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CHANGE AND CHANGE ORDERS FROM CONTRACT TO EXECUTION

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Introduction

- *"Projects" means any private or public contract for a construction work of improvement, development, or construction related services*
- *Change orders are one of the most common causes of disputes between parties to project contracts*
- *Disputes about change orders often center around:*
  - *whether the alleged "changed" work was in or out of scope*
  - *whether the parties complied with the procedural requirements in the contract regarding change orders*
  - *how to price change orders*
- *Both parties stand to gain by careful drafting and reviewing and contract administration*

TYPES OF CHANGES

1. *ACTUAL*
2. *CONSTRUCTIVE*
3. *CARDINAL/MATERIAL*

THE SIX P'S OF CHANGE ORDERS

1. *PROSPECTING (DISCOVERY)*
2. *PREPARING (SET UP A FILE)*
3. *PRICING (DOCUMENT COSTS)*
4. *PRESENTING (FOLLOW THE CONTRACT)*
5. *PERFORMING (DOING THE WORK)*
6. *PAYMENT (GETTING PAID)*

THE CONTRACT

1. *Contains Changes Clause*
2. *Permits Owner To Change The Work*
3. *Provisions Must Be Followed*

DEFINITION

1. *A change must be "within the scope of the work." Valley Constr. Co. v. City of Calistoga, 72 Cal.App.2d 839 (1946).*

2. *U.S. Supreme Court, Freund v. United States, 260 U.S. 60 (1922) states: Work is within the scope of the contract if it " ... should be regarded as fairly and reasonably within the contemplation of the parties when the contract was entered into."*

3. Criteria courts look to:

A. The general nature of the original contract as compared with that of the changed work.

B. The comparative cost of the original contract compared with that of the changed work.

C. The comparative time of performance.

D. The number of changes or the quantity of work.

WHAT IS AN ACTUAL CHANGE?

1. *When Owner makes a change in the scope of the work and requests a quote from the contractor of the impact on cost and time.*
2. *No dispute as to whether or not a change has occurred.*
3. *Only Issues:*
   A. *Cost*
   B. *Time Impact*

WHAT IS A CONSTRUCTIVE CHANGE?

1. *Owner doesn't recognize that some direction given to the contractor is, in fact, a change.*
2. *Described as follows: "Each of the other elements of the standard "changes" or "extras" clause has been present."*

3. *Owner refuses to issue change order because it believes the work is already required under the contract documents. See Dawson Constr. Co., GSBCA No. 3820, 75-1 B.C.A. (CCH) #11,339.*

4. *Constructive change occurs when the owner's interpretation is later proved to be incorrect indicating a change order should have been issued. See Blake Constr. Co., GSBCA No. 2477, 71-1 B.C.A. (CCH) #8870*

EXAMPLES OF CONSTRUCTIVE CHANGES:

1. *Defective or ambiguous contract plans or specs that require extra work.*
2. *Directives issued by owner to other trades or subs that affect the contractor's work.*
3. *Order from inspector or other governmental authority to correct work to comply with the code although the work was performed per plans and specs.*
4. *Owner's directive to accelerate work.*
5. *Added or changed work required by an answer to contractor's RFI (Request for Information).*

REASONS FOR CHANGE ORDERS

1. *Design Errors*
2. *Changes in Market*
3. *Changes in Market Conditions*
4. *Changes in Owner's Requirements (scope)*
5. *Uncovering undisclosed existing conditions*
6. *Owner, Architect or Contractor Suggestion to Initiate better, faster or more economical construction*
7. *Changes in Design Preference*
8. *Changes Required by Others*

CHANGES CLAUSE

1. *Authorize owner to change the work; no right to change the work without a change clause.*

2. *Basic elements of most "changes" clauses:*

   A. *Changes only made by a "change order"*

   B. *Change must be in writing signed by owner, contractor and architect.*

   C. *Change order must address price and time extension, if any.*

   D. *Change must be within the scope of the original contract.*

   E. *No changes in work shall be done without a written change order*

3. *Administrative Procedure*

A. *Owner may make changes by change order or construction change directive*

B. *Change order based upon agreement among owner, contractor and architect: construction change directive requires only agreement by owner and architect*

C. *Contractor shall proceed promptly*

D. *Change order signed by owner, contractor and architect*

E. *Construction change directive*

F. *CCD used in absence of total agreement on terms of change order*

G. *Adjustment of contract sum in CCD*

H. *Upon receipt of a CCD, contractor shall promptly proceed*

I. *If Contractor Disagrees With Contract Sum, the method of adjustment shall be determined by the architect on the basis of reasonable expenditures and savings plus reasonable allowance for overhead and profit; contractor shall keep and present an itemized accounting with appropriate supporting date; costs limited to:*

