

**SETTING THE STAGE:
A FUNDAMENTAL CONSTRUCTION LAW
COURSE FOR ELECTRICAL
SUBCONTRACTORS**

**Prepared for
The National Electrical Contractors Association**

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On a cautionary note, this manual is designed only to provide accurate and authoritative information in regard to the subject matter covered and nothing contained herein should be construed or relied upon as legal advice. Before implementing anything contained in this manual or when faced with any of the legal issues addressed herein, you should always first consult with and obtain the opinion of your own legal counsel.

I. THE CONSTRUCTION CONTRACT

For construction professionals, the most important work often begins before the project even starts. No matter the quality of your work, your rights and responsibilities, including your right to be paid and the manner in which you receive payment, hinge upon your contract. Despite its importance, however, many subcontractors do not spend an adequate amount of time reviewing and negotiating their contracts. In fact, most subcontractors would benefit substantially by spending more time learning about contracts, contract law, and the common clauses, both good and bad, in their contracts. By understanding these legal principles and how they interact with one another, subcontractors can effectively “set the stage” for more productive and profitable projects now and in the future.

The first step in this process, then, is gaining an understanding of how legally-binding contracts are formed.

A. Basic Principals of Contract Formation

1. Meaning of “Contract”

a. Definition

A “contract” is essentially an *agreement* which the law will *enforce*. There are three (3) elements required to create a contract:

- *Mutual Assent* (an offer and acceptance)
- *Consideration* (something each party gives up)
- *No defenses to contract formation*

i. A Promise

All contracts must contain at least one *promise* to do something in the *future*. The law views the promise as binding the person who makes it (the “promisor”) to perform some sort of duty. Breaking the promise (breaching the contract) will result in the non-breaching party having a remedy to receive in some fashion the “benefit of the bargain” that it expected to result from the other party’s performance of the contract.

ii. **Written vs. Oral Contracts**

It is often thought that a “contract” must be a *written* document which embodies the parties’ agreement. For legal purposes, though, an agreement may be binding and enforceable even though it is *oral*. Thus, with a few limited exceptions (discussed later in the Statute of Frauds section), oral contracts are enforceable so long as they meet the necessary requirements discussed below.

2. **Offer and Acceptance**

a. **Generally**

For an agreement to be enforced as a contract, the parties must “mutually assent” to the agreement. In practical terms, this assent is generally reached through an *offer* and an *acceptance* of the offer.

b. **Intent to Contract**

i. **Objective Standard**

Whether mutual assent exists is determined by an objective, or “reasonable person” standard which asks whether a reasonable person would understand the parties’ words or conduct as revealing an *intent to contract* with each other?

Note that the ‘objective’ standard does not mean that the parties *actually* agree, but only that each party *act* in such a way as to lead the other to *believe* they have reached an agreement.

ii. **Major Terms Must Be Agreed To**

The mutual assent requirement does *not* mean that the parties must agree on *all* the contract terms, but only that the parties have agreed on the *major*, or *essential*, terms. This requirement can become important in situations where, for example, one party bids on a job, has their bid accepted, and is asked to sign a contract shortly before actual on-site performance begins. If the written contract contains major deviations from the invitation to bid or the bid itself (i.e., for instance, addition of a bonding requirement) then the bidding party may have grounds for non-performance because no agreement was rendered on these new major terms.

iii. **Intent to Memorialize the Agreement in Writing**

A not-uncommon situation exists where two parties negotiate with one another, reach mutual assent on the major terms of the proposed agreement but further intend that the agreement will be put into a formal written document which both will sign. Here, whether a contract exists will depend on if the parties' words or actions make it clear that they either intend to be bound (a) *before* the legal document is drawn up (in which case there probably is a contract), or (b) only *after* the document is reduced to writing (in which case there probably isn't a contract).

