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## Project Suspension: What Owners And Contractors Need To Know – NOW!

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### I. INTRODUCTION

At the end of 2008, the American public was faced with what previously had seemed like an impossibility – Lehman Brothers Holdings, Inc. filed for bankruptcy.<sup>3</sup> Just a few days later, contractors working on the construction of a Ritz Carlton Hotel and Spa in Rancho Mirage, like so many others, received more bad news.<sup>4</sup> The construction of the Ritz Carlton was funded primarily by Lehman Brothers and, thanks to Lehman’s impending bankruptcy, the project had lost its funding.<sup>5</sup> With this newfound lack of financial backing and no prospective lender in sight, the owners of the project suspended it indefinitely while they sought alternative funding.<sup>6</sup>

This occurrence was the beginning of what now seems like an inexhaustible list of construction project suspensions in a downward spiraling economy. In fact, by December of 2008, the state of California had suspended funding that affected 2000-plus infrastructure projects that were already underway. The suspension affected work on levees, housing, schools and roads.<sup>7</sup> By January of 2009,

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<sup>3</sup> Andrew Ross Sorkin, *Lehman Files for Bankruptcy; Merrill Is Sold*, THE NEW YORK TIMES, Sept. 15, 2008, <http://www.nytimes.com/2008/09/15/business/15lehman.html?pagewanted=all>.

<sup>4</sup> Valli Herman, *Construction Halted at the Ritz Carlton in Rancho Mirage*, LOS ANGELES TIMES, Sept. 30, 2008, <http://travel.latimes.com/daily-deal-blog/index.php/ritz-carlton-rancho--2883/>.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.*

<sup>7</sup> Gov. Arnold Schwarzenegger's State of the State Address, LOS ANGELES TIMES, January 15, 2009, <http://www.latimes.com/news/local/la-me-gov-excerpts16-2009jan16,0,5693683.story>.

\$1.8 billion worth of work was in danger of being suspended due to the economic crisis.<sup>8</sup> In February, the California Department of Transportation expanded this list to include more than 100 of its projects statewide.<sup>9</sup> Private projects are not as easily documented, but it is clear that they have been equally as affected. Although the State of California has restarted work on many of the projects it had suspended,<sup>10</sup> the state financial crisis is all but over, and the financial market for private projects is anything but certain. In fact, In July of 2009, Governor Schwarzenegger declared a “state of fiscal emergency” by suspending cash payments and issuing “IOU’s” to vendors, including contractors on state projects.<sup>11</sup>

In a time where suspension is not just a possibility, but has become more of a probability, owners and contractors are left asking: What do I do? The answer is not as simple as it would seem. The best solution is for all parties to consider a clear and unambiguous suspension clause when negotiating a construction contract and protect themselves from this scenario from the beginning. But for many who are already in the midst of projects, or even worse, facing suspension, this is not an option. In the midst of suspension, owners and contractors are left to evaluate their contract as well as the interpretation of certain contractual provisions outside suspension in order to determine what damages were incurred, who is liable for what, and the total amount of potential damages. Given the lack of case law on the topic, even attorney’s have questions as to how this will play out.

By interpreting language from multiple form contracts in conjunction with decided case law relating to termination and suspension, this article hopes to shed some light on an area that appears to be anything but black and white.

## **II. DELAY, TERMINATION, AND SUSPENSION**

Contrary to what many owners and contractors believe, termination, suspension and delay are each separate scenarios with different effects and legal obligations/consequences. Treating them the

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<sup>8</sup> Rachel Gordon, *Cash-strapped California May Halt Road Projects*, SAN FRANCISCO CHRONICLE, January 13, 2009, <http://www.sfgate.com/cgi-bin/article.cgi?f=/c/a/2009/01/13/MN6C1591FF.DTL>.

<sup>9</sup> Melanie Turner, *Construction Workers Protest as Caltrans Suspends Projects*, SACRAMENTO BUSINESS JOURNAL, February 10, 2009, <http://www.bizjournals.com/sacramento/stories/2009/02/09/daily29.html>.

<sup>10</sup> Ann M. Simmons, *Intermission End: Act 2 Begins*, LOS ANGELES TIMES, April 20, 2009, at A6.

<sup>11</sup> *California Prepares to Pay Bills with IOU’s*, ASSOCIATED PRESS, July 2, 2009, [http://www.msnbc.msn.com/id/31706784/ns/us\\_news-life/](http://www.msnbc.msn.com/id/31706784/ns/us_news-life/).

same would be a mistake and could cost an owner and/or contractor significant dollar amounts in damages.

## A. Delay

Probably the most heavily litigated and developed of these three scenarios is delay. A traditional delay in a construction project generally results in a breach of the construction contract. Depending on the delay, it can result in either an extension of time for the contractor, damages for the owner, or a combination of additional compensation and an extension of time for the contractor. In a dispute with regard to compensation, courts will attempt to enforce contract provisions according to the parties' intent. The determination of damages owed due to the delay largely depends on whether the delay is the owner's risk or the contractor's risk and whether the delay is excusable or inexcusable.<sup>12</sup> The categorization of a certain delay is largely determined by the agreement between the parties.<sup>13</sup>

All delays fall into one of three categories: (1) excusable; (2) inexcusable; or (3) compensable.<sup>14</sup> Excusable delays are those that are caused by factors beyond the control of both the owner and the contractor; examples include weather, acts of God, and strikes.<sup>15</sup> In cases of excusable delays, the contractor is entitled to an extension of time but no additional compensation.<sup>16</sup>

Inexcusable delays are those that are within the control of the contractor; examples include equipment failure, failure to properly schedule the project, and failure to properly man the project.<sup>17</sup> Inexcusable delays do not entitle the contractor to an extension of time or additional compensation.<sup>18</sup> In the case of an inexcusable delay, the contractor becomes liable for liquidated or actual damages that the owner may sustain. While the amount of liquidated damages must be specified in the contract<sup>19</sup>, actual damages can come in the form of loss of use/rents, interest and increased financing, extended

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<sup>12</sup> CONSTRUCTION SCHEDULING: PREPARATION, LIABILITY, AND CLAIMS 199 (Jon M. Wickwire et al. eds., 2nd ed. 2003) [hereinafter CONSTRUCTION SCHEDULING].

<sup>13</sup> *Id.*

<sup>14</sup> KENNETH C. GIBBS & GORDON HUNT, CALIFORNIA CONSTRUCTION LAW 269 (16th ed. 2000).

