The Evolution of Section 100

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This issue of *Highway Builder* commemorates the 90th anniversary of APC's incorporation as the leading advocate of the highway construction industry in Pennsylvania. As one reflects on the long, rich history of APC, it is apparent that APC is somewhat unique among trade associations. While there are many outstanding trade associations that provide valuable services for their members, APC represents an industry in which virtually all of its members have rules established ostensibly by the same public owners: PennDOT, the Pennsylvania Turnpike Commission, and the FHWA.

Virtually every construction contract is governed, at least to some degree, by "front-end" specifications that address a number of contractual issues, legal issues, and risk allocation issues. For PennDOT contracts, those front-end specifications are primarily found in Section 100 of the Form 408 Specifications. On the auspicious occasion of APC's 90th anniversary, this column will discuss how several key portions of Section 100 have evolved over time. While hopefully such a discussion will at least be mildly interesting from an historical perspective, the evolution of certain key sections of the specifications can also help in interpreting the precise meaning of the current version of those sections – and may also highlight the need for a few changes in the near future.

In one respect, the Form 408 Specifications are a microcosm of an increasingly complex society. The 1950 Form 408 Specifications consisted of 478 pages, while the 2016 Specifications include more than 1,200 pages. As PennDOT's program has grown, and as society has become more complex and construction projects more expensive, and contentious, many new contract provisions have been added over the years. Some changes in the Form 408 Specifications have been made as a result of changes in law, such as the passage of the Commonwealth Procurement Code in 1998. Other changes have been made due to changes at the federal level, such as the enactment of the Federal Disadvantaged Business Enterprise Regulations in the early 1980s. Other changes were solely stylistic, as between 1976 and 1983 there was a mandate to reduce the thickness of "the book," which resulted in a change from the third person to the imperative tense that is still in use today (which reduced the number of pages in the Specifications by about 40 percent at the time). Other changes were due to worldwide trends such as metrication, which resulted in the short-lived 1996 Metric Edition of the Form 408 Specifications. Sometimes, a specification change has been a direct result of a court decision, with one example being the elimination of the Pennsylvania Residency requirement (i.e. to work on a PennDOT project one had to be a resident of Pennsylvania for at least 90 days), which was ruled unconstitutional when challenged by A.L. Blades in the late 1990s. Finally, some changes to the specifications have been made following extensive rewrite efforts, such as the significant rewrite effort between 2001 and 2003, which resulted in the 2003 Specifications.

Whatever the reasons for the change, many portions of the Form 408 Specifications have evolved over APC's long history, in many cases due to input from APC and its members.

Set forth below is an overview of six sections of Section 100 that have materially changed since the 1950s.

Section 110.02 – Differing Site Conditions

When the 1990 Specifications were published, Section 100 included, for the first time, a differing site conditions clause. Specifically, Section 110.02(b) was added to formally allow contractors to recover extra costs if they encountered latent physical conditions at the site which either: (1) differed materially from those indicated in the bid documents, or (2) differed materially from those ordinarily encountered in the work. While it is likely that industry input helped play a role in including this specification in Section 100 in 1990, the primary impetus for adding a differing site conditions clause at that time was because the FHWA was becoming increasingly concerned about contractors adding contingencies in their bids for such conditions. In order to obtain lower bids, Section 110.02(b) was added to provide a mechanism to allow contractors to recover extra costs due to unforeseen conditions.

The 1990 Specifications also included another significant change to Section 110.02.

Specifically, Section 110.02(d) was added, which provided that while the Department reserved the right to make changes to the work at any time, if such alterations or changes in quantity significantly changed the character of the work under contract, an adjustment to the contract price would be made. Section 110.02(d) also indicated that the term "significant change" would include those situations where an item of work either increased in excess of 125 percent of the original quantity or decreased below 75 percent of that amount. These provisions have helped protect contractors for the past 27 years, but in many cases there are disputes over whether the conditions encountered properly fall under this section. With respect to how such clauses have been interpreted in situations where a contract also contains a "site examination" clause, Pennsylvania's courts have generally held that a contractor is still entitled to be paid for costs due to differing site conditions.

