



*A Discussion of Current Laws, Regulations and Practices for  
all participants in the Construction Industry*



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# Fourth Annual School Issue Focuses on School Funding

*Our fourth annual school construction issue arrives as fall approaches and schools are back in session. Many school districts are in need of new buildings as old buildings deteriorate and as enrollment increases. Despite court decisions striking down Ohio's school funding formula, Ohio school districts are still heavily dependent on voter-approved taxes to fund both operations and permanent improvements. Taking a strategic and holistic view of a school district's entire financial picture is critical to maximizing voter support, and minimizing voter fatigue, particularly in today's challenging economy.*

In this month's “Holman, Gillis & Shevelow on Construction Documents” column author Doug Shevelow looks at three fundamentally different approaches to the question of who is in charge when it comes to determining how much to pay the contractor. The American Institute of Architects, the Engineers Joint Contract Documents Committee, and the Ohio School Facilities Commission each take a slightly different approach in evaluating an application for payment.

We begin our “What the Courts are Saying...” column with an opinion from the United States Court of Appeals for the Sixth Circuit. The court determined if OSHA can cite a contractor for the same violation where the first violation is still pending before the review commission. In this specific case, the second violation occurred at different locations on the same project and at different times. Our second decision, from

the U.S. District Court for the Southern District of Indiana, looks at indemnification language in an owner-contractor agreement. The court was asked to determine if the broad language was valid, and how long the contractor was required to indemnify the owner.

In the ADR Corner, David Riddle, P.E., looks at a decision from the United States Supreme Court where the Court determined who decides the validity of an arbitration agreement. Does the Federal Arbitration Act override a state law that vests the initial decision making authority in an administrative agency even though the parties agreed to arbitrate?

Editor's Note: This issue combines our issues for the months of August and September. Our next issue, for the month of October, will be published at the start of the month instead of at the end of the month as we have done previously.

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## Have you seen our RESOURCE CENTERS?

Bricker & Eckler LLP resource centers are web collections of articles and information relevant to a particular segment of the construction industry.

You can reach these from our website, [www.Brickerconstructionlaw.com](http://www.Brickerconstructionlaw.com). Once you are there, search the “Highlights” box on the right of your screen, and click on what interests you.

# Maximize Voter Support, Minimize Voter Fatigue



**Rebecca C. Princehor**, Chair  
Public Sector Industry Group  
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**Highlights:** Despite court decisions striking down Ohio's school funding formula, Ohio school districts are still heavily dependent on voter-approved taxes to fund both operations and permanent improvements. Taking a strategic and holistic view of a school district's entire financial picture is critical to maximizing voter support, and minimizing voter fatigue, particularly in today's challenging economy.

## Key Planning Variables

The best way to start is to chart out at least the next five years or, ideally, the next 10 years.

In each of the years, the school district should identify those variables over which it has no control, such as:

- Reappraisal cycles and whether property values are up, down, or flat;
- Relationship to the 20 mill floor;
- Expiration of the "hold harmless" relating to the tangible personal property phase-out in 2011;
- State aid position; and
- Election history, including type and term of existing levies.

Next, the school district should overlay those variables over which it has some control, including:

- Cash position and projected cash balances on Five-Year Forecast
- Collective bargaining cycle; and
- Permanent improvement needs, including likelihood of participating in an Ohio School Facilities program and, if so, funding the maintenance obligation and locally funded initiatives.

## Key Procedural Variables

Once the overlay takes shape, it should start to become apparent when the school district will need funds for operating and permanent improvements. This overlay should be compared and contrasted with the upcoming election cycle (sample attached) so that

the school district can see when deadlines fall and what kind of lag time there will be from the election to receiving the funds.

The goal then becomes how to match needs with legal options available to pose the right questions at the right times and allow for fall-back positions should the questions not be approved by the voters the first time. This matching may take a variety of forms:

- Sole or combined approach to address operating and permanent improvement needs;
- Property-based or income-based questions, depending on community economics and demographics;
- Financial modeling of impacts of options on differently situated taxpayers.

Once the key procedural steps are identified, certain other nuances can be taken into account, such as whether a 2/3 vote of the Board of Education is required to place the chosen question on the ballot. It is always best to have a unified Board of Education, but that is not always possible. Also, an emerging concern is the high cost of elections, particularly special elections where the school district may have the only question on the ballot and may have to pay the entire cost of the election.

## Not Over Until It's Over

Another recent concern is the likelihood a school district's organized opposition may try to repeal a voted property tax levy or eliminate an income tax via an election contest. For those newly approved questions, the contest period runs 15 days from the date of the certificate of result of the election. Bond issues may not be repealed.

## Conclusion

Imagine the horror of building a school district's chart and realizing that without careful planning, the school district would end up on the ballot four years in a row! True story! Repeated trips to the voters take a toll in every way—time, money, and emotional capital. Even stalwart supporters become exhausted. Pro-active and holistic planning maximizes voter support and inspires community confidence.