c. **Offer**

i. **Definition:**

The offer is the first step in creating a contract. Essentially, an offer must: (1) contain a *promise* or *commitment* to enter into a contract; (2) be *definite and certain* in its terms; and (3) be *communicated* to the offeree (the person to whom the offer is made).

ii. **Exchange of Promises**

The legal effect of the offer is to create in the offeree the *power to enter into a contract*. The offeree will create (and enter into) a contract by making his *acceptance*. In other words, the offer itself contains a promise, the performance of which is conditioned upon the offeree making a return promise. If the two parties exchange promises, a vital step in contract formation has occurred.

iii. **Revocation or Termination of Offer**

An offer may be accepted only as long as it has not been terminated or revoked. An offer can be terminated by (i) an *act of either* party or (ii) operation of *law*.

The offeror terminates an offer by either (a) directly telling the offeree that he is revoking the offer or (b) acting inconsistently with a continued willingness to maintain the offer.

The offeree can terminate an offer by (a) expressly rejecting the offer or (b) making a *counteroffer*. A counteroffer is both a *rejection* of the original offer and a *new offer*. After a party makes a counteroffer, his power to accept the original offer is *terminated* in the same manner as if he flatly rejected the offer.

An offer will terminate on its own if the offeree does not accept the offer within the *time specified* by the offer *or* within a *reasonable period* if no deadline was specified.

An offer will be terminated by *operation of law* in the following events:

- ***Destruction*** of the proposed contract's *subject matter* (e.g., the building on which the work is to be performed is destroyed or the project is cancelled.)
- ***Supervening illegality*** (e.g., some governing body makes the subject matter of the contract illegal.)
- ***Death or insanity of either party*** (this is, for obvious reasons, more of a concern when dealing with individuals than with businesses.)

d. **An Invitation for Bid (“IFB”) is *Not* an Offer**

In the construction setting, where bids are solicited through what is commonly known as an “invitation to bid,” the invitation is not an offer (unless it indicates otherwise). Instead, the invitation is viewed as a *solicitation of offers*. It is up to the entity soliciting bids (offers) to decide which offer to accept. Of course, the inviter always has the option of refusing all bids. An IFB *may* be an offer if it contains language indicating that the contract *will* be awarded to the lowest responsible bidder

Preliminary negotiations also are not offers. If in doubt, consider the (a) language used, (b) surrounding circumstances, (c) prior relationship of the parties, (d) method of communication, (e) industry custom; and (f) how definite and certain the terms are.

e. **Acceptance**

i. **Who may accept?**

Generally only the person who received the offer (or a member of the class to whom the offer was addressed) has the power to accept.

ii. **Method of Acceptance**

Acceptance is judged by an objective standard which essentially asks whether a reasonable person would believe the offer was accepted. Acceptance is permitted by any *reasonable means*

unless the person or entity extending the offer expressly limits acceptance to a particular method (i.e., “acceptance must be made by registered mail,” etc.).

iii. **Acceptance Varying from Offer: Additional Terms**

In the construction industry, if you purchase goods, you will encounter, at some point, the issue of whether an acceptance which varies from the offer can form a contract. The answer is yes and no. Under the Uniform Commercial Code (UCC), which governs sales of goods between merchants, if an offeree sends a purchase order which contains additional terms (a clause which the offer does not deal with at all -- for example, an arbitration provision), that provision automatically becomes part of the contract. However, if one party is **not a merchant** the additional term will **not** become part of the contract unless the non-merchant **explicitly agrees** to the term (e.g., by initialing next to the new term).

There are two exceptions to the above rule: (1) if the additional term would effect a “**material**” change to the contract (e.g., the addition of a bonding requirement); and (2) if the offeror, within a reasonable time after receipt of the material change, **objects** to having the additional term become part of the contract. In both situations, the additional term will not become part of the contract.

