Part 2: Construction Contract Draconian Notice Provisions — Is Prejudice Still The Issue?

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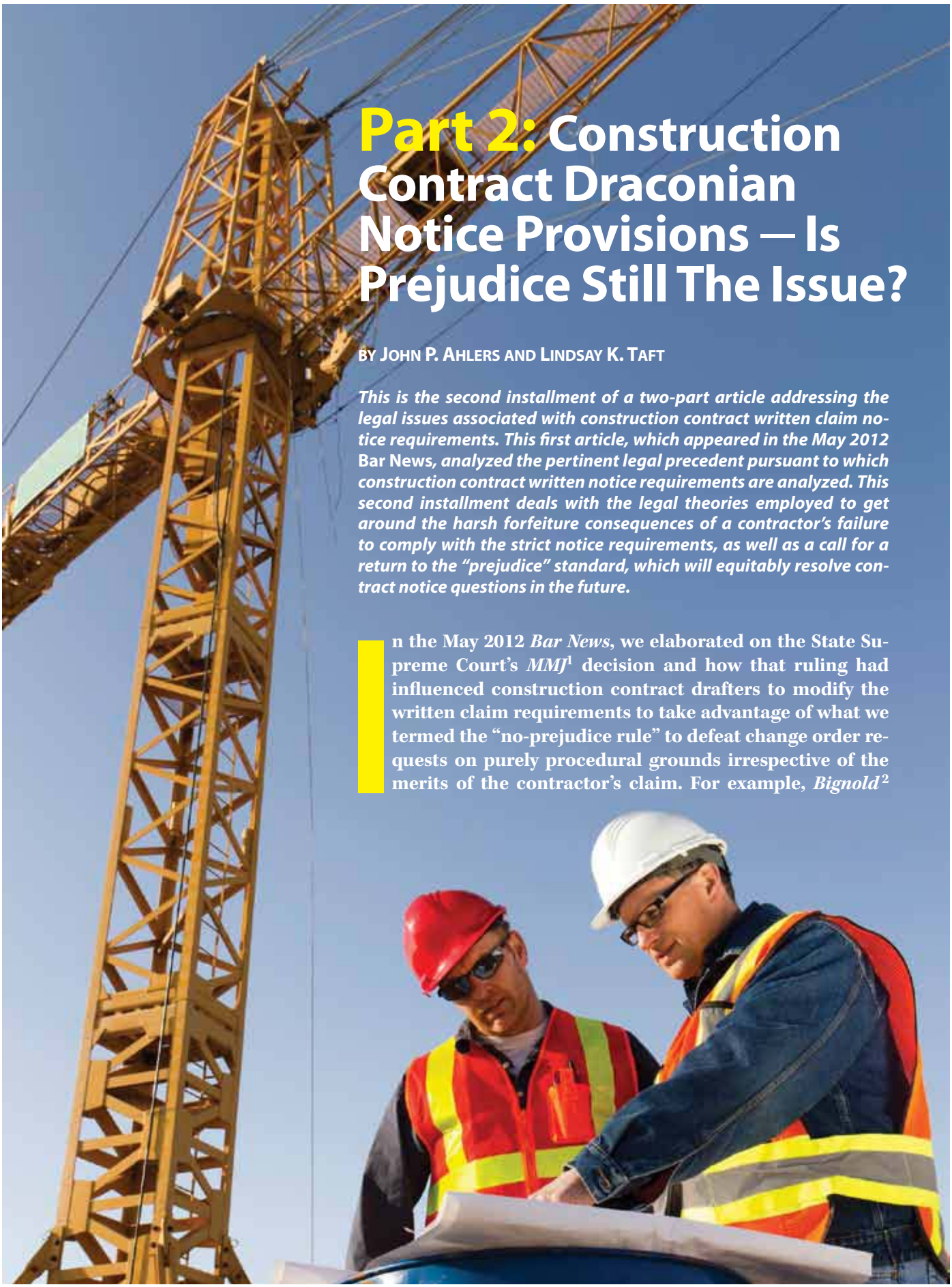
This is the second installment of a two-part article addressing the legal issues associated with construction contract written claim notice requirements. This first article, which appeared in the May 2012 Bar News, *analyzed the pertinent legal precedent pursuant to which construction contract written notice requirements are analyzed. This second installment deals with the legal theories employed to get around the harsh forfeiture consequences of a contractor's failure to comply with the strict notice requirements, as well as a call for a return to the "prejudice" standard, which will equitably resolve contract notice questions in the future.*

