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Will the Surety Industry Slow the Enactment of a Green Building Code?

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The landscape of green building initiatives is undergoing a quiet but steady revolution. Until recently, both the incorporation of green building techniques and the pursuit of Leadership in Energy and Environmental Design (LEED) certification have been largely voluntary. Gradually, some municipalities and states, such as Florida, Indiana, Maryland, New Jersey, Oklahoma, and South Dakota, have begun requiring that all public construction projects over a certain dollar amount obtain LEED certification.

Mandatory green building standards are now being introduced into private sector

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Emerging Green Risks

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The Future is Green

Although new design and construction in the United States may have dramatically slowed during the recent recession, the rate of *change* within the industry has not slowed at all. The last few years have seen the adoption of new building and energy codes as well as widespread incorporation of voluntary standards that are intended to produce less wasteful and more environmentally-sensitive remodels and new construction. The new standards, voluntary or mandatory, are not going anywhere. Here's why:

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20 Ways Your Subcontractor Might Be an Employee

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Quite often, companies in the construction industry hire "subcontractors" and classify them as independent contractors. However, these companies should take caution in proceeding with such classification. In February, the IRS began its first comprehensive audit of employment tax issues in over 25 years. The main issues to be examined in these audits are worker classification, executive compensation and taxable fringe benefits. (For a broad discussion of all of these issues, please see our Firm's November 2009 Tax alert *IRS Will Audit 6,000 Companies – Make Sure Your Employment Taxes Are in Order*.) Because worker classification is an issue that arises often for construction companies, this article focuses solely on worker classification and the factors involved in making an accurate determination.

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Will the Surety Industry Slow the Enactment of a Green Building Code?, *continued*

projects as well. California was the first state to adopt a building code, commonly referred to as CALGreen, mandating compliance with certain green building specifications. Since the passage of CALGreen, other states, such as Pennsylvania and New Jersey, are considering adopting green building codes. The International Code Council (ICC), an association that creates uniform building codes that have been adopted by all 50 states and the District of Columbia, is drafting an International Green Construction Code (IGCC) based in large part upon CALGreen. It is too soon to tell whether, and to what extent, any IGCC will be adopted by local and state governments. Nevertheless, the initiative appears to have support all over the United States, including in the Southeast. The ICC lists the cities of Franklin, Tennessee; Jackson, Mississippi; Decatur, Georgia; Arlington, Virginia; and Destin, Florida among the municipalities that have pledged their support for the development of the IGCC.

The green building revolution has stumbled, however, over the issue of performance bonds. In 2006, the District of Columbia passed landmark legislation requiring that all public and private building projects larger than 50,000 square feet meet certain green building criteria. The legislation was heavily criticized for its requirement of a "green performance bond," which was a new kind of bond that had not previously been offered by the surety market. The new performance bond enforces green building criteria by requiring any project that fails to meet green standards to pay up to 4 percent of the building's costs into a city green building fund. Whereas a typical performance bond guarantees the achievement of a quantifiable objective, the green performance bond relies instead upon a prescriptive rating system that depends upon the assessment of a third party. It hasn't helped that the same government agency maintaining the green building fund is also in charge of assessing whether a particular building has met the green building criteria.

The surety industry has been wary of green performance bonds not only because of the perceived conflict of interest, but also because of vague standards and the reliance on a third-party assessment. As surety companies continued to lobby against the D.C. legislation, some believed the battle over the green performance bond requirement threatened the future of green building codes altogether. In response to this controversy, in December 2009 the District of Columbia Council introduced a revision of the Green Building Act in which all references to "performance bond" were struck and replaced with the word "bond." Despite this recent revision, the problem still remains that bond instruments that guarantee green building certification do not exist in the current market, and surety companies are resistant to issuing such bonds.

With the development of the IGCC and the push for mandatory green building codes in many jurisdictions, it remains to be seen how the surety industry will react to the increased demand to insure the performance of green specifications. It also remains to be seen how public projects will get built if the law's requirement that contractors provide performance bonds cannot be met because green bonds are not available. If the surety industry fails to meet this demand, the future of green building will become a classic example of an unstoppable force coming up against an immovable object. The ultimate resolution is anyone's guess, but odds are that green building codes will be written to make them objective and sureties will write performance bonds to guarantee compliance with them.

If you want to have some input into the development of the IGCC, it is not too late. Comments and suggestions will be received from November 3, 2010 until January 3, 2011. For more information, please visit the ICC public comment site at http://www.iccsafe.org/cs/IGCC/Pages/PublicVersionDevelopment.aspx.

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Emerging Green Risks, *continued*

• Public entities, which represent the majority of construction dollars being expended today, are demanding improved environmental practices. These civic projects are defining current construction practices which will, over time, alter the standard practices in the industry.