**ELECTION FILING DEADLINES****2009 Calendar Year**

<b>Election Date</b>	<b>2/3/2009</b>	<b>5/5/2009</b>	<b>8/4/2009</b>	<b>11/3/2009</b>	
Type of Ballot Issue	Filing Deadlines				Action Required
1. R.C. 5705.21 Levy (Operating or Permanent Improvement)	*	*	*	*	File resolution of necessity with county auditor File election proceeding with board of elections
2. R.C. 5705.194 Emergency Levy	11/20/2008	2/19/2009	5/21/2009	8/20/2009	File resolution of necessity with county auditor File election proceedings with board of elections
3. R.C. 5748 Income Tax	11/14/2008	2/13/2009	5/15/2009	8/14/2009	File resolution of necessity with county auditor
	11/20/2008	2/19/2009	5/21/2009	8/20/2009	File election proceedings with board of elections
4. R.C. 5748 Income Tax	11/10/2008	2/9/2009	5/11/2009	8/10/2009	File resolution of necessity with state tax commissioner
	11/20/2008	2/19/2009	5/21/2009	8/20/2009	File election proceedings with board of elections
4. R.C. 133.18 Voted Bond Issue	*	*	*	*	File resolution of necessity with county auditor
	11/20/2008	2/19/2009	5/21/2009	8/20/2009	File election proceedings with board of elections**
	10/21/2008	1/20/2009	4/21/2009	7/21/2009	File State Consent application***
5. R.C. 5748.08 Voted Bond Issue combined with an Income Tax	11/5/2008	2/4/2009	5/6/2009	8/5/2009	File resolution of necessity with state tax commissioner****
	11/20/2008	2/19/2009	5/21/2009	8/20/2009	File election proceedings with board of elections

**2010 Calendar Year**

<b>Election Date</b>	<b>2/2/2010</b>	<b>5/4/2010</b>	<b>8/3/2010</b>	<b>11/2/2010</b>	
1. R.C. 5705.21 Levy (Operating or Permanent Improvement)	*	*	*	*	File resolution of necessity with county auditor File election proceedings with board of elections
2. R.C. 5705.194 Emergency Levy	11/19/2009	2/18/2010	5/20/2010	8/19/2010	File resolution of necessity with county auditor File election proceedings with board of elections
3. R.C. 5748 Income Tax	11/13/2009	2/12/2010	5/14/2010	8/13/2010	File resolution of necessity with county auditor
	11/19/2009	2/18/2010	5/20/2010	8/19/2010	File election proceedings with board of elections
4. R.C. 5748 Income Tax	11/9/2009	2/8/2010	5/10/2010	8/9/2010	File resolution of necessity with state tax commissioner
	11/19/2009	2/18/2010	5/20/2010	8/19/2010	File election proceedings with board of elections
4. R.C. 133.18 Voted Bond Issue	*	*	*	*	File resolution of necessity with county auditor
	11/19/2009	2/18/2010	5/20/2010	8/19/2010	File election proceedings with board of elections**
	10/20/2009	1/19/2010	4/20/2010	7/20/2010	File State Consent application***
5. R.C. 5748.08 Voted Bond Issue combined with an Income Tax	11/4/2009	2/3/2010	5/5/2010	8/4/2010	File resolution of necessity with state tax commissioner****
	11/19/2009	2/18/2010	5/20/2010	8/19/2010	File election proceedings with board of elections

**2011 Calendar Year**

<b>Election Date</b>	<b>2/8/2011</b>	<b>5/3/2011</b>	<b>8/2/2011</b>	<b>11/8/2011</b>	
1. R.C. 5705.21 Levy (Operating or Permanent Improvement)	*	*	*	*	File resolution of necessity with county auditor File election proceedings with board of elections
2. R.C. 5705.194 Emergency Levy	11/24/2010	2/17/2011	5/19/2011	8/25/2011	File resolution of necessity with county auditor File election proceedings with board of elections
3. R.C. 5748 Income Tax	11/19/2010	2/11/2011	5/13/2011	8/19/2011	File resolution of necessity with county auditor
	11/24/2010	2/17/2011	5/19/2011	8/25/2011	File election proceedings with board of elections
4. R.C. 5748 Income Tax	11/15/2010	2/7/2011	5/9/2011	8/15/2011	File resolution of necessity with state tax commissioner
	11/24/2010	2/17/2011	5/19/2011	8/25/2011	File election proceedings with board of elections
4. R.C. 133.18 Voted Bond Issue	*	*	*	*	File resolution of necessity with county auditor
	11/24/2010	2/17/2011	5/19/2011	8/25/2011	File election proceedings with board of elections**
	10/26/2010	1/18/2011	4/19/2011	7/26/2011	File State Consent application***
5. R.C. 5748.08 Voted Bond Issue combined with an Income Tax	11/10/2010	2/2/2011	5/4/2011	8/10/2011	File resolution of necessity with state tax commissioner****
	11/24/2010	2/17/2011	5/19/2011	8/25/2011	File election proceedings with board of elections

\* Although no specific filing deadline is provided in the specific sections of the Ohio Revised Code providing for such resolutions, the Resolution of Necessity must be filed with the county auditor with enough time for the auditor to calculate the estimated average annual property tax levy required to pay the principal of and interest on the proposed bond issue and make such calculation available to the Board of Education of the School District not later than 75 days prior to the election date.