In the May 2012 *Bar News*, we elaborated on the State Supreme Court's *MMJ*[1] decision and how that ruling had influenced construction contract drafters to modify the written claim requirements to take advantage of what we termed the "no-prejudice rule" to defeat change order requests on purely procedural grounds irrespective of the merits of the contractor's claim. For example, *Bignold*[2]



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remains an impediment to the arbitrary enforcement of forfeiture if notice technicalities are not complied with to the letter. We also explained that the Supreme Court precedent of *American Safety*[3] serves to further exacerbate the contractor's chances of negotiating the intricacies of what have become exceedingly one-sided written notice requirements. In this piece, we provide the reader with further authorities and arguments which lessen the impact of and perhaps counteract the *MMJ* ruling. We point out that, despite the *MMJ* roadmap which invites owners to include forfeiture clauses, the biggest public-works owners in the state have declined that invitation. The federal government, the Department of Enterprise Services (formerly General Administration), the University of Washington, and the Washington Department of Transportation mandate that a contractor only forfeits its claim for failure to strictly comply with the notice provisions if the owner was prejudiced by the contractor's late or defective notice. The owner and the contractor are protected because "prejudice" determines whether the claim is barred, not wooden adherence to procedural compliance that renders equity meaningless. These owners reason that if they keep their contract provisions balanced and fair, they will attract more contractors to bid on their projects, thus driving the cost of public works down and saving money on unnecessary administrative expenses in dealing with the procedural paperwork nightmare that strict adherence to written notice requirements creates. Before examining these owners' responses to *MMJ*, however, we first pick up where we left off last month with legal precedent that may serve as an antidote to the severe impact of *MMJ*.

The Prevention Doctrine and Implied Obligations

In light of the above potential unjust result, does the contractor have any defense? One such avenue may be found with the application of the "Prevention Doctrine." The Prevention Doctrine, which has been adopted in Washington, precludes a party to a contract from causing the failure of a condition in a contract and then later benefiting from that failure.[4] For example, if an event or circumstance is discovered that will result in additional work or contract time and the owner is on notice of the event, it is up to the owner — not the contractor — to determine how the contractor is to proceed. If the owner delays in providing the contractor with such instruction or the extent of the event is still being determined, how can the contractor possibly provide the owner with a detailed breakdown of the contractor's claim and increase in contract cost or time?[5] Under *MMJ,* presumably, the contractor's failure to comply with the notice provision would render the contractor's claim forfeited.

Accordingly, if a design deficiency[6] is discovered during the project that results in a substantial change to the contractor's scope of work, yet the owner refuses to timely address the deficiency or respond to the contractor's requests for information, it is impossible for the contractor to fully comply with the notice (claims submission) requirements. Under the Prevention Doctrine, the owner's failure to perform a condition precedent (providing the required information for the contractor to properly analyze its claim) to the contractor's fulfillment of the notice requirements excuses any of the contractor's procedural shortcomings.[7] The owner cannot substantially contribute to the contractor's inability to comply and then, after-the-fact, rely on the notice provision and *MMJ* to deny compensation.