• Even when the standards are optional, a strong argument can be made for the direct economic benefits of sustainable design and construction including decreased operating costs, increased building values, increased occupancies, and higher rents ("Global Survey on Corporate Real Estate and Sustainability," CoreNet, 2009). Furthermore, for approximately the same cost as traditional design ("Cost of Green Revisited," Davis Langdon, 2007), a green building will consume 26 percent less energy than a traditional building ("Assessing Green Building Performance," GSA Public Buildings Service, 2008). As a result, private developers are clamoring for professionals with the experience to deliver green projects.

• In many cases, design professionals are now obligated to present sustainable options to their clients whether or not they are required by code (see Canon IV of the 2007 AIA Code of Ethics & Professional Conduct), proving that professional ethics also drive change.

Over the last few years the legal and contractual requirements to comply with previously voluntary standards have become the rule rather than the exception in both private and public construction projects. But who is responsible for nailing down this moving target of laws and standards? What happens when the green standards are not met? What are the risks and can they be avoided? If they can't be avoided, who is responsible? To answer these questions, a brief review of the standards is necessary.

The Standards

Although the standards do vary widely, they seem to follow the same basic tenets: encouraging consideration of the siting of the building, the energy required to operate the building, the materials that are used in its construction, the management and consumption of water, and the quality of air inside and outside. Numerous competing and complementary standards have been developed to evaluate these criteria, and they continue to be revised and updated at a fairly rapid pace.

GBI's Green Globes, Build It Green's GreenPoint rating, ILBI's Living Building Challenge, NAHB's Green Building, EPA's Energy Star, BRE's Environmental Assessment Method, and the USGBC's Leadership in Energy and Environmental Design (LEED) certification are just a few of the currently published standards. LEED is the most recognizable of these standards and the one most commonly cited when green building is being discussed. LEED is also a good example of the shifting nature of the standards, as it, too, has undergone significant revisions within the last year. To further complicate matters, referenced standards from independent organizations such as ASHRAE, ASTM, and ANSI, which also undergo regular revision, are often incorporated into the basic requirements for these standards. This is certainly the case with LEED.

Green building standards are increasingly becoming mandatory on local, state and federal levels and may apply to new buildings as well as significant remodels. According to one count, 45 states, 132 cities, 35 counties, 28 towns, 35 state governments and 13 federal agencies are currently requiring some form of green building standard for qualifying construction projects (Crowell & Moring, 2010). In some cases the detailed standards have been incorporated into code documents, but in other cases, requirements such as the need to meet a particular LEED certification level are the only stated standard. This is the current state of green building standards – a hodgepodge of local, state and national referenced requirements and voluntary standards that are based on a combination of tightly defined performance criteria sprinkled with a little bit of subjectivity. Sound risky? It is.

The Risks

All design and construction projects have inherent risks that will be borne by the various participants – errors and omissions in the construction documents, untimely design changes, and delays during construction, just to name a few. In a green design

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Emerging Green Risks, *continued*

project these risks are still present, but are also accompanied by numerous new concerns. The risks vary by project and are highly dependent on the requirements set forth by local jurisdiction and on any voluntary requirements that may be made mandatory by the project's contract provisions. For the purposes of illustration, the table at right looks at the LEED certification standard. Ten risk factors associated with LEED projects are listed in the table, as are the parties who would likely bear that risk if a dispute arises.

LEED Risks	Owner	Architect	Contractor	LEED AP
1) Lower Return on Investment	x			
2) Non-LEED Design	x	x		x
3) Non-LEED Construction	x	x	x	x
4) Missed Deadlines	x			x
5) Rescinded Certification	x	x	x	
6) Untested Materials & Results	x	x		
7) Higher Operating Expenses	x			
8) Material Delays	x	x	x	
9) Building Official Enforcement	x	x	x	
10) Post-certification Operations and Transfers	x			

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While there have not yet been many publicly disclosed disputes specifically related to green building issues, disputes that include some green building element are definitely on the rise. A sampling of them can be found below. They are numbered according to the corresponding items in the table above.

2/3. The design or construction may not meet the desired level of certification. Since green design may be tied to financial incentives, specific contract requirements or code and statutory requirements, the failure to meet specific criteria may result in substantial financial damages. In one of the most publicly discussed cases, *Shaw Development v. Southern Builders*, it was initially thought that the "Captain's Galley" condominium construction failed to meet the "Silver certification level" set forth in the construction contract (Circuit Court, Somerset County, Maryland, Case No. 19-C-07-011405). The dispute was over a state tax credit that was lost because the project was delayed and ultimately the case settled so no final court opinion was rendered. Either way, the relationship between the sustainable nature of the design, a prerequisite for the available tax credits, and the lawsuit is clear.

