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Supreme Court No. 94711-2
Court of Appeals No. 48644-0-II

**IN THE SUPREME COURT
OF THE STATE OF WASHINGTON**

**City of Olympia,
Petitioner**

v.

**Nova Contracting, Inc.,
Respondent**

**RESPONDENT NOVA CONTRACTING, INC.'S
RESPONSE TO AMICUS WSAMA**

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1. Introduction and Statement of the Procedural History

This case arises from the Court of Appeals decision reversing and remanding a summary judgment order dismissing Nova Contracting, Inc.’s (referred to herein as “Nova”) claim. The core issue here was Nova’s argument that the City of Olympia violated the Warranty of Good Faith and Fair Dealing by unreasonably exercising its contractual discretion in a manner that completely frustrated Nova’s performance. Below, the Trial Court granted a Motion for Summary Judgment brought by the City of Olympia in which it asserted that (1) its termination of its contract with Nova for default was proper as a matter of law and therefore (2) Nova was liable for liquidated damages to the City of Olympia. (CP 49-66.) The Motion for Summary Judgment did not raise arguments that Nova’s claim was improper or untimely under *Mike M. Johnson, Inc. v. Spokane County*, 150 Wn.2d 375, 78 P.3d 161 (2003). The City did attempt to inject that issue into the Summary Judgment proceeding in Reply, after Nova had responded to the issues that had been raised in the Summary Judgment. (See Reply, CP 439-440). However, this process prevented Nova from making a full record on the issue and denied Nova the opportunity to rebut the argument. Further, the Trial Court properly did not reach any *Mike M. Johnson* issues (RP 26-31.)

The Court of Appeals reversed the Trial Court on Nova's argument that summary judgment was not appropriate on the claim that Olympia breached the warranty of good faith and fair dealing because there are facts in the record supporting that claim. This reversal also reversed the Trial Court's decision granting summary judgment on the City of Olympia's counterclaim for breach of contract. In reversing the Trial Court, the Court of Appeals, in dicta contained in a footnote, expressed skepticism about the extent of the application of *Mike M. Johnson v. County of Spokane*, 150 Wn.2d 375, 78 P.3d 161 (2003).

The City of Olympia sought review by this Court, focusing on the dicta footnote, and this Court accepted review. Thus, this case may be proceeding on an argument about dicta in the Court of Appeals decision, which has no bearing on the ultimate outcome of this case or the propriety of the reversal and remand of this case by the Court of Appeals. The proper outcome here is for this Court to affirm the Court of Appeals decision and allow the remand to the Trial Court. The City of Olympia could thereafter properly raise its *Mike M. Johnson* argument in a manner that allows Nova to respond and develop the record showing that those issues, like the ones previously decided, present triable issues of fact. That said, just as the Court of Appeals attempted to offer guidance, through its dicta, to help the future court decide those issues, this Court

could and probably should do so as well. However, just as the Court of Appeals' pronouncement on *Mike M. Johnson* was dicta, any such pronouncement by this Court would be dicta, and it would be improper to disturb the ultimate decision reversing and remanding the Trial Court's decision on Summary Judgment.

2. Issues Presented by Amicus Brief

The Amicus brief focuses on two issues, both of which are tangential to this case and should not affect the outcome of the case.

First, the amicus argues that Nova is asking this Court to overrule *Mike M. Johnson* but has failed to meet the burden required. Nova, like most participants in the public contracting industry, believes that *Mike M. Johnson* is a problematic and ultimately harmful decision, which has increased the cost of public work, without corresponding benefit, and operates by a process of forfeiture through waiver of otherwise righteous and just claims (see Spratt, "Strict Compliance with Construction Contract Notice Provisions: Detrimental to Contractors and Taxpayers," *Public Contract Law Journal*, Vol 40, pp 911-933 (2011) copy attached as Appendix 1). However, Nova contends that *Mike M. Johnson* is not involved in the current case as Olympia failed to raise the *Mike M. Johnson* argument below and, while the Court of Appeals mentioned *Mike*

M. Johnson in a footnote, the Court of Appeals' decision was primarily and properly focused on the issues that had been properly raised below.

Second, the Amicus focuses on an argument that, while raised below, was not accepted as a deciding factor in any of the decisions made thus far in the case – Nova's argument that sealed bid public works contracts are contracts of adhesion and should be considered as such. Because that argument was not the basis for either the Trial Court's decision or the Court of Appeals' decision, it is not an argument that has any determinative value at this stage in the case. However, just as this Court can clarify and improve public contracting law by addressing the problems caused by *Mike M. Johnson*, this Court can and should determine that sealed bid contracts, by their very nature, are contracts of adhesion (although that does not mean that they are unconscionable, unenforceable, or unfair).

3. Argument

3.1 The Issues Addressed in the Amicus Brief are Tangential to this Case.

The primary issue on which this case is proceeding, the footnote addressing *Mike M. Johnson*, was dicta on an argument not properly raised below.

RAP 2.5(a) provides that:

Errors Raised for First Time on Review. The appellate court may refuse to review any claim of error which was not raised in the trial court. However, a party may raise the following claimed errors for the first time in the appellate court: (1) lack of trial court jurisdiction, (2) failure to establish facts upon which relief can be granted, and (3) manifest error affecting a constitutional right. A party or the court may raise at any time the question of appellate court jurisdiction. A party may present a ground for affirming a trial court decision which was not presented to the trial court if the record has been sufficiently developed to fairly consider the ground. A party may raise a claim of error which was not raised by the party in the trial court if another party on the same side of the case has raised the claim of error in the trial court.

The contractual defense (claim procedure requirements and compliance) raised by Olympia to Nova's claim is (1) not jurisdictional, (2) not the basis for a CR 12 (b)(6) failure to state a claim defense and (3) does not present Constitutional issues. Further, while the record includes some tangential facts which, as argued elsewhere, are sufficient to deny Olympia's *Mike M. Johnson* defense, Nova was not given a full and fair opportunity argue this point or develop the record below. The proper course here is to remand this matter to the Trial Court, where Olympia could properly raise its *Mike M. Johnson* defense and, more importantly, Nova would have a chance to resist it with a completely engaged record.

The concern in the amicus brief with Nova's argument that sealed bid contracts are contracts of adhesion is also misplaced as the issue is not

a live issue in this case. Nova raised that argument at the Trial Court. The Trial Court ignored the argument. Nova appealed. The Court of Appeals dismissed the argument, reversing the Trial Court on other grounds. Therefore, while Nova's characterization of sealed bid public contracts as contracts of adhesion is well-taken, based on the definition of a "contract of adhesion," that argument might provide a stronger basis for the Court of Appeals' reversal and remand of the Trial Court, but it does not provide any basis to change the outcome of the Court of Appeals decision.

3.2 If this Court Addresses the *Mike M. Johnson* Decision, it Should Revise or Reconsider it, but Not Necessarily in this Case.

In 2003, this Court decided *Mike M. Johnson v. City of Spokane*, 150 Wn.2d 375, 78 P.3d 161 (2003). The *Mike M. Johnson* Court took a strict compliance approach to claim provisions in public contracts, breaking with the majority and Federal rules that contractual claim procedures exist for the dual purpose of (1) providing practical, efficient resolution of construction issues that arise during performance and (2) fair and full communication to prevent inequitable pricing of changed work, and thus require only reasonable and fair notice or substantial compliance of an event that causes the contractor to incur extra cost or take extra time in its performance of the work.

The *Mike M. Johnson* case has been very problematic. It operates as a system of forfeitures, in which public contractors perform extra work without extra compensation (sometimes because they are intentionally misled to believe that they will receive payment or reimbursement of what are real extra costs of performance beyond the scope of the contract or contemplated work). The impacts of *Mike M. Johnson* were analyzed eight years after the decision in Spratt, “Strict Compliance with Construction Contract Notice Provisions: Detrimental to Contractors and Taxpayers,” *Public Contract Law Journal*, Vol 40, pp 911-933 (2011) (attached). These impacts remain today and continue to cause the problems Ms. Spratt described in her article.

Seeing the injustice of the forfeiture outcomes that result, lower courts have struggled to limit or avoid the worst excesses of the principles in *Mike M. Johnson*. For instance, in *Gen. Constr. Co. v. PUD No. 2*, 195 Wn. App. 698, 380 P.3d 636 (2016), Division III ruled that *Mike M. Johnson* does not apply to quantum meruit claims for payment for work beyond the contemplated scope of the contract. In reaching that result, Division III sought to reconcile *Mike M. Johnson* with *Bignold v. King County*, 65 Wn.2d 817, 399 P.2d 611 (1965), although, in his concurring opinion, Judge Fearing opined that the cases are irreconcilable. The dicta in the decision below can also be seen as Division II struggling to carve

out an exception to *Mike M. Johnson*, one focused on remedy sought (damages rather than a time extension or equitable adjustment) rather than on the nature of the claim (quantum meruit as opposed to a legal contract claim).

While the efforts of the lower courts to limit the harm caused by *Mike M. Johnson* is a noble and just effort, it is inherently restricted by their subordination to this Court. Because the problems arose from a Supreme Court decision, the solution must ultimately come from a Supreme Court decision. The best solution is probably for this Court to revisit *Mike M. Johnson*, adopting the reasoning of Justice Chambers' dissenting opinion, and over-ruling and replacing the majority decision with a decision following the Chambers dissent.

