The Legal Landscape

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The construction industry continues to change as new technologies reshape jobsites and new generations of leaders rethink the way companies should operate. But one piece of the puzzle remains very much the same: Everyone needs a good lawyer.

According to the most recent edition of the Arcadis Construction Disputes Report, the average value of a dispute in the industry has soared to $42.8 million — a 42% year-over-year increase between 2021 and 2022. And based on how busy the attorneys have been this year, there is no sign of legal issues becoming less important to builders and contractors.

Every construction leader wants to spend more time and energy doing what they do best — building projects safely, efficiently, and profitably — and less time thinking about the things that might land them in court. How can you best avoid big disputes bound for mediation, arbitration, or litigation? What emerging rules and regulations should be on your radar as you develop strategies for success?

While legal issues will never disappear, listening to what some of the best construction lawyers in the country — all members of 2024 Top 50 Construction Law Firms — are thinking about offers a helpful perspective on future-proofing your business against risk, liability, and worse.

LOOKING BACK

The Consequences of COVID

Nothing moves at lightning speed in the legal system. That

means the full picture of the fallout from 2020 is only now coming into focus.

Eric Nelson, Atlanta-based managing partner at Smith, Currie & Hancock who specializes in construction law and government contracts, tells Construction Executive (CE) that the cases to watch right now are related to something that might already feel like a distant memory: the pandemic.

“COVID had a huge impact on projects across the board arising from labor availability and productivity issues and supply-chain problems caused by manufacturing shutdowns and transportation delays,” Nelson says. “When it happened, most owners said it was force majeure and that no one would be compensated. Some contractors on big jobs were looking at losses between $1 million and $100+ million, and they can’t just walk away from these types of losses.

"In some cases, legal theories are allowing contractors to proceed on their claims," Nelson continues, "while others are indicating that COVID is an uncovered risk that the contractor should bear, absent contract terms to the contrary. Right now, people should be watching as those cases move through the courts and various board of contract appeals."

For Josh Levy, a Milwaukee-based partner at Husch Blackwell who has worked in commercial construction law for more than 30 years, the disputes among contractors, trade partners, and developers in predicting and committing to prices that arose between 2020 and 2022 aren't going away anytime soon. "The cases are as active as they have ever been," Levy says.

As an example, Levy points to a general contractor that signed a deal with a trade partner for a lumber cost of $8 million in October 2020, only to have the partner ask for a $3 million change order five months later due to an increase in lumber prices. "We said, 'Time out,'" Levy says. "That's not force majeure anymore. Everyone knows that lumber is volatile."

Despite these increased challenges, Levy notes that companies are working to better understand how to assign pricing risk in advance. "The upshot of this," he says, "has been better contract clauses that address price escalation."

THE BOTTOM LINE

Financing, Payments, and Change Orders

In an uncertain economy, construction executives are struggling with a to-do item near the top of anyone's priority list: getting paid.

When 2024 kicked off, the economy was keeping many if not most CEOs up at night, with a Conference Board survey of more than 1,200 executives showing that a potential recession was the top concern while inflation ranked second. As the year passes the halfway mark, those worries aren't going away. The Federal Reserve isn't racing to make rate cuts, running contrary to what economic experts predicted and creating cash concerns.

Public vs. private funding: "If I'm a construction company working in the private sector, I would be focused on where the money is going to come from at the end of the day to pay for the project," Nelson says. "That sounds so fundamental and simple, but it doesn't always get fleshed out well enough. Oftentimes, there is a lot of smoke and mirrors behind the financing that goes into some of these jobs."

When it comes to public projects, Nelson says that construction executives can be more confident, but for privately funded projects, he recommends asking some key questions. "Who are the credit facilities?" he says. "How is this project being funded? How much of it is equity? How much of it is debt?"

Change orders: Even when contractors start a project with a clear roadmap of the money, it doesn't mean they're protected when inevitable changes arise. Angela Richie, managing partner of the Louisville office of Gordon Rees Scully Mansukhani and co-chair of the firm's construction practice group, says she's seeing clients struggle to get paid for private projects.

"While there may have been financing for the base scope, what we see lacking is the necessary contingency funds that will support paying for all the change-order work that contractors and subs are being asked to perform," Richie says. "Then, we see a trend where the owner-developer-lending team is taking a very long time to review and approve those change orders."

These types of payment delays have been increasing. Richie is currently seeing hundreds of change orders sit for anywhere from six months to two years, such as a case in Florida with change orders of $12 million that were submitted more than half a year ago. However, this type of delay was also happening long before interest rates jumped; Richie points to a set of outstanding claims for a project in Georgia from costs incurred in 2018.

"They didn't have the financing in place, and they didn't anticipate the magnitude of the changes," she says. "And so, instead of reviewing, processing, and paying, the subcontractors are carrying this financial burden for an extended period of time."

Duty to proceed: Richie says she noticed an uptick in funding issues in July 2023, when more clients began inquiring about the potential for filing bond claims and liens. She expects the challenging business atmosphere to persist for up to two more years. "The best way to mitigate these issues is to have a provision in your duty-to-proceed clause with respect to change-order work or a right to stop work if you are not getting paid," she says. "And if you're in the middle of a project but you don't have those terms, start calendaring your deadlines for bond claims to make sure that you have protections in place."

