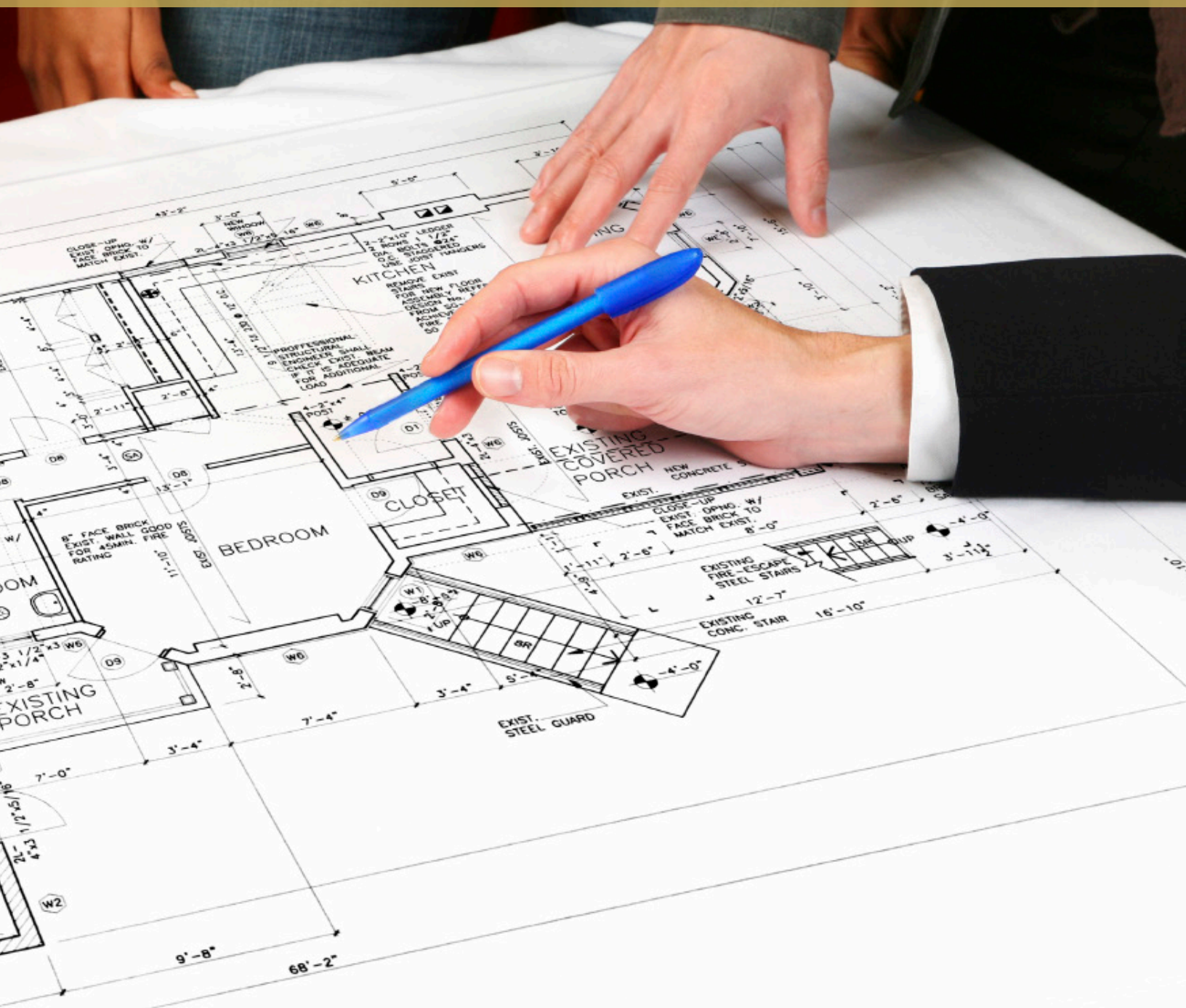
Change Orders and Pricing

Prepared by:
John A. Snow
Prince Yeates & Geldzahler



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Change Orders

The contract will generally provide the procedure for change orders. For example, some of the pertinent provisions of the AIA General Conditions regarding Change Orders are as follows:

> 7.1.1 Changes in the Work may be accomplished after execution of the Contract, and without invalidating the Contract, by Change Order, Construction Change Directive or order for a minor change in the Work….
>
> 7.1.2 A Change Order shall be based upon agreement among the Owner, Contractor and Architect; a Construction Change Directive requires agreement by the Owner and Architect and may or may not be agreed to by the Contractor….
>
> 7.2.1 A Change Order is a written instrument prepared by the Architect and signed by the Owner, Contractor and Architect, stating their agreement upon all of the following:
>
> .1 change in the Work;
>
> .2 the amount of the adjustment, if any, in the Contract Sum;
>
> .3 the extent of the adjustment, if any, in the Contract time.
>
> 7.3.1 A Construction Change Directive is a written order prepared by the Architect and signed by the Owner and Architect, directing a change in the Work prior to agreement on adjustment, if any, in the Contract Sum or Contract time, or both. The Owner may by Construction Change Directive, without invalidating the Contract, order changes in the Work within the general scope of the Contract consisting of additions, deletions or other revisions, the Contract Sum and Contract time being adjusted accordingly.
>
> 7.3.2 A Construction Change Directive shall be used in the absence of total agreement on the terms of a Change Order.
>
> 7.3.3 If the Construction Change Directive provides for an adjustment to the Contract Sum, the adjustment shall be based on one of the following methods:
>
> .1 mutual acceptance of a lump sum properly itemized and supported by sufficient substantiating data to permit evaluation;
>
> .2 unit prices stated in the Contract Documents or subsequently agreed upon;

.3 costs to be determined in a manner agreed upon by the parties and a mutually acceptable fixed percentage fee; or

.4 as provided in Subparagraph 7.3.6

7.3.4 Upon receipt of a Construction Change Directive, the Contractor shall promptly proceed with the change in the Work involved and advise the Architect of the Contractor's agreement or disagreement with the method, if any, provided in the Construction Change Directive for determining the proposed adjustment in the Contract time or Contract Sum.

7.3.5 A Construction Change Directive signed by the Contractor indicates the agreement of the Contractor therewith, including adjustment in the Contract Sum and Contract Time or the method for determining them. Such agreement shall be effective immediately and shall be recorded in a Change Order.

7.3.6 If the Contractor does not respond promptly or disagrees with the method for adjustment in the Contract Sum, the method and the adjustment shall be determined by the Architect on the basis of reasonable expenditures and saving of those performing the Work attributable to the change, include, in case of an increase in the Contract Sum, a reasonable allowance for overhead and profit.

7.3.8 [The Architect makes an interim determination for purposes of monthly certification for payment of those costs], subject to the right of either party to disagree and assert a claim in accordance with Article 4.

The claim process regarding change orders was discussed in *M.B. Hayes, Inc. v. Tak Chin Choi (In re M.B. Hayes, Inc.)*, 2003 Bankr. LEXIS 1927, 4-5 (2003):

> If the Debtor and Owner-Defendants could not agree on the terms of a change order, the architect could prepare a construction change directive with agreement by the Owner-Defendants. The construction change directive would direct the performance of the work but reserve for future determination the assessment of costs associated with the change. Under this procedure, the architect could later assess costs using one of three methods. Alternatively, the Debtor could keep an itemized accounting of the costs incurred in executing the change order -- including labor, materials, equipment, insurance and other fees, and supervision -- together with a reasonable allowance for overhead and profit. The architect determined all cost disputes for purposes of interim payments, subject to the rights of the parties to assert a formal claim.
>
> To assert a formal claim, the parties had to do so in writing within 21 days of the occurrence of the event giving rise to the claim or the time that the claimant first recognized the condition giving rise to the claim, whichever occurred later. If the

> claim requested an increase in the contract price, the claimant had to initiate the claim before proceeding with the work, except in limited emergency situations. Claims for additional time had to include an estimate of the cost and probable effect of delay on the scheduled construction. In the case of continuing delay only one claim was required.