\*\* If Bond Issue will cause School District's total net indebtedness to exceed 4% of its Assessed Valuation, the election proceedings must be filed with the State Department of Education and Department of Taxation at least 80 days before the election date to ensure that the Superintendent of Public Instruction and State Tax Commissioner can certify their decisions at 75 days before the election date.

\*\*\* Required if Bond Issue will cause School District's total net indebtedness to exceed 4% of its Assessed Valuation. In addition, the State Department of Education has advised that, if the School District is required to obtain designation as a "Special Needs" District (net indebtedness in excess of 9% of its Assessed Valuation), the School District must file the application for Special Needs designation prior to, or concurrently with, the filing of the State Consent Application.

\*\*\*\* The Resolution of Necessity for a combined Bond Issue/Income Tax must be filed with the Tax Commissioner and County Auditor 90 days prior to the election date, as shown above.



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With the Ohio economy in a recession and little sign of relief in the near future, the number of construction claims is going to increase, as contractors, owners, and design professionals are squeezed by increased costs and decreased revenues. To be prepared to deal with this increase in construction claims, join us on Monday, November 17 for Top Gun 2008, the premier Midwest Construction Claims Seminar where you will receive outstanding training, not only in the fundamentals of construction claims updated to include the most recent cases and laws, but also strategies and tactics you can use on your projects now.

Probably the most critical decision on every construction project is who is going to be the contractor responsible for building the project? As an owner you either make a good decision and get the right people on the bus in the right seats or you have a recipe for failure. This selection process is particularly difficult for public owners, who most often must publicly bid multiple prime contracts and then select multiple contractors.

Regardless of whether you are an owner, contractor, or design professional, you need to know and understand the selection process and the legal standards that apply. One of our new Top Gun segments, "Selecting Your Flight Crew – Getting Good Contractors," will be developed into a full day program and offered on February 27, 2009, at the Embassy Suites Dublin.

Top Gun 2008 also will have a training session dedicated to educating you about who is liable when there are claims, accidents, or mishaps on your construction project. When the roof leaks or an employee is injured, are you potentially responsible? You need to know and understand your risk in these situations and how to reduce your exposure to liability. Top Gun 2008 will discuss these issues and provide you with suggested action plans.

To reserve your spot at Top Gun 2008, go to [www.bricker.com/seminars](http://www.bricker.com/seminars) or call 614.227.4956 or 800.844.5292.

**Coming up!**

**Bidding for Public Construction Contracts -  
Getting Good Contractors  
February 27, 2009**

# What the Courts Are Saying...



Each month, Brickerconstructionlaw.com summarizes recent decisions of state and federal courts that may affect construction projects and those involved with them in Ohio, Indiana, Kentucky and Michigan. From time to time, we may even include cases from other states, if they seem particularly relevant. We highlight what the courts have said in these cases to keep you informed about decisions that may affect your business and your interests, but the summaries themselves are neither legal advice nor legal opinion. If we overlook a case that you think is significant, email us with your suggestions. We can always use feedback, and we would enjoy hearing from you!

We begin with an opinion from the United States Court of Appeals for the Sixth Circuit. The court determined if OSHA can cite a contractor for the same violation where the first violation is still pending before the review commission. In this specific case, the second violation occurred at different locations on the same project and at different times. Our second decision, from the U.S. District Court for the Southern District of Indiana, looks at indemnification language in an owner-contractor agreement. The court was asked to determine if the broad language was valid, and how long the contractor was required to indemnify the owner.

## When Can OSHA Issue Multiple Citations for the Same Violation?

When can OSHA cite a contractor for multiple violations of the same standard on the same construction project? In *Elaine L. Chao, Secretary of Labor v. Occupational Safety and Health Review Commission, Manganas Painting Co., Inc.*, 2008 U.S. App. LEXIS 18614, the United States Court of Appeals for the Sixth Circuit analyzed the language of the Occupational Safety and Health Act of 1970 and determined whether OSHA may issue multiple citations for the same type of violation on what can arguably be characterized as different work sites on the same project.

The contractor in *Manganas* was hired by the Ohio Department of Transportation to remove lead-based paint from parallel bridges along a highway. The project consisted of one bridge for the northbound lane and another bridge for the southbound lane.

In the spring of 1993, the contractor was working on the bridge for the northbound lane. During the work, OSHA performed an inspection and issued a citation to the contractor for using unguarded scaffolds.

Over one year later in 1994, the contractor was performing work on the bridge for the southbound lane.

