time the contracting officer receives a formal claim, he or she should issue a decision within 60 days; however, this period may be extended by the contracting officer,⁴³ and disputes often run over the 60-day period. Once the contracting officer renders a final decision, the contractor may either appeal (1) to the appropriate board of contract appeals within 90 days of the final decision⁴⁴ or (2) to the Court of Federal Claims within one year.⁴⁵ Statutes of limitations also apply for further appeals.⁴⁶

Duty to Proceed

Even if the contractor disagrees with the contracting officer on a claim, the contractor must continue to follow the contracting officer’s direction.⁴⁷ Because a contracting officer’s

direction to proceed is not appealable separately from the underlying claim,⁴⁸ refusing to follow the contracting officer’s direction may result in a termination for default. Depending on the “disputes” clause in the contract, this duty to proceed may even extend to when the contractor claims breach of contract.⁴⁹ Accordingly, a contractor should never walk off a federal project.

Practical Tips in Handling Claims

Unlike change orders, many government contracts do not require that the contractor give notice to the contracting officer before initiating a dispute.⁵⁰ Nevertheless, the contractor should give notice to the contracting officer of potential claims as soon as there is a possibility of a claim, as notice serves a number of important purposes, including (1) allowing the contracting officer to address the problem head on; (2) preventing misunderstandings from arising between the contractor and the government; and (3) making it less likely that the contracting officer will state that he or she was blindsided and needs more time to address a claim. Finally, because the contracting officer will play a large role in the performance evaluation upon completion of the

project, which is one of the major criteria used to assess a contractor's future bids for government work, it is important to ensure that the claims process (and pre-claims negotiation process) go as smoothly as possible.

In addition to giving notice, the contractor should keep track of its claims. A claim is more likely to be approved if there is thorough supporting documentation. Although there are varying methods of documenting a claim, the contractor should consider setting up a claims folder for any potential claim and include the following sections in the folder: (1) communications regarding the potential claim; (2) contract provisions and specifications relating to the claim; and (3) alleged damages with supporting documentation (preferably collected and annotated daily).⁵¹ At the front of each claims file, the contractor should also consider writing a two- to three-sentence synopsis of the claim. This explanation may be used in future discussions with the contracting officer and will ensure that the nature of the potential claim is communicated efficiently to all personnel handling the claim. Finally, the contractor should consider issuing formal letters to any of its subcontractors and suppliers that might incur extra costs related to the potential claim, asking the subcontractors and suppliers to forward all supporting documentation related to the potential claim. This letter may also serve as an added layer of protection in the event that the subcontractor does not provide the requisite documentation, the claim is denied as a result of inadequate documentation, and the subcontractor later brings an action against the contractor for extra work.

Miller Payment Bond Claims

The general contractor on a federal project must obtain a Miller payment bond for the value of the contract⁵² if the federal contract is over \$100,000.⁵³ This bond provides protection against nonpayment to entities that have an express or implied contract with a subcontractor.⁵⁴ Such entities (claimants) may obtain a copy of the

payment bond from the contracting agency by filing an affidavit with the agency, stating that it has performed labor or services and that payment for that work has not been made, or that it is being sued on the bond.⁵⁵

Surety Bonding Requirements under the Miller Act

When a claimant has not been paid in full within 90 days after the last day it provides materials or labor to a project,⁵⁶ it may bring a civil action on the Miller payment bond.⁵⁷ This civil action must be brought within

A claim is more likely to be approved if there is thorough supporting documentation.

one year after the last materials or labor were provided or the claimant will be barred from recovering.⁵⁸ Claimants should be wary of the fact that a claim on a Miller payment bond to the bonding company is not the same as bringing an action against the bond and that they must act promptly to preserve their rights under the bond.⁵⁹

Contractor Guidelines to Avoid Payment Bond Claims

Given that a claimant may bring an action on the bond if it is not paid within 90 days, a general contractor should promptly make payment to its subcontractors and suppliers. Failure to make payment may result in a bond claim and payment by the surety. Because the contractor's indemnity agreement with the contract usually contains a provision

mandating that the contractor indemnify the subcontractor for all loss, costs, expenses, and attorney fees, failure to pay subcontractors and suppliers may compound a general contractor's costs.

As a condition of issuing payment to subcontractors and suppliers, general contractors should also require that their subcontractors and suppliers provide proof that they have paid their subcontractors and suppliers for work done. This may help prevent Miller payment bond claims from second-tier suppliers and subcontractors that the general contractor does not pay directly.

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Endnotes

1. See 48 C.F.R. § 31 (2009).
2. Construction and architect-engineer contracts are defined as "[a]ll contracts and contract modifications negotiated on the basis of cost with organizations other than educational institutions (see 31.104), State and local governments (see 31.107), and nonprofit organizations except those exempted under OMB Circular A-122 (see 31.108) for construction management or construction, alteration or repair of buildings, bridges, roads, or other kinds of real property. It also includes architect-engineer contracts related to construction projects. It does not include contracts for vessels, aircraft, or other kinds of personal property." 48 C.F.R. § 31.105.
3. See *id.* § 31.201-2(a). This article does not address the terms of the contract or any limitations set forth in FAR subpart 31.2. However, the contractor should review the contract and FAR subpart 31.2 before entering into a contract with the government.
4. 48 C.F.R. § 31.201-3(a).
5. See *id.* § 31.203(b) ("What is reasonable depends upon a variety of considerations and circumstances. . . .").
6. *Id.* § 31.201-4.
7. The government may require a change in a contractor's accounting system to future accounting by direction, pursuant to a statute or regulation, or by showing that the contractor's system is inequitable. See *Litton Sys., Inc. v. United States*, 449 F.2d 392 (1971).
8. For definitions of "indirect" versus

“direct” costs, see 48 C.F.R. §§ 31.202–31.203.

9. *Id.*

10. *See id.* § 31.201-2(a).

11. *See id.* § 30.201-4. The clause is outlined in 48 C.F.R. § 52.230-2. Such CAS principles provided for under the clause may be modified if the “Disclosure and Consistency of Cost Accounting Practices” appears in the contract. 48 C.F.R. §§ 30.201-4(b), 52.230-3.

12. *See id.* § 52.230-2. The adjustment to the contract price may be either upwards or downwards depending on the situation. *See id.* §§ 52.230-2(a)(4) to (a)(5) for further guidance.

13. *See Fed. Crop Ins. Corp. v. Merrill*, 332 U.S. 380 (1947).

14. *See* 48 C.F.R. § 1.602-1; *but see* § 1.601 (providing for delegation of authority under certain circumstances).

15. *See id.* § 1.602-3.