In the future, Richie expects to see "more people try to push the cardinal-change doctrine in order to recover on their pending change-order claims." In addition to actually doing the work based on those changes, more contractors are finding themselves stuck in a position where they're feeling the effects of death by a thousand cuts — small changes that have added up to what seems like an entirely different scope of work.

"You're seeing more contractors call their lawyers to ask if they actually have to perform all the work or if there is an avenue to get out of the contract," Richie says. "They didn't anticipate doing it, don't have the crew for it, or may struggle to order materials that weren't originally contemplated."

Payment liability for trade partners: While general contractors might be focused on getting payment from owners and developers, they may also need to consider a new piece of the payment stream. Husch Blackwell's Levy points to a recent statute passed in Illinois that makes general contractors liable for paying the wages of trade partners. "It's really been a bombshell," Levy says. "Our clients in Wisconsin cross the border all the time to work in Illinois, and the notion that you as a general contractor can be responsible if your subcontractors doesn't make payroll is a landmark change in the management of risk on a project."

Similar statutes are in various stages of consideration in other state legislatures, which could force general contractors to be "much more vigilant when they are reviewing subcontractors' invoices and requests for payments," Levy says. He adds: "It's not uncommon to have 30 or 40 subcontractors. While some of those trade partners that are well-oiled large businesses will be in good shape, it could make it more challenging for some of the small firms that aren't as well capitalized.

"Contractors are going to go deep into the weeds on pre-qualifying subcontractors to determine if there is a history of lawsuits or if employees have claims against them," Levy says. "It's going to make the cost of construction increase, because companies will need to administer payment with another layer of oversight."

IVY LEAGUE IMPACT

The Future of DEI and Preferential Treatment

How does the Equal Protection Clause of the U.S. Constitution's 14th Amendment carry over to the construction industry?

In Students for Fair Admissions v. President and Fellows of Harvard College, decided in the summer of 2023, the Supreme Court effectively ended race-conscious university admissions. Because it was issued by the highest court in the land, the decision carries potential implications beyond higher education. "It dramatically changed the flexibility of any entity to have a program for preferential treatment in construction," Husch Blackwell's Levy says.

Preferential treatment: Levy was to moderate a panel addressing this topic at an upcoming Husch Blackwell event. The firm runs a "Communities for Change" program designed to help historically disadvantaged businesses along with an annual conference to help connect those types of companies with majority-owned general contractors and developers.

Those efforts are intended to help projects comply with the City of Milwaukee's goal of 17% participation by disadvantaged business enterprises — and also to grow overall opportunities for small businesses.

"This year, we're taking a look at [the conference] in light of the Supreme Court case," Levy says, "because that decision has emboldened certain organizations to challenge preferential programs in construction."

Levy references a current case against the City of Houston, which involves two small landscape companies that claim they lost out on a contract because they're not owned by racial minorities. "It's one of many challenges going on around the country," Levy says.

In addition to bringing heightened scrutiny over who wins contracts, the Supreme Court decision is reshaping how companies can secure financing from the Small Business Administration (SBA). "When you went to the SBA for a small business loan, it used to be presumed that if you were of a racial minority, you were historically disadvantaged," Levy says. "That presumption has been lifted since the Supreme Court case with Harvard.

Now, even if you are in what was previously considered automatically disadvantaged, you need to put in a statement and narrative to explain why you're disadvantaged."

Diversity and inclusion: A related question is, what will happen to businesses' big push to attract a wide range of people from different backgrounds? In the wake of the murder of George

Floyd in 2020, construction was among the many industries that committed to major DEI initiatives, including hiring chief diversity officers and implementing internal inclusivity programs. Construction Inclusion Week launched in 2021; last year's event welcomed more than 5,000 companies committed to making more progress.

But there are signs that firms across industries are beginning to rethink their commitment. In February, Revelio Labs shared data with The Washington Post that showed DEI-related jobs fell by 5% in 2023 and by 8% in early 2024 — with high-profile companies like Meta, Tesla, Home Depot, and Lyft making sizable cuts to their DEI departments. And more may follow suit.

"For a company to announce more general goals of racial diversity in hiring, like a target number of employees of color, might not be strictly illegal, provided that no individual employee was ever favored or not favored because of race," Noah Feldman, a Harvard Law professor and a Bloomberg Opinion columnist, wrote in the summer of 2023. "But it would be very risky for an employer to announce such goals, knowing that doing so could be used as evidence by a frustrated applicant suing for racial discrimination."

Despite those risks, Charlotte A. Burrows, chair of the U.S. Equal Employment Opportunity Commission, has worked to reassure employers that their DEI efforts can continue. A press release from Burrows' office stated that the Supreme Court decision did "not address employer efforts to foster diverse and inclusive workforces or to engage the talents of all qualified workers, regardless of their background. It remains lawful for employers to implement diversity, equity, inclusion, and accessibility programs that seek to ensure workers of all backgrounds are afforded equal opportunity in the workplace."