5. Certification can be challenged and possibly rescinded. In addition to the risk of initially failing to meet a particular certification level, there is also a risk of subsequently losing it. Made explicit in LEED Version 3, it is possible for anyone to challenge the certification that a building is granted by the USGBC. One of these challenges has already been widely publicized. A Wisconsin high school, Northland Pines, was granted a LEED Gold rating in 2006 but was later found to not be in compliance with the requirements at the time of the challenge. While it appears that in this case the original Gold certification will be preserved now that the problems have been corrected, it was not without cost: $40,000 was expended by the school district and $60,000 was expended by the USGBC (6/22/10 VC News-Review, Eagle River, WI). It is conceivable that a similar challenge could result in a building being stripped of its title and its associated cache and value.

6. Untested Green materials, assemblies and systems may fail. New performance requirements for mechanical equipment and new sourcing requirements for materials may lead into uncharted waters. While some products are existing products being re-launched as green, others have not yet been tested for durability or performance on actual buildings and may lead to unexpected and potentially negative outcomes. In a case recently filed in New York, *Steven Gidumal et al. v. Site 16/17 Dev. LLC*, et al., the developer of a LEED Gold-hopeful condominium building in Battery Park City is being sued for a variety of alleged construction defects including the inadequacy of the "green" heating system and excessive air infiltration at the curtain wall ("Condo Owners Go for Green with Suit," 5/29/2010, *Wall Street Journal*). While the case is primarily focused around the misrepresentations of the seller, the alleged defects are closely tied to the overall performance of the building and of its green systems.

Mitigating the Risks

The owner and its architect/engineering professionals typi-

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Emerging Green Risks, *continued*

cally carry the most risk in a green project. Nevertheless, it is in the interest of all participating parties to clearly allocate the risks before any work is performed. Having proper and coordinated contracts is a critical first step.

In a green project, contracts should allocate all special compliance requirements that are associated with the work including any specifics in the design, construction, commissioning or documentation of the project. Many issues are not clear cut and, since LEED certification is achieved by simultaneously complying with numerous requirements, the overall failure to comply may be attributable to a combination of contractor, owner, architect, engineer and consultant errors.

It is also very important to ensure that contracts for green construction projects do not provide any guarantees, particularly guarantees to meet subjective compliance levels (e.g., guarantees of LEED Gold certification). While it is the implicit and in some cases explicit requirement for the designer and the builder to comply with building codes and regionally applicable statues, offering guarantees or promises that the completed design or completed building will be certified at a particular level by an independent organization such as the USGBC creates exposure that will not be covered by a standard insurance policy. This would be the equivalent of an architect guaranteeing an owner planning commission approval for its project – impossible and imprudent. Model contract forms and language are available from a variety of industry groups including the Associated General Contractors of America (Consensus Docs 310 Green Building Addendum) and the American Institute of Architects (Owner Architect agreement B214-2007).

In addition to adopting appropriate contracts, further consideration must also be given to the makeup and leadership of the project team. If at all possible, team members should have experience with green design and construction and understand the new procedures and processes that are required.

Throughout the project it is important to regularly revisit any previously stated or defined sustainable design goals and to check that they are being satisfied. This is true during design and during construction. For many professionals, this type of quality control review is already standard practice to ensure compliance with construction documents, with code and with owner requirements. If it is not, it should be included as a contract requirement.

Finally, tight definition of roles and responsibilities as they relate to the project's green requirements must be established at the beginning of the project to avoid any confusion as the project proceeds. For example, a single agent should be assigned to stay current on the federal, state and local environmental laws that impact the project and to keep the other participants informed of them throughout design and construction. For LEED V3 projects, environmental compliance must be maintained continuously from the date of registration until the building receives a certificate of occupancy, or it runs the risk losing its certification. How can compliance be maintained if the rules aren't known? It can't. Sharing this type of knowledge throughout the project minimizes risk for all of the project participants.

Dodging Disputes

Sustainable design is not just a passing fad. Measures that help to conserve energy, water and material resources and preserve air quality are creeping into federal, state and local codes and ordinances at an ever increasing rate. The voluntary and mandatory requirements take many forms and are constantly evolving, adding additional complexity to all new design and construction. Although the design professionals and the contractors may share in some of the risk, particularly as new designs and new construction techniques are ironed out, it is ultimately the building owner who owns the majority of the risk. By anticipating the specific risks associated with green building and managing them throughout the project, typical pitfalls can be dodged and many disputes can be avoided altogether. In the future all construction will be green, in one way or another, so there is no time like the present to understand it and to plan for its risks.