16. *Id.* § 43.205(a)(1)-(5). Section 43.205(6) also provides for a research and development contract change order clause.

17. *See id.* § 52.243-1(a).

18. *See id.* § 52.234-1(c). This 30-day requirement does not always bar recovery, as the contracting officer may receive and act upon a change order proposal after the 30 days have passed. *Id.* However, it is always wise to err on the side of caution. It should also be noted that the time requirement may be adjusted within the change order clause. *Id.* § 52.234-1.

19. *Id.* § 52.234-1(e). Claims under the “disputes” clause are addressed *infra*.

20. *See id.* § 52.243-1 (Alternates I-V).

21. *See, e.g., id.* §§ 52.243-4(a)(2),(4).

22. *See id.* § 43.205(b).

23. *See id.* § 52.243-2(a).

24. *See id.* § 52.232-20 (providing a cost cap clause for certain cost-reimbursement contracts). The “limitation of funds” clause provides for a cost cap in incrementally funded cost-reimbursement contracts. *Id.* § 52.232.

25. *See id.* § 52.232-20(d).

26. *See Appeal of Chemical Const. Corp.*, I.B.C.A. 946-1-72 (I.B.C.A. 1973).

27. *See Appeal of Recon Systems, Inc.*, I.B.C.A. 1214-9-78 (I.B.C.A. 1979).

28. 48 C.F.R. § 52.243-4.

29. Government actions that delay the work may be addressed vis-à-vis the “government delay of work” clause, if contained within the contract. 48 C.F.R. § 52.242-17.

30. 41 U.S.C. §§ 605(a), 607(d).

31. *See* 48 C.F.R. § 52.243-1(b).

32. *Id.* § 48.101.

33. *See id.* § 52.248-1(b); § 52.248-3(b).

34. *See id.* §§ 52.248-1–52.248-3.

35. *See Contract Disputes Act of 1978*, Pub. L. No. 95-563, 92 Stat. 2383 (codified at 41 U.S.C. §§ 601 et. seq.). 48 C.F.R. § 33.209 implements, and 48 C.F.R. § 52.233-1 sets forth, the “disputes” clause.

36. *See* 41 U.S.C. § 605(a), § 607(d).

37. *See* 48 C.F.R. § 52.233-1(c).

38. *See id.* § 52.233-1(d)(2)(i). The certification must state specific language set forth in 48 C.F.R. § 52.233-1(d)(2)(iii) and must be made by a person authorized to bind the contractor under 48 C.F.R. § 52.233-1(e). Although no certification is required for claims of less than \$100,000, any contractor submitting a claim should verify its figures to avoid liability under the False Claims Act.

39. 41 U.S.C. 602(a). *See, e.g., United States v. Triple A. Mach. Shop, Inc.*, 857 F.2d 579 (9th Cir. 1988); *see also Forman v. United States*, 767 F.2d 875 (Fed. Cir. 1985).

40. One very important statutory exclusion to the claims disputes process includes “(a) a claim or dispute for penalties or forfeitures prescribed by statute or regulation that another federal agency is specifically authorized to administer, settle, or determine; or (b) the settlement, compromise, payment, or adjustment of any claim involving fraud.” 48 C.F.R. § 33.210; 41 U.S.C. § 605(a).

41. 48 C.F.R. § 33.204. The “disputes” clause permits the parties to resolve the conflict by mutual consent to alternative dispute resolution. *Id.* § 52.233-1(g).

42. *Id.* § 33.210.

43. 41 U.S.C. § 605(c)(1), (2); 48 C.F.R. § 33.211(c).

44. 41 U.S.C. § 606.

45. *Id.* § 609(a)(1), (3).

46. *See, e.g., 28 U.S.C. § 2522* (The contractor and government have 60 days from the date the judgment or order is entered to appeal the Court of Federal Claims decision.).

47. 48 C.F.R. § 52.233-1(i).

48. *Valley View Enters., Inc. v. United States*, 35 Fed. Cl. 378 (1996).

49. The phrase “arising under the contract” in the following standard dispute clause limits the contractor’s obligations to proceed to disputes not involving breach: “shall proceed diligently with performance of this contract, pending final resolution of any request for relief, claim, appeal, or

action arising under the contract, and comply with any decision of the Contracting Officer.” However, if the alternative phrase “continued performance . . . arising under or relating to the contract” is used, the contractor is obligated to continue performing regardless of its claim. 48 C.F.R. § 33.215; *see also id.* § 33.213.

50. However, notice may be required under the government property clause. *See* 48 C.F.R. § 52.245-1.

51. Damages may include extra materials, equipment rental or wear and tear, labor costs, and delay. The contractor should take care to isolate the added materials, equipment rental, labor costs, and the like on the applicable invoices and time sheets for future claims presentation. Damages also include indirect or inefficiency costs (e.g., overtime, stacking of trades). The measured mile approach is a particularly good way to measure inefficiency. Under this approach, the contractor compares the rate of work done during the affected period with rate of work done during the unaffected period.

52. *See* 40 U.S.C § 3131(b)(2).

53. *See id.* § 3131(b).

54. *See id.* § 270b(a).

55. *See id.* § 3133(a).

56. *See id.* § 3133(b)(2).

57. *See id.* § 3133(b)(4).

58. *See id.*; *Sloan Constr. Co. v. Am. Renovation & Constr. Co.*, 313 F. Supp. 2d 24 (D.P.R. 2004) (claimant unable to recover on Miller payment bond because it brought suit later than one year after completing last change order work on project).

59. Second-tier supplier and subcontractors should also be wary of the applicable 90-day notice provision under 40 U.S.C § 3133(a), requiring notice to the general contractor.

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Recovery Act Stimulus Funds

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comprising \$15 billion in authorization for recovery zone facility bonds (tax-exempt private activity bonds) and \$10 billion in authorization for recovery zone economic development bonds (tax credit bonds), to be issued in 2009 and 2010 to spur development in established recovery zones. The Recovery Act also authorizes \$11 billion in Qualified School Construction Bonds (tax-credit bonds for new school construction) for each of 2009 and 2010.

The U.S. Office of Management and Budget (OMB) has outlined five main

goals for the federal government's implementation of the Recovery Act: (1) award and distribute funds in a prompt, fair, and reasonable manner; (2) ensure that the recipients and uses of the funds are transparent to the public and that the resulting benefits are reported clearly, accurately, and promptly; (3) ensure that funds are used for authorized purposes and to mitigate potential for fraud, waste, error, and abuse; (4) avoid unnecessary project delays and cost overruns; and (5) achieve specific program outcomes and improved results on economic indicators.²

New Opportunities = New Risks

The Recovery Act's unprecedented infusion of money into the U.S. economy is largely targeted at relatively quick (shovel-ready) construction projects around the country. This infusion brings substantial opportunities, as well as substantial risks, particularly for construction industry participants inexperienced in federal projects. Even before the Recovery Act, companies working on federally funded projects faced risks that do not exist in private commercial work. And now the Recovery Act establishes new and expanded procurement, transparency, and oversight measures designed to track the expenditure of funds and to prevent and expose fraud, waste, and abuse. These measures increase the risks and burdens on both government owners and private companies receiving and spending funds under the Recovery Act.

