

# Ten Ways to Help Avoid Legal Problems in School Construction

*National Clearinghouse for Educational Facilities*

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**J**ust as no one builds a school without floor plans, no one should build a school without a legal plan. Litigating construction disputes is expensive, time consuming, disruptive, and harrowing. Avoiding them should be a fundamental goal of every construction project.

There are definite measures school districts can take to avoid legal disputes. Most occur early in the construction planning process, and many involve early participation by legal counsel—with the goal being to avoid more extensive involvement later on. Consider these ten measures for developing a sound, workable legal plan when undertaking a school construction project.

## **1. Don't wait to negotiate; identify contract provisions early**

School districts have broad discretion in retaining architects, construction managers, and other construction consultants, and there are many methods to select and contract with them. But even with millions of construction dollars at stake, school districts often adopt without question the contract provisions provided by outside parties. Similarly, it is not uncommon for a school district to hand its attorney a proposed professional services agreement for a “quick review,” noting that the school board plans to vote within a few days, or for the school district to ask a project architect to prepare an agreement between the district and the construction manager without a review by the school district's attorney. These procedures are ripe for creating future legal disputes.

Do not authorize an architect or construction manager to proceed with work before negotiating final contract provisions. If the school board takes official action to retain an architect or construction manager without a firm agreement in place, the appointment should be expressly subject to the successful negotiation of contract terms. Preferably, no work should be authorized until these terms are reached. Otherwise, the school district loses considerable negotiating leverage.

School districts often use a request-for-proposals (RFP) process to select project consultants. When issuing a RFP, a copy of the architect-owner agreement the district plans to use should be included in the RFP package, for the following reasons:

- Standard owner-architect agreements may include provisions that are not in the school district's best interests. Attorneys routinely recommend dozens of changes to the provisions of both the 1987 and 1997 editions of the American Institute of Architect's *Standard Form of Agreement Between Owner and Architect*. By including explicit contract provisions in the RFP, the school district can save time and ensure up front that its best interests will be met.
- Unless all applicants are asked to submit proposals based on a common understanding of the provisions of the architect-owner agreement in the RFP, it will be difficult for the school district to make an “apples to apples” comparison of the proposals. By having everyone respond to the same contract provisions, the school district can make a fair selection and obtain a reasonable price for the services provided.
- Including the school district's contract provisions in the RFP deters post-selection dickering and eliminates extended contract negotiations that cause delays. It also helps ensure that the school district's agreements with its various professional services firms are consistent.

## **2. Exercise due diligence in selecting the project team**

When it comes to due diligence, school districts typically do a good job of asking architects and construction managers to provide information about their background, past projects, litigation experiences, and related matters. There is, however, a wide variance in how effectively school districts act on this information. Accepting at face value an applicant's own characterization of its performance is not adequate due diligence, and little is gained by merely asking follow-up questions to answers that are

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unusual or disturbing. To help avoid serious problems later on, dig for information that does not jump off the page.

Begin a good due diligence inquiry by seeking the following information from each applicant:

- A list of the school construction projects the applicant, or any predecessor firm, has worked on over the past five years, including projects currently in process or for which the applicant recently has been retained.
- For each school construction project built within the past five years:
  - (1) The name of the school district and the project's construction manager or clerk-of-the-works, with contact information.
  - (2) A brief description of the project, including its location and the grade levels it was designed to accommodate.
  - (3) The name of the general contractor, with contact information.
  - (4) The type of construction—new, addition, renovation, or mixed.
  - (5) The square footage of the building(s) involved.
  - (6) The construction start and completion dates.
  - (7) Whether or not the project was completed on schedule and, if not, the causes and extent of delays.
  - (8) The amount of time after occupancy required to complete punch-list items.
  - (9) The total construction cost.
  - (10) The costs associated with project change orders or overruns, with an explanation of any abnormalities.
  - (11) Any fee concessions or payments made to the owner in excess of \$25,000 as a result of an alleged error or omission by the applicant.
  - (12) Litigation or arbitration involving the applicant arising from the project, including the names and phone numbers of opposing parties, court and docket numbers, and a brief explanation of pertinent claims details and results.