   1) Labor, 2) Materials and Equipment, 3) Rental Costs, 4) Bonds and Insurance, 5) Supervisors and Field Personnel

J. *If owner and contractor do not agree, architect determines*

ADDITIONAL ITEMS THAT SHOULD BE CONSIDERED

1. *Amount allowed for markups for contractor and subs.*
2. *Supporting documentation for costs and time.*
3. *Accord & Satisfaction clauses: i.e., change order includes all direct and indirect costs including but not limited to: impact, disruption, loss of efficiency, "ripple," other extraordinary or consequential costs.*

COST COMPONENTS OF CHANGE ORDERS

1. *Basic Elements*
2. *Direct Costs*
3. *Indirect Costs*
4. *Consequential Costs*

CHANGE ORDERS: RESERVATIONS OF RIGHTS: WHAT THE COURTS SAY

1. *Change order pricing in general:*

   A. *Cost plus mark up for overhead and profit.*

   B. *Change orders may impact unchanged work: commonly referred to as "impact" or "cumulative impact" cost.*

C. What to do with "impact" costs?

2. Court recognition of impact costs:

A. Appeal of Charles G. Williams Construction, Inc., ASBCA No. 33766 (1989): inaccuracies in drawings necessitated 26 corrective change orders: C.O.'S had 15% mark-up for "Overhead;" Contractor submitted claim for increased cost of administering and supervising the project;

Government contended said costs covered by the mark-up; ASBCA held that the changes had an impact on the unchanged work and the mark-up compensated the contractor only for overhead associated with the changed work itself.

B. *Appeal of Coates Industrial Piping, Inc., VABCA No. 5412 (1999): Government issues 157 requests for change order proposals and numerous contract modifications; contractor contended the volume of change orders impacted labor efficiency on unchanged work; VABCA said such impact was not self evidence and "there is no evidence of what the impact was, how it impacted the work, or at what cost to the Appellant."*

C. *Appeal of Freeman-Darling, Inc., GSBCA No. 7112 (1989): 40 change orders: contractor claimed "impact" on unchanged work; GSBCA stated: "we are unpursuaded that the magnitude and accumulation of changes so significantly altered the contract as to create a claim for impact costs."*

WAIVER OF IMPACT COSTS

1. *Huber, Hunt & Nichols v. Moore, 67 Cal.App.3rd 278 (1977); 103 RFI'S; 188 Change Estimates; 25 change orders encompassing 124 of the 187 change estimates; each change order stated:*

   "The undersigned contractor approves the foregoing change order as to the changes, if any, in the contract price specified for each item and as to the extension of time allowed, if any, for completion of the entire work on

account of said change order, and agrees to furnish all labor and materials and perform all work necessary to complete any additional work specified therein, for the consideration stated therein. It is understood that said change order shall be effective when approved by the lessee and ordered by the owner."

The court denied the contractor's claim stating:

> *"In the final analysis what contractor actually complains of is that the amount of money which owner paid contractor under the 25 C.O.'S and the time allowed for the changes or additional work was not sufficient to reimburse contractor for its total cost and total delay.*

Contractor argues that somehow the total result exceeded the sum of the 25 parts. Assuming without deciding that such a result is within the realm of logical possibility, we think that the responsibility for the result lies with contractor, not with architects. It was within contractor's legal power to compute estimated change order costs in a manner which would compensate contractor for its total loss. It failed to do so, architects were not legally responsible for that failure. So far as we can tell from this record, contractor was paid in almost every instance what contractor requested on the 25 C.O.'S issued. Contractor simply did not request enough on those C.O.'s which were authorized. A factor of 10 percent or 15 percent for administration and overhead was obviously too low if contractor's present claims are accurate."

2. *Appeal of Beaty Electric Co., Inc., EBCA No. 408-3-88 (1990): If there is no waiver of "impact" claims in the change order, it is assumed that the change order price covers only the listed costs of the changed work.*

3. *Result: Owner often includes waiver and release language. See Huber, Hunt & Nichols above.*

   Federal courts have also ruled that if a contractor does not intend to waive impact costs, the contractor must expressly reserve those rights in the change order;

in the absence of an express reservation, broad waiver and release language will extinguish the claim: See John Massman Contracting Co. v. United States, 23 CL.CT.24 (1991); Appeal of Central Mechanical Construction, ASBCA No. 29434 (1986).

