

March 10, 2009

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**I-75 RTMC and I-75 Corridor FMS and ITS Integration Project**

**414733-1-52-01; 416412-1-52-01; and 416413-1-52-01**

**Project DRB Hearing**

The Project Dispute Review Board conducted a hearing on March 2, 2009 to allow the parties to make oral presentations regarding whether the Contractor should be paid a 17.5% markup on Subcontractor's performing Additional Work when the Contractor is receiving payment under Section 4-3.2.1(d)(2), Average Overhead per Day.

**CONTRACTOR'S POSITION**

Miller Electric Company and the CEI negotiated a price for the work covered by Supplemental Agreements 9 through 12 (now Unilaterals 9 – 12) that included a subcontractor markup of 17.5%, as had been the case on prior Supplemental Agreements ("SA's"). It is Miller's understanding that SA's 9 – 12 were subsequently processed by the Department and the funds certified. This was confirmed at least with respect to SA #10 in the History of Events provided by the Department on the recent Fishel Sod Issue (see attached History of Events, item 11 and Exh. 18). As also confirmed by that History of Events, "the Department subsequently proffered interpretation of the subcontractor markup specification under 4-3.2 that the subcontractor markup of 17 ½% was not allowable if the Prime Contractor was being paid compensable days at the Average Overhead Per Day." In short, the Department unilaterally devised a new interpretation of Specification Section 4-3.2 in direct contradiction to the interpretation of the CEI and the interpretation applied in calculating prior executed SA's.

This new interpretation was asserted after the work covered by SA's 9 – 12 was already

underway and/or nearly complete and after the majority of the overall work on the Project had been performed. Specifically, the Department's revised interpretation of the specifications is that 17 ½% markups to subcontractors are not allowed if the prime contractor follows the formula for compensable time under Specification Section 4-3-2.1(d)(2). The Department contends that the Contractor is expected to reimburse the subcontractor its markup from monies received as a result of the markup computed under of 4-3.2.1(d)(2).

In reality, the Department's interpretation is contradicted by the plain language of Specification Section 4-3.2. Section 4-3.2.1(d) provides two methods for calculating how the Contractor's costs, overhead and profit will be calculated on work that the Contractor self performs as well as the Contractor's profit or markup on subcontracted work. Section 4-3.2.1(d) states:

4-3.2.1 (d) Indirect Costs, Expenses, and Profit: Compensation for all indirect costs, expenses, and profit of the **Contractor**, including but not limited to overhead of any kind, whether jobsite, field office, division office, regional office, home office, or otherwise, is expressly limited to the **greater of either (1) or (2) below**:

(1) Solely the payments in (a) through (c), above, and a mark-up of 17.5% thereon.

(i) Bond: The Contractor will receive compensation for any premium for acquiring a bond for such additional or unforeseen work; provided, however, that such payment for additional bond will only be paid upon presentment to the Department of clear and convincing proof that the Contractor has actually provided and paid for separate bond premiums for such additional or unforeseen work in such amount.

(ii) The Contractor will be allowed a markup of 10% on the first \$50,000 and a markup of 5% on any amount over \$50,000 on any subcontract directly related to the additional or unforeseen work. Any such subcontractor mark-up will be allowed only by the prime Contractor and a first tier subcontractor, and the Contractor must elect the markup for any eligible first tier subcontractor to do so.

(2) Solely the payments in (a) through (c), above, plus the formula set forth below and as applied solely as to such number of calendar days of entitlement that are in excess of ten cumulative calendar days as defined below.

$$D = \frac{A \times C}{B}$$

B

Where A= Original Contract Amount

B= Original Contract Time

C= 8%

D= Average Overhead Per Day

As the Board will recall, the payments in (a) through (c), referred to in 4-3.2.1(d) (1) and (2), are the actual labor, material and equipment costs. Essentially, 4-3.2.1(d) (1) provides that the Contractor's profit on self-performed extra work is 17.5%, whereas the Contractor's profit on subcontracted extra work is 10% on the first \$50,000 and 5% on any amount over \$50,000. Section 4-3.2.1(d)(2) replaces the specified percentages for Contractor's profit for self-performed and subcontracted work with a formula for calculating the Contractor's profit.

Nowhere do Sections 4-3.2.1(d)(1) or (2) address or even mention the subcontractor's allowable markup on its extra work. Instead, the costs and profit that a subcontractor is allowed to charge for extra work are addressed separately in Section 4-3.2.2, which states in pertinent part:

**4-3.2.2 Subcontracted Work:** For work performed by a **subcontractor**, compensation for the additional or unforeseen work shall be solely limited to as provided for in 4-3.2.1(d)(1), with the exception of, in the instance of subcontractor performed work only, the subcontractor may receive compensation for any premium for acquiring a bond for the additional or unforeseen work; provided, however, that such payment for additional subcontractor bond will only be paid upon presentation to the Department of clear and convincing proof that the subcontractor has actually provided and paid for separate bond premiums for such additional or unforeseen work in such amount.

In other words, the Subcontractor's cost and profit are determined by reference back to 4-3.2.1(d)(1), which provides for the actual costs reflected in (a) – (c) and the 17.5% markup.

Read together, 4-3.2.1(d) and 4-3.2.2 provide a method for calculating extra work that is consistent with the norm in the construction industry. A subcontractor is, of course, entitled to a profit on the work it performs. Likewise, a contractor is entitled to markup the work that it subcontracts to others, though in a smaller percentage. Under (d)(1), the contractor is permitted to markup self-performed work at 17.5% and subcontracted work at 5% - 10%, depending upon the amount. Under (d)(2), a formula is used to determine total contractor markup instead. The Department concedes that the Subcontractor is entitled to its own 17.5% markup under 4-3.2.1(d)(1) and the Contractor is entitled to its markup of 5% - 10% on the subcontracted work. Yet, the Department argues that the Subcontractor's 17.5% markup is somehow eliminated when the formula under (d)(2) is followed for determining the Contractor's markup. There is absolutely no language in 4-3.2.1(d)(2) that states or even suggests the Subcontractor's profit described in 4-3.2.2 is eliminated when the formula in (d)(2) is applied to determine the Contractor's profit.