Again, OSHA performed an inspection and cited the contractor three times for unguarded scaffolds. Each of the citations alleged that employees were working at heights greater than 100 feet without standard exterior guardrails or equivalent fall protection.

The contractor successfully contested the 1994 citations through an Administrative Law Judge and review by the Occupational Health and Safety Review Commission. The Commission determined that the 1994 citations were barred by Section 10(b) of the Occupational Safety and Health Act of 1970. Section 10(b) reads as follows:

“If the Secretary has reason to believe that an employer has failed to correct a violation for which a citation has been issued within the period permitted for its correction (which period shall not begin to run until the entry of a final order by the Commission in the ease of any review proceedings under this section initiated by the employer in good faith and not solely for delay or avoidance of penalties), the Secretary shall notify the employer by certified mail of such failure and of the penalty proposed to be assessed under section 666 of this title by reason of such failure, and that the employer has fifteen working days within which to notify the Secretary that he wishes to contest the Secretary’s notification or the proposed assessment of penalty. 29 U.S.C. §659(b) (emphasis added).”

The Commission apparently determined that the northbound bridge and southbound bridge were separate worksites even though they were part of the same project. The Commission also determined that even though the 1993 citations occurred on a different worksite, the 1994 citations “covered the same

The Commission apparently determined that the northbound bridge and southbound bridge were separate worksites even though they were part of the same project. The Commission also determined that even though the 1993 citations occurred on a different worksite, the 1994 citations “covered the same conditions” as the 1993 citations.

conditions” as the 1993 citations. Because the 1993 citations were still pending before the Commission, the 1994 citations were, according to the Commission, barred until the Commission issued a final order regarding the 1993 citations.

The contractor’s and the Commission’s position was that “a violation for which a citation has been issued” pertained to a particular type of violation. The basic argument is that a contractor cannot be cited for the same violation when a previous citation of that violation is still pending before the Commission.

Whereas the Secretary of Labor argued that the phrase referred to a single, discrete violation. This interpretation does not prohibit the Secretary of Labor from “alleging multiple violations of the same regulation where the violations occurred at different places or different times.”

The Appellate Court indicated that it needed to apply a two-step process for determining whether an agency’s interpretation of the statute is correct. The first step of the process is to determine whether the statutory language was unambiguous. If the statutory language was unambiguous, the Court and the agency must follow the language as written. Under the second step, if the statutory language is ambiguous, the Court must determine whether the agency’s interpretation of the statute is reasonable.

The Court determined that the language “a violation for which a citation has been issued” was ambiguous because it was possible to draw two different interpretations from the language of the Act. The question then became, which interpretation should the court use, the Commission’s or the Secretary of Labor’s?

The Court indicated that deference goes to the Secretary of Labor’s interpretation. According to the Court, the Secretary is in a better position to provide a reasonable interpretation because the Congress empowers the Secretary to write and enforce OSHA standards, the Secretary confronts more regulatory problems than the Commission, and the Secretary’s experience is better suited to determine the effects of a regulatory interpretation.

The Court found that the agency’s interpretation of the Act was reasonable. The Court did, however, emphasize that its decision is limited. In this case, the violations occurred at two different work sites and over one year apart. OSHA is allowed to issue multiple citations for violations of the same regulation where the violations occur at different work sites and where the second violation occurs at a subsequent time.

The Court found that the agency’s interpretation of the Act was reasonable. The Court did, however, emphasize that its decision is limited. In this case, the violations occurred at two different work sites and over one year apart. OSHA is allowed to issue multiple citations for violations of the same regulation where the violations occur at different work sites and where the second violation occurs at a subsequent time.

## Contractor Required to Indemnify Owner for Damages That Occur Years After Completion of Work

Many construction contracts contain an indemnity provision, which is an agreement for the promisor (typically the contractor) to compensate the promisee (typically the owner) for damage or loss sustained as a result of the promisor’s own negligence or that of third parties. But when the contract work is of a limited duration, as it is on most construction projects, how long can an indemnity clause bind the promisor, and in what situations does such a clause apply?

This question was central to a recent case from the U.S. District Court for the Southern District of Indiana, Evansville Division, *Estate of Josie A. Williams v. Southern Indiana Gas and Electric Co., Inc.* (2008), 551 F. Supp. 2d 751. The *Williams* case involved a gas explosion in an Evansville home which killed the homeowner, Ms. Hardy, and her friend, Ms. Williams.

In 2001, the local gas utility, Vectren Energy Delivery of Indiana, Inc., had contracted with KLP Construction, Inc. to install new plastic gas lines inside existing abandoned metal lines. The existing metal lines had shut-off valves, accessible through “stop boxes,” which were no longer needed once the new plastic lines were installed, and which could damage the new plastic lines if operated.

KLP’s written contract included the removal of all stop boxes, although KLP later argued that a Vectren representative had modified this requirement.