- Information about litigation or arbitration for any projects the applicant has been involved with over the past ten years, school construction or otherwise.
- The names of key individuals to be assigned to the project and their relevant training, professional experience, and specific experience with schools.
- Information about the applicant's background, insurance, and legal status (corporation, partnership, sole proprietor, etc.).

Once this information is obtained, carefully follow it up. Do not simply ask applicants to clarify or amplify their responses—check with others to verify the information provided. Call school districts where the applicant has worked and talk not only to the contact person identified by the applicant but also to the business manager or superintendent. With respect to prior litigation, arbitration, or mediation, check with the school district or other parties to see if the description provided by the applicant is accurate, or ask the district's attorney to inquire with the attorneys involved in the matter. Most importantly, inquire about the specific individuals assigned to the project; if they are new employees, ask about their experience with prior employers, and contact both the employers and former clients.

### **3. Carefully determine the level of professional liability insurance required**

What is "adequate" insurance coverage for professional liability? Many architects and construction managers carry only \$1 million in insurance coverage for negligence, while others involved in the construction process, such as materials testing companies, might carry little or none. Many school construction projects cost tens of millions of dollars, so defective work by an architect, construction manager, or other party could cost considerably more to correct than the amount of their insurance. In addition, insurance coverage often is "depleting," meaning that in the event of litigation or arbitration, the cost of legal fees and expert witness fees are deducted from the funds available. In a complex case, these fees can run into hundreds of thousands of dollars. Moreover, if professional liability policies are issued on a "claims made" rather than on an "occurrence" basis—that is, coverage applies only during the period in which a claim is made rather than the period

in which events occur that give rise to a claim—there can be a problem if a latent design or construction fault appears years later and the responsible architect or construction manager no longer is in business.

Requiring construction consultants to increase the amount or scope of their professional liability insurance may increase their fees, but a school district needs to be aware of the coverage it considers adequate. Conferring during the planning process with an insurance broker can help identify available options.

One way to provide additional insurance protection is to require a “project rider.” For example, a school district might ask its architect to add a \$4 million rider to its current \$1 million professional liability policy. The rider would take effect at the start of construction and extend for five years (the two-year construction period and three years following).

Another option for providing additional protection is project liability insurance, whereby an insurance company provides coverage in the event of defective work by the professional consultants on a particular project, including the architect, construction manager, engineers, surveyors, landscape architects, and any others named as “insured” in the policy. The advantages of project liability insurance from the owner’s perspective are that:

- In the event of a claim against more than one of the covered consultants, there is no fighting among the different parties and their insurance companies.
- The insurance is purchased at the outset of the project for a predetermined period of years—including post-construction, which provides coverage for latent damages not discovered until after construction is completed.

The disadvantages of project liability insurance from the owner’s perspective are that:

- Fighting among parties still can occur if they assert that the defect was caused by one or more of the project’s trade contractors, which are not covered (only professional consultants are covered).
- Project liability insurance can be expensive, the cost depending in part on the insurance company’s rating of the risk associated with the parties in question. Other cost factors include the amount of coverage, the cost of construction, and the number of years the coverage is sought.

The important point is that a school district should not simply assume that its professional consultants have adequate professional liability coverage. Rather, the district must include adequate coverage in its legal plan for each specific construction project. Finally, keep in mind that some owner-controlled insurance programs, which cover such things as workers’ compensation and property damage claims, do not include professional liability insurance for consultants.

#### **4. Clarify contract issues with the architect**

As noted above, standard owner-architect agreements may not serve the best interests of a school district. The provisions that warrant attention include:

- **Scope of basic services.** Standard architect-owner agreements typically distinguish between basic services included in the architect’s regular fee and services for which the architect receives further payment beyond its regular fee (called “additional services” and “contingent additional services”). Some of the services not included as basic services that might be considered as part of the architect’s regular fee are evaluating trade contractors’ proposals, substitutions, and claims; participating in legal proceedings on behalf of the owner; and attending public and municipal hearings required for project approval.
- **Fee calculation.** The most common way of determining an architect’s fee is by calculating it as a percentage of construction cost. But it may be reasonable to exclude from the base amount such costs as the project contingency or the construction manager’s fee. Also consider using a “declining scale of rates” for each million dollars in construction cost—this incrementally lowers the fee percentage as the cost of construction increases. Finally, determine whether the fee percentage should be based on project estimates or actual bids.
- **Approval of architect’s consultants and third-party beneficiaries.** Consider having the school district approve the architect’s choice of consultants, such as civil, structural, and mechanical engineers, and landscape architects. Given the major impact these consultants can have on a project, it may be appropriate to do so. In addition, the architect-owner agreement should require the

architect's agreements with its consultants to state clearly that the school district is an intended third-party beneficiary. In the event of defective work, this gives the district the right to proceed with legal action directly against the consultant.

- **Review of work performed by trade contractors and other consultants.** Standard architect-owner agreements typically require architects to “endeavor” to guard owners against defective work by visiting the site “at intervals appropriate to the stage of construction” and to become “generally familiar with the work.” Be more specific by requiring a minimum number or frequency of site visits without obviating the duty of more visits if necessary. The agreement should state expressly that in the event the architect observes defective works, the architect will immediately notify the owner and direct corrective action.
- **Standard of care.** Standard architect-owner agreements do not address the level of care to be used by the architect and its consultants in performing their work. In most states, the law places an inherent duty on the architect and its consultants to perform their duties with a standard of care ordinarily exercised under similar circumstances by competent members of their respective professions. Consider including a standard-of-care clause in the agreement so that there is no dispute regarding such expectations.
- **Legal and expert fees.** Unless the architect-owner agreement requires the architect to reimburse the school district for attorneys' fees, expert witness fees, and other related costs in the event of a claim arising from the architect's negligence, the school district will not be permitted to recover such costs, even if the school district prevails against the architect.
- **Beware of multipliers.** Standard architect-owner agreements allow architects to charge a markup on their consultants. If consultants perform additional work beyond basic services, a multiplier factor may be justified to compensate for unanticipated oversight responsibilities by the architect, but it normally should not be more than 20 percent. All other markups should be questioned when the agreement is negotiated.

## 5. Clarify contract issues with the construction manager

As with the architect, contract issues should be clarified with the construction manager. Provisions warranting attention include:

- **RFP scope of services and response.** Incorporate the RFP's scope of services and the pertinent portions of the applicant's RFP response into the construction manager's agreement. This obliges the construction manager to perform everything the school district included in its scope of services and everything the construction manager included in its response (if still applicable after contract negotiations), regardless of whether such actions are required elsewhere in the agreement.
- **Standard of care.** Specify the standard of care to be utilized by the construction manager. Provisions can be added stating that the construction manager agrees to use its best professional skill and judgment and to accept a fiduciary duty with respect to the school district and its project.
- **Adequate supervisory services.** Specify that the agreed-upon budget for construction manager's services provides an adequate level of supervision to bring the project to a successful conclusion.
- **Independent testing agencies.** Construction managers typically do not have the laboratory equipment and expertise necessary to perform materials testing; this work is normally performed by separate testing firms retained directly by the owner. Consider requiring the construction manager to (1) coordinate all testing work and review all reports issued by testing firms, (2) identify any defective work by either trade contractors or the testing firms, to the extent the construction manager has the technical expertise and professional capacity to do so, and (3) recommend and oversee appropriate corrective action.
- **Conflicts among project agreements.** Although it seems obvious that the provisions of the construction manager's agreement should dovetail with the agreements of the architect and trade contractors, this does not always occur. Sometimes special terms are negotiated into one agreement but not in others. Perform a final review of all agreements to ensure their provisions do not conflict or overlap.

## 6. Predetermine the methods used for dispute resolution

In the event of a dispute with the owner, provisions in the standard agreements for architects and construction managers require the parties to first engage in nonbinding mediation. Failing that, they are to engage in binding arbitration, rather than litigation, with the owner and the architect or construction manager, as applicable, being the only parties to the arbitration proceeding.