4. Reservation of impact costs

- *A. Address the issue in each change order*
- *B. Owner may direct contractor to proceed*
- *C. Contractor may reserve its rights*
- *D. Contractor cannot be forced to prospectively waive its right to future impact costs*

5. *Appeal of Centex Construction Co., Inc., ASBCA No. 26830 (1983) stated:*

"While it may be good contract administration on the part of the government to attempt to resolve all matters relating to a contract modification during the negotiation of the modification, use of a clause which imposes an obligation on the contractor to submit a price breakdown to cover all work involved in the modification cannot be used to deprive the contractor of his right to file claims."

6. Once a time extension has been granted, it cannot be repudiated:

"The legal effect of time extensions granted. The government seeks in its briefs to repudiate the time extensions previously granted appellant by the contracting officer. It argues that, on a factual basis, appellant was not entitled even to those time extensions it got. However, the midst of litigation is too late a time to take back such determinations by the contracting officer, and the government is bound by them. Continental Heller Corp., GSBCA Nos. 6812, 7140, 84-2 BCA ¶ 17,275, at 86,026.27."

7. *If a change order is executed without a reservation of rights, it cannot be challenged:*

"On that point, we adhere to our decision in Dawson Construction Co., GSBCA No. 3998, 75-2 BCA ¶ 11,563, AT 55,203:

'It is well established that where a change order is accepted without protest it is considered a final agreement as to the equitable adjustment and time extension stated therein and a bar to any further claim by the contractor."

Abandonment Of Contract aka Material Change Of Contract aka Cardinal Change

1. *C. Norman Peterson Co. v. Container Corp. of America, 172 Cal. App. 3d 628 (1985)*

   A. *Delay in issuance of drawings*

   B. *16,414 hours of "redesign"*

   C. *"Oral" changes by owner*

D. *Court holds contract "abandoned" and therefore contractor entitled to "reasonable value"*

E. *Private works case*

F. *Court stated: "In the specific context of construction contracts, however, it has been held that when when an owner imposes upon the contractor an excessive number of changes such that it can fairly be said that the scope of the work under*

the original contract has been altered, an abandonment of contract properly may be found. (See Daugherty Co. v. Kimberly-Clark Corp., 14 Cal. App. 3d (1971), at p. 156; Opdyke & Butler v. Silver, 111 Cal. App. 2d 912 (1952), at 916-919.)

In these cases, the contractor, with the full approval and expectation of the owner, may complete the project. (See Daugherty, supra, at pp. 156-157.) Although the contract may be abandoned, the work is not.

Under this line of reasoning, the trial court was well justified in determining that, by their course of conduct, the parties had abandoned the terms of the written contract while proceeding to complete the mill restoration project.

Abandonment of a contract may be implied from the acts of the parties. Abandonment of the contract can occur in instances where the scope of the work when undertaken greatly exceeds that called for under the contract. In Opdyke, the written contract provided that all change orders should be approved by the architect, should be in writing and the contract should be adjusted accordingly before the work was done. Yet, because the parties consistently ignored this requirement in material part, the court allowed a recovery on quantum meruit."

2. *Amelco Electric vs. City of Thousand Oaks, (2002) 27 Cal. 4TH 228 (page 140, Supp.)*

   A. *Facts: City of Thousand Oaks "Civic Arts Plaza". City hired LMB as project manager. Multiprime project. Amelco was low bidder for electrical. Original contract price was $6.7 million*

   B. *During the project, City issued 1,018 sketches to clarify or change original contract drawings or to respond to RFI's*

   C. *248 sketches affected electrical work*

   D. *Amelco requested 221 change orders*

E. 32 change orders were agreed upon adding $1,009,728 to the contract price (a 17% increase).

Amelco claimed:

1. Unusually high number of sketches were difficult to work with.

2. Scheduling of the various contractors became more difficult as a result of the changes.

3. It had to delay or accelerate tasks and shift workers among tasks to accommodate work by other trades.

4. The numbers of changes made it impossible to keep track of the impact any one change had on the project.

Job was completed in September 1994. Amelco's project manager did not determine Amelco had a claim until November 1994. In January 1995, Amelco submitted a $1.7 million total cost claim for costs resulting from the "non captured" costs of the change orders. Amelco sought $2,224,842 at trial. Amelco was awarded $2,134,586 by the jury at trial based upon a finding by the jury that the contract was breached and abandoned, allowing Amelco to recover total cost damages. The jury award was affirmed by the court appeal.