However, the present case is not the proper case to reach that result. The *Mike M. Johnson* arguments are not yet fully engaged in this case because Olympia has not properly presented this issue to the Trial Court and because Nova has not had a full opportunity to address it factually. If Olympia wishes to raise a *Mike M. Johnson* defense, it can and should do so on remand, and this Court should affirm the Court of Appeals reversal and remand to allow that to happen. There will surely be other, more real and substantial, opportunities for this Court to address *Mike M. Johnson*, and this Court should wait for those. That said, if this

Court wishes to provide guidance to the Trial Court on remand as to how to handle what is an inevitably going to be a *Mike M. Johnson* argument that Olympia plans to raise, it can and should do so through some guiding dicta, as the Court of Appeals did.

3.3 Sealed Bid Public Contracts are Contracts of Adhesion.

A contract is a contract of adhesion if (1) the contract was "prepared by one party and submitted to the other on a 'take it or leave it' basis", and (2) there was "no true equality of bargaining power" between the parties. *Blakely v. Housing Authority*, 8 Wn. App. 204 at 212-13, 505 P.2d 151 (1973), citing to *Standard Oil Co. v. Perkins*, 347 F.2d 379 (9th Cir. 1965), and 3 A. Corbin, Contracts § 559 at 271 (1960). Sealed bid public contracting operates just that way. Public bidding law prohibits bidders and public agencies from negotiating contracts, offering them to potential bidders on a "take it or leave it basis." *Platt Electric v. Seattle*, 16 Wn. App. 265 at 273-74, 555 P.2d 421 (1976). Further, an attempt by a bidder to negotiate is illegal. *Hanson Excavating v. Cowlitz Cnty.*, 28 Wn. App. 123 at 125-27, 622 P.2d 1285 (1981). Finally, public owners, but not bidders, have substantial discretion to "waive informalities" and accept or reject bidders based on "responsibility criteria" they select and apply, sometimes after-the-fact. This gives public owners, but not bidding

contractors, tremendous advantages in bargaining position. There is no equality of bargaining power in sealed bid public contracting. Thus, the contracts formed are contracts of adhesion and should be analyzed as such.

The Amicus argues that there are good reasons for this process and the WSDOT Standard Specifications are fair in any case. Those arguments are good ones. They are also not arguments against the proposition that public works contracts are contracts of adhesion. Rather, they are arguments that, even though public works contracts are contracts of adhesion, contracts based on the WSDOT bid process and the WSDOT Standard Specification are not unconscionable.

There is considerable clarity in legal analysis to be gained from the recognition that sealed bid public works contracts are contracts of adhesion. This Court should take this opportunity to so rule, leaving for a case-by-case determination whether any particular contract is unconscionable

4. Conclusion

The Amicus brief adds nothing determinative to this case. Rather, it focuses on two tangential arguments, neither of which can affect the outcome here. The *Mike M. Johnson* defense was not properly raised below. Nova has not been given a full and fair opportunity to respond to it

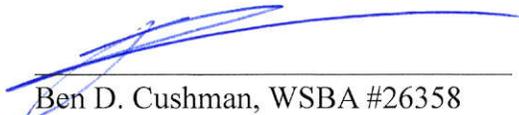
below. The record below (while suggestive and possibly sufficient to deny Olympia the defense), is far from complete on this issue, as it has never been developed for this issue. The best way to handle this *Mike M. Johnson* defense is to remand this case and allow the parties to develop the record on it, as the Court of Appeals did.

While Nova's argument that this contract, like all sealed bid public contracts, was a contract of adhesion, that position was not accepted by any lower court and therefore did not inform any of the lower court decisions. Recognizing that this contract was a contract of adhesion may bolster, but cannot undermine, the Court of Appeals decision, which stands on its own without such support.

This Court should affirm the Court of Appeals and remand to the Trial Court for further proceedings.

Respectfully submitted this 23th day of April, 2018.

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CERTIFICATE OF SERVICE

I certify that on the date signed below, I caused the foregoing document to be filed with this Court, and electronically served upon the attorneys of record for Petitioner and Amicus.

DECLARED UNDER PENALTY OF PERJURY ACCORDING TO THE LAWS OF THE STATE OF WASHINGTON.

Dated this 23rd day of April, 2018, in Olympia, Washington.


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APPENDIX 1

STRICT COMPLIANCE WITH CONSTRUCTION
CONTRACT NOTICE PROVISIONS: DETRIMENTAL TO
CONTRACTORS AND TAXPAYERS

Paige Spratt

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Ms. Spratt is a 2011 graduate of Seattle University School of Law. Prior to attending Seattle University, she worked for two major contractors as a field and project engineer, and for a large corporation as a construction manager. Ms. Spratt would like to thank her husband Rich for his unrelenting love and support.

In our first-year contracts class, we learn that when parties to a contract make an agreement, they are obligated to comply with the terms of that agreement.¹ This principle is a basic legal tenet to which courts firmly adhere.² So why would one argue that contractors should be allowed to bring a breach of contract claim when they were the party that failed to comply with the terms of the agreement? The answer is: most public works contracts contain nonnegotiable notice provisions that require contractors to provide detailed technical information about claims for equitable adjustment in a very short period of time.³ These provisions fail to recognize the aggressive nature of construction projects. In an ideal world, contractors would always comply with their contractual obligations, but sometimes strict compliance is impossible because contractors cannot know the full impact of a requested change until after the period for filing an equitable adjustment has expired.

For example, some state laws require that a contractor strictly comply with the contract's notice provision to even bring a claim for equitable adjustment.⁴ If there is any evidence that the contractor failed to comply with every aspect of the notice provision, the owner will prevail.⁵ This is true even when the owner had actual knowledge of the contractor's claim.⁶ As a result, an owner can request that a contractor perform work different from what the construction plans dictate and, knowing that those changes will increase the cost, avoid paying for the increase if the contractor failed to comply, in any way, with the contract's formal notice requirements.

This article will use Washington state law to explore the legal and practical effects of enforcing the strict compliance standard.⁷

I. INTRODUCTION

Washington state's strict compliance standard is prejudicial to contractors because it allows owners to change project requirements without having to pay for those changes if the contractor does not strictly comply with the contract's notice provisions. After the *Mike M. Johnson (Johnson)* decision, one commentator predicted that the new strict compliance standard would

1. See, e.g., *Hotchkiss v. Nat'l City Bank of N.Y.*, 200 F.2d 287, 293 (S.D.N.Y. 1911).

2. Courts have uniformly held in construction contract cases that parties should be held to the benefit of their bargains. See, e.g., *Alejandre v. Bull*, 153 P.3d 864, 870 (Wash. 2007) (citing *Berschauer/Phillips Constr. Co. v. Seattle Sch. Dist. No. 1*, 881 P.2d 986, 992 (Wash. 1994)).

3. See *infra* Part II.B. This Article will focus on public contracts; however, a court may require strict compliance in private contracts, depending on the jurisdiction. Other courts may require strict compliance with notice provisions for public contracts but apply a more liberal requirement for private contracts. See, e.g., *Barsotti's, Inc. v. Consol. Edison Co. of N.Y.*, 680 N.Y.S.2d 88 (N.Y. App. Div. 1998).

4. See, e.g., WASH. STATE DEP'T OF TRANSP., M 41-10, STANDARD SPECIFICATIONS FOR ROAD, BRIDGE, AND MUNICIPAL CONSTRUCTION § 1-04.5 (2008) [hereinafter WASH. STATE 2010 STANDARD SPECIFICATIONS], available at <http://www.wsdot.wa.gov/publications/manuals/fulltext/M41-10/SS2010.pdf>.

5. See, e.g., *Mike M. Johnson, Inc. v. Cnty. of Spokane*, 78 P.3d 161, 169 (Wash. 2003).

6. *Id.* at 166-69.

7. *Id.* at 169.

increase administrative costs for contractors, subcontractors, and suppliers.⁸ The Associated General Contractors of Washington wrote that “[b]ecause responsibility for the cost of the change is no longer determined solely on the merits of a claim, owners and contractors are pitted against each other, with contractors creating mounds of paperwork to preserve their right to obtain compensation.”⁹

This Article argues that Washington State’s strict compliance standard should be legislatively changed to a prejudice standard¹⁰ because the strict compliance standard is prejudicial to contractors, and unfair to the taxpayers, who have to foot the bill for the corresponding increase in construction costs. In Part II, this Article will discuss the transition from the state’s prejudice standard to a strict compliance standard and will analyze the cases that prompted the shift. In Part III, this Article will discuss the prejudicial¹¹ consequences of the *Johnson* holding on contractors and will explain how the strict compliance standard greatly increases the risk of providing construction services, which translates into higher costs for Washington State taxpayers. In Part IV, this Article will discuss the impact of the recently proposed False Claims Act on contractors’ attempts to adhere to the strict compliance standard. Finally, this Article will conclude by weighing the owner’s necessity for strict compliance over a prejudice standard to prove that Washington State and all states should adhere to a prejudice standard regarding notice.

II. DIFFERENT STANDARDS APPLIED TO NOTICE PROVISIONS IN CONSTRUCTION CONTRACTS

A. *The Prejudice Standard*

1. The Law in Washington State Pre-*Mike M. Johnson*

In all construction projects—small or large—changes are inevitable.¹² Prior to *Johnson*, “[t]he rule in Washington [had] been that where the contractor notifies the owner of the changed condition, failure to precisely follow claims procedures will not defeat the contractor’s right to compensation unless that procedural error causes prejudice to the owner.”¹³ This is called the prejudice

8. See, e.g., JOHN P. AHLERS, AHLERS & CRESSMAN PLLC, WRITTEN NOTICE UPDATE IN THE WAKE OF *MIKE M. JOHNSON* pt. 3.d (2007), available at http://www.ac-lawyers.com/downloads/pdfs/resources/AACEI_Presentation.pdf.

