# MEDIATING PUBLIC SECTOR CONSTRUCTION DISPUTES IN THE UNITED STATES: ''SQUARE CORNERS'', ''NO FREE LUNCH'', AND PRINCIPLES OF FAIRNESS

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Since the early days of the United States, contractors who contracted with the government learned—all too frequently the hard way—that those who seek compensation from the public treasury ''must turn square corners when they deal with the government''.[2] These ''square corners'' pervade all levels of public contracting in the United States, and are found in mandated requirements and conditions imposed at federal, state and local levels. Many such ''square corners'' impact the success of mediations in which contractors and public sector owners pursue settlement of their respective contract claims.[3] Achieving mediation settlements of claims and disputes between private contractors and public sector owners requires appreciation of many issues: those ordinarily addressed in mediation, and in addition those raised by government ''square corners''.

## I. The "normal" problems affecting mediation of construction claims and disputes that arise on both public and private projects

Achieving mediation settlements of claims and disputes between any disputants arising out of the design and construction process is difficult enough, given the technical and legal complexities of many such claims and disputes.[4] Such complexities arise out of:

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[2] *Rock Island A & L R Co* v. *US*, 254 US 141,143 (1920): ''Men must turn square corners when they deal with the government. If [the government or the law attach] even purely formal conditions to its consent to [assume contractual liability], those conditions must be complied with. *Lex non praecipit inutilia* (Co Lit 127b) expresses rather an ideal than an accomplished fact.''

[3] See generally, *Bruner and O'Connor on Construction Law* (2002 updated 2012) (hereafter *Bruner and O'Connor*); Cibinic, Nash and Nagle, *Administration of Government Contracts* (4th ed., 2006).

[4] For a broad discussion of the evolution of the use of ADR by public and private construction industry participants in the United States, see Philip L Bruner, ''Rapid Resolution ADR'' (2011). 31 *The Construction Lawyer* 6 (Spring). This article was awarded the 2011 Norman Royce Prize by Britain's Society of Construction Arbitrators.

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(1) The host of applied sciences relating to (a) design (architecture, engineering specialties of civil, structural, geotechnical, electrical, mechanical and others; (b) building materials (extraction, formulation and manufacture); and (c) the overall management and physical installation of the construction work. Construction's technological complexity frequently is frustrating to judges inexpert in construction.[5]
(2) The host of legal principles applicable to (a) the relationships between and among the multitude of parties engaged in construction projects (owners, designers, contractors, subcontractors, sureties, insurers, materials manufacturers and suppliers, building code officials, construction lenders, and others); (b) the significant differences in liability imposition and damage measurement principles among the recovery concepts of contract (express and implied), tort, equity (*quantum meruit* and unjust enrichment), and statutes (such as the Uniform Commercial Code, Contractors Bond Laws, and Building Codes), and (c) the overarching imposition of contextual legal duties implied by the transaction and contextual interpretation of ambiguous transaction obligations in conformance with ''industry realities''.[6]
(3) The host of unique conditions affecting most construction projects built to a unique design, on a unique site, by a unique aggregation of companies operating without economies of scale in an uncontrolled environment, where labour productivity and time of completion are subject to weather, geology local labour availability, building code requirements, site accessibility, and project management skills.[7]
(4) The host of varying ''human factor'' outlooks and mind-sets of the major industry participants—owners, contractors, architects, engineers, lawyers and judges—involved in resolving construction

[5] See *E C Ernst, Inc* v. *Manhattan Constr Co*, 387 F Supp 1001, 1005–1006 (SD Ala 1974), in which a federal judge advised the parties prior to trial: ''Being trained in this field, you are in a far better position to adjust your differences than those untrained in these related fields. As an illustration, I, who have no training whatsoever in engineering, have to determine whether or not the emergency generator system proposed to be furnished . . . met the specifications, when experts couldn't agree. This is a strange bit of logic. [T]he parties litigant should realize that, in most situations, they are by their particular training better able to accomplish this among themselves . . . ''

[6] See *Paul Hardeman, Inc* v. *Arkansas Power & Light Co*, 380 F Supp 298, 317 (ED Ark 1974): ''[C]onstruction contracts are a separate breed of animal; and, even if not completely *sui* generic, still [the] law must be stated in principles reflecting underlying economic and industry realities; and even if not completely *sui generis*, still the law must be stated in principles reflecting underlying economic and industry realities. Therefore, it is not safe to broadly generalize. True, general principles of contract law are applied to construction contracts, but they are applied under different operative conditions.''