In 2004, years after KLP’s work was officially complete, a water department employee opened a stop box that was still accessible in front of Ms. Hardy’s house. He then mistakenly turned the gas shut-off valve for the old metal gas line, thinking that it was the shut-off for the water line. This damaged the inner plastic pipe of the gas line and caused the gas to leak into the ground.

The water department immediately reported the mistake, and Vectren repaired the line. However, enough gas had filtered into Ms. Hardy’s basement that when Vectren’s employee attempted to relight the pilot light to Ms. Hardy’s furnace, the house exploded, killing both Ms. Hardy and Ms. Williams, who had been visiting.

Ms. Williams’ estate brought a claim against Vectren and KLP, among others. All defendants, except KLP which had by then been bought and merged with various other entities who denied any responsibility or liability, settled with Williams’ estate. Vectren’s share of the settlement agreement was \$1.95 million dollars, and Vectren sought to enforce an indemnity

OSHA is allowed to issue multiple citations for violations of the same regulation where the violations occur at different work sites and where the second violation occurs at a subsequent time.

provision in its contract with KLP to require KLP to pay Vectren's share of the settlement.

Vectren's contract with KLP included an indemnity provision that required KLP to indemnify Vectren from claims of "injuries or damages...growing out of the performance of the contract" or arising from any "activity required by [the] contract," even if "due in whole or in part to Vectren's own negligence." KLP's corporate successors raised two defenses to the enforcement of this clause: 1) The clause violated Indiana state law, and 2) The clause was ambiguous as to duration and therefore unenforceable.

KLP's first defense was that the indemnity clause violated Indiana law, which governed this case even though it was in federal court. Indiana Code 26-2-5-1 provides that in construction contracts, a clause that purports to indemnify a party against that party's sole negligence is against public policy and is therefore void and unenforceable. KLP argued that the clause was entirely void under the statute because it would have required KLP to indemnify even if the harm was due "in whole" to Vectren's own negligence.

The court, however, disagreed with KLP's reasoning. Although the court agreed that the words "in whole" violated the statute and must be deleted from the contract, the court held that the words "in part" could remain because that part of the provision was not illegal. The modifications did not change the basic purpose of parties' original agreement. Thus, if a jury found that Vectren's own negligence was any less than 100 percent of the cause of the explosion, KLP would be required to indemnify Vectren.

It is worth noting that the Ohio Revised Code contains a similar statute for construction contracts, R.C. § 2305.31, which voids all clauses purporting to indemnify the promisee for its own negligence. Although the statute does not distinguish between

total or partial negligence of the promisee, the Ohio Supreme Court has interpreted R.C. § 2305.31 to apply to all construction-related indemnity agreements, regardless of whether the negligence is sole or concurrent. *Kendall v. U.S. Dismantling Co.* (1985), 20 Ohio St. 3d 61.

KLP's second defense was that the duration of the indemnity clause was ambiguous, and that KLP did not agree to indemnify Vectren "for eternity." KLP argued that the use of present tense in the contract and the existence of other clauses of limited duration demonstrated an intent that the indemnity clause was only to be effective during the period of time that KLP was actually performing the work for Vectren.

The court determined that the duration of the indemnity clause was not ambiguous even though it contained no time limit. The court referred to the scope of the clause, and held that if a jury determined that the explosion grew out of the performance of or activity required by the contract, the indemnity clause would apply, regardless of the intervening time period. Thus, depending on a jury's findings of fact, KLP could potentially be required to indemnify Vectren *ad infinitum*.

Sometimes an indemnification clause does not get much attention until problems arise at the end of a project or even years after the work is completed. However, the best time to consider the scope of the clause is at the beginning of the project, so that each party is informed about which risks are being shifted before entering into the agreement. Don't forget to ask your legal counsel to review your front-end documents to ensure that the indemnification clause is valid, enforceable, and accurately reflects the intent of all parties.

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## BRICKER & ECKLER'S 20 RULES FOR PUBLIC OWNERS' CONTRACTING SUCCESS

These Rules represent our collective wisdom, over 100 years of construction law experience and over 100 years of construction experience. While no one can guarantee success, we believe that if an Owner understands and follows these Rules, the Owner will have a successful project. We emphasize the need for deep understanding of the Rules. To help you, we shall include articles in Brickerconstructionlaw.com explaining them. If you need further assistance, please contact us.