One of the best ways to address the risks associated with the use of Recovery Act funds and to ensure compliance with the federal government's goals for the implementation of the Recovery Act is to be aware of the requirements and put the necessary procedures in place to address them. This article highlights some of the most significant issues owners and contractors need to be aware of when using funds available under the Recovery Act. For government owners, this article presents key issues that affect the bidding process and contract negotiations. For

contractors, subcontractors, grantees, and subgrantees, this article presents issues to consider when bidding on and performing contracts to diminish risks involved in projects funded by the Recovery Act.

Preference for Competitive Fixed-Price Contracts

Section 1554 of the Recovery Act states that, to the maximum extent possible, contracts funded under the Recovery Act must be awarded as fixed-price contracts through competitive procedures. This provision is not limited to contracts executed directly with federal agencies; it is drafted broadly to cover contracts with states and municipalities that fund projects with dollars received under the Recovery Act. Moreover, any funded contract that is *not* fixed-price and *not* awarded competitively has to be summarized on the new "Recovery.gov" website.³

Fixed-price contracts generally place on the contractor maximum risk and full responsibility for cost overruns. Overruns are all the more likely when the requirements of a project are not sufficiently defined at the outset. Significantly, the Recovery Act expresses a preference for quick-start projects, which may result in projects with poorly defined requirements.⁴ Thus, the use of fixed-price contracts in a hurry-up environment could be a combustible formula for contractors, who need to be very careful about the projects they choose to pursue. This approach also has a downside for non-federal owners and grantees, as contractors may include large contingencies in bid prices to account for the risks inherent in an ill-defined scope of work, thus inflating pricing. Thus, more well-defined requirements should lead to tighter and more realistic bids and less potential for disputes.

Buy American Requirements

The Recovery Act includes two different sets of domestic preference requirements. The first, in section 604, is likely not going to be relevant to most construction projects. It applies to the procurement of items directly

The following are some of the largest appropriations related to construction work:

- **Federal Highway Administration:** \$27.5 billion in grant funds for state and local governments for surface transportation, rail, and port projects
- **General Services Administration:** \$5.5 billion for the Federal Buildings Funds
- **U.S. Army Corps of Engineers:** \$2 billion for water-related environmental infrastructure projects
- **Department of Defense:** \$5.9 billion for facilities improvements
- **Department of Energy:** more than \$11 billion to support energy-efficiency initiatives and \$4.5 billion for improvements to the national electrical grid
- **Department of the Interior:** more than \$1.3 billion for construction on federal and tribal lands
- **Environmental Protection Agency:** more than \$1.3 billion for environmental cleanup and \$6 billion for clean water projects
- **Department of Housing and Urban Development:** \$4 billion for public housing capital improvements

related to national security by the Department of Homeland Security.

The other set of requirements, in section 1605, mandates that projects for the construction, alteration, maintenance, or repair of public buildings or public works must use iron, steel, and manufactured goods produced in the United States. The only exceptions are in the case that (1) application of the requirements would be inconsistent with the public interest, (2) iron, steel, and relevant manufactured goods are not produced in the United States in sufficient and reasonably available quantities and of a satisfactory quality, and (3) including iron, steel, and manufactured goods produced in the United States will increase the cost of the overall project by more than 25 percent.⁵ If a federal agency decides that one of the exceptions applies, the agency must publish a detailed justification in the Federal Register. Also, following concerns expressed by other countries, Congress included a provision stating that the requirements are to be applied in a manner consistent with U.S. obligations under international agreements.

The Buy American provisions in section 1605, although relatively short, create significant complexities, in part because of the language concerning international agreements. These complexities are highlighted in two sets of interim rules published in the Federal Register earlier this year implementing section 1605. The first set of rules, Buy American Requirements for Construction Material,⁶ amends the Federal Acquisition Regulation (FAR) and applies to federal agency procurement contracts, as opposed to procurements funded with federal financial assistance. The second, Financial Assistance Awards,⁷ applies to financial assistance awards—grants, cooperative agreements, and loans. These two sets of rules, while generally implementing the same legislation, nonetheless contain differences, including different clauses and certain distinct definitions. The rules for procurement contracts, for example, also implement another statute—the Buy American

Act⁸—with respect to “unmanufactured construction materials.”

Given the substantial complexities in these interim rules, contractors and award recipients should become familiar with the rules (and watch for amendments to those rules), and they should take great care in reviewing and complying with Buy American provisions in solicitations and contracts or awards. If contractors and recipients believe the Buy

Fixed-price contracts in a hurry-up environment could be a combustible formula for contractors.

American requirements should not apply to certain items or materials, they should verify that belief with the appropriate government official *prior to award*—a step that is permitted under both the contract rules⁹ and financial assistance rules.¹⁰ It is in contractors’ and recipients’ interests to verify such inapplicability prior to award, as the interim rules state that post-award requests may be denied if the contractor or recipient could have made the request before award.¹¹ Similarly, government officials should keep in mind that the interplay among the various Buy American provisions and international treaties is complex. Government officials could benefit from seeking legal counsel for assistance interpreting applicable requirements, and should work closely with contractors and grantees to make sure that all relevant parties have reached a clear

understanding about the scope of such requirements for each project. The importance of complying with the Recovery Act’s Buy American requirements is underscored in the interim rules, which include provisions stating that if noncompliance is sufficiently serious, the government should consider terminating the contract or award and submitting a report to the relevant agency’s suspending or debarring official.¹²

Labor Requirements

Section 1606 of the Recovery Act provides, with respect to all projects funded by the Recovery Act, that laborers and mechanics employed by contractors and subcontractors must be paid wage rates determined under the Davis-Bacon Act. In most cases, this will likely increase project labor costs.

Several recent executive orders, although not associated with the Recovery Act specifically, may also affect labor requirements for projects funded under the Recovery Act. In particular, Executive Order 13502, Use of Project Labor Agreements, encourages federal departments to require the use of Project Labor Agreements (PLAs) for large-scale construction projects on a case-by-case basis to support labor-management stability for “efficient and timely completion of construction projects.”¹³ A PLA binds all contractors and subcontractors to the same rules, such as allowing nonunion and union contractors to bid on the same contract; guaranteeing against strikes; and establishing binding procedures for resolving labor disputes. Federal agencies may include such requirements in future regulations for projects funded by the Recovery Act. This will require more, perhaps lengthy, negotiation on a case-by-case basis at project start-up.