Section 111 – Delay Claims

Under Pennsylvania law, while "no damage for delay clauses" are technically enforceable, Pennsylvania's courts have generally found such clauses to be unduly harsh, and thus have carved out exceptions which far outweigh the rule. Under current Pennsylvania law, even if a contract contains a no damage for delay clause, a contractor must merely show "positive interference" on the Owner's part to avoid the applicability of such a clause. Thus, rather than include a no damage for delay clause in the contract, which may ultimately be ruled to be unenforceable, PennDOT added Section 111 to the Form 408 Specifications in the 1980s in an effort to define/limit the amount and type of damages recoverable in the event of a compensable delay. Section 111 is headed "Delay Claims" and outlines both the instances in which a contractor may recover its delay costs, as well as limitations on how those costs are calculated. For example, Section 111 provides that internal rates rather than *Bluebook* rates should be used to calculate equipment costs in delay claims, and Section 111 caps the recovery of home office overhead at 10 percent of the other delay costs claimed by the contractor. In effect, Section 111 has served to be a "limited damage for delay clause" rather than a "no damage for delay clause." To date, no court has ever expressly ruled on the issue of whether Section 111 improperly limits a contractor's damages, but the application by the Board of Claims of Section 111 has likely tacitly recognized the validity of Section 111.

Section 105.06(b) – Utility Delays

APC's Risk Allocation Committee, which includes representatives of the industry and PennDOT, has discussed/evaluated many difficult issues of contract risk on highway construction projects. One issue that was on

the Risk Allocation Committee's agenda for a number of years was the contractor's right to recover damages in the event utility firms were slow to move their facilities located within the project site. The failure of utility firms to timely move their facilities often resulted in litigation, and, notwithstanding disclaimers in early versions of Section 105.06, there were several instances where contractors were successful in obtaining damages for utility delays. As a result of such decisions, and after years of discussion between the industry and PennDOT, the 2007 Form 408 Specifications included for the first time an express recognition that contractors should be paid their delay in the event utilities did not timely move their facilities. Specifically, Section 105.06(b) was added to allow for compensation to the contractor in the event utility delays that occurred that were unforeseeable by a reasonable contractor. Notwithstanding the existence of this clause, getting paid such costs can still be an uphill battle. The Senate Transportation Committee held formal hearings in early 2016 on this issue, but no legislation has been advanced to date to ensure contractors are compensated for such delays.

Section 108.07 – Liquidated Damages

The purpose of liquidated damages is to compensate an owner in the event of late completion when actual damages are difficult to calculate. To be enforceable, liquidated damages must be a reasonable estimate, at the time of contract formation, of the damages the Owner will incur in the event of late completion. Otherwise, courts will find them to be a penalty, and will not enforce such clauses. While PennDOT's system of imposing liquidated damages has not materially changed over the years, the amounts charged have risen dramatically in the last 10 years. The 1954 Form 408 Specifications included a sliding scale of liquidated damages that ranged from $10.00 per day for projects of $10,000 or less, up to a maximum of $300.00 per day for projects which were $2 million or more. At that time, there was no distinction between "construction engineering" liquidated damages and "road user" liquidated damages. Notably, the high end of the liquidated damages scale stayed the same for approximately 30 years. The 1987 Form 408 Specifications eventually increased the top level of liquidated damages to $1,200 per day for projects $20 million or more, and included, for the first time, a separate concept designated as "road user" liquidated damages. Interestingly, one of the arguments that state departments of transportation often use to justify charging liquidating damages is that there is public inconvenience in the event the road is not completely open to traffic in a timely fashion. Thus, when separate road-user damages are incorporated into a contract, it raises questions

such as: (1) whether the "public inconvenience" factor can be used in calculating construction engineering liquidated damages, and (2) whether any construction engineering liquidated damages are appropriate when those amounts are easily calculated.