- 1 Analyze and understand the risks and requirements of each of your projects**, and how your team will eliminate or minimize those risks and meet those requirements.
- 2 Beginning with the hiring process, communicate your expectations to your team and follow through** to see that each team member meets those expectations.
- 3 Conduct a thorough evaluation of your design professional and, if applicable, construction manager candidates** so you hire a team of competent, cooperative, and responsive professionals for each of your projects.
- 4 Require that your drawings be well coordinated** using a competent third person to review them for conflicts. Discuss coordination with your design professional candidates, understand the process, and see that the process becomes part of the owner – design professional agreement.
- 5 Understand and address any green building issues (LEED, etc.)**. Begin early during the hiring process by discussing any green building issues with your design professional and, if applicable, construction manager candidates. Incorporate each team member's responsibilities for any green building issues into its contract.
- 6 Provide sufficient time** so that your design professional can complete the design process, including the coordination of the plans and specifications, and, if applicable, there is time for a constructability review by your construction manager.
- 7 Hire competent project administration, including observations and inspections**, so that through your design professional and/or construction manager you have knowledgeable eyes inspecting the Work each day to guard you against defective and non-conforming Work.
- 8 Make sure that your representatives, design professional, and/or construction manager, are knowledgeable about the roofing and through wall flashing Work** and that your representatives carefully review the plans, specifications and shop drawings and then inspect the Work as it is being installed.
- 9 Provide for the commissioning** of new HVAC systems or major modifications to existing systems.
- 10 Carefully think through how the risks for unforeseen site conditions** will be evaluated and allocated.
- 11 Include contractor hiring criteria** in your bidding documents that will permit you to evaluate and hire qualified contractors.
- 12 Exercise your discretion** and hire qualified contractors that can be expected to work as part of a cooperative team to complete your Project on time, on budget, and free from defects.
- 13 Use contracts that protect your interests and that are consistent with your expectations**. Have your contracts, including owner-architect agreement, owner-construction manager agreement, and owner-contractor agreement, drafted to protect you.
- 14 Train your Team in how to use your Contract Documents**. Do not stop simply with good Contract Documents that will protect your interests. Your Team needs to know how to use them. Take the additional step and provide this training.
- 15 Include indemnification provisions** in your contracts with your contractors, design professional, and, if applicable, construction manager, that will protect you from claims caused by other persons.
- 16 Be decisive and responsive - understand what you are required to do** and do it in a timely and competent manner.
- 17 Ensure that your Contract Documents** require a clear and detailed notice of any problem that would affect your budget, completion date, or the quality of the Work.
- 18 Deal with all problems on your projects immediately, including contemporaneous documentation**; do not let small problems grow into major disputes. If you sense you have a significant problem, contact your legal counsel immediately.
- 19 Keep your contractors' sureties informed about any significant problems**. If you have a significant problem with a contractor on your project, you want the contractor's surety informed and involved as early as possible.
- 20 Have the insurance provisions in your Contract Documents** reviewed by your insurance professional, follow his or her recommendations for modifying those provisions and have your insurance professional verify that you have the required coverage.

*"By failing to prepare, you are preparing to fail."* – Ben Franklin

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*All too often a Public Owner will contract with someone who does not do what the person promises to do. These Rules are intended to help protect Public Owners from those broken promises; they are not intended to state the Owner's obligations under its Agreements.*

HOLMAN, GILLIS AND SHEVELOW ON

# Construction Documents

## Who Decides How Much to Pay the Contractor?

*Ninety-ninth in a series—Each issue of this newsletter discusses important terms found in typical construction documents. This month, Doug Shevelow looks at three fundamentally different approaches to the question of who is in charge when it comes to determining how much to pay the contractor. The American Institute of Architects, the Engineers Joint Contract Documents Committee, and the Ohio School Facilities Commission each take a slightly different approach in evaluating an application for payment.*

Those of us old enough to remember the first few hours after the attempted assassination of President Reagan in 1981 may recall Secretary of State Alexander Haig, who responded brusquely that he was in control at the White House after becoming concerned with a junior staff member's response to questions from the press. While not constitutionally correct, I suppose General Haig's self-assuredness was meant to convey a message to the country that all was well.

Any great endeavor needs someone in charge to make it successful, whether it's leading a country through a crisis or managing a construction project. And many would agree that at times a big construction project can resemble a government during a crisis, with many different people trying to solve the same problem with varying points of view and responsibilities, and with incomplete information.

Governments have constitutions to guide the way. Construction projects have contracts. One problem that sometimes arises on construction projects is when the design professional and owner disagree on how much the owner should pay the contractor.

The general conditions documents published by the American Institute of Architects, Engineers Joint Contract Documents Committee, and the Ohio School Facilities Commission show three fundamentally different approaches to the question of who is in charge when it comes to determining how much to pay the contractor.

But first, note that all three general conditions are basically the same in how they approach the beginning of the payment process. The contractor starts the ball rolling by making an application, certifying that the application is correct, and presenting the application

to the owner, either through the architect, engineer, or construction manager.

### AIA Document A201-2007— The Imperial Approach

Under Section 9.4.1 of the AIA A201-2007, General Conditions of the Contract for Construction, the Architect has seven days to either forward the application to the Owner or notify the Owner and Contractor of the Architect's reasons(s) for withholding certification of the payment in whole or in part. The allowable reasons for withholding payment are listed in Section 9.5.1, and range from the fairly clear "defective work not remedied" to the more nebulous "reasonable evidence indicating probable filing of [third party] claims."

The Architect is even given authority to decertify previously certified payment application amounts for the reasons given in Section 9.5.1.