The general rule is that if the contract requires change orders for payment, then a change order must be obtained. In *Hoth v. White*, 799 P.2d 213 (Utah App. 1990) the court stated:

> Relevant contract terms provide that "[t]he amount of the purchase price may be increased if additional costs are incurred for extras as described hereafter. Buyer agrees to pay for the cost of all such extras as agreed to in a written change order as part of the purchase price of the property," and "[n]o changes shall be made to the Plans and Specifications or the purchase price except as agreed to in a written change order signed by Buyer and Contractor which sets forth the change to be made and the amount of adjustment in the purchase price required by said change." The contract thus clearly provides that unless there is a written change order signed by the parties for each extra, the purchase price is not to be increased and the buyer, therefore, is not responsible for paying for the extra. It is undisputed that the parties signed no such written change orders.

Id. at 218.

Likewise, in *Hall Contr. Corp. v. Entergy Servs*., 309 F.3d 468 (8th Cir. 2002) the court stated:

> Hall first contends that Entergy's refusal to pay additional compensation for Phase One constitutes a breach of contract. Entergy argues in response that, by failing to comply with contract procedures, Hall has waived any claims for additional compensation. *RAD-Razorback Limited Partnership v. B.G. Coney Co.*, 289 Ark. 550, 713 S.W.2d 462, 466 (Ark. 1986), states the applicable Arkansas law on this point: "The general rule pertaining to construction contracts is, absent a waiver . . ., if it is required, a request for additional compensation must be in writing and cannot be made after the work is completed." Hall does not dispute its failure to comply with change-order procedures, but argues instead that Entergy (1) waived strict compliance through its course of conduct, and (2) had actual knowledge of the debris conditions in the spillway cells.
>
> Section 6.4 of the contract clearly states: "Contractor hereby waives all claims for schedule extensions or additional compensation beyond that allowed in this Agreement or by a Contract Order, unless the claim is expressly authorized under

> this Agreement and is made in accordance with the following procedures." Sections 6.2, 6.4, and 37.3 then provide detailed procedures for the submission, approval, and payment of such claims. But according to Hall, Entergy would normally first approve change-order requests orally. Hall would only commence the written change-order procedures after it had obtained oral approval. It would then memorialize the modification with the required paperwork. Hall claims that Entergy denied Hall's initial request for additional compensation arising from the debris conditions, thus rendering a written request futile. The district court found, however, that Hall had "simply not met its burden of showing that the custom, practice and conduct of the parties was that written requests would only be made once oral approval had been received and so there is no basis for a finding of waiver." We agree.
>
> Even accepting Hall's evidence of waiver at face value, Hall has not presented evidence sufficient to create a fact question or to justify a finding of waiver under Arkansas law. In Rivercliff Co. v. Linebarger, 223 Ark. 105, 264 S.W.2d 842, 846 (Ark. 1954), the Arkansas Supreme Court found that a waiver had occurred where several changes "had been made and paid for during the construction . . . yet . . . only one written change order had been made." Likewise in *J.N. Heiskell v. H.C. Enterprise, Inc.*, 244 Ark. 857, 429 S.W.2d 71, 74-75 (Ark. 1968), the court found that a fact question as to waiver was properly submitted to the jury where the contractor had presented evidence that oral changes were approved and paid for on "many occasions." Finally, we held in *Falcon Jet Corp. v. King Enterprises, Inc.*, 678 F.2d 73, 77 (8th Cir. 1982), that waiver had occurred where virtually all changes had been approved orally. In contrast, it is undisputed in this case that Hall submitted several change orders, and Entergy paid them, according to the contract procedures, while there is no evidence that Entergy ever approved and paid for any changes without the required paperwork. The district court correctly found the evidence of waiver insufficient to create a triable question of fact.