9. *The Mike M. Johnson Case: Who Bears the Cost of Contract Changes?*, POLICY BRIEF (Assoc. Gen. Contractors of Wash.), Nov. 15, 2007 [hereinafter AGC POLICY BRIEF].

10. For the purposes of this Article, the “prejudice standard” is the enforcement of the contract notice requirement only where the owner is prejudiced by nonenforcement. See *infra* Part II.A.

11. In this context, “prejudice” refers to the hardship placed upon the contractor for not being paid for work performed.

12. “[T]he reality is that, notwithstanding the owner and the architect/engineer having progressed through every phase of the design process . . . every project of any significance (and many minor projects as well) will require changes to the work and, thus, to the price and time of performance as well.” Alan Winkler, *The Inevitability of Changes*, in CONSTRUCTION LAW § 16.01, at 431 (William Allensworth et al. eds., ABA Publishing 2009).

13. *Mike M. Johnson, Inc. v. Cnty. of Spokane*, 78 P.3d 161, 173 (Wash. 2003) (Chambers, J., dissenting).

standard.¹⁴ Under this standard, actual knowledge could serve as a proxy for fully complying with the contract's notice provisions.¹⁵ However, even under the prejudice standard, the contractor could not recover if the contractor increased the scope of a project without telling the owner.¹⁶

One way a contractor could prejudice an owner is by waiting too long to notify an owner of problems with the construction plans—forcing the owner to make choices it would not have made had it been provided with more timely notice. Another example of prejudice to the owner¹⁷ is when a contractor supplies and installs a more expensive adhesive product for flooring before notifying the owner that the architect specified an adhesive that was not compatible with the flooring material. The contractor should not be able to recover for the additional cost of the adhesive because the contractor never gave the owner any other option but to purchase the more expensive adhesive. In this scenario, the contractor's failure to provide notice prejudiced the owner because the owner did not have an opportunity to look for other flooring materials or research potential alternative adhesives.

Before the *Johnson* decision, the law in Washington State provided that, where a contractor fails to provide an owner with timely written notification about a change in project scope, and the contractor's delay prejudices the owner, then the contractor cannot recover.¹⁸ If the owner is not harmed by the contractor's claim, even if they do not comply with every notification requirement of the contract, the contractor should recover for the additional work performed.¹⁹ Many jurisdictions prefer the prejudice standard because it is better suited for the aggressive nature of construction,²⁰ which is fast paced with many unknowns.²¹ On large public projects there are often hundreds of changes to the project's scope of work, which can result in a dramatic cost increase.²² The prejudice standard gives owners and contractors a sensible way to deal with this problem. The Supreme Court of Rhode Island has stated that "[t]he purpose of the claim-notice provision is to ensure that an owner has

14. See, e.g., John P. Ahlers, *Written Notice Requirements—Time to Revisit the Prejudice Issue: Part I*, CONSTR. L. BLOG, AHLERS & CRESSMAN PLLC (May 24, 2011), http://www.ac-lawyers.com/blog_article.php?article=301.

15. *Mike M. Johnson*, 78 P.3d at 173 (Chambers, J., dissenting).

16. *Id.* at 174.

17. In some instances, a general contractor could use strict compliance as a tool to avoid paying a subcontractor for a claim. In many ways, this would be even more unfair than an owner using strict compliance as a tool against a general contractor because general contractors are in charge of every aspect of the construction project—their business is construction; therefore, nothing should come as a surprise. But this argument is beyond the scope of this Article.

18. See *C.W. Bignold v. King Cnty.*, 399 P.2d 611, 614 (Wash. 1965).

19. *Id.* at 615.

20. See *Mike M. Johnson*, 78 P.3d at 170 (Chambers, J., dissenting).

21. "Even small, simple projects normally involve necessary or at least desirable changes, whereas large, complex projects sometimes involve thousands of changes." STUART H. BARTHOLOMEW, *CONSTRUCTION CONTRACTING BUSINESS AND LEGAL PRINCIPLES* 200 (2d ed. 2002).

22. See *id.*

the opportunity to examine the work at issue and to monitor the performance and costs of repair and/or extra work.”²³ In other words, the contractor can make the required changes while continuing with construction—on time and on budget—as long as the owner is notified of the changes in a nonprejudicial manner.

2. Federal Courts Take the Prejudicial Approach

The Federal Acquisition Regulation (FAR) contains three notification requirements for contract changes,²⁴ yet federal courts do not require strict adherence to those clauses “where the Government is quite aware of the operative facts.”²⁵ In *Hoel-Steffen Construction Company v. the United States*, the Court of Claims found that a notice provision applied too technically would violate the “nature” of a notice requirement.²⁶ The court stated, “[The] inquiry is simply whether the contractor put the Government on notice [. . .], so that the procurement officials could begin to collect data on the asserted increase in cost, and could also evaluate the desirability of continuing the delay causing conduct.”²⁷

Thus, in federal contracts, the purpose of giving notice is not to create disputes regarding technicalities, but to *notify* the owner of a potential claim so that the owner has the opportunity to research the claim and choose a remedy beneficial to the owner. The Federal Circuit Court explained:

The delay in the assertion of a claim by a contractor inevitably causes some degree of prejudice to the government; *however*, the existence of prejudice resulting from the dilatory notice usually serves to increase the burden of persuasion facing the contractor asserting its claim for equitable adjustment rather than to bar its claim entirely.²⁸

Federal courts will take late notice or nonspecific cost estimates into account when evaluating claims for owner prejudice. One commentator explained, “The degree of prejudice to the government resulting from the contractor’s failure to provide proven notice is a factor employed in determining whether to excuse the insufficient notice.”²⁹ A prejudice standard still requires the contractor to notify the owner of the possibility of a change.³⁰

The Claims Court explained: “If the contracting officials have knowledge of the facts or problems that form the basis of a claim and are able to perform necessary fact-finding and decisionmaking [sic], the government is not

23. *Clark-Fitzpatrick, Inc. v. Gill*, 652 A.2d 440, 447 (R.I. 1994).

24. Alan Winkler, *Notice Requirements for Claims for Changes*, in *CONSTRUCTION LAW*, *supra* note 12, § 16.05, at 440.

25. *Hoel-Steffen Constr. Co. v. United States*, 456 F.2d 760, 768 (Ct. Cl. 1972).

26. *Id.* at 766, 768.

27. *Id.* at 766.

28. *Mingus Constructors, Inc. v. United States*, 812 F.2d 1387, 1392 (Fed. Cir. 1987) (emphasis added).

29. Winkler, *supra* note 24, at 441.

30. *Hoel-Steffen Constr. Co.*, 456 F.2d at 766.

prejudiced by the contractor's failure to submit a precise claim at the time a constructive change occurs."³¹ The contractor's position is only benefitted in the sense that they will be allowed to recover for their claims based on the merits, not their ability to meet the technical requirement for an onerous notice provision.

* * *

The prejudice standard was Washington State's law regarding notice until *Johnson* in 2005;³² yet the opinion of the courts regarding notice began its transformation with a Washington Court of Appeals case in 1995, *Absher Construction Company v. Kent School District 415*.³³

B. Washington State's Change to the Strict Compliance Standard

1. *Absher v. Kent County School District*³⁴

The *Absher* court was the first to favor strict compliance with notice requirements and began the trend away from the prejudice standard.³⁵ Absher Construction Company (Absher) was awarded a contract to construct an elementary school for Kent School District 415 (District).³⁶ Absher subcontracted the mechanical work to Chapman,³⁷ who subcontracted with Emerald³⁸ for the school's air-conditioning system.³⁹ Absher's contract with the District required Absher to "give the District prompt and detailed written notice of any claims 14 days after events giving rise to claims, enter into structured dispute resolution procedures, and mediate any remaining disputes before any lawsuit could be commenced."⁴⁰ The court held that if the contractor failed to provide "complete written notification," the contractor absolutely waived any claim that arose from, or was caused by, delay.⁴¹ The court held that in order for a contractor to bring a claim, the contractor must comply with the notice procedures set forth in the contract.⁴² Thus, if a contractor fails to strictly comply with the contract's notice provisions, the contractor will lose its claim before the court.⁴³

Absher argued that the District had actual knowledge of the claims, making the notice requirement irrelevant.⁴⁴ The court held, however, that "[s]ince

31. *Calfon Constr. Inc. v. United States*, 18 Cl. Ct. 426, 438-49 (Cl. Ct. 1989).

32. *C.W. Bignold v. King Cnty.*, 399 P.2d 611 (Wash. 1965).

33. 890 P.2d 1071 (Wash. Ct. App. 1995).

34. *Id.*

35. *Id.*

36. *Id.* at 1072.

37. Second-tier contractor from the prime contract between Absher and the District. *Id.*

38. Third-tier contractor from the prime contract between Absher and the District. *Id.*

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.* at 1075.

43. The claim did not even survive summary judgment because the contractor did not comply strictly with the notice provision. *Id.* at 1072.