Further, this result comports with the implied duty to not hinder or delay the contractor, an implied obligation relied on in *Bignold*:

> In every construction contract there is an implied term that the owner or person for whom the work is being done will not hinder or delay the contractor, and for such delays, the contractor may recover additional compensation.[8]

The same duty has been stated affirmatively as an implied obligation of both contract parties to cooperate with each other.[9] The Washington State Supreme Court has espoused the rule that the "person for whom the work is contracted to be done… will in all ways facilitate the performance of the work" of the contractors.[10] Thus, it follows that to the extent the owner fails to timely and cooperatively provide the contractor the necessary information (direction and design clarification) to appropriately comply with the contract notice requirements, the owner has breached its implied obligation, providing the contractor recourse under well-settled Washington legal precedent.

Similarly, where the owner's original design is deficient and that design deficiency prompts numerous, frequent, and pervasive changes to the project such that the contractor's ability to comply with the notice provisions is made practically impossible, application of the Prevention Doctrine suggests that the owner cannot create a condition (the multiplicity of changes) and then rely on the contract's written notice clause (another condition) to jettison (forfeit) an otherwise meritorious contractor claim.

Other Washington Precedent Supports the "Prejudice" Rule's Abhorrence of a Forfeiture

Requiring strict compliance with a construction contract's notice, protest, and claims submission procedures — without consideration of any prejudice the owner may or may not have suffered as a result — elevates considerations of the form of the contractor's submittal over the substance of the underlying construction issues on the merits. Such considerations are contrary to the Washington courts' approach in other aspects of the law. In the highly analogous context of enforcement of notice provisions in insurance policies, the courts have consistently maintained an insured's compliance with notice of claims and cooperation clauses as a defense to coverage *only if* the insurer was actually prejudiced by the insured's breach.[11] At issue in *Liberty Mutual v. Tripp,*[12] for example, was an insured's failure to give its underinsured motorist (UIM) carrier notice of a tentative settlement with the liability carrier and the impact the settlement would have had on reducing the UIM carrier's obligation to pay benefits. The Court held that the insurer could realize a windfall if it were allowed to completely deny the insured's UIM coverage, and reasoned that the insurer should be permitted to escape paying UIM benefits only in amounts "equal to the actual prejudice" it suffered on account of the insured's breach of the notice provision in the insurance contract.[13] The Court rejected the insurer's form-over-substance argument and used a prejudice analysis to put the insured's breach of the policy's notice requirement in its proper perspective.[14]

Justice Madsen, the primary author of the majority's opinion in *MMJ,* emphasized in a recent dissent that, where the principal on a performance bond failed to provide timely notice, under well-established Washington law "even inadequate notice of the principal's default relieves its surety of liability only to the

extent of any resulting prejudice."[15] Considerations of prejudice, substance over form, and avoiding forfeitures of a party's substantive rights are also found in other decisions by Washington courts.[16] These same policy considerations are equally applicable to construction contracts and should not have been overlooked by the Court in *MMJ*.

Steps Toward the Prejudice Standard

Irrespective of the potential defenses to the no-prejudice rule, the better solution is nevertheless a return to the prejudice standard as the general rule rather than the exception. As predicted,[17] after the *MMJ* case was published, owners raced to "tighten up" contract written notice procedures to include forfeiture clauses as the punishment for tardy notice.[18] In some instances, this enthusiastic rewriting process resulted in an almost incomprehensible series of written notice and claim requirements that are virtually impossible to comply with. In the heat of this "arms race," surprisingly, some of the largest procurers of construction work in Washington have acknowledged the unjust outcome (and increased long-term costs) resulting from the "no-prejudice" rule and have declined to incorporate the forfeiture language into their construction contracts, instead advocating for the more equitable result of the prejudice rule.