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Navigant Consulting, Inc. (NYSE: NCI) is a specialized, international consulting firm combining deep industry expertise and integrated solutions to assist companies and their legal counsel in enhancing stakeholder value, improving operations, and addressing conflict, performance and risk related challenges.

20 Ways Your Subcontractor Might Be an Employee, *continued*

Generally, the IRS favors classifying workers as employees. When workers are classified as independent contractors, the company does not pay employment taxes or withhold income taxes. Instead, the workers pay the full amount of employment taxes and pay income taxes, usually through estimated payments. Moreover, as independent contractors, workers are not entitled to unemployment, retirement and health benefits offered through the hiring company or many of the protections afforded to employees through the various federal acts which protect employees. As such, misclassification has a profound effect on the ability of the IRS to collect all taxes that should have been paid, and it denies workers the ability to participate in employee benefit plans and receive legal protections to which they may otherwise be entitled.

The IRS will only allow independent contractor classifications when the company hiring the contractors can show it lacks the necessary control over the workers that would indicate an employer-employee relationship. However, before analyzing control, any worker classification analysis should begin with these two threshold questions:

- Does the hiring company pay its regular employees to perform essentially the same duties as the subject worker who is treated as an independent contractor?
- Has that worker previously been paid by the company as an employee to perform essentially the same task?

If the answer to either of these questions is *yes*, the worker in question very probably is an employee for classification purposes.

Beyond these threshold questions, the IRS considers the following 20 factors to determine whether the company hiring the worker actually has control over the worker:

1. Instructions. A worker who is required to comply with another person's instructions regarding when, where, and how to perform the work is ordinarily an employee.

2. Training. Training a worker indicates that the company wants the services performed in a particular method or manner, which also indicates control.

3. Integration. Integration of the worker's services into the company's core business operations generally shows that the worker is subject to direction and control.

4. Services Rendered Personally. If the worker must personally perform services for the company, this will indicate control by the company. Alternatively, if the worker is free to engage others to perform the service for the company (i.e., subcontractors), a lack of control by the company is indicated.

5. Hiring, Supervising and Paying Assistants. Similar to #4 above, if the worker is unable to hire, supervise, and pay assistants to perform services for the company, control by the company is indicated. However, a lack of control is indicated when the worker is able to hire his or her own assistants and pay them from the worker's own funds.

6. Continuing Relationship. A lengthy and continuing relationship between the worker and the company indicates that an employment relationship exists.

7. Set Hours of Work. If the worker works certain hours set by the company, employment status is indicated. If the company does not control the hours of the worker, independent contractor status is indicated.

8. Full Time Required. If the worker must devote substantially full time to the company's business, control is indicated.

9. Work Performed on Employer's Premises. If the work is performed on the company's premises, the company is considered to have control over the worker, especially if the work could be done elsewhere. Control is also indicated when the company has the right to compel the worker to travel a designated route, to canvass a territory within a certain time, or to work at specific places as required.

10. Order or Sequence Set. If a worker must perform services in the order or sequence as determined by the company, the worker is generally subject to an employer's control. However, if the worker chooses his or her own method for completing a job, a lack of control exists.

11. Oral or Written Reports. A requirement that a worker submit regular or written reports is an indicator of control.

12. Payment by Hour, Week, Month. Hourly, weekly or monthly payments generally point to an employment relationship. On the other hand, payments based on a contract or for completing a particular job or task will generally

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20 Ways Your Subcontractor Might Be an Employee, *continued*

indicate an independent contractor relationship.

13. Payment of Business and/or Traveling Expenses. If the company ordinarily pays the worker's business and traveling expenses, the worker is ordinarily an employee.

14. Furnishing of Tools and Materials. If the company furnishes significant tools, materials, and other equipment, an employment relationship is indicated.

15. Significant Investment. If the worker does not invest in his or her own facilities, control is indicated because the worker depends on the company for such facilities.

16. Realization of Profit or Loss. A worker who cannot realize a profit beyond an ordinary salary or suffer a loss is generally considered to be an employee.

17. Working for More Than One Firm at a Time. If the worker cannot perform services for more than one company at a time, the company generally controls the worker. However, a lack of control is indicated when the worker is able to perform services for multiple companies at the same time.

18. Making Service Available to General Public. If a worker is not free to advertise his or her services to the general public on a regular basis, control is indicated. Workers who advertise their services are generally considered independent contractors.

19. Right to Discharge. The right of the company to discharge a worker without breaching a contract indicates an employment relationship as control is exercised through the threat of dismissal.

20. Right to Terminate. If, at any time without incurring liability, the worker has the right to end his or her relationship with the company, an employment relationship is indicated.

See Rev. Rul. 87-41; *see also* IRS Form SS-8. None of these factors are singularly determinative. Instead, all factors should be considered to make an accurate determination.