44. *Id.* at 1073-74.

the District did not waive the notice requirement⁴⁵ . . . Absber was required to comply with the contract notice requirements” even if the owner was not prejudiced by the claim.⁴⁶ In previous cases, courts had allowed contractors to recover when the owner was not prejudiced by the contractor’s claim.⁴⁷ In fact, before *Absber*, Washington State had never made strict compliance with contractual notice provisions a requirement for surviving summary judgment claims as long as the owner was not prejudiced by the contractor’s lack of compliance. In *Absber*, however, the court stated that “Washington does not require an element of prejudice to enforce contractual notice provisions.”⁴⁸ The supreme court case of *Johnson* followed and upheld the *Absber* court’s strict compliance requirement.⁴⁹

2. *Mike M. Johnson, Inc. v. County of Spokane*⁵⁰

Mike M. Johnson, Inc. v. County of Spokane solidified the court of appeal’s *Absber* holding by ruling that regardless of the owner’s actual knowledge, a contractor will lose its claim for a contract change unless it strictly complied with its contract’s notice provisions.⁵¹ Mike M. Johnson, Inc. (Johnson) was awarded two competitively bid sewer projects for the County of Spokane (County).⁵² The contract for both projects “incorporated the Washington State Department of Transportation’s 1996 Standard Specification for Road, Bridge, and Municipal Construction.”⁵³ Standard Specification § 1-04.5 required that Johnson “give a signed written notice of protest of work required by a change order, other written order, or oral order from the engineer before doing any work.”⁵⁴ The contract also directed Johnson to

[s]upplement the written protest within 15 calendar days with a written statement providing the following: (a) The date of the protested order; (b) The nature and circumstances which [sic] caused the protest; (c) The contract provisions that support the protest; (d) The estimated dollar cost, if any, of the protested work and how the estimate was determined.⁵⁵

Finally, Standard Specification § 1-09.11 required Johnson to submit a “claim to the project engineer in sufficient detail to enable the engineer to ascertain the basis and amount of the claim.”⁵⁶ At a minimum, the contract mandated that all claims include a notarized statement attesting to the veracity of ten

45. The district did not waive the notice requirement per the technical standards set forth in the contract. *Id.* at 1075.

46. *Id.*

47. *C.W. Bignold v. King Cnty.*, 399 P.2d 611 (Wash. 1965).

48. *Absber*, 890 P.2d at 1075.

49. *Mike M. Johnson, Inc. v. Cnty. of Spokane*, 78 P.3d 161, 169 (Wash. 2003).

50. *Id.*

51. *Id.*

52. *Id.* at 162.

53. *Id.*

54. *Id.* at 163.

55. *Id.*

56. *Id.*

specific informational requirements.⁵⁷ The contract warned that the contractor's failure to follow sections 1-04.5 and 1-09.11 constituted a complete waiver of the affected claim.⁵⁸

While preparing a portion of the roadway for the project, Johnson encountered unforeseen phone lines that were not shown on the drawings furnished by the County.⁵⁹ The County halted Johnson's work to resolve the utility conflict.⁶⁰ Although Johnson sent the County a letter addressing the delay, that letter did not meet the requirements of sections 1-04.5 and 1-09.11 of the contract.⁶¹ The County responded to Johnson by stating, "if you believe you have a claim for additional compensation within this contract please submit this claim per section 1-09.11(2) of the standard specifications."⁶² Subsequently, Johnson's attorney sent a series of letters to the County that did not comply with contract section 1-09.11.⁶³

The trial court granted Spokane County's motion for summary judgment, holding that there were no genuine issues of material fact as to whether Johnson had complied with the contract's notice provisions.⁶⁴ The court of appeals reversed and remanded the case to the trial court because it believed that there was an issue of material fact as to whether the County's "actual notice of Johnson's claims excused Johnson from complying with the mandatory contractual protest and claim procedures."⁶⁵ After the remand, the Washington Supreme Court granted review, and, in a 5-4 opinion, held that Johnson was barred from bringing its claim against Spokane County because it failed to strictly comply with the contract's notice requirements.⁶⁶ The majority's opinion holding was clear: comply with your contractual notice obligations—no exceptions.

Unfortunately, the majority failed to consider the impact of such an over-arching change in the law. Instead, the majority only considered the impact of a strict compliance standard as applied to the facts of *Johnson*, and in that case, the contractor did not comply with its contractual requirements even after the County's attorney explicitly directed them to submit the claim per the contract.⁶⁷ The County had actual knowledge of the claim in the form of letters from both Johnson and Johnson's attorney, but because Johnson failed to strictly comply with the technical requirements of the notice standard, it

57. *Id.*

58. *Id.*

59. *Id.* at 170 (Chambers, J., dissenting).

60. *Id.* at 164. Mike M. Johnson asserted that it was due additional compensation for the delays caused by the County's redesign. *Id.*

61. *Id.*

62. *Id.*

63. *Id.* at 165.

64. *Id.* at 166.

65. *Id.*

66. The court also held that "actual notice" of the claim is not an exception to contract compliance. *Id.* at 169.

67. *Id.* at 165.

lost its claim.⁶⁸ The County received work that it knew about for free to the detriment of Johnson.

On public works contracts, the general contractor is required to post payment and performance bonds.⁶⁹ The purpose of the payment bond is to ensure the owner that the contractor will fulfill its financial obligation to its subcontractors and suppliers.⁷⁰ Public works general contractors also must sign indemnity agreements making them “personally responsible to the surety for any amounts the surety might have to pay.”⁷¹ Like other public works contractors, Johnson posted payment bonds and signed an indemnity agreement for the Spokane sewer projects. Accordingly, even though Spokane County was not required to pay for the additional work that Johnson performed, the company still had to “make good”⁷² on the changed work. Johnson, however, could not afford to pay its suppliers and subcontractors and the surety had to cover these costs.⁷³ Johnson’s owners were forced to surrender their personal real estate in order to “satisfy” their surety obligations under the general indemnity agreement.⁷⁴ In March 2008, Washington’s *Daily Journal of Commerce* wrote: “Today Mike M. Johnson Inc. is out of business”⁷⁵ Its contractor’s license was suspended in 2003 and its corporate registration lapsed in 2007.⁷⁶

III. THE NEGATIVE EFFECTS OF ENFORCING A STRICT COMPLIANCE STANDARD

A. *Who Is Harmed by a Strict Compliance Standard?*

The strict compliance standard is unrealistic because it requires contractors, subcontractors, and suppliers to provide new cost figures and revised construction schedules before that information is known.⁷⁷ Because revisions to construction plans create uncertainty, contractors will sometimes discuss the requested changes with the owners, who will request that the contractor proceed in a certain way.⁷⁸ To the contractor’s dismay, they may later find out

68. *Id.* at 165, 169.

69. “The [performance bond] guarantee is the surety’s promise to fulfill the principal’s obligations to perform the [omit] contract that the principal has made with the obligee if the principal is unwilling or unable to perform.” BARTHOLOMEW, *supra* note 21, at 132.

70. *Id.* at 135.

71. Mike M. Johnson filed for bankruptcy in an attempt to seek protection from enforcing the general indemnity agreement; yet in another decision, they still were required to pay. J. Todd Henry, *How Fair Was the Mike M. Johnson Case?*, SEATTLE DAILY J. COM. (Mar. 7, 2008), <http://www.djc.com/news/re/om.html?id=11198443>.

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *Id.*

77. For an underground fuel tank example, see *infra* Part III.B.2.

78. See *infra* note 95.

that even though they followed the owner's instructions, they cannot bring a claim for the changed work because they failed to comply with the contract's notice provision.⁷⁹ Other times, contractors will comply with the notice requirements by providing liberal cost estimates⁸⁰—to the detriment of Washington State taxpayers.

The following section examines how the strict compliance standard is prejudicial toward contractors because contractors who fail to comply with a notice provision must absorb the cost of a meritorious claim, resulting in unjust enrichment to the owner. Additionally, the strict compliance standard can be devastating to the disadvantaged small and minority-owned contractors, subcontractors, and suppliers that have limited resources. Furthermore, the strict compliance standard generates higher costs for taxpayers because most notice provision requirements are onerous, and in order to strictly comply with the provision, the contractor and owner will incur additional administrative costs that will be reflected in the bid or the change order. Finally, under many circumstances, contractors cannot realize the full impact of the change until after the formal notice deadline; therefore, the contractor will overestimate the cost of the change.

1. Unjust Enrichment

Why would a contractor sign a burdensome contract at the risk of not being able to recover on a meritorious claim? Washington State public works construction contracts, like most other public works contracts, are nonnegotiable.⁸¹ If a contractor wants to perform work for a public works entity in Washington State, it must sign the contract as is.⁸² These contracts are disadvantageous to contractors because the contractor is bound to perform owner-requested changes per the contract change clauses.⁸³ Because the contractor cannot negotiate public contracts, the state can incorporate arduous notice provisions aimed at getting the contractor to perform additional work for free.⁸⁴

Below is a Washington State notice provision that is currently used by the Washington State Department of Transportation:

79. "An [o]wner who has actual knowledge of events giving rise to a claim has suffered no prejudice, and should not be entitled to rely upon a technical breach of a notice or claim submission provision to defeat an otherwise meritorious [c]ontractor claim." See BRENDA MOLNER, ATER WYNNE LLP, PROJECT DELAYS, DISRUPTIONS AND CHANGES 7 (2007).

