MANAGING CONTRACT CHANGES

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A. The Purpose of "Changes" Clause

In a regular contract, neither party can change any terms unilaterally. However, such a rule is impossible in the construction context, where unforeseen conditions, inspector requirements, and changes in products or technology may require a change to the contract. This need for flexibility on the part of owners, together with the need for assurance as to compensation for the contractor, has resulted in "change" clauses in construction contracts. These changes are deemed to be within the scope of the original agreement. In the A201, the authority for these changes is stated in 7.1.1, which reads:

> Changes in the Work may be accomplished after execution of the Contract, and without invalidating the Contract, by Change Order, Construction Change Directive or order for a minor change in the Work, subject to the limitations stated in this Article 7 and elsewhere in the Contract Documents.

A Change Order ("CO") is a written order to the Contractor, signed by the owner and the architect (or the architect alone if given such authority), issued after the execution of the contract, authorizing a change in the work or an adjustment in the contract sum or contract time. (7.2.1).

A Construction Change Directive ("CCD") is a written order prepared by the architect and signed by the owner and architect, directing a change in the Work prior to agreement on adjustment, if any, in the contract sum and/or contract time. The owner may issue such a CCD so long as the work is generally within the scope of the Contract.

(7.3.1). The CCD is used in the absence of the total agreement on the terms of a Change Order. (7.3.2).

B. Constructive Changes

A changed condition is one which is unknown, not discoverable on reasonable inspection, which significantly changes the scope of the necessary work. Usually, the contractor is required to notify the owner immediately, and then the designer or owners' representative will determine whether or not the change is significant enough to adjust price and time.

If a contractor experiences significant "changed conditions," the court will treat the contract as one undertaken in which there is a mutual mistake as to vital facts, and allow compensation regardless of the contract terms. *S.J. Groves & Sons and Co. v. State of North Carolina*, 50 N.C. App. 1, 273 S.E.2d 465 (1980). For example, excessive wetness, which required a large overrun in the undercut excavation, was deemed a changed condition for which compensation was justified. *Lowder, Inc v. Highway Comm'n*, 26 N.C. App. 622, 217 S.E.2d 682, *cert. denied* 288 N.C. 393, 218 S.E.2d 467 (1975). The purpose of changed condition clauses is to encourage low, competent bids. Without this type of clause, cost contingencies would be added to the bid prices, artificially inflating the bids.

In fact, A201 has a specific contract provision dealing which such constructive changed conditions, at 4.3.4. The AIA document breaks down these claims into two types:

Type I claims: actual conditions differ materially from that shown on the contract documents

Type II claims: actual conditions differ materially from those ordinarily found to exist or expected in work of that nature

Both Type I and Type II claims can be the basis for a Change Order or Construction Change Directive. However, where the parties to a contract expressly remove a "changed conditions" clause from their contract, the courts have refused to allow the contractor extra costs incurred because of unexpected amounts of excavation which were required. *Thompson-Arthur Paving Co. v. N.C. Dept of Transportation*, 97 N.C. App. 92, 387 S.E.2d 72 (1990).

Practice Tip: If you encounter a changed condition, it should be documented immediately. Any oral directions to proceed with work after encountering such a changed condition should immediately be confirmed in writing to establish a written record of the authorization in case of later disputes. The writing should include a statement that you will expect a change to the contract price to reflect the changed condition work which was authorized.

C. Cardinal Changes

"Cardinal change" refers to a change which is so material that the essential nature of the contract is altered. Traditionally, the "cardinal change doctrine" has been limited to contracts with the government in Federal Court.

Under the cardinal change doctrine, if a change effectively requires the contractor to perform duties materially different from those originally bargained for, it is deemed a cardinal change which essentially nullifies the contract and denies the governmental agency the privilege of using the contract's dispute resolution provisions. *Hancock Electronics Corp. v. Washington Metropolitan Area Transit Authority*, 81 F.3d 451 (4th Cir. 1996); *Executive Business Media, Inc. v. U.S. Department of Defense*, 3 F.3d 759 (4th Cir. 1993).