OMB has also issued guidance encouraging the use of local labor for projects funded by the Recovery Act. Specifically, OMB has encouraged federal departments to maximize benefits of Recovery Act projects by “supporting projects that seek to ensure that the people who live

in the local community get the job opportunities that accompany the investment."¹⁴ Contractors should be prepared that this emphasis may translate into specific bid criteria that give preferences for local hiring commitments. Such requirements may increase costs or require hiring more, smaller subcontractors, rather than one large subcontractor. The OMB guidance also encourages preferences for projects that use community-based organizations to connect "disadvantaged people with economic opportunities."¹⁵ Following this guidance, federal agencies, grantees, or owners may require contractors to participate in unique local job-training requirements.

Small Businesses and Disadvantaged Business Enterprises

Use of funds from the Recovery Act is also expected to support small businesses, which in turn stimulates economic growth and creates jobs. OMB guidance states that "agencies should provide maximum practicable opportunities for small businesses to compete and participate as prime and subcontractors."¹⁶ Federal agencies have also been directed to provide equal opportunities for disadvantaged business enterprises to the extent allowed by law.¹⁷

Time Frames

One of the basic goals of the Recovery Act is to encourage project construction in a quick time frame. The Recovery Act contains guidelines designed to ensure that funds are obligated and contracts are executed quickly. Governments, grantees, and contractors that can hit the ground running will benefit the most. Different agencies and programs have a variety of guidelines for how quickly funds must be obligated. For example, the Federal Highway Administration will be allocating \$27.5 billion in supplemental grant funds for surface transportation, rail, and port projects. Fifty percent of those funds must be obligated within 120 days after apportionment to the state, and 100 percent of funds must be obligated within one year after

apportionment to the state.¹⁸ In many other cases, grant recipients have to obligate funds within 180 days of receipt. Funds not obligated within the required time frames will be rescinded by the federal government and reallocated to other projects.

One requirement for many construction projects that can often delay timing is review under the National Environmental Policy Act (NEPA). Section 1609(b) of the Recovery Act

It is an excellent time to gain experience in the construction and use of clean energy technology.

provides that "[a]dequate resources within this bill must be devoted to ensuring that applicable environmental reviews under the National Environmental Policy Act are completed on an expeditious basis and that the shortest existing applicable process under the National Environmental Policy Act shall be utilized." Thus far, official action has not been taken to streamline or otherwise expedite NEPA review, causing some concern that NEPA review could slow project implementation.

Reporting

With the incentives for construction created by the Recovery Act also come considerable new reporting burdens on contractors, grantees, and owners associated with projects funded under the act. The Recovery

Act requires that any entity receiving Recovery Act funds directly from the federal government, including through contract, grant, or loan, must provide quarterly reports concerning, among other things, the funds received, a detailed description of the project, job creation numbers, and detailed information on any subcontracts or subgrants awarded.¹⁹ If a project is funded with a combination of Recovery Act funds and other funds, the expenditure of Recovery Act funds must be separately tracked and reported. Such reports are to be made publicly available.

Oversight and Compliance

The federal government has multiple laws and remedies it can use in connection with alleged fraud relating to projects using federal funds, as well as vast resources for auditing and investigating such projects. These laws and the federal investigative machinery impose burdens and risks on companies that receive federal funds, and the burdens and risks are increased by the Recovery Act.

The act authorizes federal inspectors general (IGs) to examine records of contractors, grantees, subcontractors, and subgrantees pertaining to contracts and grants using Recovery Act funds, and it also authorizes IGs to interview any officer or employee of contractors, grantees, and subgrantees.²⁰ The Recovery Act grants similar powers to the General Accountability Office (GAO).²¹ In addition, the Recovery Act provides millions of dollars in funding for various IG offices and the GAO.

The Recovery Act also created a Recovery Accountability and Transparency Board composed of certain IGs to coordinate and conduct oversight of covered funds to prevent fraud, waste, and abuse.²² The board can conduct audits, hold public hearings, and issue subpoenas to compel testimony from non-federal individuals.²³ Under the Recovery Act, the board will maintain the new "Recovery.gov" website to foster greater accountability and transparency in the use of covered funds. The website must include, among several

other items, detailed data on federal contracts and grants that expend covered funds.²⁴

In addition, the Recovery Act contains lengthy provisions establishing protections for state and local government and contractor whistleblowers.²⁵ An employee of any non-federal employer receiving covered funds may not be discriminated against as a reprisal for disclosing to specified entities or persons information the employee reasonably believes is evidence of “a gross waste of covered funds”; a violation of law, rule, or regulations related to an agency contract or grant using covered funds; and other circumstances.²⁶ A whistleblower can bring an action in federal court for damages against the employer after exhausting his or her administrative remedies.²⁷

In November 2008, the federal government published a final rule—the Contractor Business Ethics Compliance Program and Disclosure Requirements—that dramatically extends the government’s antifraud powers.²⁸ In general, the rule provides that a contractor can be debarred from government contracting for a knowing failure to disclose to the government certain information, including credible evidence of a violation of the civil False Claims Act (FCA).²⁹ In addition, OMB has issued guidance on the Recovery Act that instructs agencies to include a similar requirement in grants and cooperative agreements funded under the Recovery Act, stating that grantees and subgrantees must promptly refer to an appropriate IG any credible evidence that a principal, an employee, an agent, a contractor, a subgrantee, a subcontractor, or other person has submitted a false claim under the FCA or has committed a criminal or civil violation of laws pertaining to fraud, conflict of interest, bribery, gratuity, or similar misconduct involving those funds.³⁰ Further, the Department of Justice IG has issued a document stating that, “beyond what is required by the OMB guidance, granting agencies also should require the grantee or sub-grantee when they become aware of any overpayment

of funds distributed to the grantee or sub-grantee to promptly report to the OIG and granting agency that overpayment.”³¹

Finally, a few words about the FCA are warranted. The FCA is the government’s most powerful weapon against fraud in federal programs. The FCA imposes treble damages and penalties for, among other acts, knowingly presenting a false claim for payment to the federal government, or knowingly making or using a false record or statement to get a false claim paid by the federal government. The term “knowingly” does not require a specific intent to defraud but includes acting in reckless disregard of the truth or falsity of the information. Also, the FCA permits private citizens (relators) to bring claims on behalf of the government and to obtain a percentage of any recovery. On May 20, 2009, President Obama signed into law the Fraud Enforcement and Recovery Act of 2009 (FERA),³² which amended the FCA to broaden liability and enhance the ability of the Department of Justice and relators to bring actions. The amendments provide that the FCA cover certain situations in which false claims are presented to entities other than the government, such as to a prime contractor if the money claimed is to be spent on the government’s behalf and the government provided part of the money claimed. Given that the Recovery Act appropriates vast amounts of money to be used for projects that will not involve federal agency contracts, such as state construction projects, companies performing work under such projects should pay particular attention to the FCA amendments.