Washington State Department of Enterprise Services (DES): Prejudice Standard

For 2011, the DES (formally the General Administration) construction budget was $586.4 million.[19] Its contract notice provision requires that the contractor give DES written notice of an event giving rise to a claim within seven days of the event's occurrence but qualifies its forfeiture provision with the prejudice standard:

> Failure to give such written notice shall, *to the extent the Owner's interests are prejudiced*, constitute a waiver of Contractor's right to an equitable adjustment (emphasis added).[20]

DES, an entity with a half-billion dollars' worth of construction work on its books, has opted for a fair standard (the prejudice rule) and will forfeit a contractor's claim only to the extent that the lack of written notice prejudices the owner's interest in some manner. Although the *MMJ* decision provided DES with a roadmap of how to craft its specifications and take advantage of a contractor's lack of written notice, DES resisted the temptation to exploit this short-sighted opportunity. DES's refusal to jump on the *MMJ* bandwagon was not born from some sort of altruism but instead is based on sound economic consideration. By keeping its contract provisions evenhanded, DES reasons that it will attract more bidders on its projects and will not spend money on unnecessary administrative expenses associated with managing the paperwork nightmare caused by harsh, unreasonable notice provisions.

University of Washington: Prejudice Standard

The 2011 construction budget for the University of Washington, which also uses DES's general conditions for its construction work, was $106 million.[21] Just as with the DES, unless there is demonstrated prejudice to the University of Washington, a contractor's right to an equitable adjustment is not forfeited simply because the contractor failed to comply with the written notice requirements. The economic long-term consequences of forfeiture notice clauses simply do not justify the short-term advantage of defeating a contractor's

claim on procedural notice grounds.

Federal Government: Prejudice Standard

The federal government's 2011 construction budget for the Corps of Engineers, Department of Defense, and FHWA combined was $22.6 billion.[22] Remarkably, the largest purchaser of construction services in the world does not resort to the expeditious but unfair practice of simply imposing forfeiture on a contractor's claim in the event of tardy notice (on federal contracts, strict enforcement of written notice requirements depends on the government's ability to show it was prejudiced by the contractor's tardy notice).[23] Federal courts will simply take late notice or nonspecific cost estimates into account when evaluating a claim's merit, only deeming a contractor's claim forfeited for lack of notice if the federal government can show it was prejudiced by the contractor's tardy notice.

Washington State Department of Transportation

Finally, the Washington State Department of Transportation (WSDOT) construction budget for 2009–2011 was $5.4 billion.[24] WSDOT, however, takes an interesting approach to the forfeiture issue. Its standard specifications outwardly indicate that failure to comply with the notice requirements results in a forfeiture of the contractor's claim (see WSDOT Standard Specification 1-09.11(2) 2010). The notice provisions in the *MMJ* case were based on the WSDOT specifications. WSDOT officials, however, are quick to point out that WSDOT has never strictly enforced the forfeiture clause in the event of a contractor's failure to comply with the written notice requirements of the contract.[25] In other words, although WSDOT has the ability, it does not typically use the contract provision as a defense to an otherwise valid contractor's claim.

Combined, DES, University of Washington, and WSDOT perform a significant percentage of public construction work in Washington state. These giants (who frugally administer public projects) have recognized that reasonableness and leniency are better policies than strictness and irrationality, deciding not to fall into the *MMJ* trap of strictly construing the notice provisions when no purpose for enforcement of the forfeiture provision is served. By employing the prejudice standard, these public owners avoid subjecting

contractors to harsh results and forfeiture and themselves to higher administrative costs and bid prices, yet continue to preserve the underlying purpose of the notice provisions. If the owner can show that it was prejudiced as a result of the contractor's late notice, the contractor will lose its claim and the owner remains protected. "Prejudice" determines whether the claim is barred, not some wooden adherence to procedural compliance that renders equity meaningless.

In light of these sophisticated owners' refusal to employ forfeiture unless prejudiced by the lack of notice, the question then arises: why do port districts, school districts, counties, and cities cling so jealously to harsh notice clauses when these provisions ultimately increase the cost of public projects? As previously noted, contractors have no opportunity to "negotiate" a public contract before it is bid. In these harsh economic times, it is particularly disturbing that public owners would insert overreaching clauses in projects funded by taxpayers (contractors pay taxes, too) to take advantage of desperate contractors who overlook or misinterpret the onerous and often impossible to satisfy notice requirements. Particularly in those instances where public owners are not hurt (prejudiced) by the tardy notice, such forfeiture is punitive and against the evenhanded treatment we expect of our public institutions. It further results in the unjust enrichment of our public bodies in the short-term and higher costs for all in the long run.