Some states have adopted this doctrine, or the related doctrine of "abandonment of the contract." To date, however, no North Carolina court has recognized a "cardinal

change," and therefore any material change to the contract would likely be addressed under the "changed conditions" clause of the contract as a "mutual mistake."

D. Authority to Issue Change Order

The owner is usually the only one authorized to issue change orders. The owner can, however, give that authority to the architect as his agent. Moreover, if the architect is held out as having implied authority to issue change orders, that too may be binding on the owner. *See Olympic Products Col v. Roof Systems, Inc.*, 88 N.C. App. 315, 363 S.E.2d 367 (1988); *Son-Shine Grading, Inc. v. ADC Construction Co.*, 68 N.C. App. 417, 315 S.E.2d 346, *disc. rev. denied,* 312 N.C. 85, 321 S.E.2d 900 (1984).

The Architect does have the express authority in the A201 to authorize minor changes in the Work which do not increase the cost or extend the time. (4.2.8; 7.4.1).

Practice Tip: Even if the architect states that he has the authority to issue a change order, do not rely on such representation unless he commits that fact to paper. Better yet, have the owner acknowledge in writing the authority of the architect to issue change orders.

E. Waiver of Formal Requirements

North Carolina case law clearly allows a written contract to be modified or waived by the parties through an agreement or conduct which naturally and justifiably leads the other to believe the contract provision has been waived or modified. *Mulberry-Fairplains Water Assoc, Inc. v. Town of North Wilkesboro*, 105 N.C. App. 258, 412 S.E.2d 910 (1992).; *Shields, Inc. v. Metric Constructors, Inc.*, 106 N.C. App. 365, 416 S.E.2d 597 (1992). Such waivers can occur even if the contract requires that any

modifications be made in writing. *P.U.D., Inc. v. Days Inn of America*, 1999 WL 1939995 (E.D.N.C. 1999).

For example, one court found that the owner waived any expectation of adherence to the contract schedule specified in the contract by his actions. The owner had refused to allow the contractor to waste unsuitable material when requested, and yet the owner knew that the wet, unstable soil could not be used on the project. Therefore, the court found the contract schedule waived by the owner's conduct. *S.J. Groves & Sons and Co. v. State of N.C.*, 50 N.C. App. 1, 273 S.E.2d 465 (1980).

In another case, the court held that a contractor could recover extra duration-related costs for staffing the project six months after the scheduled completion date due to a gross underestimate of the amount of rock to be excavated and removed. *Davidson and Jones, Inc. v. N.C. Dept. of Admin.*, 315 N.C. 144, 337 S.E.2d 463 (1985). The court found that the excessive rock was not within the contemplation of the parties, and thus was a mutual mistake. *Id.*

F. Oral Change Orders

Avoid oral change orders if at all possible. Memories fade. People leave. Once any litigation occurs, you can guarantee that many of those oral conversations will be in hot dispute.

To the extent that an oral change is given, attempt to have it reduced to writing. At the minimum, write a letter to the architect and owner to confirm the oral change order and agreed upon price, even if you have to send the letter at the end of the day to confirm the conversation and work that took place that day. Meeting minutes are good, but an actual stand-alone letter is better.

Legally, oral change orders can be enforced under the legal theory that the owner waived the written change order requirement of the contract, or under theories of equity

such as *quantum meruit*. However, an equitable remedy is the fair market value for the services you performed, not the agreed-upon price for those services.