[7] See *Construction Planning and Scheduling* 4 (Associated General Contractors of America, 1997): ''Construction rarely proceeds as planned. There are always unexpected events and conditions that occur during construction and impact the contractor's ability to complete the project as planned.''

project disputes.[8] Such participants frequently have outlooks and attitudes fundamentally different from each other, and their prevailing mind-sets have contributed to the construction industry's litigiousness.

Contractors characteristically are seen as practical, independent, and hard headed personalities who enjoy getting their hands dirty. Architects frequently are perceived as ethereal ''right brain'' visionaries in search of aesthetic beauty in architectural design, uncomfortable with the contentiousness of the construction process and willing, in the face of modern complexities and risks of liability, to abdicate their ancient role as ''master builder''. Engineers, in contrast to architects, typically are perceived as viewing the world from the ''left brain'', think of problem solving as a mathematical exercise, and have a perceived literal outlook. Owners can be assertive and inflexible in demanding ''perfection'' and ''strict compliance,'' because they bear the project's financial risk and must rely on others to complete a project conforming to their desires. Add to this mix the mind-sets of lawyers and judges, who rarely view disputes as all black and white, inevitably identify different shades of grey in their search for fairness and equity, and ponder amid the shifting sands of construction industry practice and customs whether circumstances warrant enforcement of or excuse from contractual obligations willingly assumed, and the resulting brew can be downright volatile in creating potential misunderstandings and resulting mistrust. To illuminate such mind-set differences between municipal engineers and lawyers, and to endeavour to overcome mistrust and misunderstanding, was the objective of the celebrated 1954 speech of New York lawyer Max Greenberg, one of the mid-20th century ''deans'' of the American Construction Bar, to the Municipal Engineers of the City of New York:

> ''There is a basic difference in the training and thinking of lawyers and engineers. It is a difference which you must understand, if you want to comprehend how and why lawyers—which includes judges—arrive at conclusions which may appear to you to be entirely contrary to the clear and express provisions of a contract. Engineers deal basically with the immutable laws of nature. You are taught to look a fact in the face and to accept it without equivocation. Steel has certain qualities. It has certain defined stresses and strains, and while you may devise means to employ its qualities for your purposes, you can't change it. You accept it for what it is. It is a fact . . .
>
> Lawyers [and judges], however, deal with vagaries of the human mind. We seek an indefinable, illusive something, called Justice. Justice depends merely on our sense of fairness. It may mean different things in different ages, or different things in the same

[8] Such commonly recognised personality differences recently have become subjects of academic interest, and of participant efforts to soften mind-set differences through employee education. See Hynds, ''Personality Type Profiling of a Commercial Construction Company and its Companion Architecture Firm'', 26 *The Professional Constructor* 18 (April 2002); Eberhard, *Architect and the Brain* (2007); Dvorak, ''Construction Firm Rebuilds Managers to Make Them Softer'', *Wall Street Journal* 1 (USA edition, 16 May 2006).

age under different circumstances; it may mean different things to different people in the same age and circumstances . . .

Now when you, as engineers, read a contract which in plain understandable English states that the [public owner] shall not be liable for damages for delays, resulting from any cause whatsoever and that the sole remedy of the contractor shall be an extension of time, that, to you, with your type of background and training is a fact; it means what it says. To us, as lawyers, 'It ain't necessarily so'.

The effectiveness of a contract provision excusing the owner from liability for damage for delays . . . must yield when it conflicts with a basic, though perhaps not express, rule of law which implies that the owner will do its share toward getting the contract completed within the time specified. Every contract imposes obligations on both sides."[9]

## II. The public sector's "square corners": added problems and complexities in achieving mediation settlements

Adding to the "normal" complexities of reaching settlement of construction claims and disputes are the public sector's "square corners". These "square corners" are layers of legal requirements, conditions and constraints that rarely are present in private construction. Successful mediation with public owners dictates an understanding by all disputing parties of the impact of such "square corners" upon the mediation process. These typical public sector "square corners" include:

### *1. Public sector representatives' authority is limited to "actual" or "implied" authority, and frequently is subject to limitations that require multi-level approvals before settlements are binding*

No settlement with a public owner is binding, unless the public representative agreeing to the settlement had "actual"[10] or "implied"[11] authority to

[9] Max Greenberg, "It Ain't Necessarily So!", 40 Muni Eng J Paper 263 (2d Quarterly Issue 1954).