The most distinguishing feature of the A201, compared to other form contract documents, is that under Section 9.6.1, the "Owner shall make payment" to the Contractor once the Architect certifies a payment application. Short of invoking the contract's dispute resolution procedures, the Architect has sole discretion in determining whether the Owner pays a particular pay application. Both the Owner and Contractor must live, at least initially, with how the Architect rules.

Article 9 of the 1997 A201 is substantially the same as the 2007 version, yielding the same result—the Architect is in the driver's seat when it comes to determining how much the Contractor gets paid.



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## EJCDC C-700 (2002)—The Check That Balances

The payment process set by the C700 is very much the same as the A201 with one key difference—in Section 14.01.C the Engineer merely makes a recommendation as to the payment amount. The Owner has an express veto over what the Engineer thinks is appropriate to pay. Of course the Owner has to justify any decision to withhold payment of a recommended amount. The Owner’s reasons are set forth in 14.01.C and D. The reasons are very similar to those set forth in the AIA A201 Section 9.5.1, but without the nebulous reference to probable third party claims. In the C700, to justify withholding payment, a claim has to have been actually brought; it may not merely be a contingent claim.

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## OSFC General Conditions (May 2007)—The Collaborative Approach

Paragraph 9.2 of the OSFC General Conditions takes a more collaborative approach. Payment is to be made within 30 days of the approval of an application by the Construction Manager, Board of Education and Architect. Theoretically any of the three parties hold a veto over a payment application.

As far as withholding partial payment goes, under Paragraph 9.6 the Construction Manager and Architect may recommend to the Board of Education and

the OSFC that payment applications be disapproved in whole or in part for two express reasons: Contractor’s breach of contract and “damage cause by the Contractor.” Theoretically the Board and OSFC could fail to follow the recommendation, but in reality such discord among the Owner’s team members is highly unlikely.

Paragraph 9.6.2 of the OSFC General Conditions gives the Board and OSFC express authority to decertify previously made payments.

## Conclusion

The fact that all three general conditions forms take a different approach to setting ultimate responsibility for declining to pay all or part of a Contractor’s pay application suggests that there is not one best way to do it. It also gives us insight into how the various construction professions see their role on a project.

The Architect’s clear final authority approach is reminiscent of the “master builder” concept where the designer takes ultimate responsibility for the project from planning through completion. The Engineer’s willingness to yield to the Owner’s discretion, but only after setting forth objective criteria for the Owner to follow, suggests a more cautious philosophy and less willingness to assume potential liability. The OSFC’s collaborative approach emphasizes the teamwork necessary to guide a project through the multi-prime process when project ownership is shared between the OSFC and the Board of Education.

# Upcoming Seminars

## Involving Bricker & Eckler LLP Attorneys

For Registration Information, call Amy Abbey at (614) 227-4989

Date & Time	Seminar	Location	B&E Attorneys	Other Speakers	Sponsors
September 23, 2008	Front End Documents	Holiday Inn South Independence, OH	H. Reder; S. Wampler		Bricker & Eckler LLP
September 26, 2008	Protecting Owners’ Rights	West Chester Conference Ctr West Chester, OH	A. Balcar; D. Riddle J. Rosati; D. Shevelow		Bricker & Eckler LLP
October 10, 2008	Rejecting Bad Bidders	Bricker & Eckler Columbus, OH	K. Brown; J. Rosati S. Wampler; M. Warnock		Bricker & Eckler LLP
November 17, 2008	6th Annual Top Gun Construction Claims Seminar	Embassy Suites Dublin, OH	A. Balcar; S. Davis; M. Evans; S. Gillis; M. Holman; B. Hyden; C. McCloskey; B. Princehorn; J. Rosati; M. Stout; S. Wampler	D. Cullimore; A. Englehart; M. Leary; D. Riddle; B. Vail	Bricker & Eckler LLP
February 17, 2009	Bidding for Public Construction Contracts	Embassy Suites Dublin, OH	TBA		Bricker & Eckler LLP

# ADR Corner

## Who Decides the Validity of An Arbitration Agreement?

Shakespeare said in Hamlet, “For ‘tis the sport to have the engineer Hoist with his own petard.” He was referring to the irony of the bomb maker being blown up by his own bomb. The phrase might also apply to a recent United States Supreme Court decision: *Preston v. Ferrer*, 2008 U.S. LEXIS 2011.

The question raised in *Preston* was who gets to decide the validity of a contract containing an arbitration provision? The irony of the situation is in the identity of the defendant, Alex E. Ferrer. Fans of syndicated court programs will recognize the name as that of the judge on the daytime television program Judge Alex.

Many, if not all, of the syndicated court programs are actually arbitrations with the “judge” acting as an arbitrator. Cases are typically culled from small claims courts across the country. The parties agree to dismiss their local cases and have the dispute resolved, or arbitrated, by the “judge.”