For contracts that are **not** for the sale of goods, like most construction contracts, generally an acceptance which varies the terms of an offer does **not** invalidate the offer unless the acceptance is made to **depend** or assent to the changed or added terms.

iv. **Duration of the Power of Acceptance**

An acceptance is only valid if the power of acceptance is still in effect. The power of acceptance can be extinguished in five ways: (1) the person to whom the offer is made **rejects** the offer; (2) the person to whom the offer was made makes a **counter-offer** (this includes the above situation where the acceptance contains a material change to the offer); (3) the offeror **revokes** his offer **before it is accepted**; (4) the **lapse of time** between offer and acceptance (if the offer does not expressly set a time limit to respond, the power of acceptance terminates at the end of a “reasonable” time period); and (5) the **death or incapacity** of the offeror or offeree.

v. **Who bears the risk if the offer contains a clerical mistake?**

The *person making the offer* generally bears the risk of a mistake in the offer. In other words, a contract will be formed on the offer *as received* by the offeree.

This general rule does not apply if the person who receives the offer ***knows or should have known*** that the offer contained a mistake. In this situation, the offer ***cannot*** be accepted as it was received.

EXAMPLE: Four electrical contractors are asked to bid on a project. Three of the bids are between \$50,000.00 and \$75,000.00 while a fourth bid is for \$6,200.00. Since there is an obvious mistake (it appears a decimal was misplaced), the general contractor receiving the bid cannot ‘snap up’ the \$6,200.00 offer and the contractor who made the offer will not be forced to do the work at his bid price.

vi. **Who bears the risk of a misunderstanding?**

As a general rule, if the parties have a misunderstanding about what they are agreeing to, there is no ‘meeting of the minds’ and thus a contract will probably not exist so long as the parties have a different subjective belief about a ***material*** contract term and the other party neither ***knows*** nor has ***reason to know*** of the misunderstanding. If a party does know (or should know) of the misunderstanding, courts are likely to find a contract has been formed on the terms as understood by the ***innocent*** party.

3. **Consideration**

Courts will generally only enforce contracts which are supported by consideration. A promise is supported by “consideration” if (1) the person receiving the promise ***gives up something*** he does not have to give up (called suffering a ‘***legal detriment***’) and (2) the person making the promise does so as part of a ‘***bargain***’ in exchange for the other party’s legal detriment.

a. **Legal Detriment**

A party does something to his detriment when he either does something he is not legally obligated to do or refrains from doing something he has a legal right to do. Typically, courts will not inquire into the adequacy of consideration because as long as the party suffers some detriment (no matter how small) there has been consideration. However, if the court determines that the consideration was ***entirely devoid of value*** or a “***sham***” (consideration recited in the contract but never paid) then the consideration may be held insufficient.

b. **The Bargain**

A 'bargain' exists when the parties agree on some return consideration to be given to the party suffering legal detriment in exchange for the work.

c. The Pre-Existing Duty Rule

i. Definition

If a party does or promises to do what he is *already legally obligated to do* or if he forebears (or promises to forebear) from doing something *he has no right to do*, under the 'pre-existing duty rule' that person has not incurred a 'detriment' for purposes of consideration. In other words, performing or promising to perform an existing legal duty is *not sufficient consideration* to form a valid contract.

NOTE: The Uniform Commercial Code (UCC), which applies only to the *sale of goods*, has *abolished* the pre-existing duty rule. As such, any *good faith* agreement modifying a sale of goods contract does not need to be supported by consideration. For subcontractors, the UCC is likely to apply to equipment and material purchases *only*, not to their construction contracts with general contractors.

Even for services contracts, however, there are numerous exceptions to the pre-existing duty rule and consideration does exist if:

- (a) *new* or *different* consideration is promised;
- (b) the pre-existing duty is owed to a *third-person* rather than to the promisor;
- (c) an *honest dispute* exists as to duty; or
- (d) there are *unforeseen circumstances* sufficient to discharge the duty.

ii. Construction Contracts

A frequent situation where the pre-existing duty rule arises (and will be enforced) is in construction contracts. For instance, if a contractor agrees to build a structure for a fixed sum and then, at some point during the work realizes it will cost much more than anticipated, the contractor cannot force the owner to increase the price by threatening to walk off the job. This is because the contractor had a *pre-existing obligation to build* the structure. As

such, the builder's promise to continue building is *not* consideration for the owner's promise to pay more money.