[10] See *Federal Crop Ins Corp* v. *Merrill*, 332 US 380, 384 (1947): "Whatever the form in which the government functions, anyone entering into an arrangement with the government takes the risk of having accurately ascertained that he who purports to act for the government stays within the bounds of his authority . . . And this is so even though, as here, the agent himself may have been unaware of the limitations upon his authority." *S & M Management Inc* v. *US*, 82 Fed Cl 240 (2008), holding that a government contracting officer's technical representative had not been delegated in writing the authority to make changes to the contract. *City of El Centro* v. *US*, 922 F 2d 816, 820 (Fed Cir 1990): "[F]ederal expenditures would be wholly uncontrollable if Government employees could, of their own volition, enter into contracts obligating the United States." Illustrative state and local cases are: *A-G-E Corp* v. *State*, 719 NW 2d 780 (SD 2006), denying a contractor's recovery for changes directed by a state inspector, because the contract expressly stated that the inspector had no authority to change the work; *Nether Providence Tp School Authority* v. *Thomas M Durkin & Sons, Inc*, 478 A 2d 904 (Pa 1984), refusing to enforce a claim settlement approved by two public board members not authorised to speak for the board, because the public owner could be bound only by a vote of the full board or by its authorised representative.

[11] See *Martin J Simko Const Inc* v. *US*, 11 Ct Cl 257 (1986), vacated on other grounds, 852 F 2d 540 (Fed Cir 1988); *Strickland* v. *US*, 382 F Supp 2d 1334 (MD Fla 2005): "A government agent's actual authority may be implied if contracting authority is an integral part of his assigned duties."

bind the public owner. ''Apparent'' authority is not enough.[12] Government regulations and contract specifications frequently impose limitations on a public representative's actual or implied authority. Assuring the proper level of settlement authority is no easy task where a public representative's commitments are not binding until subjected to multi-levels of higher reviews and approvals. This problem frequently arises when multiple public agencies contribute to project funding and are expected to share in settlement costs, and thus must approve settlements to which they are expected to contribute. Public owner representatives and any other parties participating through representatives (such as insurance companies) should make clear early in the mediation process the nature and extent of their representatives' settlement authority.

### *2. Public sector claim settlement justification requirements*

Those who approve settlements involving payment of government funds typically must furnish for the public record detailed documentation and written justifications that substantiate public responsibility for claim entitlement and reasonableness of *quantum*. This means that public settlements usually must be justified in detail on their ''merits''. Such ''merits'' rarely include the public owners' cost of litigation. To substantiate such merits, public owners often are obliged on larger claims to retain construction claim consultants to assist in developing claim settlement positions for mediation and in marshalling settlement ''merits'' justifications. Whenever such claims consultants are hired by public owners, contractors usually are wise to hire their own for the same purposes. Competent consultants can help to foster good communications and can add an air of professionalism to the mediation process.

### *3. Public sector damage justification and allocation preferences*

''Merits'' settlements of public claims also require documentation of and justification for acceptance of damage amounts as to ''reasonableness'', proper allocation and measurement. Both public owners and contractor claimants are expected to sort out and allocate their damages, which can be difficult where the claims involve multiple parties which have caused

[12] See *Whiteside* v. *US*, 12 Ct Cl 10, 93 US 247 (1876): ''Although a private agent, acting in violation of specific instructions, yet within the scope of his general authority, may bind his principal, the rule as to the effect of the like act of a public agent is otherwise, for the reason that it is better that an individual should occasionally suffer from the mistakes of public officers or agents, than to adopt a rule which, through improper combinations or collusion, might be turned to the detriment or injury of the public.'' *Nelson* v. *Anderson Lumber Co*, 99 P 3d 1092, 1098 (Idaho Ct App 2004), finding no actual or apparent authority but articulating the doctrine of apparent authority as follows: ''Apparent authority differs from express and implied authority in that it is not based on the works and conduct of the principal toward the agent, but on the principal's words and conduct towards a third party. Consequently, apparent authority cannot arise from the acts and statements of the agent alone; it must be based upon the principal's words and conduct.''

multiple events producing activity-related and time-related damages. Unsegregated ''total cost'' or ''modified total cost'' claims clearly are disliked by both public owners and courts because of their opaqueness, and parties asserting them must shoulder heavy burdens of proof to justify such recoveries.[13] Given such dislike, parties participating in mediation usually should not present their claims on an unsegregated damage measure basis.