80. For example, a contractor may estimate that a requested change will increase the cost by \$10,000, when, ultimately, the change only cost \$10,000. This price differential does not mean that the contractor provided the estimate in bad faith. In fact, it is unlikely that a contractor would present a bad faith estimate because contractors are contractually and statutorily forbidden from providing bad faith estimates. See *infra* Part IV.B.

81. WASH. STATE 2010 STANDARD SPECIFICATIONS, *supra* note 4, § 1-03.3.

82. *Id.*

83. See *infra* note 90.

84. "[T]he University of Washington and the state General Administration—two of the largest state public agencies—already provide [a prejudice standard] in their contracts." AGC POLICY BRIEF, *supra* note 9.

Procedure and Protest by the Contractor:

[T]he Contractor shall: Immediately give a signed written notice of protest to the Project Engineer or the Project Engineer's field inspectors before doing the work; Supplement the written protest within 14 calendar days with a written statement providing the following: The date of the protested order; The nature and circumstances which caused the protest; The contract provisions that support the protest; The estimated dollar cost, if any, of the protested work and how that estimate was determined; and an analysis of the progress schedule showing the schedule change or disruption if the Contractor is asserting a schedule change or disruption⁸⁵

In most cases, a contractor's failure to meet the above-listed requirements would not prejudice an owner. For example, suppose Contractor Inc. is hired to build forty miles of a new two-lane highway in Washington State. Both the state and Contractor Inc. sign the Washington Department of Transportation's standard contract, which applies the notice provision outlined in section 1-04.5. After the contract is signed, but prior to mobilization,⁸⁶ the state asks the contractor to provide a three-lane highway in lieu of a two-lane highway with design drawings forthcoming.⁸⁷ According to section 1-04.5, the contractor has fourteen days to provide written notice to the state of its claim. Yet an owner that is regularly engaged in highway construction should know that a three-lane highway is vastly more expensive and complicated than a two-lane highway. And while the provision requires an estimated dollar value and a determination of schedule delays, without drawings, Contractor Inc. cannot determine the cost estimate of the new work or the schedule impact associated with the claim (and does not want to assume the risk of underestimating). But the strict compliance standard requires Contractor Inc. to provide cost and schedule estimates within fourteen days.⁸⁸ If Contractor Inc. fails to give the owner a cost estimate or revised schedule as a part of its formal notice, does it waive its right to an equitable

85. WASH. STATE 2010 STANDARD SPECIFICATIONS, *supra* note 4. Notice the change from fifteen calendar days in *Mike M. Johnson* to fourteen calendar days in the 2010 specification. In 2008, the Washington Department of Transportation only allowed seven days for a contractor to give notice. WASH. DEP'T OF TRANSP., 2008 STANDARD SPECIFICATIONS § 1-04.5, Procedure and Protest by the Contractor.

86. Mobilization is the industry term for the activity by which contractors set up their trailers, equipment, and materials onsite prior to starting work.

87. A change of this magnitude could be considered a cardinal change; however, for this example we will assume that it is not. An owner may be found liable for breach of contract by imposing a cardinal change on the contractor. "A cardinal change is defined as a change to the work that goes so far beyond the scope of the original contract as to constitute a materially different undertaking." Alan Winkler, *Cardinal Changes*, in *CONSTRUCTION LAW*, *supra* note 12, § 16.09, at 450. There are different formulas for determining whether a change is in fact a cardinal change. It is important that a contractor not rely on a change being determined a cardinal change. In case the owner were to sue for breach of contract, if a change is found to *not* be a cardinal change, the contractor could be held liable. MOLNER, *supra* note 79, at 5.

88. *See supra* Part II.

adjustment?⁸⁹ Fortunately, most owners are reasonable and will pay the contractor for such a vast change of scope. But contractors should not have to gamble with such a risk.

Most public contracts have change clauses that allow the owner to make changes and require the contractor to perform the requested change for additional compensation.⁹⁰ A contract change clause allows an owner to unilaterally change the scope of the contract and binds the contractor to perform the changed or added work without delay.⁹¹ The strict compliance standard turns change clauses into large business risks for contractors. The Associated General Contractors of Washington have stated that “because of *Johnson*, public construction contracts may not allow for the necessary time, creating a ‘gotcha’ situation for the contractor.”

Moreover, public owners could use an arduous notice provision as a tool to receive additional work for free.⁹² The *Johnson* decision motivates owners to add frivolous notice requirements with the hope that the contractor will fail to comply with each condition. When a contractor fails to comply with the technical requirements of the contract’s notice provisions, the trial court must dismiss the claim on a motion for summary judgment.⁹³ This means that the judge must dismiss the contractor’s claim even if the owner actually knew of the event giving rise to the claim, directed the contractor to proceed with the extra or changed work, and watched the contractor perform the extra work.⁹⁴ An owner could require the contractor to submit its claims on rare bamboo paper or require a custom-made, three-inch staple in the right-hand corner. If the contractor submits its claim on standard white paper or binds it with a standard staple in the left-hand corner, the trial court should grant summary judgment for the owner because the contractor did not strictly comply with the contract’s notice requirements.

Although the three-inch-custom-staple example seems extreme, requiring immediate notification of a claim, with a detailed estimate of cost and schedule impacts within fourteen days, can be just as burdensome—especially on

89. This example is similar to the issue presented in *Weber Construction, Inc. v. County of Spokane*, 98 P.3d 60 (Wash. Ct. App. 2004). In *Weber*, the superior court applied the holding from *Mike M. Johnson* and granted summary judgment for the county because Weber failed to submit a cost estimate with its formal notice documents. *Id.* at 61–63. Yet Weber stated in the documentation that it could not provide an estimate because the county did not give them enough information. *Id.* at 63. Fortunately, the court of appeals reversed, holding that Weber complied with the notice provision. *Id.* But Weber’s win came only after a costly appeal. See generally *id.*

90. “A change clause can allow an owner to change the contract unilaterally by directing the contractor to perform changed work under a pricing formula or under an owner-imposed price, with the right to contest the price preserved.” Alan Winkler, *The Purpose of a Changes Clause*, in CONSTRUCTION LAW, *supra* note 12, § 16.02, at 433.

91. *Woodburn Constr. Co. v. Encon Pac., LLC*, 2007 WL 174090, at *2 (W.D. Wash. 2007).

92. See J. Todd Henry, *American Safety: The Final Nail in the Coffin of “Implied Waiver”*, NORTHWEST CONSTR., Apr. 1, 2009.

93. See *id.*

94. “*Johnson* resulted in fear that more onerous notice clauses would begin to appear in construction agreements, and that anything but strict compliance with them would result in contractors being denied otherwise justly deserved compensation for owner-caused problems and changes.” *Id.*

large projects. Even if Contractor Inc. had received the design drawings at the same time that the state requested a three-lane highway, it is doubtful that fourteen days would have been sufficient for Contractor Inc. to create a new work plan including new estimates for crew sizes and material lead times. Yet, in order to maintain the project schedule and comply with a changes clause,⁹⁵ the contractor must proceed with the work.

Contract change clauses entitle the owner to change the work while requiring the contractor to perform the work without delaying the project.⁹⁶ In most cases, the contractor proceeds with the work because it is necessary to move forward on the project.⁹⁷ An owner can demand additional work outside the scope of the original contract, observe the contractor perform that work, discuss the work with the contractor, and yet deny fair compensation for services rendered if, within fourteen days, and before the owner's plans are even completed, the contractor fails to submit a written request for additional time for the demanded work or fails to produce an itemized invoice in precise technical format.⁹⁸ The owner is unjustly enriched at the detriment of the contractor because the contractor failed to comply strictly with the precise technical requirements of the contract even though compliance was practically impossible.

A hypothetical can illustrate the above point. Imagine Owner hires Contractor to paint Owner's house, and Contractor discovers that 100 square feet of Owner's siding is damaged from dry rot. Contractor informs Owner of the damage, who in turn asks Contractor to replace the siding. Owner has actual knowledge that Contractor will replace the siding, but if Contractor fails to comply with the technical notice requirements, Owner will receive 100 square feet of siding for free.

*a. Unequivocal Conduct Constitutes Waiver*⁹⁹

A contractor who fails to comply with the technical requirements of a contract's notice provision may recover if the owner waived the notice

95. Often to avoid liquidated damages. See Andrew D. Ness, *Significance of Time for Performance*, in CONSTRUCTION LAW, *supra* note 12, § 11.01, at 306.

96. See *Woodburn Constr. Co.*, 2007 WL 174090, at *2.

97. "A differing site condition is a physical condition other than weather, climate, or other act of God, discovered on or affecting a construction site and differing in some material respect from what reasonably was anticipated. The condition must be physical; changes in political conditions, economic conditions, or labor issues are not differing site conditions." *Turnkey Enters., Inc. v. United States*, 597 F.2d 750, 754-55 (Ct. Cl. 1979); *Cross Constr. Co.*, CBCA No. 3676, 79-1 B.C.A. (CCH) ¶ 13,707, at 67,230; *W. Contracting Corp. v. State Bd. of Equalization*, 114 Cal. Rptr. 227, 233-34 (Cal. Ct. App. 1974); *Foster Constr. & Williams Bros. v. United States*, 435 F.2d 873, 876 (Ct. Cl. 1970); *Hallman Bros. v. United States*, 68 F. Supp. 204, 204-05 (Ct. Cl. 1946).