Although mediation and arbitration can work quite well as alternatives to litigation, these provisions may be contrary to the interests of the school district. Because mediation is nonbinding, it makes no sense to require it as a precondition to arbitration or litigation. There are many reasons why the school district might not be in a position to agree to a compromise at the onset of a construction dispute. Indeed, there is a strong possibility that at the early stages of the dispute the school district might not know enough about the problem to participate meaningfully in mediation. There is little reason, therefore, to mandate that in the event of a dispute the parties must incur the time and cost of participating in mediation before moving to arbitration or litigation. This does not denigrate the use of mediation, which very often is an effective tool for resolving construction disputes later in the litigation process.

Arbitration can be useful in resolving minor disputes, but it is usually not as helpful to school districts as litigation in dealing with more significant matters. Consider modifying the standard contract provisions on arbitration as follows:

- Require arbitration only for disputes less than a stipulated amount—usually something in the range of \$100,000 to \$200,000.
- Ensure that arbitration is mandatory only if it includes all pertinent parties. This can be accomplished either by (1) permitting the parties to opt out of arbitration if the dispute includes other parties not subject to mandatory arbitration, or (2) requiring all consultants, trade contractors, and their respective subcontractors to agree to the same arbitration language in their agreements, so that arbitration includes all parties involved in the dispute.
- Require that any litigation occur in a court with jurisdiction over the municipality where the project is located. Because construction litigation can be

extremely complicated, confusing and lengthy, consider including a provision that any trials will be decided by a judge and not a jury (an exception would be if local judges tend not to support school districts).

## 7. Review the nontechnical contract provisions in bid packages

Bid packages contain the contract provisions to be entered into with trade contractors. School districts often authorize architects and construction managers to distribute bid packages without a legal review of the provisions that will govern the parties during construction. While the school district's attorney usually does not need to review the technical aspects of the bid packages (although sometimes this can be helpful if there are questions on the interpretation of specific provisions), include in the project schedule adequate time for legal review of the nontechnical provisions that detail the legal rights and obligations of the trade contractors. The contract documents containing such nontechnical provisions typically are the owner-contractor agreement, the general terms and conditions, the supplementary general terms and conditions, and the nontechnical specifications.

A number of the issues concerning a school district's agreements with architects and construction managers should be similarly considered in agreements with trade contractors, including methods of dispute resolution, the waiver of jury trials, and the reimbursement of school district legal and expert fees in the event of a claim over defective work. Although a complete discussion of trade contractor agreements is beyond the scope of this publication, the following are some additional subjects school districts may wish to address in their construction agreements:

- **No delay damages against owner.** The owner-contractor agreement can provide that in the event a contractor's work is delayed for reasons beyond the contractor's control, the contractor cannot make a claim against the district for damages arising from the delay (this does not preclude the contractor from obtaining additional time to complete its work). Courts usually will uphold such a prohibition unless the owner has contributed to the delay. Another option is to preclude delay damages against the owner but expressly provide that a

trade contractor may seek recovery against other trade contractors responsible for the delay. This provision, however, can lead to the school district becoming embroiled as a nonparty in litigation among its contractors.

- **Liquidated damages and other damages for contractor delay.** The owner-contractor agreement should provide for liquidated damages to the owner if a trade contractor fails to complete its work within the time allocated in the agreement. The liquidated damages provision should make clear that the amount of damages being assigned on a daily basis is not a penalty (which the courts might find to be unenforceable), then go on to explain that because a contractor delay may create damages in an amount that will be difficult to ascertain, the parties are agreeing at the outset on the amount to be paid in the event of delay. Also, where a delay by one contractor causes another contractor to accelerate its work in order to meet a deadline, the agreement can require the delaying contractor to pay for the other contractor's acceleration costs if a claim for such acceleration is approved by the school district.
- **Reviewing plans and specifications and reporting defects.** In the owner-contractor agreement, provide that if there are design defects a trade contractor should have found (due to its expertise and experience), it owes a duty to the owner to identify and report them. If a trade contractor was in a position to identify and report the error but failed to do so, this may provide the school district with an alternative source of recovery for design errors.