*4. Public sector settlement scrutiny*

Because federal, state and local ''Freedom of Information'' Acts and ''Sunshine'' laws may expose settlements to public scrutiny, public authorities typically are careful to approve settlements that are justified on their ''merits,'' and that all legal requirements for settlement are complied with. Particularly where settlements involve expenditures of substantial dollars, the level of both political and public interest and scrutiny can be expected to rise. Thus, not only should public owner settlements be justified on their merits, but the mediating parties should address prior to settlement the subject of confidentiality of the settlement terms and the mediation proceedings.

*5. Public sector budgetary spending constraints*

One almost universal legal requirement of settlement approval authority centres on funding. Availability and sources of public agency settlement funds typically are subject to strict appropriation and budgetary legal limitations. Public owners and other participants should confirm to all mediating parties the availability of adequate funds for settlement.

*6. Public sector mandated contract clauses and cost accounting principles*

At the federal level, the well-settled ''*Christian* Doctrine'' incorporates into contracts all clauses mandated by regulations having the force and effect of law.[14] Large claims involving settlement with federal funds also may be subject to the federally mandated cost accounting principles and claim audit requirements.[15] At the state level, contracts controlled by statute, such

[13] Unsegregated damage measures, such as total cost or modified total cost approaches, are not accepted by either public owners or courts, except as theories of last resort. See *Edge Const Co* v. *US*, 95 Fed Cl 407 (2010): ''An actual cost approach, as distinguished from a total cost approach, is preferred.'' *Huber, Hunt & Nichols, Inc* v. *Moore*, 136 Cal Rptr 3d 603 (Cal App 1977): ''[I]t is obvious that Contractor could have maintained a proper accounting system to establish its alleged damage proximately caused by[the architect's] alleged negligence, if it desired to do so.'' *City of Westminster* v. *Centric-Jones Constructors*, 2003 WL 22908771 (Colo Ct App 2003), rejecting a public owner's attempt to obtain a ''total cost'' recovery against multiple parties without segregation and allocation of damages to specific causes of damage.

[14] See *G L Christian & Assoc* v. *US*, 312 F 2d 418 (Ct Cl 1963).

[15] See Federal Acquisition Regulations, §§30,000 *et seq.*, 48 CFR 30.00 *et seq.*, addressing Federal Cost Principles and the Federal Cost Accounting Standards Board.

as public contractor bonds, are deemed to include all terms mandated by statute.[16] This ''square corner'' requires mediating parties to know what clauses and other terms are implied into their public contract as a matter of law.

### *7. Public sector ''sovereign immunity'' and ''oral change'' defences*

In some states, oral change orders, oral extra work directives, and implied contract claims are barred by public ''sovereign immunity'' defences.[17] Some state statutes reach the same result by permitting recovery only for changes authorised in writing, thus barring oral commitments by an authorised representative.[18] Public owners intending to defend against contractor claims on a ''sovereign immunity'' or unenforceable oral commitments theory should perhaps seek adjudication of that defence before entering mediation.

### *8. Public sector contract and claim statute notice and substantiation limitations*

Public claim statutes and public contract terms typically impose upon contractors strict claim notice time limitations and substantiation requirements.[19] Although the Federal Government and some states apply a ''no prejudice rule'' under which the public owner must prove ''prejudice'' from late notice or inadequate substantiation as a condition of enforcing such limitations,[20] many states still follow a ''strict enforcement rule''.[21]

[16] See *US for the use of Hill* v. *American Surety Co*, 200 US 197 (1906), reading the scope of liability of a surety on a public contractor's payment bond to be consistent with the statute pursuant to which the bond was given.

[17] See *Department of the Army* v. *Blue Fox, Inc*, 525 US 255 (1999), enforcing the Federal Government's ''sovereign immunity'' doctrine to bar a subcontractor's equitable lien claim against prime contract funds. *Dept of Transportation* v. *White Oak Corp*, 946 A 2d 1219 (Conn 2008), invoking sovereign immunity to deny a contractor's claim for delay damages.

[18] See *P & D Consultants, Inc* v. *City of Carlsbad*, 190 Cal App 4th 1332 (2011), enforcing a statutory written change order requirement.

[19] See 1 *Bruner & O'Connor*, §§4:35 to 4:36.

[20] See *Miller Elevator Co Inc* v. *US*, 30 Fed Cl 662, 699 (1994), dismissed, 36 F 3d 1111 (Fed Cir 1994): ''[A]bsent a showing of prejudice to the Government, the thirty day notice requirement for a constructive change has not been strictly enforced. Moreover, if a contracting officer maintains actual or constructive knowledge of the conditions which caused the constructive change to the contract, in most cases, no prejudice to the Government occurs . . . [T]his court finds no prejudice in the [contractor's] failure to notify the contracting officer of the claim for additional work within a thirty-day time period.''