4. The Statute of Frauds

a. Generally

As discussed above, oral contracts are, for the most part, as binding as written contracts. However, a legal principle known as the "*statute of frauds*" provides an exception to this rule. The statute of frauds requires that certain agreements *must be in writing* to be enforced. The more relevant agreements to which this principle applies include:

- i. Promises to answer for the debt or default *of another* (i.e., to act as a surety);
- ii. Promises that by their terms *cannot be performed within one year*; and
- iii. *Real estate* contracts.

The statute of frauds will be satisfied if there is some document which contains the following:

- i. The *identity of the parties* to the agreement;
- ii. Identification of the *contract's subject matter*;
- iii. *Terms and conditions* of the agreement; and
- iv. The *signature of the party to be charged* or his agent.

Note that while the above must be *in writing*, the writing need not be a full-fledged contract and can result from several pieces of correspondence between the parties.

5. Mistakes

If there has been a *unilateral mistake* (a mistake on the part of one party), courts are typically unwilling to change the contract the parties have entered into merely because one party was mistaken. The traditional rule has been that the mistaken party will only be able to avoid its mistake if the non-mistaken party knew or had reason to know of the mistake at the time the contract was created. *Job bidding* is one of the more common situations where unilateral mistakes occur. Assuming the owner or general contractor did not cause (or have reason to know of) the mistake, the mistaken bidder *must show* that enforcement of the contract as written would be *unconscionable*. Generally, this means that the bidder must show not only

(a) that he would be *severely harmed* if forced to perform, but (b) that the other party *has not relied* on the bid (e.g., used the bid when submitting an offer).

a. **Categories of Mistakes**

- i. **Clerical Errors** : Courts are more likely to grant relief for *clerical* mistakes in computing the amount of the bid than they are for granting relief for other types of mistakes. Even for clerical errors, however, the standard applies that the mistake must be material *or* the other party must have known about (or been responsible for) the mistake before the mistaken party will be granted relief.
- ii. **Judgment Errors** : The risk of a mistake because of an error in judgment (e.g., the bidder underestimates the amount of labor a project will need) is generally borne by the party whose *business judgment* was faulty rather than the party who solicited the bid.

EXAMPLE: The Warner Electric Company (“Warner” or “electrical subcontractor”) submitted a bid for electrical work on the construction of a U.S. General Services Administration (“GSA”) Metallurgy Research Center in Salt Lake City, Utah. Warner’s bid was the lowest bid received, although not significantly lower than the others. The general contractor on the project -- John Price Associates, Inc. (“Price” or “general contractor”)-- used Warner’s subcontract bid when preparing its bid for the general contract. When the GSA informed Price that it was the low bidder, Price informed Warner of that fact and the GSA approved Warner as the project’s electrical subcontractor.

A few days after the general contractor signed a contract with the GSA, the electrical subcontractor realized that it had inadvertently excluded a portion of the work in its bid price because it had not realized that this work was within the scope of the subcontract work. The electrical subcontractor thus refused to sign a subcontract unless it received additional compensation for the work it omitted when originally calculating its bid. When the general contractor refused to increase the subcontract price, the electrical subcontractor withdrew its bid, claiming the project specifications had been ambiguous.

The general contractor then subcontracted with the Howard P. Foley Company (“replacement subcontractor”), which had submitted the next lowest bid. The replacement subcontractor, however, had also not included the same work that Warner had excluded from its bid. As such, the replacement subcontractor increased its original bid to take into account the additional money for increased material costs and labor needed to perform the “extra” work.