It is important to note that the various state revenue and labor departments are also concerned with worker misclassification and have been increasing enforcement at varying speeds. The worker classification analysis used by many states will differ substantially from the 20-factor test utilized by the IRS, resulting in different classifications based on the same facts. As such, a state may classify a worker as an independent contractor while the IRS may classify the same worker as an employee.

If your construction company utilizes subcontractors and you have classification questions, either at the federal or state level, after reviewing this 20-factor test, please contact your Baker Donelson attorney for assistance.

Nicholas C. Tomlinson is an attorney in our Atlanta office.

Health Care Reform's Impact on Employers

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While at present there are no mandates on employers – either in or out of the construction industry – to provide health coverage to independent contractors or even to employees, those businesses that do provide health coverage are finding that an entire new regulatory world awaits them.

The new law affects employer-sponsored group health plans with a host of new rules and requirements, some of which became immediately effective and others of which are delayed for a number of years. Some provisions apply to so-called "grandfathered plans," while others apply initially only to non-grandfathered plans.

Because so many of the changes – particularly the most costly ones – don't become effective until 2014 or beyond, this article addresses only those changes effective now through 2012.

Some of the key changes and their impact on employer plans are outlined here.

Grandfathered Status

Many employers are already planning revisions to their medical plans for 2011. Under health reform, if "grandfathered plans" (generally plans with at least one participant on March 23, 2010) make changes in their benefit structure, they may lose grandfathered status.

The advantage of being a grandfathered plan is that the plan does not have to comply with a number of otherwise applicable requirements that become effective in 2011 and 2014, such as:

- coverage of certain preventive care services without cost-sharing;
- certain appeals processes, requirements relating to access to primary care physicians, emergency services, pediatric care, and OB/GYN services;
- nondiscrimination based on health status;

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Health Care Reform's Impact on Employers, *continued*

- no discrimination against providers;
- restricted annual out-of-pocket limits; and
- coverage of clinical trials.

Under the draft regulations, published June 14, 2010, changes that will result in the loss of grandfathered status include:

- elimination of all or substantially all benefits to diagnose or treat a particular condition;
- any increase, measured from March 23, 2010, in a percentage cost-sharing requirement (such as an individual's coinsurance requirement);
- any increase in a fixed-amount cost-sharing requirement other than a copayment (e.g., deductible or out-of-pocket limit), if the total percentage increase exceeds the increase in the overall medical inflation;
- any increase in a fixed-amount copayment, determined as of the effective date of the increase, if the total increase in the copayment exceeds the greater of an amount equal to $5 increased by the overall percentage increase in medical inflation or if the total increase in the copayment is greater than the increase in medical inflation plus 15 percentage points; or

- a decrease in the contribution rate by employers and employee organizations towards the cost of similarly situated individuals by more than five percentage points below the previous contribution rate.

The language relating to grandfathering status and collective bargaining plans is unclear. It appears that self-insured plans maintained pursuant to a collective bargaining agreement will maintain grandfathered status (as long as they meet all other rules under these regulations) even after the agreement expires. The proposed regulations clarify that collectively bargained plans are subject to all other mandates that apply to non-collectively bargained grandfathered plans.

The draft regulations provide guidance around transition rules for plan changes that were planned but not put into effect until after enactment of the reform law. A group health plan or health insurance issuer does not lose its grandfathered status if it:

- adopted changes pursuant to written amendments on or before March 23, 2010, even though they were not effective at that time;
- made changes to the plan after March 23, 2010 that were made pursuant to a legally binding contract entered into on or before March 23, 2010; or
- made changes to the plan after March 23, 2010 that were made pursuant to a filing on or before March 23, 2010 with a state insurance department.

If a group health plan or health insurance issuer makes changes that are adopted prior to publication of the interim final rules, the changes will not cause the plan to cease to be a grandfathered health plan if the changes are revoked or modified effective as of the first day of the first plan year beginning on or after September 23, 2010.

Expansion of Coverage for Young Adults: Age 26 Rule

A plan (whether insured or self-funded) that provides dependent coverage for children must continue to make that coverage available to an adult child (whether or not married) until the child turns 26. The plan is not required to make coverage available for a spouse or child of a child receiving dependent coverage. Regulations require the cost of the Age 26 coverage be no more than for younger dependent children. While not required, the Obama administration has encouraged early adoption of the Age 26 Rule.

This change is effective for plan years beginning on or after September 23, 2010 (January 1, 2011 for calendar year plans).

This mandate applies to grandfathered plans as well as non-grandfathered plans. However, until January 1, 2014, a grandfathered plan can limit this Age 26 Rule coverage to children who are not eligible to enroll in other employer-provided coverage.