Id. at 473-74.

A similar discussion was contained in the case of *RAD-Razorback Ltd.*

Partnership v. B.G. Coney Co., 289 Ark. 550, 556, 713 S.W.2d 462 (Ark. 1986):

> The contract contained the standard construction industry provision which requires that a claim for extra work must be made and approved before the work is begun, and without such authorization the contractor cannot recover for that work. No claim was ever made by Coney. Coney's explanation for this omission was that he thought it was the owner's responsibility or that the job was "just moving too fast." Coney testified that he had built three K-Mart stores and about one hundred Wal-Mart stores. From that background it is incredible that Coney would not be fully aware of the consequences of failing to file a work claim for the added compensation he now demands. Nor do we find from the record that this provision in the contract had been waived by previous conduct on the part of

> RAD-Razorback, as occurred in *Sellers v. West-Ark. Construction*, 283 Ark. 241, 676 S.W.2d 726 (1984). The general rule pertaining to construction contracts is, absent a waiver or certain circumstances not evident from the record in this case, if it is required, a request for additional compensation must be in writing and cannot be made after the work is completed. *Ida Grove Roofing v. City of Storm Lake*, 378 N.W.2d 313 (Iowa 1985); *Elec-Trol, Inc. v. C.J. Kern Contractors*, 284 S.E.2d 119 (N.C. 1981); *Chambless v. J.J. Fritch*, 336 S.W.2d 200 (Tex. 1960); 13 Am Jur2d § 22, Building and Construction Contracts; 2 ALR3d, Private Construction Contracts-Extras.

However, the owner's failure to follow the change order process, and issue change orders as provided, will entitle a party to abandon the contract. In *Darrell J. Didericksen & Sons v. Magna Water & Sewer Improv. Dist.*, 613 P.2d 1116 (Utah 1980) the court stated:

> Although promised, no change orders for such contract modification were ever forthcoming, and the Contractor proceeded with its work as originally outlined and performed thereunder until the project came into what the trial court found was a direct conflict with the DOT highway project and could not be performed as the contract specifications were written. After notice, the Contractor ceased operation when no change order was forthcoming, and the trial court found a substantial change in the nature of the project had occurred, justifying the Contractor to abandon further performance and maintain this suit for damages.

Id. at 1117-18.[1] The Court also stated:

> The evidence is uncontradicted that soon after the parties entered into their agreement there was reason to believe the work could not be performed in accordance with the terms of that instrument, although the record further substantiates that Magna held out the expectation that appropriate change orders would be forthcoming as necessary. Under such circumstances the Contractor was well within its rights by continuing in good faith to carry out its part of the contract so long as such work could go forward, and it was only when Magna refused to provide acceptable change orders that the work stopped, as the

[1] In the *Didericksen* case, the Court was addressing contract documents that provided: "17. Changes in Work: No changes in the work covered by the approved contract documents shall be made without having prior written approval of the owner. 18 . . . . The owner may order extra work or make changes . . . . No claims for any extra work or materials shall be allowed unless the work is ordered in writing by the owner. 22. Claims for extra cost. No claim for extra work or cost shall be allowed unless the same was done in pursuance of a written order of the engineer approved by the owner . . . ." *Id.* at 1118.

> Contractor refused to proceed further without written direction or authorization as required. Under such facts the trial court correctly determined the Contractor was justified in working until further performance could not continue under the agreement. The law with respect to written change orders in a public construction contract long extant in this state is enunciated in *Campbell Building Company v. State Road Commission*, 95 Utah 242, 70 P.2d 857 (1937), holding that the requirement for written change orders is binding on the parties and must be complied with or the contractor may waive recovery for such work outside the contract specifications. In the absence of a change order the Contractor had the election either to proceed outside the terms and specifications or to shut down and declare the contract breached.