[21] See *Dugan & Meyers Constr Co, Inc* v. *Ohio Dept of Admin Services*, 864 NE 2d 68 (Ohio 2007): ''[W]e reject [the contractor's] argument that it was excused from complying with the specific change-order procedure for requesting extensions because the State had actual notice of the need for changes to the deadline, and therefore any failure to comply with procedures was harmless error.'' *Koren-Diresta Const Co Inc* v. *New York City School Constr Auth*, 740 NYS 2d 56, 60 (1st Dept 2002), upholding strict enforcement of a public owner's ''lack of timely claim notice'' defines without a showing of prejudice, but ruling that the claim filing period hadn't begun to run because the owner had not filed a certificate of substantial completion as required by law.

*9. Public sector claim statutes of limitation and repose*

Public claim statutes and public contracts sometimes invoke shorter suit durations for commencement of suit against public owners than do those statutes applicable to private contracts,[22] and sometimes attempt to lengthen the period in which public owners may pursue contractors.[23]

*10. Public sector "Severin Doctrine" defence*

As conditions to contractors' settlements of their subcontractors' claims with public owners for the public owners' alleged breaches of contract, contractors must be prepared in mediation to verify that they are still liable to the subcontractors for the damages claimed on the subcontractors' behalf. This proof is required under the *Severin* Doctrine.[24] During mediation, this proof is customarily accomplished by producing legally sufficient "pass-through" or "liquidation" agreements, which are usually required by public agencies before claim settlements based on unreimbursed subcontractor costs will be allowed.[25]

*11. Public sector False Claims Acts*

Contractors who seek mediated settlements of claims submitted to public owners may risk significant liabilities if their presented claims are "overstated". The Federal Government's False Claims Act,[26] Forfeiture of

[22] See *Delon Hampton & Associates, Chartered* v. *Washington Metropolitan Transit Authority*, 943 F 2d 355 (4th Cir 1991), invoking a public owner's "sovereign immunity" to avoid imposition of a state statute of limitation that, if applicable, would have barred its claims against a design professional.

[23] See *State* v. *Lombardo Brothers Mason Contractors, Inc*, 54 A 3d 1005 (Conn 2012), rejecting a state's attempt to override a contractual limitation of suit so as to be able to pursue a contractor for alleged construction deficiencies 12 years after project completion, and refusing to invoke the ancient maxim that "no time runs against the king".

[24] See *Severin* v. *US*, 99 Ct Cl 435 (1943): "[P]laintiffs had the burden of proving, not that someone suffered actual damages from the [Government's] breach of contract, but that they, plaintiffs, suffered actual damages." *George Hyman Const Co* v. *US*, 30 Fed Cl 170,174 (1993), affirmed 39 F 3d 1197 (Fed Cir 1994): "Under the *Severin* doctrine, a suit . . . may be maintained only when the prime contractor has reimbursed its subcontractor or remains liable for such reimbursement in the future . . . Thus, when the subcontract contains a clause completely exonerating a prime contractor from liability to its subcontractor for the damage complained of, suit may not be maintained by the prime contractor against the Government. The same result will follow when the subcontract provides for a complete release of the prime contractor's liability to the subcontractor upon the granting of additional time for the subcontractor's performance, or the acceptance of final payment by the latter."

[25] See 3 *Bruner and O'Connor*, §8:51, discussing American law regarding pass-through claims.

[26] 18 USC §287 (criminal) and 31 USC §§3729–3733 (civil). See also, Krista L Pages, "The False Claims Act and Other Fraud Statutes", in *Federal Government Construction Contracts* (ABA, 2nd ed., 2010); *Daewoo Engineering and Const Co Ltd* v. *US*, 73 Fed Cl 547 (Fed Cl 2006), affirmed 557 F 3d 1332 (Fed Cir 2009), upholding denial of a contractor's $64m. claim, and the grant of $50m. in damages to the Government, opining that "rarely does a case of this magnitude provide evidence of fraud so clearly".