The law amends the Internal Revenue Code to extend the individual federal income tax exclusion for medical care benefits under an employer-provided plan so that benefits provided to an employee's child who has not turned 27 as of the end of the year are excludible, even if the child does not otherwise meet the Code's definition of dependent. This provision was effective March 30, 2010.

Elimination of Preexisting Condition Exclusions for Children Under Age 19

A plan (whether insured or self-funded) may not impose any preexisting condition exclusion on enrollees who are under 19 years of age. (The law prohibits imposing preexisting condition exclusions altogether after 2013.) This change is effective for plan years beginning on or after September 23, 2010.

This prohibition applies to grandfathered plans as well as non-

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grandfathered plans.

Elimination of Lifetime and (after 2013) Annual Limits on Essential Benefits

A plan (whether insured or self-funded) may not establish lifetime limits on the dollar value of "essential health benefits" for any participant or beneficiary. Also, a plan's annual limits on the dollar value of essential health benefits will be restricted (in accordance with regulations yet to be issued). (The law prohibits these annual limits altogether after 2013.)

"Essential health benefits" is broadly defined to include ambulatory patient services, emergency services, hospitalization, maternity and newborn care, mental health and substance use disorder services, including behavioral health treatment, prescription drugs, rehabilitative services and devices, laboratory services, preventive and wellness services and chronic disease management, and pediatric services, including oral and vision care. Regulations will further define essential health benefits.

The elimination of Lifetime Limits is effective for plan years beginning on or after September 23, 2010. The elimination of Annual Limits is effective for plan years beginning on or after January 1, 2014.

This prohibition applies to grandfathered plans as well as non-grandfathered plans.

Elimination of Over-the-Counter Drug Reimbursement

Over-the-counter medications (except for insulin) are no longer eligible for reimbursement under health savings accounts, Archer MSAs, or health flexible spending accounts.

This provision is effective for tax years beginning on or after January 1, 2011. This means that flexible spending account plans with grace periods that extend into 2011 will not be allowed to reimburse over-the-counter medications in 2011. Any over-the-counter medicine purchased on or after January 1, 2011 and submitted for reimbursement during the two-and-a-half-month grace period will require a prescription.

There is no grandfathering associated with this provision.

Limit on Health FSA Deferral Contribution

Annual salary reduction contributions to health flexible spending accounts are limited to $2,500 (an amount that may be adjusted for inflation after 2012). The change is effective January 1, 2013. There is no grandfathering associated with this provision.

Anti-Discrimination Rules Applicable to Fully-Insured Health Plans

An insured group health plan must comply with certain requirements in the Internal Revenue Code that prohibit discrimination in favor of certain highly compensated employees. (Under prior law, only self-insured plans were subject to this nondiscrimination requirement.) This change is effective for plan years beginning on or after September 23, 2010.

This prohibition does not apply to a grandfathered plan. Therefore, companies that currently maintain insured benefits that would otherwise be discriminatory should take steps to preserve the plan's grandfathered status.

Penalties

Failure to comply with any of the Health Care Reform mandates could subject an employer to an excise tax of $100 per day per person to whom the failure relates. ERISA's civil enforcement rules also may apply to violations of this provision.

Small Employer Tax Credit

For tax years 2010 through 2013 small employers (those employing fewer than 25 employees with average annual wages of less than $50,000) who purchase health insurance for their employees may receive a sliding scale tax credit. Small employers with 10 or fewer workers with an average wage of $25,000 or less may receive the full value of the credit. To qualify for a tax credit, an employer must contribute at least 50 percent of the total premium cost of a benchmark premium.

Eligible small employers are those with fewer than 25 full-time equivalent (FTE) employees. The credit phases out for employers starting with 10 FTEs and fully phasing out at 25 FTEs. Generally business owners/partners and their relatives are not to be counted as FTEs and nor are seasonal employees counted. However, employees of affiliated entities must be counted using the affiliation rules of IRC §414(b), (c) (m) or (o).

The guidelines for calculating the tax credit are complicated and employers are urged to consult with their advisers for a detailed determination of their eligibility for this credit.

Andrea Bailey is an attorney in our Birmingham office.

THEY'RE BAAAACK: PLAs Return to Haunt Non-Union Contractors

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On April 13, 2010, the Federal Acquisition Regulation (FAR) Council released a final rule implementing President Obama's Executive Order 13502, which encourages federal agencies to use Project Labor Agreements (PLAs) on federal construction projects valued at $25 million or more. EO 13502, which was actually issued on February 6, 2009, repealed President Bush's Executive Orders 13202 and 13208, which in turn declared that neither the federal government, nor any agency acting with federal assistance, shall require or prohibit construction contractors to sign union agreements as a condition of performing work on government construction projects. It is estimated that, in the eight years it was in existence, President Bush's EO 13202 caused at least $147.1 billion worth of federal construction projects to be competitively bid without discrimination against non-union contractors.