98. *Mike M. Johnson, Inc. v. Cnty. of Spokane*, 78 P.3d 161, 170 (Wash. 2003) (Chambers, J., dissenting).

99. A notice provision waiver could be a law review topic in itself. Nevertheless, I will briefly touch on the subject to emphasize that a contractor should not rely on a showing of waiver by the owner when attempting to assert a claim for equitable adjustment.

requirement.¹⁰⁰ The waiver doctrine, however, has limited applicability to public works contractors because most public works contracts contain provisions disclaiming any waiver of rights.¹⁰¹ Waiver “requires unequivocal acts of conduct evidencing an intent to waive.”¹⁰² In *American Safety*, the court found that the City of Olympia’s agreement to “enter into negotiations, without more, does not constitute an implied waiver of contractual rights.”¹⁰³ The plaintiff, American Safety, was the surety for the contractor who had been hired by the City of Olympia to construct a portion of a pipeline project in Olympia, Washington.¹⁰⁴ After the project was complete, the City agreed to negotiate with the surety on a claim for equitable adjustment.¹⁰⁵ Following the city’s request for documentation and American Safety’s attempts to comply, the city rejected the claim.¹⁰⁶ The trial judge granted summary judgment for the city because American Safety did not comply with the contractual provisions regarding notice.¹⁰⁷

The court of appeals reversed, holding that there was a material issue of fact as to whether the city waived the notice requirement.¹⁰⁸ The Washington Supreme Court stated that “[a]t most, the fact that the City agreed to consider negotiations . . . constitutes equivocal conduct.”¹⁰⁹ In summary:

American Safety stands for the proposition that the only effective waiver of a contract’s written notice requirements is one made in a signed writing. Any lingering hope of handshake agreements, project site arm waving and unsigned acknowledgements in conversations or meeting minutes will suffice to preserve a contractor’s claims is now “unequivocally” dead.¹¹⁰

2. Hurting Disadvantaged Contractors

The Government requires most public owners to guarantee that a percentage of their contract awards are set aside for small or disadvantaged businesses.¹¹¹

100. See generally *Mike M. Johnson*, 78 P.3d 161; *Absher Constr. Co. v. Kent Sch. Dist.* 415, 890 P.2d 1071 (Wash. Ct. App. 1995); *Am. Safety Cas. Ins., Co. v. City of Olympia*, 174 P.3d 54 (Wash. 2007); *Weber Constr., Inc. v. Cnty. of Spokane*, 98 P.3d 60 (Wash. Ct. App. 2004).

101. See, e.g., WASH. STATE 2010 STANDARD SPECIFICATIONS, *supra* note 4, § 1-07.27.

102. *Am. Safety Cas. Ins. Co.*, 174 P.3d at 58.

103. *Id.* at 59.

104. *Id.* at 55.

105. *Id.* at 56.

106. *Id.* at 57.

107. *Id.*

108. *Id.*

109. *Id.* at 59.

110. *Henry*, *supra* note 92.

111. “The Contractor hereby agrees to carry out this policy in the awarding of subcontracts to the fullest extent consistent with efficient contract performance. The Contractor further agrees to cooperate in any studies or surveys as may be conducted by the United States Small Business Administration or the awarding agency of the United States as may be necessary to determine the extent of the Contractor’s compliance with this clause.” FAR 52.219-8(b). These programs must be “narrowly tailored” to pass a strict scrutiny standard to show that the requirement does not violate the Equal Protection Clause of the Constitution. See *Adarand Constructors, Inc. v. Pena*, 515 U.S. 200, 235 (1995).

A contractor can be certified¹¹² as a small business or Disadvantaged Business Enterprise (DBE) by the federal Small Business Administration (SBA).¹¹³ The SBA uses many factors to determine if a contractor qualifies as a small business or DBE, including the number of employees, ownership statutes, and total income.¹¹⁴ Not only do small contractors receive bid preferences because of their status, but they receive other government benefits such as “set asides.”¹¹⁵ Essentially, those contractors that are certified as small business contractors have reason to stay small. Large contractors, in turn, have an incentive to use small contractors to meet a project’s small business goals and to ensure preferential consideration on future projects.¹¹⁶

Small businesses do not have the same resources as larger contractors.¹¹⁷ In general, most small businesses cannot provide the administrative support¹¹⁸ required to strictly comply with the notice provisions for contract changes. If a small business owner fails to comply with a contract’s notice requirements, the business owner must pay for the change. Because these businesses are small, they can only handle

112. In Washington State, the Small Business Administration contracts with the Washington Office of Women and Minority Business Enterprises (OMWBE) to process the federal certification applications. See *Federal DBE Certification Program*, OMWBE, http://www.omwbe.wa.gov/certification/certification_dbe.shtml (last visited May 30, 2011).

113. “The Small Business Act (Act) established SBA to aid, counsel, assist and protect the interests of small business concerns, to preserve free competitive enterprise, to insure that small businesses receive a fair portion of the Federal Government’s purchases, and to maintain and strengthen the Nation’s overall economy. The Act defines a small business concern as one that ‘is independently owned and operated and which [sic] is not dominant in its field of operation.’” *Guide to Size Standards: Guide to SBA’s Definition of Small Business*, SMALL BUS. ADMIN. (Apr. 1, 2010), <http://www.sba.gov/content/guide-size-standards>.

114. See *Summary of Size Standards by Industry*, SMALL BUS. ADMIN. (Apr. 1, 2010), <http://www.sba.gov/content/summary-size-standards-industry>; *Small Business Audiences*, SMALL BUS. ADMIN. (Apr. 1, 2010), <http://www.sba.gov/about-sba-services/201>.

115. “Set asides can be of two basic types: (1) pure set asides, which provide that a certain percentage of the total number of government contracts be allotted to minority owned businesses and (2) subcontractor goal set asides, which require a certain portion of prime contractor’s fee be spent with minority owned contractors.” Mitchell F. Rice, *Government Set-Asides, Minority Business Enterprises, and the Supreme Court*, 51 PUB. ADMIN. REV. 114, 114 (1991).

116. FAR 52.219-8(a):

It is the policy of the United States that small business concerns, veteran-owned small business concerns, service-disabled veteran-owned small business concerns, HUBZone small business concerns, small disadvantaged business concerns, and women-owned small business concerns shall have the maximum practicable opportunity to participate in performing contracts led by any Federal agency, including contracts and subcontracts for subsystems, assemblies, components, and related services for major systems. It is further the policy of the United States that its prime contractors establish procedures to ensure the timely payment of amounts due pursuant to the terms of their subcontracts with small business concerns, veteran-owned small business concerns, service-disabled veteran-owned small business concerns, HUBZone small business concerns, small disadvantaged business concerns, and women-owned small business concerns.

117. Resources can range from the number of employees to the technology available to the experience of the management.

118. “Examples are general and administrative expenses, such as the salaries of project management, engineering, craft supervisory personnel including project managers, engineers, and craft superintendents.” STUART H. BARTHOLOMEW, *ESTIMATING AND BIDDING FOR HEAVY CONSTRUCTION* 42 (2000).

paying for so many changes before they lose their business.¹¹⁹ Hiring additional workers to comply with the notice requirements is not an option because the small or disadvantaged business would risk losing its DBE certification status.

Because of the incentive to remain a small business, these contractors do not have the same resources as a large general contractor that can handle onerous notice provisions, which results in a late claim submission or reliance on a verbal directive that they will get paid for a claim. A small contractor cannot track every potential claim; it is costly to its business and tremendously time-consuming. Unfortunately, most contractors, small or large, do not understand that in a strict compliance regime, failure to comply results in a forfeiture of any equitable adjustment. Because small and disadvantaged contractors can only afford to pay for a few changes before going out of business, they rely on the owner to compensate them fairly for any extra work they perform, regardless of whether they fully complied with the contract's notice provisions.

3. The Strict Compliance Standard Creates Higher Costs for Washington State Taxpayers

An onerous notice provision requires contractors to assume the risk of not being compensated for a meritorious claim, which creates higher administrative costs to track claims. Contractors account for risks in a number of ways.¹²⁰ The most common way is by adding a contingency line item¹²¹ to the bid or increasing the overhead percentage rate. The contingency line is a form of self-insurance, which decreases the harm that a contractor will suffer if it cannot receive an equitable adjustment.¹²² Contractors also attempt to reduce the risk that a claim will fail by tasking their staff with identifying any potential changes and overwhelming the owner with paperwork—just to ensure that it complies with the notice requirements.¹²³ The owner, in turn, will have to ensure its staff is large enough to track and research each of the contractor's claims.¹²⁴

119. Cf. R. Harper Heckman, *The Croson and Adarand Decisions and Hiring Preferences*, in CONSTRUCTION LAW, *supra* note 12, § 8.03.C(2)(f), at 208 (“Because the construction industry has few educational and financial barriers to entry, it has long been a vehicle to effectuate change.”).

120. A contractor can allocate risk by including contingencies in their bid, purchasing insurance and bonds, increasing overhead rates, and increasing profit.

121. “Contingency allowances are included in project cost estimates to cover special risks for which the potential costs are not included in the estimate, things that simply may go wrong, or cost items that possibly have been overlooked when the estimate was prepared.” BARTHOLOMEW, *supra* note 118, at 49. “Contractors with substantial experience understand that when they bid jobs, they can predict with some degree of accuracy the cost of materials, labor, and so forth that go into finishing a project. They also know that most projects will experience some unforeseen occurrences that are not specifically planned in the budget. A contractor who projects job costs with no consideration for unplanned expenses undertakes substantial risks.” Stephen A. Hess, *Comparison of Pricing Terms Based on Pricing Mechanism*, in CONSTRUCTION LAW, *supra* note 12, § 9.05, at 241–42.