California Supreme Court:

1. *Reversed and sent the case back for the trial Court to retry the issue of damages.*

2. *Specifically the court stated: "We conclude the theory of abandonment does not apply against a public entity, and that Amelco Electric failed to adduce sufficient evidence to warrant instructing the jury on total cost damages for breach of contract."*

3. *The court refused to follow the private works cases of abandonment and federal cases allowing cardinal change.*

3. *Why?*

   A. *Because "abandonment" is fundamentally inconsistent with the purpose of the competitive bidding statues.*

   B. *The court is without authority to abrogate the bidding statutes and make a new contract between the parties.*

   C. *Permitting a contractor to claim abandonment following completion of the work and to recover reasonable value would unduly punish the tax paying public.*

   D. *Allowing abandonment to occur at some indeterminate point (where the next change becomes excessive) and allowing the contractor to recover its total costs from inception of the job until completion, prevents timely notice of claims to allow public entities to make project management, budget and procedural adjustments during construction.*

E. Allowing total cost as opposed to bid costs would encourage contractors to bid unreasonably low with the hope of prevailing on an abandonment claim.

F. Public Contract Code 7105 provides that a contract may be terminated, amended or modified only if termination, amendments or modification is provided for in the contract and compensation shall be determined as provided in the contract: abandonment is not allowed under this section.

4. As to "damages". The court held:

A. Court did not rule on question as to whether or not total cost was appropriate in a breach of public contract case.

B. Court merely held that Amelco did not produce substantial evidence to support instructing the jury on the four-part total cost theory of damages.

What About Private Works?

1. *Issue Not Addressed*
2. *See Dissent in Amelco*
3. *Sehulster etc. v. Taylor Bros./Obayashi, 111 Cal.App.4th 1328 (2003)*
   - A. *Prime signs a "no cost" change order with public owner for substantial change in design*
   - B. *Prime directs sub to make the design change without a change order;*
   - C. *Sub presents claim for $2.545M on abandonment theory*

D. Court held:

1) Sub could pursue abandonment claim against prime even though prime could not pursue claim against owner: because dealing with two private parties

2) Prime could not pass through claim or seek indemnity against owner because of "no cost" change order

4. Result: Theory may still be available on private works

Implementation & administration of changes and claims

- *Merely performing extra work or using higher quality material may not necessarily entitle a contractor to extra payment and schedule relief*
  - *The contractual change order procedures and notice requirements are enforceable as conditions precedent (See Opinski Constr., Inc. v. City of Oakdale (2011) 199 Cal. App. 4th 1107; P & D Consultants, Inc. v. City of Carlsbad (2010) 190 Cal. App. 4th 1332)*
  - *Telling the contractor "don't worry about submitting a claim, we will sort it out later" is not a good idea*
  - *Estoppel, waiver (See Opinski and P&D)*
  - *"I think I have a copy of the contract… somewhere"*
  - *Knowing the Ts and Cs from the start is very important*
  - *Time bars do not allow for late claims administration (See Opinski and P&D)*

Potential risks, pitfalls and resolving commercial disputes

- *Most common dispute is whether the "changed" work is in or out of scope*
- *Dispute resolution:*
  - *General laws of contract interpretation*
  - *Contractual interpretation provisions*
  - *Order of precedence*
  - *Dispute resolution provisions*
- *Common contract pitfalls that increase the risk of dispute:*
  - *"We know the specifications are wrong or have gaps, but it's the owner's document, so it's not our risk"*
  - *Implied warranty that contract documents are accurate and complete: U.S. v. Spearin (1918) 248 U.S. 132, 63 L.Ed. 166, 39 S.Ct. 59*

Potential risks, pitfalls and resolving commercial disputes

- *Clear unequivocal disclaimers may displace the implied warranty: Wunderlich v. State of California (1967) 65 Cal.2d 777*

- *Common contract pitfalls that increase the risk of dispute:*
  - *Proposal documents being attached to the contract documents*
    - *Attaching email negotiations to a contract is a petri dish for disputes*
    - *Proposals may include unsuitable marketing language*
  - *Gaps, omissions, vague language in the contract documents*
    - *Work may be included in the contractor's obligations even if it is not expressly mentioned*

- *Conflicts and inconsistencies between different parts of the contract documents*

- *Even where a change order is not issued, claims may be brought for work outside the contract (Public / Private)*
  - *Unjust enrichment, quantum meruit, implied contract, collateral contract*
  - *Total cost recovery / Cardinal change*

Thank you for your attendance.

If you have any further questions, please contact us at the email address below.

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