Conclusion

When changes arise on public projects, it is only appropriate that contractors be fairly and equitably compensated for the extra work. For projects with harsh notice provisions in place, should a contractor miss the notice deadline, the knee-jerk reaction from an owner's representative is to forfeit the claim resulting in a windfall to the owner who ultimately receives the contractor's work for free. Margins are already tight, and the inevitable reaction from the contractor will be to engage in a paperwork battle on the project to the detriment of the quality of the work performed as well as increasing costs for taxpayers/owners. In turn, owner representatives confident in the strength of their contract clauses fight notice issues to the overall detriment of the construction project. The issue, at a huge cost to society, eventually ends up in court, and

potentially the Supreme Court, where resources are further wasted due to the intransigence of each side's legal position.

Arguably, such harsh claim notice clauses cause more litigation and unnecessary administration instead of resolving disputes on their merits. Thus, taxpayers lose in two ways: first, projects are more expensive to administer; second, bidders who submit prices on projects with forfeiture clauses increase their prices to account for compliance with exacting written notice and complicated claim provisions — another huge administrative cost. In the end, everyone loses. The owners of the largest construction projects in the state and the nation have accepted the inherent fairness, justice, and efficiency of the prejudice rule and realized that forfeiture comes with a high societal price. It is time for courts, legislators, and, more importantly, other owners to jump on the same bandwagon and put societal resources into the construction of quality projects — not into the administration and resolution of unnecessary disputes.

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NOTES

1. *Mike M. Johnson v. County of Spokane,* 150 Wn.2d 375, 78 P.3d 161 (2003).
2. *C.W. Bignold v. King County,* 65 Wn.2d 817, 399 P.2d 611, 614 (1965).
3. *American Safety Cas. Ins. Co. v. City of Olympia,* 162 Wn.2d 762, 174 P.3d 54 (2007).
4. *Puget Sound Service Co. v. Bush,* 45 Wn. App. 312, 318, 724 P.2d 1127 (1986).
5. See, e.g., *Weber Const., Inc. v. County of Spokane,* 124 Wn. App. 29, 98 P.3d 60 (2004) (holding that the County waived strict compliance when it failed to provide the contractor requested design information that was necessary to calculating the claim amount).
6. Under the federal *Spearin* doctrine, recognized in Washington, the owner warrants the adequacy and sufficiency of the design. *Dravo Corp. v. Municipality of Metropolitan Seattle,* 79 Wn.2d 214, 218, 484 P.2d 399 (1971) (citing *United States v. Spearin*, 248 U.S. 132, 136, 39 S. Ct. 59, 63 L.Ed. 166 (1918)).
7. See *Puget Sound Service Co.,* 45 Wn. App. at 318.