The general contractor later filed a claim with the GSA for the increased costs but both the GSA contracting officer and then the Board of Contract Appeals denied the general contractor's claim. The general contractor then sued Warner, contending that a contract existed between the parties and that Warner was thus precluded from withdrawing its bid.

Assuming that there was no conduct by the general contractor that could be viewed as misleading to Warner, what are the relevant questions to determine whether the general contractor and Warner had a contract? How might a court rule as to whether a contract existed on the facts presented?

1. Letters of Intent

a. Is a letter of intent a binding contract?

While the most basic purpose of a letter of intent is simply to alert the subcontractor that a general contractor intends to award the subcontractor work a letter of intent by itself can be sufficient to form a binding contract. Whether a binding contract, in fact, has been formed depends on the language used in the letter and the objective intent of the parties.

b. Necessary Elements of a Letter of Intent

The necessary elements in determining whether a letter of intent qualifies as a contract are the same elements needed to form basic contracts: mutual assent, consideration, and no defenses to formation. Thus, for example, if a subcontractor submits a bid and the general contractor follows up with a letter of intent, the basic "contract" has probably been formed. If the letter of intent includes language directing the subcontractor to commence work, such as preparing shop drawings and/or submittals, etc., the subcontractor should thoroughly document the type and value of the work he is being asked to do as well as arrange a process by which he will be compensated for his pre-contract work, and reach an agreement that, if a mutually-agreeable contract is not reached, the subcontractor has no duty to continue to work on the project.

7. The Parol Evidence Rule

The so-called "parol evidence rule" is not really a rule of "evidence" because it is only about the *terms of the contract*. In other words, the rule is *substantive law* which affects the terms of the contract, *not* formation of the contract. The rule essentially states that:

When parties have agreed to a *written* contract as the *final expression* of their agreement, a *prior (or contemporaneous) agreement cannot* be used to *vary* the terms of that written contract.

There are three things to keep in mind about the rule:

- i. It will *only* apply if there is a written contract;
- ii. The rule looks *backwards* in time; and
- iii. It *only* applies to *earlier* “agreements” between the *same parties*.

8. Performance of Contract Conditions

a. Generally

Generally, a contract condition will *create, limit, or excuse* a party’s obligation to perform a duty under the contract. For instance, in many construction contracts, the owner’s duty to pay is often expressly conditioned upon the project architect’s acceptance of the project work. In practice, this typically means that the general contractor must obtain an *architect’s certificate* certifying that the work conforms to the plans and specifications. In most cases, payment by the owner is conditioned upon such a certificate being issued. With conditions to modify promises made in the contract, a party will have an *absolute duty to perform* its contractual obligations *unless* the duty is discharged in some way.

There are two general types of contract conditions: (1) *express conditions* -- any condition on which the parties agree (either explicitly or implicitly by conduct); and (2) *constructive conditions* - a condition not agreed-to by the parties but which the court imposes as a matter of law to insure fairness. The distinction is important because *strict compliance* with express conditions is generally necessary before the other person’s duty of performance arises, while *substantial compliance* is ordinarily necessary to satisfy constructive conditions.

0. **Performance of Constructive Conditions**

A constructive condition is a condition *not* agreed upon by the parties but which a court will read into the contract to insure that the parties receive what they bargained for. Most often, a constructive condition will be found in “bilateral” contracts where the parties have exchanged promises with one another. In a construction contract, for instance, in the absence of a contract provision otherwise, many courts will treat the contractor’s performance (or even substantial performance) as a constructive condition of the owner’s duty to pay.