THREE QUESTIONS

Elevated Risk, Independent Contractors, and Extreme Heat

No matter where your company operates or what type of work it does, these three considerations will change how you manage risk.

Are you unknowingly accepting elevated risk?

The devil may be in the details, but it can be difficult to sort through all of them in a construction contract that resembles a thick novel. However, it's never been more important to comb through every word.

"In the contract models that are coming out, I am seeing much more shifting of risk to the contractor," Smith Currie's Nelson says. "Sometimes, that risk is insurable, but oftentimes, it's not. And sometimes, it's hard to even recognize it's being shifted to you. I am very concerned about contractors getting starry-eyed over the type of project or the size of the project, but not fully appreciating the risk that they may be taking on."

Nelson adds: "A lot of these contracts are very heavy-handed. Contractors want the work because it's high-profile work. And it can go well. But if it goes south, it can take people down. The losses can be astronomical."

One type of risk-shifting that Nelson has been seeing more frequently is a reversal of how the industry has historically handled concurrent delay. "In the past, if both the contractor and the owner contributed to critical path delay, everybody got time, and nobody got money," he says. "Now, a lot of owners are saying, 'No, we're not going to give you time. The only way you will get extra time is if you can show that somebody else was the sole and exclusive cause of that delay.' That runs counter to over 40 years of law and common practice in the industry and is a troubling trend."

Are they employees or independent contractors?

Peckar & Abramson's Moore points to the U.S. Department of Labor's new rule on employee or independent contractor classification that "promises to crack down on the extensive use by contractors of so-called 1099 employees or individuals as subcontractors." The rule includes a framework of six factors that make up a balancing test:

- The worker's opportunity for profit or loss depending on managerial skill;
- Investments by the worker and the potential employer;
- The degree of permanence of the work relationship;
- The nature and degree of control;
- The extent to which the work performed is an integral part of the potential employer's business; and
- The worker's required skill and initiative.

"Basically, the more the worker looks like an independent business, the more likely they are to classify as an independent

contractor," Moore says.

"The more control exercised by the contractor, the less likely the workers will be found to be subcontractors. Misclassification can, among other concerns, lead to liability for wages and, most significantly, unpaid overtime."

Are you doing enough for excessive heat?

While OSHA has yet to issue a final rule in its Heat Injury and Illness Prevention in Outdoor and Indoor Work Settings rulemaking process, Moore notes that the agency has gone through all the necessary steps leading up to an official standard.

"Compliance is expected to require each employer to have a written plan — including site-specific plans — detailed training, monitoring, acclimatization, permitting extensive rest breaks, and providing plenty of drinking water," Moore says. "This program will apply to every part of the U.S., as heat stress is an issue any time the exposure is to unusual temperatures and humidity or those to which the employees are not acclimatized."

In addition to meeting the government's expectations and taking the proper steps to protect workers, companies may no longer be able to point to severe weather as reasons to request project extensions. The advent of weather-related regulations such as the Phoenix City's Council's ordinance for all city contractors and trade partners to have heat plans in place demonstrates how the risk of weather impacts is entering the mainstream.

"Force majeure is for something that's not foreseeable through the exercise of reasonable diligence," Husch Blackwell's Levy says. "The contractors that have a plan and know how to deal with excessive heat the right way will have better production and efficiency and be more competitive than those that can't accommodate an excessive heat event and have to shut down operations.

"And if I was the developer, I might be saying, 'You don't get extra days. You should have built that into your schedule,'" Levy says. "While the developer will bear the risk of a pandemic or a tornado, it's not automatically bearing the risk of heat anymore in Phoenix."

LOOKING AHEAD

Watching What's Next in Washington, D.C.

Increased potential for reshoring spells good news, while the federal government's increased focus on elevating environmental standards may create additional work for contractors in the public space.

"I'm watching what the federal government is doing right now with protecting our material supply line," says Allen W. Estes III, a partner with Gordon Rees Scully Mansukhani. "There are a few agencies that are amending [Federal Acquisition Regulation] Part 40 to add security requirements for information and material supply lines."

Estes doesn't think that kind of change will be esoteric, either. "I'm not going to say that the government will require to make everything in America, but certain components like steel and semiconductor chips might be required to be made and manufactured here," he says. "That leads to the private sector making more manufacturing plants in the United States, which then leads to more of this industrial work for the construction industry. And then, they would be dealing with not only a change in law but an area that is more lucrative and fuels more opportunities in the future."

While those opportunities are promising, GRSM's Richie notes something to be mindful of when it comes to federal projects: the potential need to adhere to heightened environmentally responsible standards. For now, environmental product declaration requirements are limited to certain locales for certain types of work. In Colorado, for example, the state's Department of Transportation collects EPDs on cement, concrete, asphalt, asphalt mixtures, and steel. However, the Inflation Reduction Act's authorization for two new EPD programs from the Environmental Protection Agency is a signal that construction companies should be planning ahead.

"If you're a federal contractor or federal subcontractor," Richie says, "environmental regulations and environmental product declarations could add significant paperwork and reporting requirements for your compliance efforts.

About the Article

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