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.*

<sup>18</sup> *Id.*

<sup>19</sup> See CAL. PUB. CONT. CODE § 10226 (Liquidated damage provisions are required to be included in state construction contracts); See also GIBBS & HUNT, *supra* note 14, at 206.

maintenance and operation, and/or special damages.<sup>20</sup> However, such actual damages must either arise naturally from the breach or must have been within the contemplation of the parties at the time of execution of the prime contract.<sup>21</sup>

Unlike excusable and inexcusable delays, a compensable delay is any delay to the project caused by the owner and/or by agents for whose acts and omissions the owner is responsible.<sup>22</sup> Examples of these owner-caused delays include failure to grant site access, delays in responding to requests for information, or other acts or omissions of the owner that delay the work on the critical path.<sup>23</sup> In cases of compensable delay, the contractor is entitled to both a time extension and additional compensation.<sup>24</sup> Compensable delays can leave the owner liable to the contractor for damages such as extended overhead and job site costs, equipment standby costs, wage escalation, financing costs, and extended supervision.<sup>25</sup>

## B. Termination

Unlike a delay, the termination of a contract results in its end and neither party is required to continue performance under it. However, once the contract is terminated, the parties may still be entitled to damages based on the termination. The nature and amount of these damages depends, again, on the way termination is treated in the construction contract.

A termination provision in a construction contract takes one of two forms; the provision is either a termination “for cause” clause or a termination “for convenience” provision. The most crucial difference between these two types of termination is that in order for an owner to terminate the contract “for cause”, the contractor must have *materially* breached the contract.<sup>26</sup> Termination “for

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<sup>20</sup> *Id.*

<sup>21</sup> CONSTRUCTION SCHEDULING, *supra* note 12, at 571; *see also Mednoyoma v. County of Mendocino*, 8 Cal.App.3d 873 (1970).

<sup>22</sup> For example, any delay caused by the owner’s architect or project manager would be a compensable delay for which the owner was liable. *See, e.g.,* CONSTRUCTION SCHEDULING, *supra* note 12, at 571.

<sup>23</sup> *Id.*

<sup>24</sup> GIBBS & HUNT, *supra* note 14, at 269.

<sup>25</sup> CONSTRUCTION SCHEDULING, *supra* note 12, at 486.

<sup>26</sup> GIBBS & HUNT, *supra* note 14, at 217.

cause” almost always results in claims back and forth between the owner and the terminated contractor.<sup>27</sup>

“Termination for convenience” provisions, on the other hand, allow the owner to terminate the contract *for any reason*.<sup>28</sup> These provisions generally require the owner to compensate the contractor for the work actually performed prior to such termination and costs incurred by reason of the termination.<sup>29</sup> However, the amount of this recovery by a contractor will vary depending on the terms of the contract. For example, unlike the Engineers’ Joint Contract Documents Committee (“EJCDC”) and the Federal Acquisition Regulation (“FAR”), the American Institute of Architect’s (“AIA”) contracts expressly allow recovery of “reasonable profit on the work not yet executed” where the contractor was terminated “for convenience.”<sup>30</sup>

### C. Suspension

As opposed to termination and delay, suspension is a *contractually allowable delay* during the course of construction of a project. As such, according to construction law scholars Philip L. Bruner and Patrick J. O’Connor, Jr., the modern “suspension of work clause” is “nothing more than a compensable delay authorized and addressed by contract.”<sup>31</sup>

Prior to the time when contracts commonly contained such clauses, several federal cases addressed the issue of “compensable delays” where there was **no** suspension of work clause in the construction contract.<sup>32</sup> In these cases, where the owner or government suspended the contract, the court generally found that the government or owner was in breach of the contract.<sup>33</sup> The

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<sup>27</sup> *Id.* at 216.

<sup>28</sup> See AIA Document A201 §14.4.

<sup>29</sup> GIBBS & HUNT, *supra* note 14, at 216-17.

<sup>30</sup> PHILIP L. BRUNER & PATRICK J. O’CONNOR, JR., BRUNER AND O’CONNOR ON CONSTRUCTION LAW § 18:46 (West 2008).

<sup>31</sup> *Id.* at §15.84.

<sup>32</sup> See *L.L. Hall Const. Co. v. United States*, 379 F.2d 559 (1966); *Scott Timber Co. v. United States*, 333 F.3d 1358 (Fed. Cir. 2003); *Haney v. United States*, 676 F.2d 584 (1982).

<sup>33</sup> See *L.L. Hall Const. Co. v. United States*, 379 F.2d 559 (1966); *Scott Timber Co. v. United States*, 333 F.3d 1358 (Fed. Cir. 2003); *Haney v. United States*, 676 F.2d 584 (1982).

government/owner was then found solely responsible for the delay and the contractor's extra costs associated with the suspension.<sup>34</sup>

Modernly, most construction contracts include suspension of work provisions which provide for this scenario and prevent the contractor from claiming a breach of contract. The suspension of work provision thereby prevents the contractor from seeking all remedies that are associated with breach – such as a claim of “contract abandonment” by the owner.<sup>35</sup> In fact, in many cases, the contractor who is ordered to suspend work on a project where the contract contains a suspension of work clause would not automatically be able to terminate the contract and would be required to continue to perform upon the projects reinstatement. Any refusal to do so would be considered a breach on the part of the *contractor*.

By including such a provision, the contract can also limit the compensatory damages the contractor may recover based on the suspension.<sup>36</sup> A perfect example of this is the FAR's exclusion of profits from the “adjustment” the contractor may be entitled to due to the government's suspension of the work.<sup>37</sup> If the contract had lacked a suspension of work clause excluding profits from recovery, it is likely that the court may have awarded the contractor profits based on the contractor's inability to take on new work in light of the suspension.<sup>38</sup>

Generally, in order for an owner to invoke the suspension of work clause, the owner must provide the contractor with written notice of the suspension (the “Suspension Order”).<sup>39</sup> Upon receipt of the Suspension Order, the contractor is required to stop all work and take reasonable steps to mitigate its damages during the suspension.

That said, conduct of the owner can be constructed as “constructive suspension” (i.e., suspension without written notice by the owner). Constructive suspension is any compensable delay

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<sup>34</sup> See *L.L. Hall Const. Co. v. United States*, 379 F.2d 559 (1966); *Scott Timber Co. v. United States*, 333 F.3d 1358 (Fed. Cir. 2003); *Haney v. United States*, 676 F.2d 584 (1982).

<sup>35</sup> BRUNER AND O'CONNOR, *supra* note 29, at §15.84.

<sup>36</sup> See *Ace Stone, Inc. v. Wayne Township*, 89 N.J. Super. 482, 215 A.2d 560 (App. Div. 1965), *cert. granted*, 46 N.J. 337, 217 A.2d 13 (1966), *rev'd on unrelated grounds*, 47 N.J. 431, 221 A.2d 515 (1966).

<sup>37</sup> See Part III.B.ii.

<sup>38</sup> See *Ace Stone, Inc.*, *supra* note 35.

<sup>39</sup> GIBBS & HUNT, *supra* note 14, at 242.

that is not acknowledged by the owner that occurs under a contract with a “suspension of work” clause.<sup>40</sup> Courts treat the constructive suspension as arising under the contract and within the “suspension of work” clause. This doctrine allows the contractor to recover under the contract, as opposed to a claim for breach, even though the owner did not specifically call the stopping of work a suspension and invoke the suspension clause.