9. **Waiver**

A party who owes a conditional duty may indicate by words or conduct that he will *not* insist upon the occurrence of the condition before performing his duty. In some circumstances, his willingness to forego the benefit of a condition will excuse that condition. When this occurs, the promisor has *waived* the condition. While you cannot, obviously, waive conditions which benefit *another* party, you may unilaterally waive any contractual provisions which exist *for your benefit*.

a. **A Party May Retract His Waiver**

If the party receiving the benefit of a waiver has (1) given no consideration for it and (2) *not* detrimentally relied on it, then the party *giving* the waiver (the promisor) generally has the power to reinstate the condition.

1. Continuation of Performance

If you *continue* your own performance *after* learning that a condition to a duty has not occurred, your conduct may operate as a waiver of that condition.

2. Waiver of Subsequent Conditions

If a contract contains a series of similar conditions, waiver of *one* condition by accepting benefits generally will *not* excuse the later conditions. Importantly, though, if a party *accepts* several *similarly defective performances* without objecting, his conduct may lead the other party to justifiably conclude that *all such conditions were intended to be excused*.

EXAMPLE: Joe, from *Joe's Electric Company*, accepts a job to install the electric wiring for a theater soundstage owned by the Monty Burns Foundation ("MBF"). The contract price is to be paid in nine installments and an architect's certificate is a *condition* to MBF's duty to make such payments. Joe does the work and bills accordingly. MBF pays the first seven installments on account without the Architect's certificate. Joe completes his contract work and submits his final invoice. However, MBF refuses to pay the final two payments and Joe sues MBF.

Assuming that the Architect would testify that Joe's work did not deviate from the project specifications would Joe recover if *MBF* defended against the suit on the grounds that Joe did not procure an Architect's certificate for the last payment?

2. Assignment and Delegation

a. Generally

A contract "assignment" occurs when a party to an existing contract transfers to a third-party his *rights* under the contract. In contrast, a "delegation" is made when an existing party to a contract appoints a *third-party* to perform his *duties* under the contract. Most often, though not always, an existing party will *both* assign and delegate (i.e. delegate his duty to perform the work and assign his right to be paid for the work). With the exception of those rights that are covered by state or federal law, an assignment of contract rights does *not* have to be in writing.

b. What rights may be assigned?

With a few limited exceptions, most of which deal with basic fairness concerns, *all contract rights* are usually assignable. Examples of

rights that are not assignable include *certain personal services contracts* (where the unique nature may affect the bargain between the parties) and *insurance policies* (where the premium can vary depending on the insured).

c. **Continued Liability of Delegator**

When a right is *assigned*, the assignor's interest in that right is normally extinguished. For example, a subcontractor can assign his right to be paid to his creditor. When performance of a duty is *delegated*, however, the delegator *remains liable*. For example, if subcontractor "A" delegates his duty to perform to subcontractor "B," subcontractor "A" will *still* be liable if subcontractor B fails to perform. The reason for this rule is to ensure that potential delegators take care in picking a delegatee. If this were not so, parties could be free to delegate their respective duties to persons with no ability to perform (i.e., an owner delegating his duty to pay his contractor to a bankrupt corporation) and thereby effectively escape having to pay for work for which they benefitted from.

d. **Novation**

An exception to the 'continued liability of the delegator' rule is when the person who is owed the duty (the "obligee") agrees to accept the performance of the delegatee and release the delegator. If this occurs, and if the delegatee expressly agrees to perform, or "*assume*," the delegator's duties the obligee has given a "*novation*." A novation releases the delegator from liability for the delegatee's failure to perform. It is important to note, however, that the person to whom the duty is owed (the obligee) *must* consent to the novation for it to be effective. If the obligee does not consent, you have a simple *delegation* and if the third-party fails to perform, the original party who delegated his duties may be held liable for breach.

e. **Non-Delegable Duties**

As a general rule, a duty of performance is delegable unless the person who is owed the performance has a *substantial interest* in having the *delegator* and no one else perform. Typically, construction contracts are expressly not assignable because the party contracting does not want an unqualified or unfamiliar company performing its work.

