

May 6, 2020

SHOULD CONTRACTORS BE PERMITTED TO RECOVER PAYROLL & EXPENSES FORGIVEN UNDER SBA PPP LOAN PROGRAM UNDER THE CHANGE ORDER PROCESS?

Is an expense defined as a cost of the work upon it being incurred by the contractor, or incurred and paid by the contractor?

Cost of the Work

It is widely accepted that costs of labor, including payroll taxes and unemployment insurance, union fringes and workers compensation insurance premiums are defined as reimbursable costs of the work incurred by the contractor in its performance of the Work. Typically, the issues in dispute regarding reimbursement of such payroll costs concerns whether events occurred that restricted the contractor's ability to perform as planned or required acceleration and expenditure of overtime or shift work. In these disputes, the contractor has the burden of establishing that the delaying event or impact was not caused by the contractor's actions and could not be reasonably avoided.

As a result of the COVID-19 Pandemic, many construction companies have incurred (or will incur) additional costs to comply with health safety standards regulated by local and federal government, or will experience reduced revenues caused by delays and/or suspensions in the performance of their work. It is anticipated that, upon re-opening of the construction sites, these contractors will be submitting requests for change orders to recover these unforeseen costs, as well as additional costs that may be required to perform work in the immediate future following these health safety guidelines.

However, many of these same contractors have received loans under the Small Business Administration ("SBA") Paycheck Protection Program ("PPP"). In fact, the SBA estimates that 13% of the initial \$350 billion program allotment, or \$44,906,538,010, was provided to construction firms.¹ These loans provide each recipient with funds equivalent to 2.5 times qualifying monthly payroll and if certain requirements are met, may be forgiven in their entirety. Thus, while each contractor may actually use the loan funds for payment of costs of labor and expenses, in the long run, these costs may *actually* not be defined as costs incurred *in the true sense*.

Thus, should the contractor be permitted to recover payroll and expenses forgiven under the SBA PPP loan program as part of the change order or contract claims process? We will examine this question as it pertains to the following contract arrangements:

- ✓ Fixed Price Agreements
- ✓ Guaranteed Maximum Price ("GMP") Agreements
- ✓ Unit Price Agreements

¹ <https://usafacts.org/articles/these-are-states-receiving-most-350-billion-small-business-loans/>

Fixed Price Agreements

Under a fixed price agreement, the owner and contractor have negotiated a lump sum or fixed price to be paid upon performance or completion of the work. To the extent that the contractor requests the issuance of a change order seeking entitlement to additional costs beyond the negotiated contract sum, these additional costs should not include payroll costs and expenses that are forgiven under the SBA PPP. The difficulty will be in determining the value of such loan forgiveness as it relates to a specific project.

If a portion of the contractor's payroll and expenses funded as part of the SBA PPP, are these expenses still a definable cost of the work?

For example, Contractor ABC employs 250 workers across various projects and has received a loan under SBA's PPP which provides funding sufficient to cover its payroll for an eight-week period. On certain projects that were deemed essential, Contractor ABC was permitted to continue its construction work after implementing certain health safety measures. Work on other projects, however, was suspended in part or shutdown entirely in compliance with local and/or State orders. As a result, Contractor ABC was forced to reduce its overall company workforce.

Upon re-commencing work on projects that were shutdown, Contractor ABC incurred re-mobilization costs, in addition to the shutdown and demobilization costs it incurred weeks earlier, and is planning on implementing the following acceleration measures to recover lost time on these projects:

- ✓ Shift Work to Reduce congestion onsite; and
- ✓ Overtime / Weekend Work Schedules to increase the available workhours.

These acceleration measures, however, will increase payroll costs due to shiftwork and overtime premium pay, as well as possibly reduce the efficiency of the workforce through a diminished return on hours worked if the acceleration period is prolonged.² Thus, Contractor ABC prepares a change order request for owner consideration that seeks entitlement to these additional costs on the basis that the acceleration measures were necessitated by the COVID-19 Pandemic and not of any action by the contractor (i.e., beyond the contractor's control).

During the change order review process, the owner learns that Contractor ABC received funds under SBA's PPP and questions whether the contractor has taken this into account. Specifically, the owner questions whether the short-term payroll of Contractor ABC has not already been funded under the SBA PPP and, therefore,

² There are numerous studies published by both owner and contractor organizations that recognize the loss of productivity based on prolonged used of extended workweeks.

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should not qualify as additional costs under its contract change order provisions. Contractor ABC, however, provides the following rationale for the inclusion of these payroll cost in the change order request:

The resolution of change orders and claims attributed to the COVID-19 crisis will have to address the issue of whether the contractor's inclusion of payroll and expenses forgiven under the SBA PPP loan program is akin to receiving payment twice for the same services performed.

1. Payroll costs and related expenses (e.g., taxes, insurance premiums, union fringes) are a defined cost of the work.
2. Source(s) of financing for the payment of payroll should not be a factor in determining entitlement.
3. The decision on whether SBA PPP funds will be forgiven is speculative until the SBA issues a final determination; and
4. SBA PPP funds are being used, if not fully exhausted, on other projects for which Contractor ABC was permitted to both continue and accelerate their work efforts.

As with any dispute, there is often two sides to the story, and only a full and detailed understanding of the specifics of the project and the contractor will allow for a clear resolution. Notwithstanding, it is clear from the above that the answer regarding whether the contractor should be permitted to include payroll and expenses forgiven under the SBA PPP loan program as part of the change order or contract claims process is not a clear yes or no.

Guaranteed Maximum Price (“GMP”) Agreements

In contrast to fixed price agreements, GMP agreements reimburse the contractor for the actual cost of the work necessarily incurred during project performance, subject only to a maximum ceiling. Thus, the issue on whether payroll and expenses forgiven under the SBA PPP should be included concerns not only change orders and claim requests, but also whether these costs should be included in the short-term applications for payment. Specifically, for the eight+/- week period covered by funds distributed under SBA PPP, these payroll costs, although incurred, will have been reimbursed provided the loan is forgiven.

American Institute of Architects (“AIA”) Document A102,³ a standard form used for GMP Agreements, provides no mechanism or guidance for the owner to deny payments of these payroll and expenses for funding the contractor receives under SBA’s PPP. This, however, is not expected to prevent owners from questioning

³ AIA Document A102 – Standard Form of Agreement Between Owner and Contractor where the basis of payment is the Cost of the Work Plus a Fee with a Guaranteed Maximum Price.

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whether such payroll and expenses qualify for reimbursement under the GMP agreement.

Unit Price Agreements

Similar to the issue concerning requests for change orders under fixed price agreements, the funding of payroll and expenses under the SBA PPP will only come into question if the contractor seeks a modification to negotiated unit prices. Whether the basis for such unit price modification is under the quantity variation clause or attributed to COVID-19 events, inclusion of payroll and expenses forgiven under the SBA PPP loan program in calculations for revised unit pricing should raise similar concerns and questions from owners.

In Summary

The issue concerning whether adjustments are required to omit payroll and expenses forgiven under the SBA PPP loan program as part of the change order or contract claims process, or as a reimbursable cost under GMP agreements, will need to be evaluated individually for each contractor and project. Even then, as this issue is unique and not addressed in the standard contract terms and conditions, it is likely that the final resolution as to whether to include these expenses, in part or whole, will require negotiation between the contracting parties.

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