### **III. A SIMPLE TWIST OF LANGUAGE: THE EFFECT OF CONTRACT TERMS ON SUSPENSION**

Once the owner of a construction project chooses to suspend work, contractors on the project are left with many questions: Who is responsible for the extra costs associated with the suspension? Is the contractor obligated to continue performing under the contract once the suspension is lifted? Can the contractor terminate the contract if the suspension lasts for an unreasonable period of time? The answers to these questions are not black and white, and the contractor who does not fully understand his contractual and legal obligations in the face of suspension could subject himself to further liability. The first place a contractor should look to understand his legal obligation is to the construction contract.

Most modern construction contracts give the owner the right to “suspend” all or part of the work on the project for the owner’s convenience. However, the implications of the suspension, how long the suspension can last, and which party bears the responsibility for costs of the delay, depend on the language of each specific contract’s suspension provision. This language can vary from contract to contract – and pre-contract negotiations between the parties. That said, many construction contracts are based on form contracts created by construction associations or the government.<sup>41</sup> In order to evaluate each party’s legal rights and obligations in a suspension, this article will address four of the most common form contracts and their suspension provisions in the realm of both public and private construction projects.

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<sup>40</sup> BRUNER & O’CONNOR, *supra* note 29, at §15:87.

<sup>41</sup> The Construction Management Association of America, Inc. (“CMAA”), the Design-Build Institute of America (“DBIA”), the Construction Owners of America (“COAA”), and the National Association of Attorneys General (“NAAG”) are just a few of the organizations that have developed standard form contracts to be used on construction projects. See Philip L. Bruner & Patrick J. O’Connor, Jr., BRUNER & O’CONNOR ON CONSTRUCTION LAW (West 2008).

## **A. Private Projects: Standard Contract Provisions**

On a construction project, every provision of the construction contract can have a serious impact on the duties and obligations of all of the parties on the project. However, in the world of private construction projects, the construction contract is rarely uniform. Along with this lack of uniformity, unfortunately, most contractors do not take the time to read every provision of the contract to determine how certain provisions might affect them and their performance. And even if they did, an attempt to negotiate those provisions, depending on the circumstances, may lose that contractor the job.

In the hopes of addressing – and perhaps doing away with – this issue, certain construction industry organizations have drafted and published standard contract forms to be used in the construction industry. While there are several organizations with a specialized focus that have drafted documents for their particular fragment of the industry,<sup>42</sup> the two most common general standard contracts are products of the American Institute of Architects and the Associated General Contractors of America.

### **i. The AIA Contract**

The American Institute of Architects (the “AIA”) was founded in New York City in 1857.<sup>43</sup> The purpose of the AIA was to “promote the scientific and practical perfection of its members” and “elevate the standing of the profession.”<sup>44</sup> As a part of this mission, the AIA later developed standard form contract documents that have since served as models for the design and construction industry. Many private construction projects use the standard AIA specifications as a part of their project contracts. As such, when dealing with suspension on a private project, it is likely that most contractors and subcontractors will be dealing with a similar provision to that found in the AIA documents.

The suspension sections in the AIA general conditions state:

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<sup>42</sup> See *supra* note 40 and accompanying text.

<sup>43</sup> The American Institute of Architects, *History of the American Institute of Architects*, <http://www.aia.org/about/history/index.htm>.

<sup>44</sup> *Id.*

14.3.1 The Owner may, without cause, order the Contractor in writing to suspend, delay or interrupt the Work in whole or in part for such period of time as the Owner may determine.

14.3.2 The Contract Sum and Contract Time shall be adjusted for increases in the cost and time caused by the suspension, delay or interruption as described in Subparagraph 14.3.1. Adjustment of the Contract Sum shall include profit. No adjustment shall be made to the extent:

.1 that performance is, was or would have been so suspended, delayed or interrupted by another cause for which the Contractor is responsible; or

.2 that an equitable adjustment is made or denied under another provision of the Contract.<sup>45</sup>

Through this language, the AIA contract documents allow the owner to suspend the construction of a project for “such a period of time as the owner may determine.” Unlike the Federal government suspension provisions,<sup>46</sup> the AIA general conditions do not limit the owner’s suspension to one for a “reasonable” period of time. In fact, it appears from the reading of this provision that the owner’s so-called suspension could last for as long as the owner wishes, so long as the contractor is compensated for the delay in accordance with provision 14.3.2. That said, the contractor may be entitled to terminate the contract pursuant to section 14.1.2 if the suspension were to last beyond the lesser of 120 days in any 365-day period or 100 percent of the total number of days scheduled for completion.<sup>47</sup> There is also an argument under Section 14.1.4 that the contractor would be entitled to

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<sup>45</sup> AIA Document A201 §14.3.2.

<sup>46</sup> See, e.g., FAR §52.242-14(b).

<sup>47</sup> AIA Document A201 states in Section 14.1.2 that:

The Contractor may terminate the Contract if, through no act or fault of the Contractor or a Subcontractor, Sub-subcontractor or their agents or employees or any other persons or entities performing portions of the Work under direct or indirect contract with the Contractor, repeated suspensions, delays or interruptions of the entire Work by the Owner as described in Section 14.3 constitute in the aggregate more than 100 percent of the total number of days scheduled for completion, or 120 days in any 365-day period, whichever is less.

terminate the contract if the suspension lasted for more than sixty (60) consecutive days.<sup>48</sup> The owner could work around these provisions and prevent the contractor from terminating, however, by agreeing to change orders and time adjustments whenever such a suspension occurs.<sup>49</sup>

## ii. The AGC

The Associated General Contractors of America (the “AGC”) has also developed standard form contract documents for use in the construction industry.<sup>50</sup>

The suspension sections of the AGC General Conditions state:

11.1.1 **Owner Suspension.** Should the Owner order the Contractor in writing to suspend, delay, or interrupt the performance of the Work for such period of time as may be determined to be appropriate for the convenience of the Owner and not due to any act or omission of the Contractor or any person or entity for whose acts or omissions the Contractor may be liable, then the Contractor shall immediately suspend, delay or interrupt that portion of the Work as ordered by the Owner. The Contract Price and the Contract Time shall be equitably adjusted by Change Order for the cost and delay resulting from any such suspension.

11.1.2 Any action taken by the Owner that is permitted by any other provisions of the Contract Documents and that results in a suspension of part or all of the Work does not constitute a suspension of Work under this Paragraph 11.1.<sup>51</sup>

The language of the AGC provisions allows a project owner to suspend the construction project for an appropriate period of time for the owner’s convenience. Similar to the AIA General Conditions, it appears from the reading of the clause that the owner’s suspension could last for as long the owner wishes, so long as the contract price and time is equitably adjusted. However, if the owner

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<sup>48</sup> See AIA Document A201 §14.1.4.

<sup>49</sup> See WERNER SABO, LEGAL GUIDE TO AIA DOCUMENTS 506 (5th ed. 2008).

<sup>50</sup> However, it is important to note that the AIA (See Part III.A.i.) contract documents are more widely used and more easily interpreted due to frequent litigation over their terms.