8. *Bignold*, 65 Wn.2d at 825-26; See also *Warren Bros. Roads Co. v. United States*, 105 F. Supp. 826 (1952); *United States v. L.P. & J.A. Smith*, 256 U.S. 11, 65 L.Ed. 808, 41 S.Ct. 413 (1921); *Hammond v. Beeson*, 112 Mo. 190, 20 S.W. 474 (1892); *Haley v. Brady*, 17 Wn.2d 775, 137 P.2d 5059 (1943); *Ericksen v. Edmonds Sch. Dist.*, 13 Wn.2d 398, 125 P.2d 275 (1942) and cases cited therein; see also *V.C. Edwards Contracting Co., Inc. v. Port of Tacoma*, 83 Wn.2d 7, 13, 514 P.2d 1381 (1973); *Lester N. Johnson Co., Inc. v. City of Spokane*, 22 Wn. App. 265, 268, 588 P.2d 1214 (1978), review denied, 92 Wn.2d 1005 (1979).
9. *Cedar Lumber, Inc. v. United States*, 5 Cl.Ct. 539, 549 (1984); and *Corbin on Contracts*, §570.
10. *Haley v. Brady*, 17 Wn.2d at 789.
11. *Liberty Mutual Insurance Co. v. Tripp*, 144 Wn.2d 1, 16, 25 P.3d 997 (2001).
12. *Id.*
13. *Id.* at 17.
14. The Court also stated it was the insurer's burden to prove prejudice and that prejudice was an issue of fact, which can seldom be established as a matter of law. *Id* at 18.
15. *Colorado Structures v. Ins. Co. of the West*, 161 Wn.2d 577, 611, 167 P.3d 1125 (2007) (dissenting opinion).
16. See *Duskin v. Carlton*, 136 Wn.2d 550, 965 P.2d 611 (1998) (Department of Labor and Industries form letters constituted a proper demand to assign a worker's compensation action to the Department. Notice statutes in civil cases should fairly and sufficiently apprise those who may be affected of the nature and character of an action. Unless someone is actually misled or confused, notice is deemed adequate. The gravamen of a legal demand is its notice providing function.); *State v. Storhoff*, 133 Wn.2d 523, 946 P.2d 783 (1997) (In the absence of actual prejudice, incorrect notice from the Department of Licensing did not invalidate revocation of three defendants' licenses); *Beal v. City of Seattle*, 134 Wn.2d 769, 954 P.2d 237 (1998) (holding amendment to complaint to name the real party in interest after the statute of limitations had expired permitted where there is no prejudice to the defendant; the purpose of CR 15(c) is to permit amendment provided the defendant is not prejudiced and has notice); *Clark v. Pacific Corp.*, 116 Wn.2d 804, 809 P.2d 176 (1991) (holding failure to comply with mandatory notice provisions in Worker's Compensation Act did not bar subsequent action by claimant when the purposes of the notice requirements met by alternative means and Department was not prejudiced), overruled on other grounds *Gilbert H. Moen Co. v. Island Steel Erectors, Inc.*, 128 Wn.2d 745, 761, 912 P.2d 472 (1996).
17. *See* J. Ahlers, "Notice in Washington Construction Contract: Is Prejudice The Issue?" (52 *Washington State Bar News*, No. 4 (1998)).
18. Public testimony before the Washington Legislature (Judiciary Committee) February 2008 by Associated General Contractors and Washington Utility Contractors Association representatives.
19. See www.fortress.wa.gov/ga/apps/eaupcomingproj/upcomingprojects.aspx (2011).
20. See General Conditions § 7.02 A 2(a)–(b).
21. "University of Washington Up-Coming Construction Project List" (Jan. 31, 2011) (www.cpo.washington.edu/docman/web_ftp/docmanftp/upcoming%20uw%20construction%20projects%20march%202010.pdf).
22. See Corps of Engineers-Civil Works Budget For Fiscal Year 2011 (www.usace.army.mil/cecw/pid/documents/budget/budget2011.pdf); Department of Defense Budget for Fiscal Year 2011 (www.comptroller.defense.gov/defbudget/fy2011/budget_justification/pdfs/03_rdt_and_e/osd%20rdte_pb_2011_volume%203b.pdf); and Department of Transportation National Infrastructure Innovation and Finance Fund (www.dot.gov/budget/2011/budgetestimates/niiff.pdf).
23. "The delay in assertion of a claim by a contractor inevitably causes some degree of prejudice to the government; however, the existence of *prejudice* resulting from the dilatory notice usually serves to increase the burden of persuasion facing the contractor asserting its claim for equitable adjustments *rather than to bar its claim entirely*." *Mingus Constructors, Inc. v. United States* (emphasis added), 812 F.2d 1387, 1392 (1987).
24. See www.wsdot.wa.gov/finance/budget/2009-11expenditures table.htm.
25. Interview with WSDOT officials.