“Green” Contracting Opportunities

The unprecedented level of funding for “green” projects adds another consideration for contractors—an edge for those already versed in green building and an incentive to learn new technologies for those who are not. Overall, it has been estimated that the Recovery Act provides about \$94 billion in funding for clean energy companies and

projects, through direct spending as well as tax incentives and other financing programs. For example, the General Services Administration will be spending \$4.5 billion on energy efficiency upgrades to federal facilities; states will receive more than \$11 billion in funding for energy efficiency retrofits and weatherization of public buildings and private homes and businesses; and about half of the Department of Defense’s \$6 billion of construction and repair projects identified to date are for energy efficiency and alternative energy projects. Given the magnitude of stimulus funds committed to the energy sector, it is an excellent time for contractors and subcontractors to gain experience in the construction and utilization of clean energy technology.

Several key websites include the most up-to-date information about federal contracting opportunities funded by the Recovery Act and associated rules and regulations.

www.Recovery.gov

The main federal website for information related to the Recovery Act, including information about time frames, grant awards and contracts, and formula allocations.

www.FedBizOpps.gov

Lists announcements of all proposed federal contracts expected to exceed \$25,000, including all major solicitations, contract awards, subcontracting opportunities, surplus property sales, and foreign business opportunities. The site includes a special list of contracts funded by the Recovery Act. (Use the “Search Recovery Opportunities” button.)

www.Grants.gov

Includes a list of grant opportunities from 26 different federal agencies. For grant opportunities related to the Recovery Act, use the “Recovery Act Opportunities” link from the homepage.

Some Early Experiences

As this article goes to press, the federal government has announced that already more than \$73 billion in funds from the Recovery Act have been disbursed and that thousands of projects funded by the Recovery Act have been started. Much of this first wave includes backlogged surface transportation projects, such as highway and airport improvements. Initial experience with these projects reveals a higher number of bidders for each project than foreseen, and, as a result, bids are lower than expected. For example, the U.S. Department of Transportation announced that bids for transportation work were coming in 10–30 percent below expectations.³³ With such heavy competition for work, bidders must be more sophisticated than ever in preparing bids while being mindful of the requirements under the Recovery Act. Similarly, government owners should carefully review low bids for their scope to ensure that they have accounted for the full implementation costs of the contracting requirements, especially wages,

reporting and oversight, and time frames for completion. For transportation projects, low bids can still be a win-win for both owners and contractors. The Department of Transportation has announced that cost savings from low bids for projects funded by the Recovery Act must be used for other projects eligible under the Recovery Act, which means additional contracting opportunities.³⁴

Finally, there has been some public concern about the speed of decision making required to meet the Recovery Act's aggressive deadlines. For example, in Texas, a public advocacy organization led public protests to raise questions about the state's decision-making process for the use of its transportation funds provided by the Recovery Act, raising the concern that the state had not undertaken adequate planning and prioritization efforts.³⁵ Therefore, government owners should emphasize transparency in the selection and prioritization of projects funded by the Recovery Act.

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Endnotes

1. American Recovery and Reinvestment Recovery Act of 2009, Pub.L. No. 111-5 (2009) available at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h1enr.txt.pdf.

2. Memorandum for the Heads of Departments and Agencies: Updating Implementing Guidance for the American Recovery and Reinvestment Recovery Act of 2009, at 1 (Apr. 3, 2009), available at www.recovery.gov/sites/default/files/m09-15.pdf.

3. See also Memorandum for the Heads of Executive Departments and Agencies: Government Contracting (Mar. 4, 2009), available at www.whitehouse.gov/the_press_office/Memorandum-for-the-Heads-of-Executive-Departments-and-Agencies-Subject-Government.

4. See Recovery Act § 1602.

5. *Id.* § 1605.

6. 74 Fed. Reg. 14,623 (Mar. 31, 2009) (to be codified at 48 C.F.R. pts. 1, 5, 25, and 52).

7. 74 Fed. Reg. 18,449 (Apr. 23, 2009) (to be codified at 2 C.F.R. pt. 176).

8. 41 U.S.C. §§ 10a–10d (2006).

9. 74 Fed. Reg. at 14,627 (FAR 25.604).

10. 74 Fed. Reg. at 18,453 (§ 176.100).

11. See 74 Fed. Reg. at 14,627 (FAR 25.606); 74 Fed. Reg. at 18,453 (§ 176.120).

12. 74 Fed. Reg. at 14,628 (FAR 25.607); 74 Fed. Reg. at 18,453–54 (§ 176.130).

13. Exec. Order No. 13,502, 74 Fed. Reg. 74 (Feb. 6, 2009).

14. Memorandum for the Heads of Departments and Agencies, *supra* note 2, at 5.

15. *Id.* at 6.

16. *Id.* at 5.

17. *Id.* at 6.

18. Recovery Act, div. A, tit. XII.

19. *Id.* § 1512.

20. *Id.* § 1515.

21. *Id.* § 902 (with reference to contractors and subcontractors).

22. *Id.* §§ 1521–22.

23. *Id.* § 1524.

24. *Id.* § 1526.

25. *Id.* § 1553.

26. *Id.* § 1553(a).

27. *Id.* § 1553(c)(3).

28. Contractor Business Ethics Compliance Program and Disclosure Requirements, 73 Fed. Reg. 67,064 (Nov. 12, 2008).

29. 31 U.S.C. §§ 3729–33 (2006).

30. Memorandum for the Heads of Departments and Agencies: Initial Implementing Guidance for the American Recovery and Reinvestment Recovery Act of 2009, at 37 (Feb. 18, 2009), available at [www.recovery.gov/files/Initial Recovery Act Implementing Guidance.pdf](http://www.recovery.gov/files/Initial%20Recovery%20Act%20Implementing%20Guidance.pdf).

31. Inspector General, U.S. Dep't of Justice, Improving the Grant Management Process 6 (2009), available at www.usdoj.gov/oig/special/s0903/final.pdf.

32. Pub. L. No. 111-21 (2009) (enrolled bill available at <http://thomas.loc.gov/cgi-bin/query/C?c111:./temp/~c111OgbY5O>).