<sup>51</sup> AGC Document No. 200 §11.1.2.

takes any action permitted under the contract which results in suspension, it appears from a strict reading of these provisions that the contractor would not be entitled to any adjustment of the contract, even if the resulting suspension lasted for an unreasonable period of time.<sup>52</sup> The contractor would likely be able to make an argument for delay damages in such a situation.

## **B. Public Projects: Standard Contract Provisions**

On most projects, especially with respect to large and/or complex projects, the relationships, rights, duties, obligations, and allocation of risks between the owner and the general contractor are defined by a number of documents and drawings. These documents are collectively referred to as the “contract documents.”<sup>53</sup> A contract for a public work may be a brief document referring to the plans and specifications, the proposal for bids, the information and instructions to bidders, the notice inviting bids, and the required bid forms for a statement of the obligations of the parties, making these writings expressly a part of the formal contract.<sup>54</sup> While there are several sources for standard government specifications, the two most common sets of specifications referred to in government contracts are the Greenbook, in state contracts, and the Federal Acquisition Regulation §52.242, in federal contracts.

### **i. State Contracts: The Greenbook**

In public works projects in the state of California, many contracts are governed by specifications in what is called the “Greenbook.”<sup>55</sup> The Greenbook is updated every year and contains standard specifications for public works of construction. Rather than list such specifications in every contract, most state contracts simply refer to the Greenbook and incorporate it into their contract.

With regard to suspension for convenience, the Greenbook states:

**General.** The Work may be suspended in whole or in part when determined by the Engineer that the suspension is necessary in the interest of the

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<sup>52</sup> *See id.*

<sup>53</sup> GIBBS & HUNT, *supra* note 14, at 101.

<sup>54</sup> 53 CAL. JUR. 3d *Public Works and Contracts* §14 (2009).

<sup>55</sup> PUBLIC WORKS STANDARDS, INC., THE “GREENBOOK”: STANDARD SPECIFICATIONS FOR PUBLIC WORKS CONSTRUCTION (2009 ed.).

Agency. The Contractor shall comply immediately with any written order of the Engineer. Such suspension shall be without liability to the Contractor on the Part of the Agency except as otherwise specified in 6-6.3.

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**Payment for Delays to Contractor.** The Contractor will be compensated for damages incurred due to delays for which the Agency is responsible. Such actual costs will be determined by the Engineer. The Agency will not be liable for damages which the Contractor could have avoided by reasonable means, such as judicious handling of forces, equipment, or plant. The determination of what damages the Contractor could have avoided will be made by the Engineer.<sup>56</sup>

Like the AIA and AGC standard specifications, the Greenbook allows the state to suspend construction and does not provide time limitations on how long a suspension may last. However, these provisions give the Engineer a minimal amount of discretion when it comes to determining the amount of compensation that the contractor will receive from the suspension. The actual costs of the damages incurred due to the suspension are determined by the Engineer. The Engineer is also responsible for determining which of the contractor's damages could have been reasonably avoided. This means that upon suspension, the contractor on a state project must diligently evaluate how to handle the suspension with regard to labor, materials and equipment in order to avoid any excess costs.

## **ii. Federal Acquisition Regulation §52.242**

Where California state projects are governed by the Greenbook, Federal construction contracts are most often governed by the Federal Acquisition Regulation ("FAR"). Examples of Federal projects include ....

Section 52.242-14 of the FAR deals with the suspension of federal construction projects and states:

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<sup>56</sup> *Id.* at 29-31.

(a) The Contracting Officer may order the Contractor, in writing, to suspend, delay, or interrupt all or any part of the work of this contract for the period of time that the Contracting Officer determines appropriate for the convenience of the Government.

(b) If the performance of all or any part of the work is, for an unreasonable period of time, suspended, delayed, or interrupted (1) by an act of the Contracting Officer in the administration of this contract, or (2) by the Contracting Officer's failure to act within the time specified in this contract (or within a reasonable time if not specified), an adjustment shall be made for any increase in the cost of performance of this contract (excluding profit) necessarily caused by the unreasonable suspension, delay, or interruption, and the contract modified in writing accordingly. However, no adjustment shall be made under this clause for any suspension, delay, or interruption to the extent that performance would have been so suspended, delayed, or interrupted by any other cause, including the fault or negligence of the Contractor, or for which an equitable adjustment is provided for or excluded under any other term or condition of this contract.

(c) A claim under this clause shall not be allowed (1) for any costs incurred more than 20 days before the Contractor shall have notified the Contracting Officer in writing of the act or failure to act involved (but this requirement shall not apply as to a claim resulting from a suspension order), and (2) unless the claim, in an amount stated, is asserted in writing as soon as practicable after the termination of the suspension, delay, or interruption, but not later than the date of final payment under the contract.

This "Suspension of Work" clause provides that the government, at its convenience, may require the contractor, by written order, to suspend or delay all or part of the construction on a project. The suspension can be for any period of time that the Contracting Officer determines is appropriate. If the suspension is later lifted, and the contractor submits a request for compensation, the government must make an equitable adjustment in the cost of performance of the contract, so long as the delay was (1) for an *unreasonable* period of time, AND (2) the suspension was *caused by an act or a failure to act* by

the government.<sup>57</sup> Presumably, under this language, if the suspension were for a “reasonable” period of time, then the contractor would not be compensated for that portion of the delay.

Whether a particular delay is reasonable or not depends upon the circumstances of the particular case.<sup>58</sup> Based on cases addressing this issue, delay caused by defective government specifications has been determined to be per se unreasonable,<sup>59</sup> whereas delay, concurrent with extreme winter weather conditions, which would have prevented the contractor from working at the site,<sup>60</sup> was considered a reasonable. Thus, the “reasonableness” of a particular delay will be determined on a case by case basis.

However, given the recent economic turmoil and the fall-out of private and public funding, it seems that the more timely issue is what constitutes an act or a failure to act by the government for purposes of recovery by the contractor under the FAR. In the 1976 case *C.H. Leavell & Co. v. United States*, the Court held that an equitable adjustment was available under the “suspension of work” clause for an unreasonable suspension, even though the cause of the suspension was an appropriation cut-off.<sup>61</sup> In 1978, the Court in *S.A. Healy Co. v. United States* extended this ruling, finding that an equitable adjustment for losses incurred in a suspension caused by a lack of funding was appropriate even though the contract contained a “funds available clause.”<sup>62</sup> Other such examples of owner-caused acts or omissions are the owner’s failure to respond to requests for deviation or interpretation,<sup>63</sup> failure to provide the required construction permit,<sup>64</sup> and late issuance of a notice to proceed.<sup>65</sup> Under each of

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<sup>57</sup> FAR §52.242-14.

<sup>58</sup> See *Tri-Cor, Inc. v. United States*, 458 F.2d 112 (1972).

<sup>59</sup> See *Carl M. Halvorson, Inc. v. U.S.*, 461 F.2d 1337 (1972); *Chaney & James Constr. Co. v. U.S.*, 421 F.2d 728 (1970).