122. *See id.*

123. AGC POLICY BRIEF, *supra* note 9.

124. *Id.*

The contractor also may account for risk by artificially inflating the figures it gives to owners for project changes—especially when they do not have time to adequately assess the impact of the change.¹²⁵ Because most Washington State construction projects are funded through state and local taxes, the taxpayer bears the brunt of these cost increases.¹²⁶

B. Allocating Risk

1. Increased Cost to Contractor's Overhead and Owner's Direct Costs

Large public works projects such as the upcoming SR 520 Replacement Bridge¹²⁷ and the Alaskan Way Viaduct Replacement¹²⁸ projects in Seattle, Washington, will have hundreds, even thousands, of changes due to unforeseen conditions, engineering errors, and owner-requested scope additions. The contracts will likely contain a clause barring a contractor from recovering costs associated with answering requested changes.¹²⁹ In order to cover the costs associated with preparing these changes, the contractor will account for these costs in the project's contingency budget or in the project's overhead costs.¹³⁰ "Project contingency" is a standard general contracting term for costs included in the budget to account for unknowns.¹³¹ Often the contractor will calculate the contingency allowance by adding either a lump-sum value or a percentage of the expected costs to the total budget based on how much risk the contractor thinks is associated with the project.¹³² Overhead rates for changes usually include costs for construction offices, temporary utilities, and salaried staff.¹³³ The greater the risk that changes will occur, the higher the contractor's overhead rate must be if the contractor cannot otherwise recover the preparatory costs.¹³⁴

A burdensome notice provision will increase the risk of the project for the contractor because the contractor has to rely on its employees to comply perfectly with the technical requirements of the notice provision. The contractor will account for the risk of human error by increasing the overhead

125. See *infra* underground tank example, Part III.B.2.

126. The sources of funding depend on the nature of the project.

127. The Washington State Department of Transportation (WSDOT) awarded this project to Kiewit-General Joint Venture for \$367 million. *SR 520—Pontoon Construction Project*, WASH. STATE DEP'T OF TRANSP. (Mar. 28, 2010), <http://www.wsdot.wa.gov/projects/sr520/pontoons.htm>; *SR 520 Pontoon Project Open House Set for Jan. 19*, WASH. STATE DEP'T OF TRANSP. (Jan. 12, 2011), <http://www.wsdot.wa.gov/news/2011/01/SR+520+Open+House+Jan.+19.htm>.

128. WSDOT awarded this project to Skanska USA Civil for \$114.6 million. *WSDOT Awards Contract to Replace Southern Mile of the Alaskan Way Viaduct*, WASH. STATE DEP'T OF TRANSP. (May 13, 2010), <http://www.wsdot.wa.gov/News/2010/05/13-awv-contract.htm>.

129. The costs associated with preparing the change include the personnel to prepare the estimate and to formalize the change order paperwork.

130. BARTHOLOMEW, *supra* note 118, at 49.

131. *Id.*

132. *Id.* at 43–50.

133. *Id.*

134. See *id.* at 50.

percentage rates and the contract contingency. Furthermore, the contractor also may increase the contingency and overhead rates to account for a potential waiver by the owner of notice.¹³⁵ These risk factors can create an adversarial environment for contractors and owner's representatives, and can lead to more litigation—another risk factor that must be accounted for in the cost of the project.¹³⁶ Finally, each risk factor (the cost of a burdensome notice provision, the uncertainty of waiver, and increased litigation) will raise the cost of the contractor's insurance and the cost of obtaining payment¹³⁷ and performance¹³⁸ bonds.¹³⁹

2. Limited Time to Assess the Full Impact of the Change

Onerous provisions do not allow for contractors to properly assess the full impact of changes in the timeframe provided. Many times, the contractor will simply provide a rough-order-magnitude (ROM) estimate to serve as the cost estimate for proper notice. These estimates will often be significantly higher than the actual cost of the change.¹⁴⁰ For example, the Johnson contract gave the company fifteen days to submit a detailed cost and schedule report for a particular change.¹⁴¹ Many changes require additional or revised design documents that are not given to the contractor until well after the fifteen days pass. There are also instances where the change is based on an unforeseen condition and the contractor cannot fully assess the scope of the change until the work is completed. In either case, the contractor has *only* fifteen days to fully assess the change and provide the owner with the requisite information.

For example, imagine a contractor has been chosen to build a new municipal building in Seattle. The contract requires the contractor to provide notice of a claim for equitable adjustment within fourteen calendar days of filing a written protest.¹⁴² The fourteen-day notice requirement includes providing the owner with cost information and schedule revisions, as well as other details necessary to support the claim. Imagine that during excavation for the building footings, the contractor encounters a large underground tank. The size of the tank has yet to be determined, but in order to determine how the tank can be removed, the contractor has to wait for its demolition subcontractor to bring the proper equipment to the site, which could take between seven and

135. Under *American Safety*, the contractor bears the burden of proving that the conduct was an unequivocal act of waiver to survive a motion for summary judgment. *Am. Safety Cas. Ins., Co. v. City of Olympia*, 174 P.3d 54, 59 (Wash. 2007).

136. The cost of litigation impacts more than just the cost of construction, but also the cost to the courts—even more taxpayer dollars.

137. *BARTHOLEMW*, *supra* note 21, at 135.

138. *Id.* at 132.

139. We specifically saw this after *Mike M. Johnson*, when the surety had to pay the construction claims. See *supra* note 71 and accompanying text.

140. See *AGC POLICY BRIEF*, *supra* note 9.

141. *Mike M. Johnson, Inc. v. Cnty. of Spokane*, 78 P.3d 161, 163 (Wash. 2003).

142. Per the Washington Department of Transportation 2010 Specification Standard. *WASH. STATE 2010 STANDARD SPECIFICATIONS*, *supra* note 4, § 1-03.5.

ten days. The demolition subcontractor has stated that the price to remove the tank cannot be determined until the equipment is onsite and it can “see what we got.” Furthermore, the tank is an old fuel tank, so the soil underneath may be contaminated. If so, the contractor may be contractually obligated to hire a licensed remediation contractor, which means that it will take even more time to get that contractor mobilized and a contract in place. The contract also requires the contractor to have all soil tested before removal and testing can take up to five days. Testing will determine if and how much soil will be removed—all of which contributes to the final cost of the change. Considering all of these factors, there is no way that the contractor will have a determination of the cost and schedule impacts within fourteen calendar days.

According to *Johnson’s* strict compliance standard, the contractor must provide pricing and the schedule impact of the change within fourteen calendar days.¹⁴³ The contractor, aware of the strict compliance standard, will submit an inflated ROM cost estimate to the owner for approval.¹⁴⁴ The contractor only submits an inflated ROM because it does not have enough information to submit an accurate estimate. It could try to negotiate an extension or exception with the owner, but then it risks having to participate in subsequent litigation about whether or not the owner actually waived its rights to strict compliance with the notice provision.

IV. THE STRICT COMPLIANCE STANDARD: FUTURE EFFECTS AND THE NEED FOR LEGISLATIVE CHANGE

A. Proposed Legislative Change

The *Johnson* dissent agreed that actual notice was not sufficient to excuse a contractor’s failure to comply with its contractual obligations.¹⁴⁵ The dissent proposed an “actual notice plus” test.¹⁴⁶ The dissent explained that “an obligation to pay for work performed may be triggered by actual notice and direction by the owner or his agent to continue working.”¹⁴⁷ The dissent’s concern was that owners would use overly technical notice provisions to avoid paying for claims.¹⁴⁸ The dissent continued: “[T]he owner cannot . . . rely solely on technical non-compliance with a claim provision to deny reasonable compensation, especially when the owner has not been prejudiced by the non-compliance.”¹⁴⁹

143. *Mike M. Johnson*, 78 P.3d at 169.

144. Yet the contractor cannot, in good faith, submit an inflated ROM. See *infra* Part III.B.

145. *Mike M. Johnson*, 78 P.3d at 173 (Chambers, J., dissenting).

146. *Id.* at 173–74.

147. *Id.* at 174.

148. “Owners are making notice and claim provisions hyper-technical and difficult to comply with in the hope that contractors will fail to meet them and therefore cannot seek additional compensation.” COMM. ON GOV’T OPERATIONS & ELECTIONS, WASH. STATE SENATE, SENATE BILL REP. SB 5936, S. 59-5936.SBR, Reg. Sess. (2006).

149. *Mike M. Johnson*, 78 P.3d at 174.