f. **Rescission**

A rescission is basically a "*canceling*" of the contract. So long as the contract is *executory* on both sides (i.e., neither party has fully performed), those parties may agree to cancel their contract. If one

party *has* fully performed, however, the parties *cannot agree* to rescind the contract because there has been no mutual consideration. If one party to the contract commits fraud, duress, mistake, or material breach, the other party may *unilaterally* cancel (or terminate or “unilaterally rescind”) the contract.

g. **Accord and Satisfaction**

An executory *accord* occurs when parties to a contract agree that one party may provide a *subsequent performance* (in the future) and the other party agrees to *accept* that substitute and discharge the existing duty. While such an agreement is enforceable, the accord does *not discharge* the previous contractual duty *until the terms of the accord have been performed*. Once the terms are performed there has been an accord *and* satisfaction. If a party does not *perform* under the terms of the executory accord, the other party has the option of suing for breach of the *original* agreement *or* breach of the accord.

EXAMPLE: Joe, from *Joe's Electric*, signs a \$5,000 contract with Mr. Homeowner for certain electrical work at Homeowner's house. Joe soon realizes, however, that because of other jobs, he will be unable to perform the contract work in a timely manner. Joe recruits a substitute company, *National Electric Company*, to do the work at Homeowner's house. If Mr. Homeowner gives his consent to having *National* perform the work *and* releases *Joe's Electric* from liability, the result is a novation. If Homeowner does not consent, Joe can probably still delegate his duties and assign his right to payment to *National*, but risks remaining liable for *National's* work.

II. THE PRINCIPAL TYPES OF CONSTRUCTION CONTRACTS

A. Fixed Price or "Lump Sum" Contracts

A fixed-price, or "lump sum" contract is a type of contract where the parties establish a **firm** pricing arrangement **at the time of contracting**. Under such contracts, payments are made to the contractor or subcontractor on the basis of pre-established prices or a Schedule of Values against which the progress of the work is measured. In general, a "firm-fixed-price" contract is **not** subject to adjustments on the basis of the contractor's *actual* in-the-field costs.

B. Cost-Plus-A-Fee Contracts

Cost-plus-a-fee contracts are essentially **cost-reimbursement contracts** in which the contractor is paid for the **actual incurred costs** to the extent such costs are "**allowable**" under his contract. On top of the costs, however, is a **fee** (or "profit") that is fixed at the inception of the contract. Many such contracts will also contain a "**guaranteed maximum price**" ("GMP") which acts as a ceiling on the total costs which the contractor can recover. As an incentive to bring the project in "under" the GMP, most GMP contracts provide that the contractor (or subcontractor) will receive a percentage of the savings he is able to realize under the GMP.

C. Design-Build Contracts

Design-build contracts are contracts where the contractor also acts as the designer (or "architect") of the project. The benefits of a design-build contract to an owner include a single point of responsibility and an elimination of construction claims based on design deficiencies. Disadvantages of such contracts include the loss of independent judgment of building design professionals stemming from the financial risks which often occur on the "build" side of the design/build process.

D. Time and Materials

1. Generally

A "**time and materials**" ("T&M") contract is the subcontractor's equivalent to a general contractor's cost-plus-a-fee contract. Under a T&M contract a

subcontractor will be paid his *labor and material* costs plus a percentage mark-up on those costs (or “fee”) for *overhead and profit*. The most frequent use of T&M contracts comes in situations where the general contractor has encountered difficulties and must hire either a replacement subcontractor or must authorize extra work from his current subcontractor and there is not sufficient time to allow for a detailed and comprehensive fixed price proposal for the work.

2. **“Not to Exceed”**

A “*not to exceed*” clause in a T&M contract is the functional equivalent of the GMP in a cost-plus-a-fee contract. Essentially, the subcontractor estimates the upper limits of what his work may cost and the subcontractor bears the risk that his costs may exceed that number.