33. Press Release, U.S. Dep't of Transportation, U.S. Transportation Secretary LaHood Says Cost Savings Returned to States (Apr. 20, 2009), available at www.dot.gov/affairs/2009/dot5509.htm.

34. *Id.*

35. Jessica Sondgeroth, *Advocacy Groups Protest TxDOT Stimulus Projects*, NEWS8AUSTIN (Mar. 3, 2009), available at www.news8austin.com/content/your_news/?SecID=278&ArID=233887.

Save the Date

April 22–April 23, 2010
Austin, Texas

The ABA Forum on the Construction Industry Annual Meeting, cosponsored by the Construction Litigation Committee, will focus on sustainable design and construction issues. Historically, the Construction Litigation Committee has presented a plenary program, and hosted a breakfast program and a Dutch treat dinner for members.

April 21–April 24, 2010
New York, New York

ABA Section of Litigation Annual Conference. The committee will be submitting several programs for consideration and will host a networking lunch.

Arbitration Agreements

continued from page 1

great frequency in construction contracts, and many courts have been unyielding in providing their support and enforcement to these clauses.

However, the strong policy support behind arbitration clauses and the strict construction applied to mechanics' lien statutes have placed some parties between a rock and a hard place—the quandary of whether to give the arbitration clause or the lien statute paramount consideration. While many lien laws specify enforcement in the courts and require that certain parties be joined in those proceedings, arbitration clauses place claims before an arbitrator and may not be entered into by all those parties necessary for a lien enforcement action. This and similar conflicts created between mechanics' lien laws and arbitration clauses in certain jurisdictions have left courts in those states to grapple with reconciling the interests and purposes of both the mechanics' lien laws and arbitration clauses, as well as the statutes and case law supporting them.

As one author has observed, “When it comes to mechanic’s liens . . . it could easily be said that ‘there is no new thing under the sun.’”¹ However, there certainly is no unanimity of opinion on this issue, particularly in light of some significant revisions to some of these statutes in certain states, including Florida, Tennessee, New Mexico, and Pennsylvania, to name a few. Likewise, there is still some disagreement remaining as to whether the court or the arbitrator should determine the validity of the underlying lien once arbitration has occurred. Further, although all jurisdictions seem to agree that the contractual obligation to arbitrate a mechanic’s lien can be waived, they disagree over the proper standard for a waiver and the impact of the pursuit of a mechanic’s lien claim on the agreement to arbitrate. The essential points of these issues are highlighted below.

Determining the Validity of the Underlying Mechanic’s Lien

In many instances, the courts have struggled to address certain conflicts between enforcement of mechanics’ lien rights and obligations to arbitrate. When these laws and claims collide, many states permit a claimant to file a mechanic’s lien with the court but then allow arbitration of the amount owed under the lien.² Generally, the right to arbitrate the

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claim under a contract is not waived by filing a mechanic’s lien in court. In fact, most states recognize that the initial filing is necessary to protect the claimant’s rights under mechanics’ lien statutes.³

There is a difference of opinion between states, however, on who should make the determination of the validity of the mechanic’s lien—the arbitrator or the court. The seminal case in this area seems to be *Brescia Construction Co. v. Walart Construction Co.* The contract between the parties in *Brescia* contained a broad arbitration provision stating that any disputes arising under the contract would be submitted to arbitration. An arbitrator determined the amount of the award due the plaintiff, but the court held that this amount was not chargeable against the property until the court determined the validity of the lien. Thus,

the contract’s arbitration provision was limited to determining the amount due the plaintiff, which was “merely a step in enforcing the plaintiff’s remedies.”⁴ New York courts that have subsequently addressed the issue have held that the validity of a mechanic’s lien is a matter “beyond the power of the arbitrators to determine.”⁵

In *CVN Group, Inc. v. Delgado*, a Texas court rejected this view and instead held that nothing in the mechanics’ lien statute indicated that arbitrators were not permitted to determine the validity of a mechanic’s lien. Thus, rather than requiring a court to determine whether the technical requirements for perfecting a mechanic’s lien have been satisfied, Texas permits the arbitrator to make that determination under a broad arbitration provision. Because the arbitration provision in *CVN Group* was broad, requiring “all claims, disputes or other matters in question between the parties” to be submitted to arbitration, the court held that the arbitrator had plenary authority to determine not only the amount but also the validity of the lien.⁶

Any case involving an arbitrable lien claim must resolve two principal issues. The first is the validity of the underlying claim in terms of amount and entitlement. Then, of course, there is still the issue of whether compliance with the mechanics’ lien statute at hand has been shown. Under certain approaches to this mechanics’ lien/arbitration dichotomy, pursuing these issues in two separate forums could require a duplication of proof along with, possibly, an inconsistency of result. Although the general sanctity of an arbitrator’s award is largely well respected in the law, a court, in evaluating whether to enter the judgment on the award, may find that the arbitrator’s jurisdiction did not extend to certain determinations more associated with the statutory operation of the mechanics’ lien laws, as opposed to something within the arbitrator’s proper purview.

For example, if a state’s mechanics’ lien law allows for an extended period of time between filing and

One State in Focus: Pennsylvania

A focused look at one jurisdiction's laws regarding the enforcement of a mechanic's lien proceeding is instructive. In Pennsylvania, under the Mechanics' Lien Law of 1963, once a mechanic's lien claim has been perfected, a complaint to enforce the lien must be filed within two years of the date of the lien filing, and judgment must be fully and finally achieved within five years (accounting for any court-driven delays of an extended nature). The rules of procedure provide that, among other things, the enforcement proceeding must occur by virtue of a complaint filed in the Office of the Prothonotary (the Clerk of Courts) in the county in which the project is located. Almost immediately, there is an issue to the extent the arbitration provision would not be consistent with this requirement. Furthermore, both Pennsylvania's lien law and the procedural rules

of enforcement contemplate that no counterclaims are permitted in the mechanic's lien enforcement proceeding and that only a set-off can be raised in response.¹ It is most certainly uncertain as to whether the arbitrators would consider themselves so constrained by this statute and procedural rule that they would forgo the opportunity to address by way of counterclaim any claims that the owner may have to the various causes of action asserted against it by the lien claimant. Indeed, and as a corollary to this concern, Pennsylvania's lien law and the procedural rules do not permit joinder of any other causes of action to the complaint to enforce.² Unfortunately, most arbitration provisions contain language requiring that any and all claims then possessed by the claimant be brought at the same time. Thus, these provisions find themselves directly at odds with

one another, making it difficult, if not impossible, for the potential claimant to reconcile these competing demands for certain treatment and resolution. Moreover, Rule 1661 of the Pennsylvania Rules of Civil Procedure, which provides for enforcement of the mechanic's lien claim before a judge, may be viewed as inconsistent with the right to seek enforcement of such claims in an arbitration forum. Because the lien laws of the states are so varied, it is essential to evaluate each individual state's lien laws covering the project to determine whether there is an enforcement conflict between that particular state's laws and a desired or mandated arbitration proceeding.