Fraudulent Claims Act,[27] the fraud provisions of the Contract Disputes Act[28] and other statutory requirements[29] create the risk of imposition of civil and criminal sanctions upon contractors who submit ''overstated'' claims to the Federal Government.[30] Over 10 states have enacted their own civil False Claims Acts governing state and local contract claims,[31] while other states address overstated claims via common law decisions imposing forfeiture or contractor debarment.[32]

### *12. Public sector dispute resolution procedures and forums*

Public contracts routinely designate non-judicial ''ladders'' and forums for resolution of disputes. Dispute resolution procedures may follow a ''ladder'' beginning with mandated ''structured negotiation'', followed by mediation, non-binding recommendations of project neutrals or dispute review boards, and capped by binding decisions of ''boards of administrative appeal'' that may be appealed only then to courts.[33]

## III. No "free lunch" for the public sector in unfairly enforcing its "square corners", and the implied duty of good faith and fair dealing

Public owners seeking mediated settlements must be *practical and fair* in their enforcement of their ''square corners''. Although some ''square corners'' dictated by statute offer little latitude in enforcement, there is more latitude with ''square corners'' imposed by contract. Public owners that insist on taking extreme enforcement positions ignore the cautionary

[27] 28 USC §2514. See generally *Kellogg Brown & Root Servs, Inc* v. *US*, 99 Fed Cl 488, 496–501 (Fed Cl 2011): ''Since plaintiff's claims are based entirely upon [one] contract, a contract under which he practiced fraud against the Government, all of his claims under the contract will be forfeit [even valid ones] pursuant to [The Forfeiture Act].'' *Larry D Barnes, Inc* v. *US*, 45 Fed Appx 907 (Fed Cir 2002), upholding forfeiture of a contractor's overstated claim.

[28] 41 USC §7103 (c) (2).

[29] Such other Federal requirements are found in the False Statements Act, 18 USC §1001; the Major Fraud Act, 18 USC §1031; the Truth in Negotiations Act, 10 USC §2306 (f); the Conspiracy Statute, 18 USC § 371; the Mail Fraud Statute, 18 USC §1341; and the mandatory disclosure rule imposed by the Federal Acquisition Regulations.

[30] See 6 *Bruner & O'Connor*, §19:121, discussing American law regarding false and overstated claims.

[31] These states include California, Delaware, Florida, Hawaii, Massachusetts, Minnesota, Montana, New Jersey, Nevada, Tennessee, Virginia, as well as the District of Columbia. See Gerald E Wimberly *et al.*, ''What Government Contractors Need to Know About State False Claims Statutes'', *Construction Briefings* (May 2012); *Fassberg Const Co* v. *Housing Authority of the City of Los Angeles*, 60 Cal Rptr 3d 375 (Cal App 2d Dist 2007), upholding compensatory and punitive damages under the California False Claims Act, where a contractor submitted a false change order proposal.

[32] See, e.g., *Stacy & Witbeck, Inc* v. *City and County of San Francisco*, 44 Cal Rptr 2d 472 (Cal App 1st Dist 1995), upholding a city's five year debarment of a contractor who submitted a false claim; *RAC Group, Inc* v. *Board of Educ of City of New York*, 799 NYS 2d 599 (2d Dept 2005), forfeiting a claim for breach of contract where the claimant had engaged in fraud in tendering performance under a public contract.

[33] See Philip L Bruner, ''Rapid Resolution ADR'', n. 4, above, discussing the top 10 American approaches to resolution of construction claims and disputes.

adage that ''there is no free lunch''. Illustrative is *Koren-Diresta Const Co Inc* v. *New York City School Constr Auth*,[34] in which a public school construction agency denied a contractor's $3.6m. claim for contract balance ($1.3m.), extra work ($1.7m.) and acceleration and impact ($650,000) for the reason that the contractor allegedly failed to file its formal notice of claim within the statutorily required three-month period following the date of project substantial completion (which the agency alleged was the date upon which the building official's certificate of occupancy was issued). The court eventually ruled in favour of the contractor after concluding that the date of substantial completion was the date upon which the agency was to have issued its own certificate of substantial completion, which the agency had not done. In doing so, the court in its opinion gave the public owner the following lecture about the effect of its reliance upon the technical notice defence:

> ''Seemingly lost in the procedural morass in which [the contractor] finds itself is the 'salutary purpose' to be served by notice of claim provisions, which permit municipal defendants to conduct an investigation and examine the plaintiff with respect to the claim and to determine whether the claims should be adjusted or satisfied before the parties are subjected to the expense of litigation. As the record in this matter makes clear, defendant Authority exercised comprehensive oversight of the construction project, maintaining senior managers and full-time personnel on the site inspecting its work, which inspection was done on a daily basis. In addition, the project was subject to inspection by the Facilities and Inspection Department, by the architect, and by mechanical engineers, consultants and other agents acting on behalf of defendant. Finally, plaintiff contractor held bi-weekly job meetings with defendant Authority in addition to coordination meetings conducted with defendants' agents. Given the degree of oversight, it is difficult to imagine what might be gained by further investigation of work items.
>
> The absence of any prejudice to defendant from the lack of notice is not dispositive, however. Where an agency has received sufficient information concerning a particular claim, substantial compliance is sufficient with respect to the details that must be included in the notice; the proper public body or official must still be given the requisite notice; a burden which is not lifted simply because no prejudice has resulted, even to avoid a harsh result.
>
> The contractor who hopes to retain the right to bring suit on any item for which payment might be disputed is confronted with the necessity to file a notice of claim, 'at the latest', within three months of submitting its bill for such services. The contractor in this case submitted some 180 change estimates for approval, some of which took over a year to be processed by defendant . . . Presumably, to preserve its right to dispute the adequacy of compensation for the necessary changes, plaintiff should have filed a notice of claim with respect to each of the 180 change estimates it submitted to defendant for approval. It is difficult to fathom how such a practice would further the Authority's mandate 'to improve the efficiency, economics and quality of the process by which the city's schools are renovated and constructed'.
>
> The School Construction Authority should bear in mind that the relationship between parties to a commercial venture is not governed primarily by rules of law. Rather it is governed, first and foremost, by rules of economics. And one of the primary tenets of the dismal science is that there is no such thing as a free lunch . . .

[34] 740 NYS 2d 56, 59–60 (1st Dept 2002).

> Should it generally be perceived that a party to an agreement with defendant is unable to obtain redress for the agency's breach of a construction contract, prudent economic practice dictates that an amount be added to bids submitted in connection with any school construction project as an allowance for such a contingency. Second, if it should be perceived that the agency has a reputation for failing to honour its contractual obligations (with apparent impunity), only contractors truly desperate for work will resort to submitting bids on any school construction project. Finally, though perhaps the least harmful effect of the agency's success in avoiding litigation will be to reward it for its inefficiency. Failure to make prompt decisions on items submitted for payment, thereby running the three-month notice period of Public Authorities Law §1744 (2), obviates the need to justify its legal position in court. The practical result of these effects is that taxpayers of the City of New York will continue to pay inflated costs for poor quality facilities constructed by an inefficient bureaucracy. Anomalously, this is exactly the situation the New York City School Construction Authority was designed to remedy.'' (Numerous citations omitted throughout.)[35]

Encouraging practical and fair settlements is the universal legal duty of good faith and fair dealing implied in every American contract as a matter of law. As stated by the United States Court of Federal Claims:

> ''[A]n implied term of every contract, including government contracts, is that each party will act in good faith toward the other, and that a party may be found to have breached the contract by acting in bad faith. A breach of the covenant of good faith occurs when there has been sharp dealing, such as taking deliberate advantage of an oversight by your contract partner concerning his rights under the contract.''[36]

A further explanation of the duty of good faith was articulated by respected American Federal Judge Richard Posner in this way:

> ''The duty of good faith in the performance of a contract entails the avoidance of conduct such as evasion of the spirit of the bargain, lack of diligence and slacking off, wilful rendering of imperfect performance, abuse of a power to specify terms, and interference with or failure to cooperate in the other party's performance. But the duty of good faith does not require you putting one of your customers ahead of the others, even if the others are paying you more. Parties are not prevented from protecting their respective economic interests. [E]ven after you have signed a contract, you are not obliged to become an altruist toward the other party and relax the terms if he gets into trouble in performing his side of the bargain.''[37]

In essence, public sector contractual ''square corners'' and contract terms which are discretionary and not mandated by law must be addressed by both public owners and contractors in the context of the implied duty of good faith and fair dealing.

[35] *Ibid.*

[36] *Moreland Corp* v. *US*, 76 Fed Cl 268, 291 (2007), finding that the Federal Government breached its implied duty of good faith. See also *Bannum* v. *US*, 80 Fed Cl 239 (2008): ''In every contract there exists an implied covenant of good faith and fair dealing. In a government contract, an implied covenant of good faith and fair dealing requires the government not to use its unique position as sovereign to target the legitimate expectations of its contracting partners . . . For the plaintiff to successfully assert a claim for breach of the implied covenant of good faith and fair dealing respecting a contract with the government, he or she must allege and prove facts constituting a specific intent to injure the plaintiff on the part of the government official.''

[37] *Wisconsin Elec Power Co* v. *Union Pacific Railroad Co*, 557 F 3d 504, 510 (7th Cir 2009).