Id. at 1118.

In the case of *Allstate Transp. Co. v. SEPTA*, 2000 U.S. Dist. LEXIS 3831, 58-60 (D. Pa. 2000) the court stated:

> Under Pennsylvania law, where a public contract states a procedure by which the contract may be changed or modified, no claims regarding work changes or extra work are allowed unless the contract procedure has been strictly followed. *Nether Providence Township School Auth. v. Thomas M. Durkin & Sons, Inc.*, 505 Pa. 42, 476 A.2d 904, 906-7 (Pa. 1984). Waiver of public contract provisions regulating change orders "can be accomplished only by a formal written action (i.e. a new contract) by the public body authorized to enter into the contract, or the express ratification of the extra work claim by resolution of the public body." 476 A.2d at 907.\

Equitable theories such as unjust enrichment will not avoid application of the change order procedure. *Ebenisterie Beaubois Ltee v. Marous Bros. Constr., Inc.*, 2002 U.S. Dist. LEXIS 26625, 18-20 (N.D. Ohio 2002).

Pricing

There are various forms of pricing, but the two basic forms are the “fixed price” and “cost plus.” There are variations on these types of compensation. Even though these two forms of pricing are used extensively, there are still many mistakes made by the parties to the contract.

Fixed-price contracts provide a specific price for completion of a specified project as designed. Fixed-price contracts generally place the higher risk on the contractor to complete the project for the amount of the contract. The owner has no concern regarding the actual cost of construction, but merely is concerned that the contractor complies with the drawings and specifications.

A problem commonly encountered with fixed price contracts is the definition of the scope of the work. The contractor or subcontractor will attempt to argue that various aspects of the work are outside the scope of the original design and is an extra, which requires additional compensation. The owner, of course, will claim that all work is within the original design. Accordingly, when dealing with fixed sum contracts, importance should be placed on a precise definition of the scope of the work as outlined by the plans and specifications to the extent possible. In *Maguire Co. v. Herbert Constr. Co.*, 945 F. Supp. 72, 78 n.7 (S.D.N.Y. 1996), the court stated regarding extra work:

> Where one agrees to do, for a stated sum, a thing possible to be performed, he is not entitled to additional compensation merely because he encounters unforeseen difficulties. . . . Recovery cannot be had for extra work which actually falls within the subcontract or the plans and specifications . . . but recovery may be had for work outside the contract where the subcontractor was in fact specifically ordered to do work not within the scope of that called for by the subcontract.

Id. at 78 n.7.

Cost-plus contracts are frequently used when there are uncertainties in the actual scope of the work and what will be required to complete the project that the cost of performance cannot be reasonably or accurately estimated. Under a cost-plus form of contract, the owner agrees to pay the contractor for its costs plus a fixed fee or percentage of costs. An issue with the cost plus contract is that it provides no incentive to perform the contract in a cost-efficient manner.

An area of confusion that does arise in cost plus contracts is what costs can actually be charged to the owner. Generally, the contract does specify and define costs, but even then there can be issues as to what are proper charges. Unless otherwise defined, the term costs, generally means the actual costs incurred as opposed to average costs or market rates. *Freeman & Co. v. Bolt*, 968 P.2d 247, 254 (Idaho Ct. App. 1998). The party performing under a cost-plus contract must keep a record of who worked on a given job and of his hourly wage. Approximations and averages are insufficient. *Arc Electric Co. v. Esslinger-Lefler, Inc.*, 121 Ariz. 501, 591 P.2d 989 (Ariz. Ct. App. 1979). If overhead expense is to be included in the costs, it must be expressly written into the contract, and the overhead intended to be covered must be defined. *Nolop v. Spettel*, 64 N.W.2d 859, 863-864 (Wis. 1954). It is a generally accepted principle that administrative time is not covered under a cost-plus contract. *Keever & Assocs. v. Randall*, 119 P.3d 926, 930-929 (Wash. Ct. App. 2005).