In 2005 a Senate Committee on Labor, Commerce, Research & Development proposed legislation intended to overrule the *Johnson*¹⁵⁰ decision:

Any clause in a construction contract, [as defined in RCW 4.24.370¹⁵¹] that purports to waive, release or extinguish the claim rights of a contractor to damages or an equitable adjustment based on failure to submit claim notice or claim related documentation in a specified time frame or form is enforceable to the extent that the party failing to receive such notice was prejudiced.¹⁵²

In 2006 the Committee modified the proposed legislation to make it clear that the contractor has the burden of establishing that the owner was not prejudiced by its failure to comply with its contractual obligations.¹⁵³

Owners will argue that contractors should be required to comply with their contractual obligations because they should have known what they were getting themselves into when they signed the contract. The *Johnson* dissent explains that “[t]he purpose of a prompt notification requirement of changed conditions involving possible delay and increased expense is to give the owner the opportunity to verify and investigate the differing site condition and to make the most cost-effective arrangements possible.”¹⁵⁴ Owners argue that failing to strictly enforce contractual notice provisions is equivalent to saying the owner waived the notice requirements.¹⁵⁵ Waiver should only be allowed when the owner unequivocally waives its rights because “[w]aiver permanently surrenders an established contractual right.”¹⁵⁶ But would judicial enforcement of the prejudice standard actually impair owners’ contractual rights or impinge upon the benefits of a strict compliance system? No. A prejudicial standard still supports the same policy goals that concerned the majority in *Johnson* when they protected owners’ rights to contemplate changes prior to contractor performance.¹⁵⁷

Additionally, although a contractor should know what they are getting themselves into, public contracts do not allow for negotiating mandatory provisions.¹⁵⁸ Because public contracts are nonnegotiable, the only way a contractor can account for the risk imposed on it by onerous notice provisions is to

150. *Id.* at 161.

151. “‘Construction contract’ for purposes of RCW 4.24.360 means any contract or agreement for the construction, alteration, repair, addition to, subtraction from, improvement to, or maintenance of, any building, highway, road, railroad, excavation, or other structure, project, development, or improvement attached to real estate, including moving and demolition in connection therewith.” WASH. REV. CODE § 4.24.370 (2011).

152. WASH. SENATE BILL REP. SB 5936, *supra* note 148, S. 59-5936.SBR, at 2.

153. “The substitute adds the requirement that the contractor make an initial prima facie showing that the public owner was not prejudiced by the failure to submit notice as required by the contract and shifts the burden to the owner to prove that it was prejudiced.” *Id.* The substitute bill also defines the term “prejudiced.” *See id.*

154. *Mike M. Johnson*, 78 P.3d at 173 (Chambers, J., dissenting).

155. *Am. Safety Cas. Ins., Co. v. City of Olympia*, 174 P.3d 54, 59 (Wash. 2007).

156. *Id.*

157. *Mike M. Johnson*, 78 P.3d 161.

158. *See, e.g.,* WASH. STATE 2010 STANDARD SPECIFICATIONS, *supra* note 4.

increase its bid prices.¹⁵⁹ Increased bid prices lead to increased project budgets, which are ultimately paid for by the taxpayer.¹⁶⁰ In response, owners could argue that the prejudice standard would actually be more costly to taxpayers because they will have to pay for more claims. This counterargument will fail, however, because the prejudice standard only allows for enforcement of meritorious claims that are not prejudicial to the owner and that must be paid in order to prevent unjust enrichment. Thus, taxpayers will only pay for project costs that should rightly be paid to the contractor for additional or changed work.

One commentator noted that “[b]ecause responsibility for the cost of a project change is no longer determined solely on the merits of a claim, owners and contractors are unnecessarily pitted against one another. Contractors are basically forced to create mounds of paperwork simply to preserve their rights to be paid.”¹⁶¹ The owner is unjustly enriched if the contractor does not get paid for additional work requested by the owner.¹⁶² The reality of the *Johnson*¹⁶³ decision has not even been fully realized by most contractors in Washington State. Most contractors still believe that their claims will be considered on the merits, not realizing that anything short of strict compliance will cause them to lose on a motion for summary judgment.¹⁶⁴

B. *The Impact of Mike M. Johnson on Future Laws: Senator Adam Klein’s “False Claims Act”*¹⁶⁵

To further complicate the strict compliance issue, Washington State Senator Adam Klein¹⁶⁶ and the Washington Senate Committee are proposing new legislation to impose severe penalties against persons who “knowingly” present a false claim to a government entity.¹⁶⁷

The proposed False Claims Act¹⁶⁸ states that

[a] person who knowingly presents, or assists in the presentation of, a false or fraudulent claim that results in losses to a state or local government entity of at

159. See *supra* Part III.A.3.

160. See *id.*

161. AHLERS, *supra* note 8, at 3.

162. See *supra* Part II.

163. Mike M. Johnson v. Cnty. of Spokane, 78 P.3d 161 (Wash. 2003).

164. “Construction projects are fluid and dynamic, and the court swung the pendulum too far in the direct[ion] of owners.” WASH. SENATE BILL REP. SB 5936, *supra* note 148, S. 59-5936. SBR, at 3.

165. Similar to the federal False Claims Act enacted in 1863. David A. Senter, *Specific Payment Issues*, in CONSTRUCTION LAW, *supra* note 12, § 14.06, at 395.

166. SENATOR ADAM KLINE, <http://www.senatedemocrats.wa.gov/senators/kline/>.

167. STAFF OF COMM. ON JUDICIARY, WASH. STATE SENATE, SENATE BILL REP. SB 5144, S. 61-5144-SBA-JUD-09, Reg. Sess., at 1 (2009).

168. Many states have already adopted false claims legislation. See, e.g., *What Is the False Claims Act & Why Is It Important?*, TAXPAYERS AGAINST FRAUD, <http://www.taf.org/whyfca.htm> (last visited June 2, 2011).

least \$1,000 is liable for a civil penalty of: (i) at least \$5,000, (ii) but not more than \$10,000, (iii) plus three times the damages, attorney's fees and costs.¹⁶⁹

The owner does not need to produce "specific proof of intent to defraud."¹⁷⁰

Let us apply the False Claims Act to the unforeseen fuel tank hypothetical in Part III.¹⁷¹ The contractor could play it safe and overestimate the potential cost, but under the proposed False Claims Act, the contractor would be penalized because the contractor would have knowingly presented a false claim for equitable adjustment.¹⁷² However, the contractor still must strictly comply with the contract's notice provisions in order to recover for the cost of removing the tank. If the contractor knowingly submits an inflated cost estimate to remove the underground fuel tank, the contractor will be liable under the False Claims Act.¹⁷³ If the contractor does not submit a cost estimate, the contractor risks not being paid for the tank removal.¹⁷⁴ What should the contractor do? If the False Claims Act is enacted,¹⁷⁵ the price of construction will skyrocket because contractors will have to account for the cost of potential False Claims Act litigation.¹⁷⁶

V. CONCLUSION

Under a strict compliance standard, courts must dismiss a case on a motion for summary judgment if the contractor does not comply with the technical requirements of the contract's notice provision.¹⁷⁷ Yet the dynamics of construction are fast-paced and an onerous notice provision fails to take into account the realities of construction.¹⁷⁸ The strict compliance standard is prejudicial toward contractors because it prevents a contractor from receiving an equitable adjustment simply because it overlooked the notice requirements or because the notice requirements were impossible to satisfy.¹⁷⁹ The strict compliance standard increases the cost of construction across the board because contractors have to account for the additional risk in their bids. Additionally, owner's costs are increased because they have to keep track of the contractor's attempts to comply with the strict compliance standard, creating a skyscraper

169. WASH. SENATE BILL REP. SB 5144, *supra* note 167, S. 61-5144-SBA-JUD-09, at 1.

170. Senter, *supra* note 165, at 395.

171. See *supra* Part III.B.2.

172. See WASH. SENATE BILL REP. SB 5144, *supra* note 167, S. 61-5144-SBA-JUD-09, at 1.

173. See *id.*; *supra* Part III.B.2.

174. See *Weber Constr., Inc. v. Cnty. of Spokane*, 98 P.3d 60, 63 (Wash. Ct. App. 2004).

175. In March 2011, the Washington State legislature voted down the False Claims Act; however, the bill, having been presented multiple times in the past, will most likely continue to plague contractors in the future.

176. See WASH. SENATE BILL REP. SB 5144, *supra* note 167, S. 61-5144-SBA-JUD-09, at 2.

177. See *supra* Part III.

178. See *BARTHOLOMEW*, *supra* note 21.

179. "It is unjust to declare as a matter of law that the contractor is *not* entitled to fair compensation merely because the contractor did not *also* conform to additional highly technical claims procedures." *Mike M. Johnson v. Cnty. of Spokane*, 78 P.3d 161, 170 (Wash. 2003).

of paperwork. Some of the contractors stuck with paying the owner's tabs could potentially be small, disadvantaged businesses that could easily be put out of business for an uncompensated change brought about by a single technical omission.¹⁸⁰

Washington's legislature needs to change the strict compliance standard to a prejudicial standard. The prejudicial standard would even the playing field between contractors and owners and make Washington State law consistent with federal law.¹⁸¹ Contractors could justly recover for the cost of additional work performed, while owners would only have to pay for the cost of work that they should rightly pay for.¹⁸² Under a prejudicial standard, contractors would still be required to notify owners of claims in a timely and nonprejudicial manner, but owners would not be able to rely on technicalities to avoid paying meritorious claims.¹⁸³ Finally, the potential for future False Claims legislation makes the need for change even more compelling. If enacted, the proposed False Claims Act would force contractors to choose between full compliance with their contractual notice obligations and exposing themselves to potential False Claims Act liability.¹⁸⁴

Johnson's strict compliance standard is harmful to both contractors and taxpayers and should be changed to a standard that is more appropriate for the construction industry.

180. See *supra* Part III.A.2.

181. See *supra* Part II.A.2.

182. See *supra* Part IV.A.

183. See *supra* Part II.A.2.

184. See *supra* Part IV.B.

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