## IV. Achieving mediated settlements with public owners

Mediation as a settlement process invariably is selected for resolution of complex construction claims and disputes. An evaluative mediator experienced in the field of construction claims and disputes and expert in the mediation process can do much to pull the parties' positions and perspectives together. Mediation settlement prospects will be enhanced by evaluative mediators with requisite experience and expertise in dealing with the construction industry's multitude of complexities—technical, legal, differing party outlooks, and public sector ''square corners''. Good mediator qualities include:

(1) respect of the parties;
(2) expertise in construction law;
(3) experience in construction industry practices and customs;
(4) knowledge about construction claims and settlement constraints affecting public projects;
(5) the ability to communicate well and work with the parties;
(6) the ability to manage the mediation process; and
(7) good judgement in assisting parties in evaluating their respective positions.

Settlement through mediation is most likely to be achieved by good preparation on all sides.[38] To reach ''merit based'' settlements, ''square corner'' issues should be disclosed early, disputed factual and legal issues regarding claim entitlement and *quantum* should be defined and simplified in advance, differences in perspectives narrowed and softened, settlement ''expectations'' managed between and among parties and their decision makers, and reasonable assessments of risk and justifications for settlement developed. Litigation risk analysis of the factual and legal issues is particularly helpful in developing settlement positions.

The public sector's ''square corners'' do impose upon parties careful pre-mediation preparation to consider impediments to settlement, and to address disposition of ''square corner'' issues. Some ''square corner'' issues might require early document exchanges, possibly some discovery, and dispositive motions to resolve them before mediation, thereby simplifying the issues remaining in dispute. Before mediating, each party should be prepared to present during mediation its detailed results of technical investigations by experts and legal overviews by counsel.

As a general rule, public owners actively seek ''merit based'' settlements that can withstand scrutiny by higher public officials and the public. Public owners usually are not persuaded to settle claims on the basis of ''cost of defence'' or ''cost of litigation'', unless perhaps if they have retained outside litigation counsel. Moreover, time rarely is of the essence for public owner achievement of claims settlements, particularly where they hold the

[38] See Dwight Golann and Jay Folberg, *Mediation: The Roles of Advocate and Neutral* (2nd ed., 2011).

contractor's money and multi-levels of settlement approvals must be obtained.

Notwithstanding the added burdens placed on mediating parties by public sector ''square corners,'' mediated settlements are attractive to well-managed public owners, who usually recognise the value of mediated settlements and the obvious long-term cost-saving incentives achieved by:

(1) maintaining a reputation for fairness through proactively working toward claims settlements;
(2) working internally to address promptly and present ''square corners'' issues;
(3) preparing professional well-analysed presentations of positions for use in negotiations and mediations, and by fairly analysing all elements of contractor claims;
(4) avoiding unreasonable interpretations of contract obligations; and
(5) maintaining continuing good working relationships with reputable contractors.

Mediated settlements also offer attractive long term cost-saving incentives to contractors by:

(1) allowing them to maintain relationships with unpaid subcontractors and suppliers, and with their sureties;
(2) freeing staff to get on about the business of making money on other projects;
(3) avoiding litigation costs; and
(4) maintaining long-term relationships with public owners.

To achieve cost-effective and fair settlements, contractors cannot ignore the issues added by the public sector's ''square corners''. ''Square corners'' exist to protect the public purse and the integrity of the public contracting system, and should not be ignored by contractors. Contractors necessarily are obliged to work *patiently, respectfully and professionally* with public owners to achieve ''merit-based'' settlements by respecting public sector ''square corners'', by providing public owners with detailed information and claim justification, and by resolving or narrowing disputed issues of fact and law. All parties are well advised to take a long-term *practical* view of relationships and reputations beyond the ''heat of the moment''.

Success in achieving mediated settlements, even with good evaluative mediators, requires the parties to exercise mutual ''good faith'' and ''fairness'', to make careful assessment of the risks of not settling, to work patiently with the mediation process, to be reasonable in considering the outcome of myriad complex issues of fact and law, to be objective in viewing both sides of a dispute, and to take a long term practical view of relationships and reputations. The next job may be even more important than the last for both parties. Fairness remains a critical ingredient. But

while fairness principles may cause public owners not to attempt to enforce unrealistic and unfair concepts of contract ''strict compliance'', contractors must remain aware that they will he held fairly to their contract bargains and to their general obligations to turn the public sector's ''square corners''. Neither contracting party may expect ''a free lunch''.