## 8. Develop surety bonds to include with bid packages

School districts should develop their own surety bonds to include with bid packages instead of using the standard industry bond forms. This can be of particular value with respect to performance bonds. By specifying that the performance bond remains in effect until the trade contractor completes all work defined in the contract documents, the bond remains in effect even if years after project completion the owner identifies construction that was never properly performed.

## 9. Carefully deal with nonresponsible bidders and contractor bid errors

There are often questions about whether a school district must select the lowest bidder on a construction project. This may be because the district is trying to reject what it believes to be a “nonresponsible” bidder or because a contractor claims to have made a bid error and wants to withdraw its bid. In many states, there is no clear guidance about what constitutes a “nonresponsible” bidder.<sup>1</sup> A contractor may argue that if it can obtain the requisite surety bonds for a project, it is considered “responsible” in the marketplace and cannot be rejected as the lowest bidder. In such a case, the school district can offer the contractor an informal hearing before the school board. If there is legitimate cause to conclude the contractor is not responsible, the board may reject the bidder as nonresponsible. This determination may be based on failures by the contractor on prior projects, lack of adequate experience or qualifications, or other good cause.

Bids may not be legally withdrawn by the low bidder for a “judgment mistake” on its part, but when a low bidder seeks to withdraw its bid on the basis of a “clerical error in arithmetic,” the school board may permit the withdrawal if it chooses. When a low bidder makes a mistake that is arguably a nonmaterial “technicality” that gives it no competitive advantage over other bidders, the school district may permit the bidder to “cure” the error. The instructions to bidders should expressly state that the school district has these rights of election.<sup>2</sup> In general, whenever a school board considers whether to reject a low bid or to refuse withdrawal of a low bid, the price difference between the lowest and next lowest bids is an obvious factor to consider, but the risk of keeping the low bidder must also be taken into account.

<sup>1</sup> In Pennsylvania, the factors to be considered are financial responsibility, integrity, efficiency, industry experience, promptness, and ability to successfully carry out the project (*Marx v. Lake Lehman School District*, 817 A.2d 1242 (Pa. 2003)).

<sup>2</sup> There have been several recent cases in Pennsylvania on this issue: *Gaeta v. Ridley School District*, 788 A.2d 363 (Pa. 2002), which permitted the low bidder to substitute a surety bond with inadequate rating for a bond with the requisite rating; *Marx v. Lake Lehman School District*, 817 A.2d 1242 (Pa. 2003), which permitted the low bidder to submit an untimely performance bond where the bid bond had been submitted properly), and *Balsbaugh v. DGS*, 815 A.2d 36 (Pa. 2003), where an unsigned bid was not considered legally responsive.

## 10. Carefully consider involvement in contractor disputes

Two big decisions for a school district during construction are (1) when to get involved in a developing dispute and (2) when to involve legal counsel. Address these situations on a case-by-case basis. The school district is already paying its project consultants to manage the project and does not wish to spend undue time or money duplicating the consultants' efforts. Most construction lawyers can identify situations, however, where they might have kept a minor problem from erupting into a major one had they been invited to help resolve it earlier in the process. Ensure, too, that the facts of the dispute are carefully documented. Some contractors are highly proficient at documentation, so make certain that the school district's positions are not neutralized by a lack of proper documentation.

### In Summary

School construction disputes can be expensive, time consuming, disruptive, and harrowing. Include a legal plan in every school construction project that includes: negotiating agreements with the project architect and construction manager early on; exercising due diligence in selecting the project team; determining proper levels of professional liability; clarifying contract issues with the architect and the construction manager; predetermining methods of dispute resolution; reviewing nontechnical contract provisions in bid packages; developing surety bonds for bid packages, and exercising care in handling nonresponsible bidders, bid errors, and contractor disputes.

Properly applying these measures can significantly increase the chances of completing a school construction project on time, within budget, and without litigation.

### Suggested Additional Reading

*From the Ground Up: Legal Issues in School Construction*, a publication of the Council of School Attorneys of the National School Boards Association, contains extensive information on selecting and contracting with architects and construction managers; see Chapters 3 and 4 (Brickman 2002). Nicholas Sargent's article "Protecting Yourself from Liability: Architectural Contacts by Design," contains additional useful information (Sargent 1996).

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