So what's the big deal about PLAs anyway? A PLA is a multi-employer, multi-union, pre-hire agreement designed to systemize labor relations between multiple construction trade unions and contractors on a specific construction site. PLAs typically require that the contractor hire all workers through union halls, that nonunion workers pay dues for the length of the project and that the contractor follow union rules on pensions, work conditions and dispute resolution. Opponents of PLAs argue that they are nothing more than payback to organized labor, citing the fact that the construction industry has changed from being dominated by union monopolies to being 85 percent non-union with full and open competition. In addition, the Associated Builders and Contractors Association complains that the final rule fails to acknowledge any of the discriminatory effects of government-mandated PLAs on non-union contractors and their employees, noting in particular that the rulemaking record is filled with proof that PLAs discriminate against such firms, most of whom are small businesses, by greatly increasing their costs and forcing them to pay for union pensions that will never benefit non-union employees.

What does the final rule address?

- As noted, it applies to federal construction projects costing $25 million or more and does not specifically address smaller-scale federal projects.
- The rule does not mandate the use of PLAs. Rather, it allows federal agencies flexibility in developing individual agency PLA policies that that can be applied to federal projects on a case-by-case basis.
- It allows federal agencies several options for when they can require contractors to submit a PLA during the acquisition process: (1) when the offers are due; (2) prior to an award (by apparent successful offeror); or (3) after an award.
- It allows agencies to specify the minimum terms and conditions of a PLA in the project bid solicitation. As a condition of receiving a contract award, federal agencies can require the successful offeror to become a party to a PLA containing a minimum of agency-drafted terms and conditions.
- It prohibits agencies from retroactively mandating PLAs on federal projects already underway.
- It gives agencies discretion in addressing the impact of a PLA on small businesses.

Shortly after President Obama issued EO 13502, an effort got underway in the U.S. House and Senate to pass legislation designed to override the executive order. Bills S.90 and H.R.983, the Government Neutrality in Contracting Act, would direct the head of any federal agency that awards or obligates funds for any construction contract, or that awards grants, provides financial assistance, or enters into cooperative agreements for construction projects, to ensure that bid specifications, project agreements or other controlling documents do not (1) require or prohibit a bidder, offeror, contractor, or subcontractor from entering into, or adhering to, agreements with a labor organization, with respect to that construction project or another related construction project; or (2) otherwise discriminate against such a party because it did or did not become a signatory or otherwise adhere to such an agreement. Construction contractors opposed to PLAs are encouraged to contact their representatives, or their Baker Donelson attorney, in Washington to seek co-sponsors for these bills.

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Government Contracting Doesn't Have to be Rocket Science

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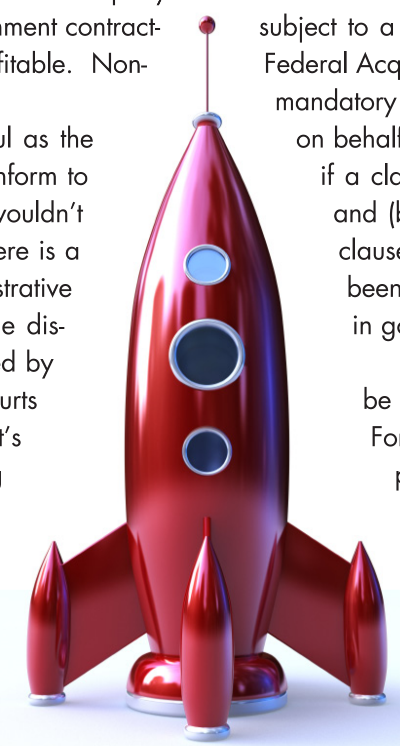
In the first three quarters of fiscal year 2009, the United States government awarded more than $146 billion in contracts to more than 91,000 contractors.[1] A review of the top 100 awardees reveals that five defense contractors claimed more than 27 percent of contract dollars awarded. This correlates to a substantial sum going to very few contractors, but how's this for perspective: the construction company claiming the 99th spot on the list of the top 100 contractors won only 14 percent of contract dollars awarded, and that correlated to contracts worth more than $206 million combined. Not a bad first three quarters for a company that came in 99th. The lesson here is that government contracting does not have to be rocket science to be profitable. Non-defense contractors can also do very, very well.