Endnotes

1. PA. R. CIV. P. 1658; Pa. Lien Law § 1701(e).
2. PA. R. CIV. P. 1657.

enforcement, the lien claimant may be best served by filing and perfecting its mechanic's lien, then pursuing the underlying substantive rights to the claim in an arbitration forum and later initiating proceedings to enforce the mechanic's lien claim. Then the remaining court proceedings should involve only compliance with the mechanics' lien law. This is not to suggest that such an approach may not be subject to challenge by the opposing party during the arbitration proceedings or thereafter. However, if the opponent objects that the mechanic's lien issue should be arbitrated, the claimant would then be in a position to modify its approach during the arbitration and proceed accordingly.

In sum, the majority view, anchored by the New York decisions in *Brescia* and *May*, is that although an arbitration provision may give the arbitrator authority to determine the amount of the mechanic's lien, the court retains

its obligation to ensure that the technical elements of perfecting that lien, including establishing its validity, have been met. Texas, as shown by the *CVN Group* decision, supplies the minority view, taking a more hands-off approach, as it allows the arbitrator not only to determine the amount of the lien but also its validity.

Waiving the Right to Arbitration by Filing a Mechanic's Lien Claim

Parties that contractually agree to arbitrate their contract claims (including, presumably, claims for mechanics' liens) can waive that right in certain circumstances, although the jurisdictions disagree over the proper standard to use to determine whether waiver has occurred. Within the past few years, more state courts have joined the general view that a party to an arbitration agreement may file an initial mechanic's lien claim with the court *without* waiving its right to pursue arbitration.⁷ Along

with other jurisdictions that have so held, these courts have permitted a party to file an initial mechanic's lien despite an arbitration agreement so that arbitration and mechanics' lien statutes can be read harmoniously.⁸ More important, mechanics' liens are generally permitted in this context so that the party to the arbitration agreement can protect its entitlement to a remedy under the mechanics' lien statutes.⁹

Additional actions beyond merely filing and perfecting a mechanic's lien claim itself, however, may serve to waive the right to arbitration. Courts in some jurisdictions have determined that filing a complaint or answer without a demand for arbitration waives the subsequent right to engage in arbitration.¹⁰ For example, Ohio courts hold that a party may waive its right to arbitrate by filing suit. The defendant may save the right to arbitrate by applying for a stay, but if the defendant

does not do so and instead files responsive pleadings, that defendant was held to have lost its ability to compel arbitration.¹¹

Generally speaking, however, courts have required a greater degree of participation in the judicial process before waiver is found to exist. Typically, courts hold the party seeking arbitration has waived the right to arbitration if it has *substantially* invoked the litigation process in a manner that is inconsistent with the right to arbitrate and if the party opposing arbitration will be substantially prejudiced by these actions.¹² Depending on the jurisdiction, substantial involvement in the judicial proceedings may be found if a party files a motion for summary judgment, engages in substantial discovery, or opposes an earlier attempt to compel arbitration. Indeed, by engaging in substantial discovery in the court proceeding, you run the biggest risk of waiving the right to proceed further in arbitration.

Jurisdictions also vary on the amount of prejudice required before waiver is found, as well as the method of proving prejudice. It is interesting to note that Texas follows the strictest standard, which requires the party opposing arbitration to demonstrate *actual* prejudice. If the opposing party fails to demonstrate actual prejudice, arbitration will still be compelled, regardless of whether a party has invoked the judicial process to a substantial extent or for a substantial amount of time.¹³

A third approach that some courts have taken is not to require a showing of prejudice at all. These courts require merely that the party seeking arbitration has acted inconsistently with its right to arbitrate.¹⁴ For these courts, prejudice is simply not a factor, and arbitration is deemed waived if the party acted inconsistently with the claimed right to arbitrate.

Thus, depending on the jurisdiction, a party may inadvertently waive its right to arbitrate a mechanic's lien by merely filing a complaint with the court. Most courts will go a step further, however, and require that the party also *substantially* invoke

the judicial process by, among other things, engaging in certain levels of discovery or filing dispositive motions. If a party wishes to maintain its right to arbitrate a mechanic's lien in the future, it would be most prudent to avoid any act that may be considered an invocation of the judicial process (aside from merely filing and perfecting a mechanic's lien claim against the property).

It may be necessary for practitioners to refine their approaches to contract drafting.

Participating in these types of actions, however, seems less risky in a state that follows Texas in requiring *actual* prejudice to be shown by the party opposing arbitration. If the jurisdiction does not require prejudice or is willing to infer it from a delay in requesting arbitration, a party intending to request arbitration at a later date would be well advised to avoid unnecessary invocation of the judicial process entirely beyond those essential steps necessary to file and perfect the mechanic's lien claim in the first instance.

One state has tried to address this quandary. As of July 1, 2007, New Mexico specifically allows enforcement proceedings on mechanics' lien claims within its jurisdictional boundaries to occur in binding arbitration.¹⁵ For that reason, the foreclosure proceedings must be commenced within two years and occur either in the courts or in binding arbitration. However, as one New Mexico practitioner and author

has observed in his materials on New Mexico's lien law, the revision to the statute raises and leaves unresolved a number of questions, including the scenario in which only some and not all of the participants are subject to the binding arbitration clause but are required to be joined in the mechanic's lien enforcement proceeding, and whether the arbitration award would still need to be foreclosed in a court action relating to the property.¹⁶ Despite these uncertainties, the State of New Mexico should be applauded for its recognition of the issue and an effort to accommodate the clause, which is so frequently encountered in most construction contracts.

A Solution for the Gordian Knot?

To resolve the conflict, it may be necessary for practitioners to refine their approaches to contract drafting. Indeed, because many of the states are unwilling or unable to be nimble in their refinement of their respective mechanics' liens provisions, a more comprehensive acknowledgment of the conflict between arbitration agreements and mechanics' lien enforcement proceedings must occur and be dealt with by the industry as a whole. For example, and in addition to any typical or standard arbitration provision, the following language could be added to supplement the dispute resolution proceeding clause to accommodate what needs to be undertaken to enforce an already perfected lien claim:

Notwithstanding anything contained herein to the contrary, this provision shall not be construed to preclude enforcement of any mechanic's lien rights which may otherwise be held by the contractor. Further, to the extent required by law, the contractor shall be permitted to pursue any and all actions to preserve and enforce its rights to a mechanic's lien claim and any such action shall not be construed as a waiver of the parties' agreement to arbitrate as herein contained.