From 1987 to 2007, the top end of the liquidated damages sliding scale of Section 108.07 rose slightly, as in 2007 the maximum amount of liquidated damages was $1,975 per day for projects greater than $15 million. However, between 2007 and 2011, the maximum amount of liquidated damages on projects greater than $15 million almost tripled, as PennDOT raised the daily penalty from $1,975 per day to $5,675 per day. No real justification was provided for this significant increase. While PennDOT continues to charge liquidated damages when the project runs beyond the original completion date, to date there has not been a court decision that has ruled on the validity of PennDOT's sliding scale of liquidated damages. If the amounts in the scale are determined by a court to not have been reasonable estimates of the harm PennDOT would incur in the event of late completion of that specific contract, the liquidated damages provisions will be ruled to be unenforceable. The dramatic recent increases in the daily charges could be used to support these arguments.

Section 105.01 – Pre-Claim Process

As most in the industry are aware, the ultimate tribunal to resolve claims against PennDOT is the Pennsylvania Board of Claims, which was also known at one time as the Board of Arbitration and Claims. However, the pre-claim processes available to contractors have changed over the years. Prior to 1970, there was no specific pre-claim process, but rather the resolution of claims was up to the "Engineer" (i.e. the District Engineer) to decide disputes prior to them being submitted to the Board of Claims. In 1970, Section 105.01 was amended to require claims to be submitted first to the Deputy Chief Highway Engineer, with the right of appeal to the Deputy Secretary for Highway Administration. Finally, the 1987 Specifications established the process where the claims were to be heard by the District Executive, who could, at his or her discretion, convene a Claim Review Committee made up of the District Executive, a representative from Central Office Construction, and a representative from PennDOT's legal office to evaluate the claim. This process remains in place today, and is used widely by many districts and sporadically by others.

Section 110.03 – Force Account

One final section of the Form 408 Specifications that has evolved considerably over the years is the amount PennDOT pays for change orders when a price cannot be agreed upon and the use of the force account process, or the calculation of "time and materials," is necessary. While the concept of force account has largely remained the same (i.e. payment for labor, materials, equipment, plus markup for overhead, etc.), the specifics of the force account calculations have changed over the years. For example, in 1954 there was no industry rental rate book available for equipment, and thus the contractor was required to be paid a "reasonable rate" for its equipment needed for the work in question. The first reference to an industry rental book for equipment was in the 1967 Specifications, and the "Bluebook" was first referenced in the 1977 Specifications. Additionally, the markup for a contractor's overhead has changed over the years as well. In the 1960s, contractors were paid a 20-percent markup on labor and a 15-percent markup on material. By 1990, the markups were 40 percent on labor, 25 percent on material, 5 percent on equipment, and 8 percent on subcontracting. Those amounts did not fluctuate much until PennDOT raised concerns over the last several years that the force account markups were not consistent with surrounding states. As a result of a series of meetings held between industry representatives and PennDOT representatives, Section 110.03 has now been amended to include markups of 30 percent on labor, 15 percent on material, and 5 percent on equipment, subcontractor work, and services. Additionally, changes were made to how various insurances would be evaluated, including the public liability insurance.

Possible Future Changes

While contractors and government officials will likely have differing perspectives as to both the meaning of and the policies advanced by many portions of Section 100, including those referenced above, it is clear that the Form 408 Specifications are a fluid document that has changed considerably over the years. Looking forward, it is hard to predict what other changes may be implemented to Section 100. However, with respect to the issues raised by the six contract provisions set forth above, there are two areas of possible change that should be considered in the coming years. First, PennDOT has made increasing use of the design-build method of delivery in the past 10 years. However, the Form 408 Specifications simply have not caught up with PennDOT's regular practices. This has led to an increasing number of disputes on design-build projects, as, for example, some districts have questioned the viability of differing site conditions claims when the contract is a design-build contract.

One other area for possible change relates to how disputes are informally resolved. As the size of projects increase, the dollar amount of many disputes will invariably increase as well. When PennDOT first implemented the District Claim Review process in the 1980s, that process was successful in resolving many small- to medium-sized claims. However, under the current Claim Review process, it is hard to resolve claims of any size or complexity, as it is difficult for a Claim Review Committee hearing a claim for the first time to make a recommendation to pay a significant amount of money to a contractor. Ultimately, if there is a mutual desire to reduce the number of claims that are presented to the Pennsylvania Board of Claims, it would be prudent for both PennDOT and the industry to consider utilizing other informal claims resolution processes, such as mediation, to resolve significant claims.

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