<sup>60</sup> See *CEMS, Inc. v. U.S.*, 59 Fed. CL. 168, 231-32 (2003).

<sup>61</sup> 530 F.2d 878 (1976) (“It is immaterial, in this instance, whether or not the suspension and delay was due, in whole or in part, to the Government’s fault. There are occasions for the Suspension of Work clause to operate when the Government is at fault, as we recently noted [citations omitted], but the clause can likewise be effective, as we have also held, when there is a suspension not due to the Government’s fault, dereliction or responsibility...An instance of the latter category is a suspension and delay which lasts so long (regardless of the absence of government fault) that the contractor cannot reasonably be expected to bear the risk and costs of the disruption and delay”).

<sup>62</sup> 576 F.2d 299 (1978).

<sup>63</sup> See *Hardie-Tynes Mfg. Co.*, ASBCA No. 20,582, 76-2 BCA ¶ 11,972 (1976); *Hensler v. City of Los Angeles*, 124 Cal.App.2d 71 (1954).

<sup>64</sup> *Rottau Electric Co.*, ASBCA No. 20,283, 76-2 BCA ¶ 12,001 (1976).

<sup>65</sup> *DeMatteo Constr. Co.*, PSBCA No. 145, 76-1 BCA ¶ 11,845 (1976).

these circumstances the court held the suspension was unreasonable **and** resulted at the hands of the government. Thus, the contractor was able to recover for the delay.

It is important to note, however, that under the FAR suspension provision no adjustment is to be made to the extent that performance would have otherwise been suspended, delayed or interrupted by any other cause, including the fault of the contractor. The provision of an equitable adjustment is also limited by the other terms of the contract. So, when evaluating whether or not the contractor is able to recover, it is important to look at provisions in the contract beyond the one related to suspension.

It is also worth noting that the FAR provides simply for an “adjustment”, as opposed to the “equitable adjustment” presumably contemplated by the AIA and the AGC.<sup>66</sup> However, courts interpreting the FAR language continue to refer to the adjustment as an equitable one, and the distinction may be nothing more than semantics.<sup>67</sup>

#### **IV. DAMAGES FOR SUSPENSION**

In the midst of so much speculation and interpretation, one thing is clear: the price of suspension is not cheap. Not only does the suspended contractor continue to sustain overhead costs as a result of the delay, but, if the suspension is long enough, the contractor could be prevented from taking future projects that might overlap with the extended schedule. And, what if during the course of the delay the cost of materials or labor rates change substantially?<sup>68</sup> Each of these increased costs would have been unforeseeable at the time of contracting, and it is highly unlikely that the contractor has prepared for them. The question then becomes: Who is responsible for these damages?

As anyone who has ever litigated a construction case knows, it is difficult to calculate the damages sustained by parties after any type of delay has occurred.<sup>69</sup> Thus, it is fair to say that this

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<sup>66</sup> Compare the FAR’s use of “adjustment” in the suspension of work clause, as opposed to the “equitable adjustment” provided for claims under the termination for convenience clause. See F.A.R. § 52.249-2(J).

<sup>67</sup> See *C.H. Leavell & Co*, 530 F.2d 878 (1976); *S.A. Healy Co.*, 576 F.2d 299 (1978).

<sup>68</sup> See Part IV: Material Escalation.

<sup>69</sup> See, e.g., Bernhard A. Aaen, *The Total Cost Method of Calculating Damages in Construction Cases*, 22 Pac. L.J. 1185; JEAN-CLAUDE WERZ, *DELAY IN CONSTRUCTION CONTRACTS* (1994); Rocky Unruh & John Worden, *Liquidated Damages For Delay In Completion of Commercial Construction Projects: Are They Recoverable By The Owner When The Owner Contributes to the Delay?*, 34 Santa Clara L. Rev. 1.

process takes on new complications when, as was the case with the Ritz Carlton in Rancho Mirage,<sup>70</sup> the underlying cause of the suspension was of no direct fault of any contracting party. So what to do? The legal approach to answering this question depends largely on the project's status as public or private, and again on the terms of the contract documents.

Unfortunately, this issue has not been as heavily litigated in the realm of private construction projects. While there are many cases focusing on damages related to terminations for convenience by the owner, there are no published cases interpreting the AIA or the AGC suspension provisions.<sup>71</sup> As such, the best guidance for how a court *might* interpret these contract provisions is the way termination clauses and the more heavily litigated federal government suspension provisions have been construed. Although this section focuses largely on public construction contracts and cases, the same principles and interpretation of language can be used to interpret suspension of work provisions in private contracts. Thus, for purposes of this section, the availability of the following damages applies to both private and public contracts. However, it will be noted where deviations occur or recovery of a specific damage is limited or unavailable.

Like delay damages, damages for suspension of work could include extended overhead costs, job site costs, equipment standby costs, financing costs, wage escalation, material increases and extended supervision. However, unlike delay damages which are determined by the court, because suspension is provided for in the construction contract, the contractor's recovery is governed by the contract language in the suspension of work provision and anything not covered by this provision or explicitly excluded would not be recoverable by the contractor.

**Time Extensions.** First and foremost, almost all suspension of work provisions provide for some extension of time in order to complete the work. The AIA and AGC specifically provide for an adjustment to the "Contract Time."<sup>72</sup> And while the California Greenbook and the federal government's FAR provisions do not specifically mention a time adjustment, they don't exclude one either.<sup>73</sup> It could be argued that if no time extension was given, based on the language in these provisions, "damages

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<sup>70</sup> See Part I.

<sup>71</sup> See *Torncello v. United States*, 681 F.2d 756 (Ct. Cl. 1982).

<sup>72</sup> See AGC Document No. 200 §11.1.2; AIA Document A201 §14.3.2.

<sup>73</sup> See FAR §52.242-14; see also PUBLIC WORKS STANDARDS, INC., THE "GREENBOOK": STANDARD SPECIFICATIONS FOR PUBLIC WORKS CONSTRUCTION (2009 ed.).

incurred” would include the contractor’s recovery of liquidated damages for any delay in the completion of the project attributable to the suspension.

Such a time extension should be, at a minimum, equal to the length of the suspension and could be done by change order or construction change directive. The contractor may also be entitled to additional time caused by demobilization and remobilization (once the project “restarts”).