A North Carolina court enforced an oral change order in *Shield, Inc. v. Metric Constructors, Inc.*. A contractor was ordered to utilize stronger 18 gauge material in lieu of the 20 gauge material originally specified in the contract. The court held that the contractor was entitled to proceed on a claim for the oral change order despite the requirement of written change orders specified in the contract. "The provisions of a written contract may be modified or waived by a subsequent parol agreement, or by conduct which naturally and justly leads the other party to believe the provisions of the contract are modified or waived . . . ". 106 N.C. App. 365, 370, 416 S.E.2d 597 (1992) (citations omitted). *See also Centex-Rodgers Construction Co. v. Wake County*, 993 F.2d 228, 1993 WL 147487 (4th Cir. 1993 (N.C.)) (unpublished disposition). In *Centex-Rodgers*, the court held that the owner was obligated to pay under both waiver and *quantum meruit* theories where (1) the owner had ample notice of the "changed conditions" and the "extra work;" (2) the architect had ordered the work to be performed; and (3) the contractor notified the owner of the price estimates prior to performing the extra work.

In some cases, though, the courts have refused to allow a claim based on an oral change order, strictly adhering to the language of the express contract where no "waiver" was found. *See Brokers, Inc. v. High Point City Board of Education*, 33 N.C. App. 24, 234 S.E.2d 56 (1977). Therefore, you should not rely on an oral change order but insist upon a writing for all changes to contract time or amount.

G. Notice

Written notice is usually required for claims for additional compensation resulting from changed or unforeseen conditions. In A201, the General Conditions of the Contract, a 21 day written notice is required. Failure to comply with the notice provision under the contract will bar a delay claim. See *D.W.H. Painting Co., Inc. v. D.W. Ward*

Construction Co., Inc., __ N.C. App. __, 620 S.E.2d 887 (2005); *American National Electric Corp. v. Poythress Commercial Contractors, Inc.*, 167 N.C. App. 97, 604 S.E.2d 315 (2004).

In one case, the court held that the contractor's demand for increased costs due to delay in construction was not untimely, since the delay did not occur on a specific date, and that therefore, the written notice within 20 days of occurrence provision was not a necessary condition to the making of a claim. *Triangle Air Conditioning, Inc. v. Caswell Co. Board of Education*, 57 N.C. App. 482, 291 S.E.2d 808 (1982).

H. Determining Cost of Changes

In general, the cost of a change is determined through a series of proposals and acceptances depending on who initiates the change request.

If the contractor is the source of the change, he will prepare the proposed Change Order for approval by the owner with a stated cost for the changed work. If the owner does not approve the change, then the proposed changed work is rejected.

If the owner is the source of the change, the owner will generally direct the architect to prepare the proposed Change Order for the contractor's approval. If the contractor does not agree with the projected cost for the change, or if the cost has not yet been determined, the architect and owner can issue a Construction Change Directive, which allows the work to proceed subject to a later determination on the proper cost.

The cost of a Construction Change Directive is determined by A201 para 7.3.3, which includes three methods:

- mutual acceptance of a lump sum properly itemized and supported by sufficient substantiating data to permit evaluation;
- unit prices stated in the Contract Documents or subsequently agreed upon; or
- cost to be determined in a manner agreed upon by the parties and a mutually acceptable fixed or percentage fee.

If the contractor fails to promptly respond to or expresses disagreement with the method of calculating an adjustment, the adjustment is made by the architect on the basis of reasonable expenditures and savings attributed to the change, including a reasonable allowance for overhead and profit. (7.3.6).

I. Creating an Effective Change Order

If the owner initiates the change, the design professional usually prepares the documentation. If the contractor initiates the change, to which the owner consents, the contractor typically prepares the documentation, which is then reviewed by the design professional.

To be effective, a change order should include:

- description of the additional or changed work to be performed;
- number of days the work is extended for this additional/changed work;
- amount of money contractor is to be compensated for the additional/changed work;
- signature and date of owner, architect, and contractor; and
- back-up proposals, invoices, logs, etc. to support the change order requested.

No other information is necessary to execute an enforceable change order. If the price is not yet determined but the parties have agreed to a unit price, for example, the agreement for the unit price should be included in the change order. A follow-up modified change order can then include the actual number of units, and compensation, involved in the changed work.

Summary Tip: Changes occur on every construction project. It is imperative that you follow the precise terms of your contract for making a claim for changed conditions, changed work, or changed duration.