

GET PAID WHAT YOU DESERVE
– MANAGING THE CHANGE ORDER PROCESS –
(2012 International Builders Show)

Charles (CJ) Schoenwetter, Esq.

LEARNING OBJECTIVES

- A. The purpose of Change Orders.
- B. What Ordered Changes are.
- C. What Cardinal Changes are.
- D. What Constructive Changes are.
- E. The requirements for making changes.
- F. How to create an effective Change Order.
- G. How formal requirements for Change Orders are waived.
- H. Liability issues associated with Change Orders.

A. PURPOSE OF CHANGE ORDERS

- Change orders are used to implement and document changes to the construction contract.
- A change order is a document issued to the Contractor or Subcontractor to identify required changes to the original plans, specifications, or other contract documents.
- Upon successful negotiation of the associated changes in project scope, cost and schedule, the final change order with the proper signatures becomes a legal amendment to the construction contract.

Why Are Change Orders Important?

Construction rarely proceeds entirely as planned. At times, it resembles organized chaos.

1. Assures a clear understanding by the parties.
2. Documents respective obligations and responsibilities.
3. Critical step towards payment.
4. Proactively avoid disputes.

Change Orders Affect Efficiency

Magnitude of Change Orders – A 1995 study concluded that the United States construction industry spends \$50 Billion annually on new construction change orders.

Many are Unnecessary – A 1998 audit report of 865 projects built for the State of Washington concluded that one-third of the total number of change orders (6,413 total change orders) could have been avoided.

- Inadequate field investigation
- Unclear specifications
- Plan errors
- Design changes
- Mistakes by engineers

Examples of Inefficiencies Due to Change Orders:

- Increased frequency of planning and replanning.
- Interruption, interference, and lack of availability of tools, labor, and materials to meet the requirements of the changes.
- Increased project management and supervision.
- Ripple Impact: stacking of trades, schedule compression, and out-of-sequence work.

What Happens If There Is No Accepted Change Order Process?

1. Construction projects would take longer. Each time a change is suggested, a negotiation process would begin and construction would halt.
2. Unscrupulous negotiators could hold the project “hostage” by seeking a drastically increased price or other unfair terms under the threat of not completing the half-finished project.



An Agreed Upon Change Order Process:

1. Allows changes without voiding the contract as a whole;
2. Permits parties to rely on their original bargain; and
3. Provides uninterrupted continuous work.

B. ORDERED CHANGES

Scope vs. General Scope

Changes in the work required of a construction project fall into 4 categories:

1. Work within the Scope of the project.
2. Work within the General Scope of the project.
3. Cardinal Changes to the scope of work.
4. Constructive Changes to the scope of work.

Perhaps one of the most fundamental questions is: When is a change order necessary/appropriate?

The answer depends on how the change is classified (scope, general scope, cardinal change, constructive change).

Scope

- A change is within the scope of a contract when it is within the work, responsibilities, and risks assumed by the contractor in consideration for the price charged when the contract was formed.

- Courts consider contractors to bear the risks within the limits of the undertaking. Changes within the scope of a contract are treated as routine and expected.
- To determine scope, courts look at the contract itself.
- A change within the scope of the contract is one for which the contractor receives no further compensation.

EXAMPLE: AIA Document A201-2007 (General Conditions of the Contract for Construction), section 7.4 entitled “MINOR CHANGES IN THE WORK” allows the architect to order “minor changes to the Work not involving adjustment to the Contract Sum or Contract Time and not inconsistent with the intent of the Contract Documents.”

General Scope

- Most construction contracts authorize changes within the general scope of the contract.
- What is within the general scope of the contract is determined by examining the intent of the contract.
 - Reasonableness
 - Substantiality
 - Materiality



Such determinations are inevitably fact specific and court opinions vary widely.

The practical significance of designating a change in work being within the general scope of the project is:

1. Changes are administratively remedial pursuant to contract terms regarding notice and damages.
2. Changes are not subject to sovereign immunity defense.
3. Contractor not permitted to rescind the contract.
4. Changes do not discharge performance bond surety.
5. No additional competitive bidding required for public work.
6. Contractor not relieved from continuing performance under contract pending resolution of disputes regarding changes.