**Overhead Costs.** One of the largest and most highly litigated issues in the realm of government contracts is the contractor’s ability to recover overhead costs after the suspension of a government project. As mentioned previously, this issue has not been addressed with regard to the AIA or AGC suspension provisions or private contracts. However, this issue is an important one, as in many cases the contractor will claim that it is forced to “stand-by” for an extended period of time and therefore is unable to take on additional work due to the uncertainty of the present contract. Courts have determined that in order to recover, the contractor must prove the following three elements: (1) that there was a delay and the delay was caused by the government, (2) that the contractor was required to wait and be on standby, and (3) that the contractor could not have taken on other work.<sup>74</sup>

**Profits.** The AIA contract specifically provides for the recovery of profits. And while the AGC contract and the Greenbook specifications do not specifically provide for recovery of profits, the AGC’s reference to an adjustment to the “Contract Price” and the Greenbook’s failure to exclude them makes their recovery likely.<sup>75</sup>

It is also worth reinforcing the fact that, unlike the other form contract suspension provisions, the *FAR* specifically excludes profit from recovery by the contractor. Thus, if the contractor were to be delayed due to a suspension and be prohibited from taking further work, it is still possible that, even though he would be compensated for his time and *potentially* his overhead<sup>76</sup>, he would be in a worse position due to the suspension. Because of this, a contractor should carefully evaluate all aspects of the suspension and determine whether there is another avenue for recovery of his profits. For example, when a change in performance provided for by the contract occurs during the time the contractor’s

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<sup>74</sup> See *West v. All State Boiler, Inc.*, 146 F.3d 1368 (Fed. Cir. 1998).

<sup>75</sup> See *supra* notes 50 and 55 and accompanying text.

<sup>76</sup> See *West v. All State Boiler, Inc.*, 146 F.3d 1368 (Fed. Cir. 1998).

progress has been suspended by the owner, the contractor should allocate the claimed profit between the suspension of work clause and the changes-clause in the contract.<sup>77</sup> This way, the contractor will be able to recover those profits attributable to the change in performance.

Where profits are recoverable, the best guide for calculation of profits in the realm of suspension would be the calculation of profits on costs incurred due to delays. In case law addressing delay damages, recovery is limited to a “reasonable” profit.<sup>78</sup> This profit may not be the same amount incorporated into the original contract or bid amount.<sup>79</sup> Instead, the risk involved is usually evaluated and used to calculate profits – i.e., the higher the risk the higher the profit margin.<sup>80</sup> Generally, ten percent is an accepted rate of profit and is a good indicator of how much the contractor can expect to recover.<sup>81</sup>

**Material Escalation.** When a contractor is unable to order materials due to a delay in the critical path under the contract, the contractor is often faced with a situation in which he may not be able to take advantage of the prices on which he based his bid.<sup>82</sup> If the contractor is unable to order the material at the time it was originally contemplated due to a suspension, and the cost for that material rises, then the contractor should be able to recover for this escalation in price.<sup>83</sup> The difference between the contemplated price and the actual expense constitutes a legitimate and compensable element of these damages.<sup>84</sup>

**Labor Costs.** Labor costs include the basic wages for the employees of the contractor who perform work on the project. Owners should be prepared to compensate the contractor for labor costs directly associated with the suspension (i.e., protecting the property during the time of suspension (e.g., if the envelope is not complete, plywood over window and door openings, roof openings, protection of material stored on site, etc.), or labor to demobilize). In addition, the contractor is likely to incur wage escalation costs as well as idle-labor costs, both of which are recoverable.

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<sup>77</sup> CONSTRUCTION SCHEDULING, *supra* note 12, at 543.

<sup>78</sup> *Id.* at 542.

<sup>79</sup> *See Itek Corp.*, ASBCA No. 13,528, 71-1 BCA ¶ 8906 (1971).

<sup>80</sup> *See Aerojet Gen. Corp.*, ASBCA No. 17,171, 74-2 BCA ¶ 10,863 (1974).

<sup>81</sup> *See Carvel Walker*, ENGBCA No. 3744, 78-1 BCA ¶ 13,005 (1977).

<sup>82</sup> CONSTRUCTION SCHEDULING, *supra* note 12, at 497.

<sup>83</sup> *See id.*

<sup>84</sup> *Id.*

Most contract bids are predicated on a calculation of hourly labor rates. These rates account for rates existing at bid time, the number of hours expected to be billed in a given period and foreseeable increases.<sup>85</sup> If the contractor is forced to stay on the project for longer than originally expected due to a suspension, and the cost for labor increases beyond the contractor's original calculation, then the contractor should be able to recover for this escalation in wages. Thus, the contractor would be entitled to wage escalation costs – i.e., the difference between the actual expenditure and the “planned” expenditure.<sup>86</sup> (*Note that some prevailing wage rate classifications are locked in for the duration of the work and may not be affected by a suspension*)

Moreover, during periods of delay or suspension, it might be necessary for the contractor to retain workers or supervisors even though no work is being performed because it is not feasible to dismiss them. In such cases, contractors have been permitted to recover these idle-labor costs.<sup>87</sup>

**Equipment Standby Costs.** Where a suspended contractor has equipment that is idle, but is impractical to transport and use on another job, the contractor may recover these costs.<sup>88</sup> With regard to contractor-owned equipment, because idle equipment does not suffer any wear and tear, courts frequently allow the contractor to only recover 50 percent of the AGC Schedule rate.<sup>89</sup> Conversely, courts allow the contractor to recover the actual costs of rented equipment. However, the contractor must mitigate his damages and return rented equipment during the suspension if it is feasible and economical under the circumstances.<sup>90</sup>

**Prompt Payment Penalties/Release of Retention.** Under California Civil Code section 3260, an owner of a private work of improvement must release retention funds withheld from the contractor within forty-five (45) days of the date of completion. A cessation of labor for sixty (60) continuous days qualifies as actual completion under the statute. Thus, if a project has been suspended and there has been a cessation of labor for sixty (60) continuous days, an owner must release retention funds within forty-five (45) days, regardless of whether the project is to resume in the near future. If the owner or

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<sup>85</sup> *Id.* at 496.

<sup>86</sup> *See id.*

<sup>87</sup> *Id.* at 497; *see also* *Barnet Brezner*, ASBCA No. 6194, 1962 BCA ¶ 3381 (1962).

<sup>88</sup> CONSTRUCTION SCHEDULING, *supra* note 12, at 498.

<sup>89</sup> *Id.*; *See, e.g., L.L. Hall Const. Co. v. United States*, 379 F.2d 559 (1966).

<sup>90</sup> CONSTRUCTION SCHEDULING, *supra* note 12, at 498.

general contractor wrongfully fails to make payment in accordance with the statutory provisions, the owner or general contractor would be assessed a statutory penalty of two percent per month on the amount due “in lieu of any interest otherwise due.”<sup>91</sup> The Public Contract code provides for similar penalties on public works of improvement.

**Release of the Surety.** The potential release of the surety on a project due to a suspension is a valid concern for the owner. However, cases addressing situations where the surety is released from its obligation to pay on the bond require that the surety show that the bonded contract was materially altered without the surety’s consent.<sup>92</sup> A material alteration is one that works a change in the meaning or legal effect of the contract.<sup>93</sup> The bond and the contract must be construed together, as the bond incorporates the terms of the contract into the bond, “so that the scope of the bond is determined by the limits of the [] contract.”<sup>94</sup> The terms of the Performance Bonds for the Project more than likely will specifically incorporate the contract (which provides for suspension). Thus, the surety most likely cannot assert that a suspension is a material alteration,<sup>95</sup> thereby precluding its release. That said, the surety should receive a copy of the Suspension Order.