When you contract with a client as powerful as the United States of America, you're expected to conform to a number of processes and regulations that you wouldn't otherwise have to deal with.[2] What's more, if there is a project dispute, you will have to seek an administrative remedy from the agency on the other side of the dispute, and if your issue is not satisfactorily resolved by the agency you may have to seek relief from courts and boards that you are not familiar with. But that's not the worst of it. If you do something wrong like submit a bill for an amount not due (whether accidentally or not), you can be hit with treble damages and you might go to jail.[3]

For an example of how not to deal with the federal government, see the case of *Daewoo Engineering and Const. Co., Ltd. v. U.S.*, 73 Fed.Cl. 547 (2006), *aff'd* 557 F.3d 1332. There, a contractor who may have had a legitimate claim in the amount of $13.4 million decided to claim $64 million as a negotiating ploy instead, thereby submitting a false claim in the amount of $50.6 million. The penalty for doing so was (1) a fine in the amount of the false claim, and (2) forfeiture of the potentially legitimate claim. What the company viewed as a (perhaps routine) tactic of beginning negotiations with a high number was actually a $64 million lapse in judgment.

So, forget about this federal contracting business, right? Wrong. Here's the deal: The federal government is spending huge amounts of money to have work done by companies like yours. So it behooves you to compete for and win some of these lucrative projects. Federal contracting doesn't have to be rocket science (either literally or figuratively speaking), but care must be taken to handle business details precisely [4] and to understand the differences between federal and commercial contracting.

Take, for example, the *Christian* Doctrine.[5] In a commercial setting, parties are generally free to agree that unwanted contractual clauses will be omitted. Likewise, parties to a commercial contract are free to include any mutually agreeable contractual clause. With limited exceptions, courts will simply look to the language of the contract (as agreed to) and the intent of the parties to decide whether the included or omitted clause will be enforced. This is not necessarily true, however, when the project owner is the United States. Contracts with the government are subject to a number of statutes and regulations, including the Federal Acquisition Regulation (FAR). The FAR includes certain mandatory clauses for various types of contracts entered into on behalf of the government. Under the *Christian* Doctrine, if a clause stricken by the parties is (a) required by law and (b) based on fundamental procurement policy, that clause will be read back into the contract as if it had not been stricken. Certain clauses will always be included in government construction contracts.

Conversely, there are other clauses that may not be written into a government construction contract. For example, in a commercial setting, if a contemplated project results in more potential liability than the contractor is comfortable with, the contractor might negotiate an indemnity provision shifting a portion of that potential liability to the project owner. When the project owner is the federal government, however, this isn't allowed. Contracting officers do not have authority to bind the government beyond funds actually allocated for the project. In other words, an agency contracting officer may not usurp the role of Congress by allocating funds not assigned to the project, even though expenditure of those funds is uncertain (as in the case of potential indemnity). A contracting officer who agrees (without Congressional allocation of sufficient funds) to such an indemnity provision may be in violation of statutes collectively known as the Anti-Deficiency Act[6] and may be subject to harsh penalties. A contractor reviewing a federal request for proposal must become comfortable with the level of potential risk, knowing that the contracting officer doesn't have the authority to negotiate indemnity from the government.

While federal contracting is, at times, unlike commercial contracting, the rules generally make sense when viewed in perspective. Rules described above, for example, simply stand for

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Government Contracting Doesn't Have to be Rocket Science, *continued*

the propositions that (1) the FAR generally controls the content of a government contract and (2) federal agencies may not agree to expend funds not allocated by Congress. These simple propositions apply to government contractors whether they build spacecraft or storage sheds. It really doesn't have to be rocket science.

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1. www.fedspending.org
2. This is true of all federal contracts, but even more so where American Reinvestment and Recovery Act (ARRA) funds comprise any portion of the contract. For an understanding of ARRA opportunities and additional obligations for contractors who win these contracts, visit www.recovery.gov.
3. Statutes at issue include: 18 U.S.C. § 286 (conspiracy to defraud); 18 U.S.C. § 287 (False Claims); 18 U.S.C. § 1001 (False Statements); 18 U.S.C. § 1341-1343 (Mail and Wire Fraud); 18 U.S.C. § 1031 (Major Fraud Act); and 31 U.S.C. § 3729-3733 (Civil False Claims Act).
4. Practical Tip: Take your billing practices off of auto pilot. For example, some companies routinely bill the project owner for the cost of project bonds in the initial billing cycle (sometimes during mobilization or during a design phase of the project). Be sure that the department responsible for procuring the bonds has done so before billing the federal project owner for them. The fact that the company has received a quote, made application and received word that bonds are forthcoming may not suffice, and an invoice charging the government owner for a bond promised but not yet procured may be a false claim.
5. Named for a case in the United States Court of Federal Claims called Christian & Associates v. United States, 312 F.2d 418 (Ct. Cl. 1963).
6. 31 U.S.C. §§ 1341-1344, 1511-1517.

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