EXAMPLE: In *Wunderlich Contracting Co. v. U.S.*, 173 Ct. Cl. 180, 351 F.2d 956 (1965) the court held extensive changes adding 50% to performance time were remediable within the contract’s general scope.

- Government supplied specifications contained “large number of errors” requiring 35 change orders and resulting in 318 days more to complete the work than the 540 days upon which the project was bid.
- Included changes in footing walls and columns, water table recomputations, furring of walls and ceilings and lowering of ceilings, finish and color changes, convector changes, and modifications to doors and door frames.

Authority to Order Changes

Private Contracts—typically provide for the owner, architect and/or engineer having the authority to order changes to the scope of work.

AIA Document A201-2007 (General Conditions of the Contract for Construction), section 7.2.1 requires the architect to prepare the change order and the owner, contractor and the architect to sign the change order.

- However a Construction Change Directive is prepared by the architect and signed only by the owner and architect.

EJCDC C-700 Standard General Conditions of the Construction Contract (2002), Paragraph 10.03, requires both “the Owner and Contractor shall execute appropriate Change Orders recommended by the Engineer[.]”

- However, if a dispute arises and one party is not willing to execute the Change Order, then the Engineer must take action to resolve such claims.

Public Contracts — Contracts with the Federal Government typically designate one individual as the “Contracting Officer” and that person alone possesses authority to contractually bind the federal government.

- Federal Acquisition Regulations (FAR) 53.243-4 Changes (Aug. 1987).
- Public Contracts — MnDot Spec. § 1103 defines a change order as a “written order issued by the engineer...” Contractors are required to sign these change orders and return them before they are considered effective.

The law recognizes changes ordered by an individual based upon the doctrines of actual authority and apparent authority.

The first and best place to look to determine whether a party possesses authority to issue a change order is in the contract documents.

NO AUTHORITY = NO PAYMENT FOR WORK

Actual Authority to Authorize a Change Order

- Actual authority is the actual grant of authority, in fact, by the owner.
- Actual authority may be granted either expressly (e.g., by contract), or it can be implied.
 - AIA Document A201-2007 (General Conditions of the Contract for Construction), Article 4 entitled “Architects Administration of the Contract.”

**QUESTION
AUTHORITY**

- “Apparent authority [to authorize a change order] exists when the principal holds the agent out as having authority, or when the principle permits the agent to act on its behalf.”
- Existence of implied authority depends on the relationships and representations of the parties.

Example: General contractor issues a written authorization for extra work by a subcontractor to place additional carpet beyond amount specified in subcontract because of a scaling error in blue prints relied on when bidding the project.

- “In Minnesota this is sufficient to imply the consent of the owner for the additional work.”

C. CARDINAL CHANGES

A change which is outside the general scope of the contract is called a cardinal change.

- A cardinal change is also sometimes referred to as “abandonment” of the contract.
- Such changes are so substantial and materially different from the work originally bargained for in the contract that contractors are not required to perform such changes.
- A cardinal change is a material breach of the contract.
- Cardinal changes typically release the other party from performance, void liquidated damages clauses and permit recovery of damages.
 - Compensation for cardinal changes is determined under common law principles rather than the contract’s change order clause.
- What constitutes a cardinal change depends on the unique circumstances of each case and the contract governing the work.
- A cardinal change can be either an addition or a deletion.
- A cardinal change can be a single large change, or a series of small changes that—in total—constitute a significant change.
 - “Death by a thousand cuts.”

Whether changes are cardinal changes, or within the general scope of work is determined by examining several factors:

1. The individual and cumulative impact of the change.
2. The degree of difficulty caused by the change.
3. The practical nature of the disruption caused by the change.
4. The overall impact to cost and time.

D. CONSTRUCTIVE CHANGES

Contractors may be entitled to an adjustment of the contract price and/or contract completion date even where there has not been a formal written change order or construction change directive if a “constructive change” can be demonstrated.