The dispute in *Preston* concerned a services contract between Ferrer and Arnold M. Preston, an attorney in the entertainment industry. Preston, in an attempt to collect fees allegedly due under the contract, invoked the parties’ agreement to arbitrate “any dispute . . . relating to the terms of [the contract] or the breach, validity, or legality thereof.”

In response, Ferrer petitioned the California Labor Commissioner to declare the contract void under the California Talent Agencies Act. Ferrer claimed that Preston acted as a talent agent without the license required under the Act and thus the entire contract was void.

The hearing officer for the Commission determined that Ferrer had a “colorable basis for the exercise of the Labor Commission’s jurisdiction.” However, the officer denied Ferrer’s motion to stay arbitration citing lack of authority.

Ferrer then filed suit in Los Angeles Superior Court seeking a declaration that the validity of the contract was not subject to arbitration. As part of that suit, he requested an injunction to prevent Preston from proceeding with the arbitration. Preston responded with a motion to compel the arbitration.

The trial court found in favor of Ferrer and stopped the arbitration from proceeding “unless and until the Labor Commissioner determines . . . she is without jurisdiction over the dispute.” Preston appealed the decision.

In the timeframe between the trial court’s decision and the decision by the appeals court, the United States Supreme Court rendered a decision in the case of *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440. In *Buckeye*, the Court found that challenges to the validity of a contract with an arbitration provision “should . . . be considered by an arbitrator, not a court.”

The appellate court found that *Buckeye* did not apply to the dispute between Ferrer and Preston and that unlike *Buckeye*, the dispute between Ferrer and Preston involved “an administrative agency with exclusive jurisdiction over the disputed issue.”

The California Supreme Court refused to review the decision. However, this case involved an issue of federal law: Does the Federal Arbitration Act override a state law that vests the initial decision making authority in an administrative agency even though the parties agreed to arbitrate? This allowed Preston to appeal to the U.S. Supreme Court.

When there is a dispute that involves both federal and state law, the court will first look to see if there is a conflict between federal and state law or if the two can be somehow read in harmony. If there is a conflict, federal law will govern.

The federal law in question, §2 of the Federal Arbitration Act, states:

**A written provision** in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction . . . shall be valid, irrevocable, and enforceable, save upon such ground as exist at law or in equity for the revocation of **any** contract.

The state law in question, the TAA, required talent agents to be licensed in accordance with the Act and provided that an unlicensed person’s contract with an artist to provide talent agent services was illegal and void. Controversies arising under the TAA were to be decided by the Labor Commissioner. The TAA allowed for arbitration if the agreement between the parties contained an arbitration provision that provided for reasonable notice to the Labor Commissioner of the time and place of all arbitration hearings and provided the Labor Commissioner with the right to attend all arbitration hearings.



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As the U.S. Supreme Court viewed this dispute, the TAA conflicted with the FAA on two points: First, the TAA granted the Labor Commissioner the exclusive jurisdiction to decide an issue that the parties agreed to arbitrate where the FAA requires courts to enforce the parties' agreement to arbitrate all disputes; and second, the TAA imposed conditions on arbitration not imposed on contracts generally where the FAA requires that arbitration provisions be treated the same as every other contract provision.

Ferrer argued that the two laws could be harmonized because the TAA merely postpones arbitration until the Labor Commissioner exercised her primary jurisdiction. After the Labor Commissioner's decision, either party would be free to file a motion to compel arbitration. The Court in *Preston* did not agree.

Quoting from an early Supreme Court case, *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, the Court observed that one of the primary objectives of an agreement to arbitrate is to achieve "streamlined proceedings and expeditious results." Requiring the parties to refer the dispute initially to the Labor Commissioner would frustrate this objective.

Ferrer also argued that the two laws could be harmonized because the TAA was an administrative proceeding rather than a judicial proceeding. Allowing the parties to proceed to arbitration without the involvement of the Labor Commissioner would deprive the artist the protection intended under the TAA.

The Court again looked back to one of its earlier decisions that addressed the role an administrative agency plays in enforcing a statute where the parties have agreed to arbitrate disputes. The issue in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, involved an age discrimination claim. In *Gilmer*, the Court considered and rejected the argument that allowing the private parties to arbitrate all disputes, including age discrimination, would undermine the role of the administrative agency in enforcing federal law.

In the case at hand, the Court summed up its holding: "When parties agree to arbitrate all questions arising under a contract, the FAA supersedes state laws lodging primary jurisdiction in another forum, whether judicial or administrative."

As with many Supreme Court decisions, this was not a unanimous decision. Justice Thomas dissented arguing that the FAA does not apply to proceedings in state courts.

This case further reinforces the point that if the parties agree in their contract to arbitrate disputes, the agreement will likely be enforced by the courts. Coupled with other Court decisions regarding the role of law in arbitration proceedings and the role of the courts in reviewing arbitration decisions, the decision to include arbitration as a dispute resolution mechanism should be carefully analyzed. Arbitration has the benefit of finality and arguably speed, but these same benefits can also be viewed as disadvantages.

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