## **DEPARTMENT'S POSITION**

### **BACKGROUND:**

As a matter of principle, the FDOT is committed to paying fair and equitable compensation for any delays and/or extra work on our jobs. Our Standard Specifications provide that FDOT will pay all reasonable and necessary costs plus an additional amount to cover overhead and profit. However, the Specifications clearly limit the prime contractor's payment as related to overhead and profit. The prime contractor may receive a 17½% markup on direct costs of added work or they may receive a per diem overhead amount based on the entire contract value and duration. The contractor may not receive both as this would constitute a duplicate reimbursement for overhead. Had the prime contractor self-performed the additional work, there would be no question as to the appropriate application between the 17½% markup and the daily rate. The fact that a subcontractor performed the work should not cause this line to blur; the contract clearly stipulates that the prime contractor is paid either the daily rate (which is based on the entire contract amount – including the subcontracted amount), or the markups on direct cost. Having been compensated by the daily per diem rate, it is now the prime's responsibility to negotiate a share of that payment with their subcontractor for overhead and profit.

### **FDOT's POSITION:**

The D-B Contractor and the CEI, representing the FDOT, had entered into negotiation over several months to resolve the following items:

1. The Pond Re-design at the RTMC due to changes by SFWMD (#9).
2. Re-alignment of the Fiber Optic Backbone conduit along I-75 (#10).
3. Type of foundation for the CCTV and MVDS poles (#11).
4. Re-location of Splice Vaults and Pull boxes in the *iROX* construction zone along I-75 (#12).

Agreement was eventually reached on these issues and resulting supplemental agreement packages were developed with the D-B Contractor's involvement and agreement to compensate the Contractor for the additional work associated with these issues.

Supplemental Agreement packages #9, #10, #11, and #12 were prepared with the D-B Contractor's involvement and agreement, and submitted to the Department for processing and execution. It should be noted that #9, and #11 were always Unilateral Payment documents due to the fact that there was not complete agreement by both parties.

While reviewing Contract Changes 9, 10, 11, and 12, the Department determined that the methodology used to derive the Engineer's Estimates for these changes with respect to compensation for the Prime Contractor's markups was incorrect and not in accordance with Specification 4-3.2 (d) vs. the markups for subcontractors as allowed by Specification 4-3.2.2.

As required by Specification 5-5, an interpretation of the application of these markups was obtained from the FDOT Director, Office of Construction. The interpretation provided by the Office of Construction is that whenever the Prime Contractor receives markups for indirect costs, expenses, profit, overhead, etc in accordance with 4-3-2.1 (d) (2), the subcontractor(s) **is(are) not allowed** a markup of 17.5% for indirect costs, expenses, profit, overhead, etc on the work performed by the subcontractor(s). It is the Department's expectation that the Prime Contractor will reimburse the subcontractor(s) any markups from the monies received as a result of the markups computed per 4-3.2 (d) (2).

Subsequently, the CEI was instructed to advise the Contractor that the 17 ½% markups for the subcontractors would not be payable based on the interpretation of the Director, Office of Construction. Upon receiving this determination, the Contractor subsequently notified HNTB that they did not concur, submitted a Notice of Intent to Claim and requested that this issue be presented to the Disputes Review Board.

## **BOARD FINDINGS**

The Board has reviewed the submittals and rebuttals by the Contractor and the Department, as well as the oral presentations. The essence of this dispute lies in Contract Sections 4-3.2.1, Allowable Costs for Extra Work, and 4-3.2.2, Subcontracted Work, and the Board has focused extensively on these sections.

The Board could find no contract language directing the contractor to provide a pro rata share of the Average Overhead per Day to its subcontractor and not allow the sub 17 ½% for indirect costs (markup). The contract addresses contractor markup in one subsection (4-3.2.1), while addressing subcontractor mark-up in a separate subsection (4-3.2.2). In 4-3.2.2, the Board finds particular significance in the language "For work performed by a subcontractor, compensation..... shall be solely limited to as provided

for in 4-3.2.1(d)(1)". The Contract's use of the word "solely" leads the reader toward limiting the subcontractor's mark-up to the 17 ½% of (d)(1) and away from applying the Department's interpretation of paying the sub part of the per diem overhead under d(2).

Testimony by the Department during the hearing revealed that they have submitted for industry review language that would make it clear how the 17 ½% mark-up for subcontractors is to be applied. When the Department was asked why it provides a computation aid spreadsheet on its website that interprets the subcontractor markup in a manner consistent with Miller's interpretation, their reply was that the spreadsheet was in error and would be corrected. The Board could not help but find these two facts evidence that the present language does not clearly direct contractors not to include a 17 ½% subcontractor mark-up when they also include per diem overhead.

The Board is directed in the DRB Specifications Guidelines to consider the requirements of the Contract in its entirety and not to render decisions based on "what is fair". The Board has indeed focused on interpreting the Contract language in this instance.

The Board could not find language supporting the Department's contention that the 17 ½% subcontractor markup is prohibited when the Contractor receives per diem overhead. We recommend that the subcontractor be entitled to a 17 ½% markup on its work in each of the SA's in question.

Signed by the Chairman with the consent of all Board Members.

A handwritten signature in black ink, appearing to read "Peter A. Markham", with a stylized flourish at the end.

Peter A. Markham, P.E.

Chairman