

Preservation of Claims and Change Orders

By Jeff Chapman

In previous editions of this column, we've discussed contractual language that addresses claims and dispute resolution. In last month's column, the topic focused on protecting your right to payment. One of the topics addressed was the use of change order requests as a means of protecting your right to payment. In this edition, we'll look deeper into that issue and address how a contractor can preserve a claim using a change order request when the contract terms are unfavorable to such action.

In many contract forms, the language addressing payment prohibits the contractor from adding items to a previously approved schedule of values unless the item to be added is memorialized in an approved and fully executed change order. If work has been performed that is outside the scope of the original agreement, but there is not an agreement on a change order, what can a contractor do to preserve its right to payment while not holding up progress payments on undisputed items?

Generally speaking, the most prudent course of action in that situation is to formally put the other party on notice that the contractor is reserving its rights to assert that claim once the incidents giving rise to the extra work or claim have passed. In reserving that right, the contractor can avoid the opposing party's argument that a claim has been waived by the request and receipt of interim progress payments.

A contractor that has never been in a situation where an ongoing dispute can span months of work, may find itself in an uncomfortable and unknown position when these types of situations arise. At times, the desire to finish the job can, from a purely legal analysis, actually jeopardize and weaken the contractor's position with respect to enforcement of legal rights. If the contractor modifies the schedule of values to reflect the additional work, and

payment is withheld because of an unapproved modification of the schedule of values, then the nonpayment may be a breach of contract. But continued performance, even without pay, may give the payor and opportunity to argue that certain rights to payment has been waived.

Take, for example the following situation: The contractor performs work to correct work that was deficient due to intervening causes. Where an owner has entered into multiple contracts for adjacent or sequential scopes of work and one contractor's work is damaged by another, the contract frequently requires each contractor not to interfere or damage the others work, but the same contracts are often silent as to claims or damages across contractual lines. In this situation, the Owner would be responsible for compensating the contractor whose work has been damaged. If that dispute takes some time to resolve, the contractor who performed additional work risks losing rights to payment without taking proper action.

As the project progresses, the contractor should put the owner on notice of potential claims. If the claim is developing beyond the end of a pay period, then the contractor should be careful not to waive any rights to an adjustment in the contract amount. Texas courts have held that the execution of a lien release waiving claims for payment are binding on contractors. If an impact is realized during a pay period, the claim must be noticed before signing a release or the contractor must expressly exclude that claim from the scope of the release.

The Texas Legislature has recognized the potential that a requisite release of lien could have broader impact that simply waiving lien rights. Because of that fact, chapter 53 of the property code contains language that renders lien releases ineffective unless they meet certain criteria. For example, in

section 53.284, the form for an enforceable lien release contains an exemption from the release for "unpaid retention, pending modifications or changes, or other items furnished." This language would protect a claimant from unknowingly waiving a right to a lien or right to payment for pending changes. But in the event that the additional work is not the subject of an owner directed change, per se, the language would give rise to a factual dispute that may be difficult to resolve.

If the contractor's claim for extra pay does not arise out of a modification or change, then the prudent course of action would be to use an asterisk or other indicator to call attention to a handwritten exemption in the pay application and lien release. Of course, the payment procedures required of the contractor may also influence how the claim should be noticed and preserved. Typically, simply modifying the schedule of values to provide notice is not enough.

In addition to taking care not to unknowingly or accidentally release a claim through a request for payment, contractors should proactively reserve rights to bring a claims for impacts such as those described in this column or similar situations. Bearing in mind that the burden of proving entitlement and establishing the proper amount of a requested adjustment lies with the claimant contractor, getting to a position where one can meet that burden is a necessary first step. In order to preserve the right to bring a claim, the contractor should first send notice to the responsible parties as soon after the event giving rise to the claim as possible. In that notice letter, especially if the claim is one that will take some time to fully develop, the contractor must expressly reserve its rights to bring the claim.

The next step after reserving rights would be to examine the claim process outlined in



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the contract and comply with that process. In most contracts for civil works, the initial presentation of the claim must be delivered to the Engineer for review and evaluation. Manuscript contracts often modify this requirement and some leave only claims involving design or interpretation of the technical documents to the Engineer. In vertical contracts, the architect often has the responsibility to resolve claims. If this language exists, contractors must also give these entities a copy of the reservation as well as the claim notice once complete.

In summary, contractual and legal traps exist that can impair a contractor's ability to assert a claim. In situations where the claim does not arise from an owner directed change, contractors should be careful to properly reserve their rights to bring that claim when ripe. Failure to do so may result in waiver.