**Other Costs.** More obvious costs that a contractor should be able to recover for will be: direct job site expenses such as telephone costs, additional or increased insurance costs, and extra bond premium expenses. Less obvious costs that a contractor could potentially recover include: impairment of bonding capability and loss of profits from impairment of capital.<sup>96</sup>

## V. PROTECTION FROM SUSPENSION

Understanding the rights and legal obligations of parties under certain provisions of a contract is only a step in the right direction. In order for an owner or a contractor to fully protect itself from unseen problems associated with suspension, the party must do ample research before entering into any contract and follow specific procedures post-contract in order to preserve its rights.

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<sup>91</sup> CAL. CIV. CODE §3260.

<sup>92</sup> *United States v. Reliance Ins. Co.*, 799 F.2d 1382 (9th Cir. 1986).

<sup>93</sup> *Hill & Morton, Inc. v. Coughlan*, 214 Cal.App.2d 545, 549 (1963).

<sup>94</sup> *Verdugo Highlands, Inc. v. Security Ins. Co.*, 240 Cal.App.2d 527, 530-31 (1966).

<sup>95</sup> *See Borsook v. Continental Casualty Co.*, 107 Cal.App.2d 21 (1951).

<sup>96</sup> GIBBS & HUNT, *supra* note 14, at 226-27.

## A. Pre-Contract

As it is with most business dealings, the best course of action for any owner or contractor is to take the necessary steps to protect his interests before problems arise. By researching projects prior to acceptance,<sup>97</sup> only taking projects with sufficient financial support from the beginning, and negotiating favorable contract terms, a contractor can attempt to avoid projects which are likely to end in delays and, in the event that a suspension does occur, have a better understanding of his contractual risks and compensable damages.

While negotiating contract terms may be determined by the relative negotiation strength of each party to the proposed contract, given the current state of the economy, making an effort to address certain issues before they arise is a necessity. For example, in order to assist in the calculation of costs and avoid any ambiguity, the owner and contractor should work to define certain terms in the contract.

When negotiating the contract, both owners and contractors should consider the following:

- It is important to define what damages are included in “costs.”<sup>98</sup> When making this determination, both the owner and the contractor should keep in mind all costs that would be associated with a suspension or delay. Should “costs” include unabsorbed overhead created by an idle plant, lost profits, and any other standby costs? Parties might also consider limiting damages by providing a liquidated damages provision for suspension (a popular provision in public contracts) as a “daily rate”. Although a liquidated damages provision might seem like an attractive option due to the guarantee of payment, contractors should be cautious of accepting such provisions. Often, the damages that the contractor incurs greatly exceed that allowed by the liquidated damages provision. In these situations, if the contractor’s contract contained a

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<sup>97</sup> Contractor’s should only bid (and accept) projects which are not “questionable.” The conscientious contractor must not only read documents before he signs them, but he must diligently research the proposed project. Researching the project includes: performing background research on both the owner and the lender, running a title search on the property to ensure title is not clouded, and possibly contacting former contractors from the owner’s previous projects. Often, a simple internet search of the project owner will yield very useful information with regard to the owner’s financial background, previous successful and unsuccessful projects, business practices, and financial strength.

<sup>98</sup>See *supra* note 44 and accompanying text.

liquidated damages provision for suspension, the contractor would be barred from full recovery.

- For private projects, one of the most overlooked (and thus underutilized) tool a contractor has is California Civil Code Section 3110.5. In general, for projects with a contract value of more than \$5.0 million (or more than \$1.0 million for tenant improvement projects) the owner must “post project security” for the benefit of the contractor in amounts varying from 15-25% (depending on when the project is initially scheduled to be substantially complete) of the contract value. There are three acceptable types of security that an owner can post: a payment bond, an irrevocable letter of credit, or the owner can deposit funds directly to an escrow account. This code section cannot be waived by the contractor. However, to date, most contractors have not forced owners to comply with this code section for fear of losing the contract to another bidder. Given the current state of the economy and the risk of suspension, all contractors **must** consider requiring compliance with this code section.
- As an owner, it may be wise to eliminate the recovery of profits altogether.
- It is important to note that the contractor should be familiar with the suspension of work provision in its particular contract and make special note of any owner notification requirements so as to timely notify the owner when a work suspension occurs.<sup>99</sup>
- It has been suggested that when facing the AIA suspension provision, as discussed above, the contractor may want to delete subparagraph 14.3.2 in its entirety.<sup>100</sup>
- In federal contracts, as previously discussed, an ambiguity may arise as to the “reasonableness” of a particular suspension. In order to avoid such ambiguity, the best course of action would be to define what constitutes a reasonable delay. The parties

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<sup>99</sup> GIBBS & HUNT, *supra* note 14, at 243.

<sup>100</sup> See JONATHAN J. SWEET, SWEET ON CONSTRUCTION INDUSTRY CONTRACTS: MAJOR AIA DOCUMENTS 89 (5th ed. 2009).

should also consider including the duration of a reasonable delay as applied to specific circumstances.<sup>101</sup>

- In some states, a general contractor may attempt to protect itself from liability through the use of a “pay-if-paid” clause. Its hope is to avoid the circumstances discussed previously where the Owner loses funding (or goes bankrupt) and is no longer able to pay, and the general contractor remains liable on its contracts with subcontractors. However, in California, these contract provisions are deemed void as a matter of public policy.<sup>102</sup>
- Owners will often add provisions to their contracts that specifically preclude a contractor’s claim of abandonment. If a complex construction project runs into trouble due to erroneous/defective plans, unanticipated site conditions, or substantial changes requested by the owner, the project is usually completed late and materially over-budget.<sup>103</sup> In situations such as these, a contractor will often claim entitlement to the total cost of performing the work under the doctrine of abandonment of contract. California courts permit recovery under this doctrine, which is also known as the “cardinal change” doctrine.<sup>104</sup> Once a contractor proves abandonment of contract, the contractor is entitled to recover on a quantum meruit or total cost basis and is not limited by the contract price.<sup>105</sup>

The abandonment of contract doctrine is favorable to contractors who have incurred numerous damages. Owners, however, often include contract provisions that preclude this type of recovery. Contractors should examine all contract terms relating to change orders and payment procedures. Owners will often include language in the contract that contains an affirmative statement that by executing a change order, the parties

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<sup>101</sup> See *Blinderman Const. Co., Inc. v. U.S.*, 39 Fed.Cl. 529 (Fed. Cir. 1997) (“[C]ontract gave notice that the Navy might take up to 14 days to investigate potential asbestos problems and, impliedly, several more days to actually remove any asbestos...”).

<sup>102</sup> *Wm. R. Clark Corp. v. Safeco Ins. Co.*, 15 Cal.4th 882 (1997).

<sup>103</sup> Jean M. Boylan and Barbara Gadbois, *The Abandonment-of-Contract Doctrine in Construction Disputes*, LOS ANGELES LAWYER, January 2002, at 21.