To recover for a constructive change, a contractor must demonstrate:

1. The minimum performance required by the contract;
2. The work exceeded the required minimum; and
3. The owner required the additional work or the work was required to correct a problem attributable to the owner.

Without the constructive change doctrine, an informal change would force the contractor to choose between performing the work without a change in contract price (or time of completion) or walking off the job and risking liability for breach of contract.

The Constructive Change Doctrine has been applied in 5 distinct situations:

1. Contract interpretation disputes during performance.
2. Interference or failure to cooperate by the owner.
3. Defective specifications.
4. Misrepresentation or nondisclosure of superior knowledge.
5. Acceleration of work.

NOTICE—A contractor who wants reimbursement for its work is obligated under most contracts to provide prompt notice that it will be filing a claim for reimbursement related to extra work not covered by a formal change order.

- AIA Document A201-2007 (General Conditions of the Contract for Construction), section 15.1.2 requires written notice of a claim to be provided to the Architect and other party “within 21 days after occurrence of the event giving rise to such Claim or within 21 days” after recognizing the conditions giving rise to the Claim.

In a case using language identical to AIA Doc. A201-2007, section 15.1.2, a Minnesota court held notice of a claim for \$90,000 in delay damages provided 7 days after project was completed, but 5½ months after the scheduled completion date, was too late. The owner had “waived” its claim.

- AIA Document A201-2007 (General Conditions of the Contract for Construction), section 15.1.2 requires written notice of a claim to be provided to the Architect and other party “within 21 days after occurrence of the event giving rise to such Claim or within 21 days” after recognizing the conditions giving rise to the Claim.
- “The parties were free to contract as to the type of notice that would be required. In this contract *written notice* was required. The trial court correctly found that written notice of claim was a condition precedent to his claim.”

- Buchman Plumbing Co., Inc. v. Regents of the Univ. of MN, 215 N.W.2d 479, 486 (Minn. 1974).

NOTICE—timely and adequate notice permits other parties to:

1. Assess the implications and potential liability they face.
2. Investigate whether the claimed extra work is under the contract.
3. Document costs incurred in performing the extra work.
4. Fairly adjust the contract price before memories fade and documents are lost, etc.

E. REQUIREMENTS FOR MAKING CHANGES

1. Read the Contract! Know the correct procedures for making changes and follow them in a timely fashion.
2. Determine whether the change is within the scope or general scope of the contract, or involves a cardinal change.
3. Provide notice to the appropriate people.
4. Involve people with authority to enter into a change order.
5. Execute the change order or construction change directive prepared by the individual with authority.

F. CREATING AN EFFECTIVE CHANGE ORDER

1. Same as “Requirements for Making Changes” in previous section, plus:
 - A. Written Change Orders or Construction Change Directives should specifically address and quantify any adjustments to payment and/or to time for completion of work.
 - B. Must include a clear explanation of what changes are being made. (Attach revised drawings, specifications or plans to make this clear.)

Change orders are tedious during the hustle and bustle of construction.

But they are the best preventive medicine to avoid: litigation, further expenses and impositions on your schedule in the future.

G. WAIVER OF FORMAL REQUIREMENTS

Although construction contracts typically require change orders to be in writing, the reality is that changes are often made without a written change order or construction change directive.

However, contractors may still recover payment if they can establish a waiver of the written requirement.

To establish waiver entitling the contractor to payment, a court must find:

1. The owner’s actual knowledge of a change in the work;
2. A course of dealing which repeatedly disregards the requirement; or

3. A promise to pay for extra work by the owner and a contractor's performance in reliance upon the promise.

Establishing waiver—and thus an entitlement to reimbursement—can be very challenging.

Courts require oral modification of a contract to be proven by “clear and convincing evidence.”

This typically requires more than he-said-she-said testimony at trial.

H. LIABILITY ISSUES

Managing changes to a construction contract presents a host of liability issues.