This is but one example of supplemental or addendum language to accommodate the necessary mechanics' lien enforcement actions. Still, it does provide a solution for achieving the desired goal of permitting the contractor to take those necessary steps to secure and enforce its rights when those statutory criteria for lien enforcement do not expressly accommodate the arbitration option.¹⁷

Conclusion

For anyone familiar with the power of a mechanic's lien claim, its leverage can be extremely significant and, therefore, the claim can translate to almost instantaneous relief for the claimant. Unfortunately, when the mere filing of the lien itself does not prompt immediate payment and enforcement of the lien becomes a necessary step on the road to financial recovery, there is another layer of concerns to be addressed if the underlying contract documents contain arbitration provisions for resolution of disputes. Clearly, the beneficial and preferred method is to do whatever is necessary to file and perfect the underlying mechanic's lien claim. Once that is done, the particular jurisdiction's lien law provisions on enforcement of the lien must be considered in conjunction with the arbitration provisions in the contract documents to determine the plan of action to take to ensure the most secure method of maintaining the viability of the lien without waiving the entitlement to pursue arbitration rights as well. In some jurisdictions, such proceedings appear to be able

to coexist without conflict, but in other jurisdictions within the United States, these concerns will be more acute and must be more thoroughly and thoughtfully planned for, even perhaps at the time of contract negotiation.

Edward B. Gentilcore is a partner with Duane Morris, LLP in Pittsburgh, Pennsylvania. He thanks Carla M. Bennett for her help writing this article.

Endnotes

1. Michael Marsh, *Mechanic's Liens and Materialman's Liens: A Review of Selected Issues*, Haw. B. J. (Apr. 1997) (quoting *Ecclesiastes* 1:9).
2. See, e.g., *Brescia Constr. Co. v. Walart Constr. Co.*, 190 N.E. 484 (N.Y. 1934) (holding that the arbitration award was conclusive as to the amount due but that a valid lien must be established by the court before payment is required); *Caretti, Inc. v. Colonnade*, 655 A.2d 64, 66 (Md. Ct. Spec. App. 1995).
3. *Stewart v. Covill & Basham Constr.*, 75 P.3d 1276 (Mont. 2003).
4. *Brescia*, 190 N.E. at 487.
5. *May v. New Amsterdam Cas. Co.*, 60 N.Y.S.2d 613, 614-15 (N.Y. App. Div. 1946).
6. *CVN Group, Inc. v. Delgado*, 95 S.W.3d 234 (Tex. 2002).
7. *Paragon Ltd., Inc. v. Boles*, 2007 Ala. LEXIS 278, at *8 (Ala. Dec. 21, 2007); *Newman v. Valleywood Assoc., Inc.*, 874 A.2d 1286, 1290 (R.I. 2006); *Brendsel v. Winchester Constr. Co.*, 898 A.2d 472, 482 (Md. 2006).
8. *Newman*, 874 A.2d at 1290 ("Any holding to the contrary would frustrate the purposes of both statutes because it would require potential litigants to choose between arbitration and filing a mechanic's lien.").

9. See, e.g., *Stewart*, 75 P.3d at 1279; *Brendsel*, 898 A.2d at 481.

10. *Galion Iron Works & Mfg. Co. v. J.D. Adams Mfg. Co.*, 128 F.2d 411, 413 (7th Cir. 1942); *McNeff v. Capistran*, 120 Wash. 498, 208 P. 41 (1922); *Peridia, Inc. v. Showe Constr. Co., Inc.*, 2003 Ohio App. LEXIS 1369, at *5 (Ohio Ct. App. Mar. 14, 2003).

11. *MGM Landscaping Contractors, Inc. v. Berry*, 200 Ohio App. LEXIS 1117, at *7 (Ohio Ct. App. Mar. 22, 2000).

12. *Paragon*, 2007 Ala. LEXIS 278, at *7; *Modern Piping, Inc. v. Blackhawk Automatic Sprinklers, Inc.*, 581 N.W.2d 616, 621 (Iowa 1998); *Nw. Constr. Co. v. Oak Partners*, 248 S.W.3d 837 (Tex. Ct. App. 2008); *Gen. Equip. & Supply Co., Inc. v. Keller Rigging & Constr.*, 544 S.E.2d 643 (S.C. Ct. App. 2001).

13. *Nw. Constr.*, 248 S.W.3d at 849.

14. *Finlay Prop., Inc. v. Hoosier Contracting*, 802 N.E.2d 453 (Ind. Ct. App. 2003); *TSP-Hope v. Home Innovators of Ill.*, 2008 Ill. App. LEXIS 640, at *8; *La Hood v. Cent. Ill. Constr., Inc.*, 81 N.E.2d 585 (Ill. Ct. App. 2002).

15. See N.M. STAT. ANN. § 48-2-10 (1978).

16. Carl A. Calvert, *New Mexico Lien Law*, available at www.lienlawonline.com.

17. The American Institute of Architects does come closer to another possible solution in its AIA Document A201—General Conditions of the Contract for Construction. Section 15.2.8 in the Initial Decision section provides that "[i]f a Claim relates to or is the subject of a mechanic's lien, the party asserting such Claim may proceed in accordance with applicable law to comply with the lien notice or filing deadlines." Interestingly, however, there is no counterpart language in the Arbitration section of the same document, nor is there any other waiver protection language included there.

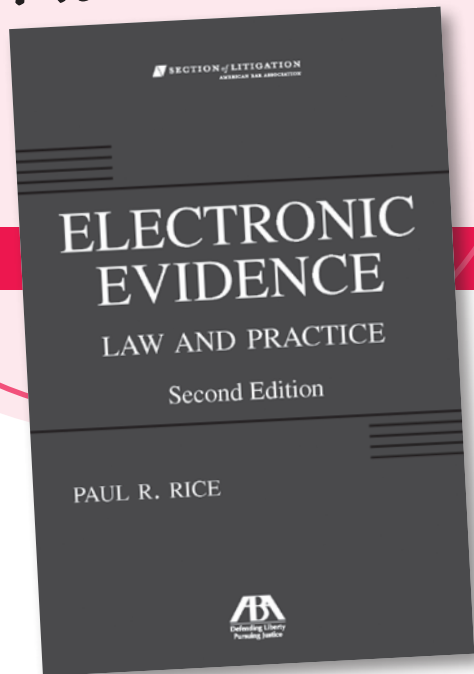


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