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

have reached accord and satisfaction for direct and indirect costs arising from the change, including delay, inefficiency, and acceleration costs.<sup>106</sup>

## **B. Post Contract**

Unfortunately, for the most part, no one saw this financial storm coming. While contracting around these issues in *future* contracts is the best course of action, most contractors are currently facing the likelihood of suspension or an actual suspension with standard form provisions like that of the AIA in their contract. Under these types of provisions, the owner is permitted to suspend work for as long as the owner may determine necessary. Often, the contractor will be unaware of how long the suspension period will last. Once a contractor has encountered a suspension of work, it is important to begin monitoring and documenting all additional costs associated with the suspension of work.<sup>107</sup>

**Keep Detailed and Accurate Records During All Phases of Construction.** Accurate and complete records are the principal source of evidence for verifying that the contractor's work conformed to the contract documents. Proper record management is key to resolving proof of time delays and damages.<sup>108</sup> During the entire period of performance, the contractor should establish and maintain an effective record-keeping system.

**Preserve All Statutory Rights.** Once a contractor is faced with an actual suspension of the project, it is important that the contractor preserve all of his rights and remedies. In most states, the remedies available to contractors include mechanic's liens, stop notices and bonds. On private works of improvement, all of these remedies are available to contractors.<sup>109</sup> However, on public works of improvements, there is no right to a mechanic's lien and only subcontractors have the ability to serve a stop notice and make a claim on a payment bond.<sup>110</sup>

**Bringing Claims Against The Owner.** Once there has been a suspension on a project, and the contractor has identified the problems that were encountered in the project, the contractor must

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<sup>106</sup> *Id.*

<sup>107</sup> GIBBS & HUNT, *supra* note 14, at 243.

<sup>108</sup> CONSTRUCTION SCHEDULING, *supra* note 12, at 173.

<sup>109</sup> *See* GIBBS & HUNT, *supra* note 14, at 289, 347, 354.

<sup>110</sup> *See id.* at 419.

determine if he is entitled to recover money and/or a time extension for such claims. Again, it is important that the contractor review the suspension clause in the construction contract. This can be determinative as to whether the contractor will be able to recover costs associated with the suspension, whether the contractor can terminate the contract based on the suspension, or whether the contractor is obligated to continue performance. It is at this stage in the suspension process where contractors and owners alike should seek legal counsel in order to determine their prospective damage and liability.

**Prompt Payment Claims in Private Contracts.** Although a project owner might be able to avoid liability for paying a contractor any amounts due to suspension, the owner is liable for all payments due prior to the delay and/or suspension. Under California Civil Code section 3260, an owner of a private work of improvement must release retention funds withheld from the contractor within forty-five (45) days of the date of completion. As was mentioned previously, a cessation of labor for sixty (60) continuous days qualifies as actual completion under the statute.<sup>111</sup> Thus, if a project has been suspended and there has been a cessation of labor for sixty (60) continuous days, an owner must release retention funds within forty-five (45) days, regardless of whether the project is to resume in the near future.<sup>112</sup> If the owner or general contractor wrongfully fails to make payment in accordance with the statutory provisions, the owner or general contractor would be assessed a statutory penalty of two percent per month on the amount due “in lieu of any interest otherwise due.”<sup>113</sup>

**Prompt Payment Claims in Public Contracts.** As previously discussed, when a public project is suspended, a contractor might not receive any compensation for the duration of the suspension. However, a contractor is entitled to progress payments for all work that has been completed before the suspension.<sup>114</sup> Moreover, the California Public Contract Code provides a remedy for subcontractors who are not paid in a timely manner. Section 10262.5 of the California Public Contract Code requires prime contractors and subcontractors to pay their subcontractors not later than ten days after receipt of each progress payment, unless otherwise agreed to in writing, the amounts allowed on account of the work performed by the subcontractors. The law imposes a penalty of two percent per month, payable to the

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<sup>111</sup> CAL. CIV. CODE §3260; See Part IV.

<sup>112</sup> *Id.*

<sup>113</sup> *Id.*

<sup>114</sup> See GIBBS & HUNT, *supra* note 14, at 146.

contractor for noncompliance. The prevailing party in an action to recover a progress payment wrongfully withheld is entitled to recover attorneys' fees and costs.<sup>115</sup>

It is worth noting that Public Contract Code section 10261.5 also provides that any state agency that fails to make a progress payment request shall pay interest to the contractor at the rate set forth in Code of Civil Procedure §685.010, namely, ten percent. The law also requires that state agencies review and process progress payment requests as soon as practicable.

### **C. In Bankruptcy**

Given the current economic situation, the number of distressed projects and the number of owners and contractors filing for bankruptcy has skyrocketed. For subcontractors and other parties on the project, bankruptcy is riddled with unknown rules and countless concerns, as either a creditor or a debtor of the bankrupt party. Subcontractors are particularly vulnerable during a bankruptcy because they are often the first to provide services to a project and the last to receive payment.<sup>116</sup> Thus, it is imperative that parties understand how to deal with claims in a bankruptcy as it could significantly affect a creditor's rights and remedies.

When an owner or general contractor files for bankruptcy while a project is still under construction, it is crucial that the owner and the contractor determine whether the project will go forward or cease. If a Chapter 7 bankruptcy petition was filed, it is most likely that the project will cease, whereas in a Chapter 11 bankruptcy it is possible that the project will continue.<sup>117</sup>

Regardless of whether it is the owner, general contractor, or subcontractor who files for bankruptcy, the party filing for bankruptcy has the option whether to continue on the project (assume the executory contract) or discontinue work on the project (reject the executory contract).<sup>118</sup> The right to assume or reject the contract must be exercised within the statutory time limits.<sup>119</sup> Any debtor who is unsure as to whether they are required to perform under a contract for a party who is in bankruptcy

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<sup>115</sup> PUB. CONT. CODE §10262.5.

<sup>116</sup> GIBBS & HUNT, *supra* note 14, at 459.

<sup>117</sup> *Id.*

<sup>118</sup> *Id.* at 460.

<sup>119</sup> *See id.* at 460-61.

should immediately seek legal counsel to either work with the debtor to assume or reject the contract, or ask the court to set a deadline for assumption/rejection. Ultimately, the bankruptcy judge has the discretion whether to grant the assumption or rejection of the contract.

Finally, if an Owner files for bankruptcy, the general contractor, subcontractors and material suppliers are not precluded from protecting their statutory rights (i.e., recording a mechanic's lien or serving a stop notice on the construction lender).<sup>120</sup> Thus, those entities must be extremely diligent in seeking legal counsel to determine the procedure to follow in order to enforce these rights.

## **VI. CONCLUSION**

The construction industry is an important part of the national and state economies. In order to continue to be a successful part of that economy, owners and contractors must have a clearer understanding of their rights, duties and obligations to each other now and for future projects. Hopefully this article raises awareness that there remains material uncertainty in the contracts that are widely used in the construction industry, so that parties can address those uncertainties in future dealings.

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<sup>120</sup> *See id.* at 464-65.