Practical considerations relating to efficiency which affect everyone's bottom line are, of course, important.

Failure to manage these issues effectively may result in disputes that must be resolved either in arbitration or litigation.

Manage your liability issues proactively.

- Use a good contract. Standard form contracts are a good resource.
- Know what your construction contract requires.
- Follow the procedures for making changes.
- Engage professionals early to resolve disputes before they blossom into litigation

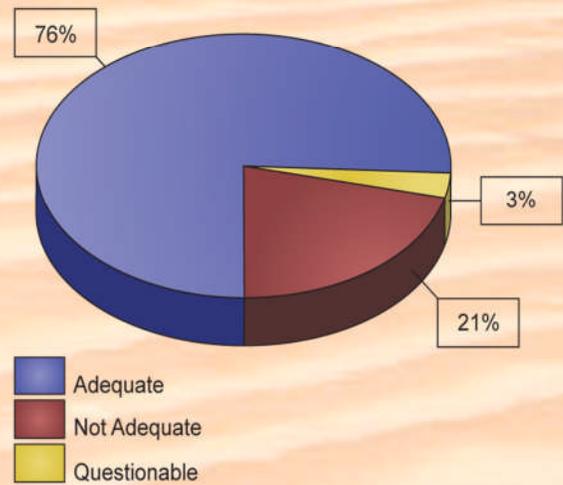
DOCUMENT, DOCUMENT, DOCUMENT!

- Position yourself for success in the unlikely event that disputes cannot be resolved informally.
- Respectful documentation will not be resented by other parties.
- Given the standard of proof required to prevail – “clear and convincing evidence” – documentation is important.

MAKE SURE YOU ARE PART OF THE 76% WHO PROPERLY DOCUMENT CHANGE ORDERS.

Documentation

For Change Order



If you would like copies of other PowerPoint presentations and articles on related topics, please: (1) give Mr. Schoenwetter a business card indicating which materials you would like; or (2) send Mr. Schoenwetter an email requesting one or more of the following:

- Effectively Resolving Construction Disputes.
- Personal Guaranties: Do They Really Equal Personal Liability?
- Defending Against Mold Claims In Court: How to Succeed.
- Minnesota Mechanic's Lien Issues: Doing It the Right Way.
- Minnesota Construction Law on Defects and Failures: Defenses to Claims for Defects & Failures.
- Emerging Issues in Premises Liability Litigation: Causation Issues in Mold Cases.
- Qualified Immunity for Architects and Engineers.

Charles (C.J.) Schoenwetter, Esq.
Bowman and Brooke LLP
150 South Fifth Street, Suite 3000
Minneapolis, MN 55402
(612) 656-4037 – Direct
(612) 751-4600 – Cell
cj.schoenwetter@bowmanandbrooke.com

Speaker Evaluation Form

Name of speaker: Charles (CJ) Schoenwetter

Presentation date: 2/9/12

Name of Presentation: Get Paid What You Deserve – Managing the Change Order Process

Please rate the speaker on each item, using the following scale:

1=poor 2=fair 3=average 4=good 5=excellent

I. Content of presentation

Speaker introduced the topic/subject clearly:	1	2	3	4	5
Main points of the presentation were clear:	1	2	3	4	5
Main points were well supported by examples:	1	2	3	4	5
Language of the speaker was accurate:	1	2	3	4	5
Language of the speaker was clear:	1	2	3	4	5
Topics covered flowed from point to point:	1	2	3	4	5

II. Delivery of presentation

Speaker began and finished without rushing:	1	2	3	4	5
Speaker maintained eye contact with the audience:	1	2	3	4	5
Speaker's words were clearly understandable:	1	2	3	4	5
Speaker used visual aids effectively:	1	2	3	4	5
Speaker finished within time limits:	1	2	3	4	5
Presentation held your interest:	1	2	3	4	5

III. Overall presentation

Using the same scale, how would you rate the overall presentation? 1 2 3 4 5

IV. In your opinion, what did the speaker do most effectively?

V. Could you provide any suggestions that would improve the presentation?