E. **Use of Form Subcontracts**

0. **Common Forms Used in the Industry**

a. **American Institute of Architects Standard Form Subcontract**

The American Institute of Architects (“AIA”) standard form contracts are perhaps the most widely used of the general industry form contracts. The cornerstone of the AIA document family is AIA A201, *General Conditions of the Contract for Construction (1997)* (the “A201”), which defines the basic roles of the parties by identifying the rights and obligations of owners, architects, contractors, and subcontractors. AIA Document A401, *Standard Form of Agreement Between Contractor and Subcontractor (1997)* (the “A401”), is the relevant document which defines the contractor-subcontractor relationship. The A401, however, expressly provides that the subcontract’s general provisions *will be the A201*. As a practical matter, this is unique because (1) as a general rule most subcontracts do not have their own set of general conditions, and (2) it opens up the possibility that the subcontract general conditions will be the A201 even when the A201 is not part of the prime contract between the owner and general contractor.

b. Associated General Contractors Standard Form Subcontract

The Associated General Contractors (“AGC”) standard form contracts are another widely-used form contract. The AGC Document 600 - *Subcontract for Building Construction* (the “AGC 600”) - is the traditional AGC document governing contractor and subcontractor relationships. In 1998, however, the AGC introduced two new standard subcontract forms -- **the AGC Document 650 (1998)** (the “AGC 650”) and the **AGC Document 655 (1998)** (the “AGC 655”). These documents were developed in an attempt to be fairer to subcontractors, many of whom perceived the AGC 600 as being unduly harsh because of its strict conditional payment (or “pay-if-paid”) provision. Pay-if-paid clauses are clauses in which the general contractor has no obligation to pay the subcontractor unless the general contractor is first paid by the owner.

The Associated Specialty Contractors (“ASC”), an umbrella organization comprised of numerous specialty contractors associations, including the National Electrical Contractors Association, has endorsed the AGC 650, making it the first AGC standard document to be endorsed by another construction industry trade organization. Essentially, the AGC 650 and AGC 655 are similar except that AGC 655 (which the ASC has not endorsed) contains a pay-if-paid clause while the AGC 650 mirrors the AIA A401 payment terms in that it obligates a general contractor to pay its subcontractors provided the owner’s non-payment is not related to any fault or failing of the subcontractor.

c. The AGC/American Subcontractors Association (ASA)/and Associated Specialty Contractors (ASC) Standard Form Subcontract

The AGC/ASA/ASC standard form construction subcontract was developed in 1994 through the joint efforts of the three named trade-groups. This subcontract was intended to be compatible with the A201. The cooperation of the various trade groups led to a document in which the parties’ rights and responsibilities were more evenly apportioned than other documents. Although originally viewed as a breakthrough in contractor/subcontractor relations, shortly after its introduction the AGC withdrew its support of the document primarily because of outcry from local AGC chapters over the document’s absence of a “pay-if-paid” provision. As a result, this contract’s use is increasingly rare. In 1998, the AGC drafted the AGC documents 650 and 655 (discussed above) as a compromise. The ASC actually participated in the drafting process of the AGC’s 650 and 655 documents while the ASA declined input.

2. **Advantages of Trade Association Form Subcontracts**

Industry-wide form contracts offer many advantages, not the least of which is that their use *reduces the amount of negotiation* that would otherwise occur between the parties. Additionally, the contracts are *comprehensive* as they have evolved over the years and had many provisions tested in a court of law. Finally, although the form contracts tend to reflect the priorities of the trade group which authored the contract, the contracts also strive for a *rough parity between the parties*, and certainly are much fairer across the board than many general contractors' own specially-drafted subcontracts.

3. **Disadvantages of Trade Association Subcontracts**

While industry-wide form contracts have many advantages, they are not without a downside. First, most such subcontracts contain so-called “*flow-down*” and/or “*pass-through*” provisions wherein the subcontractor is bound to accept terms and conditions and obligations in the prime contract between the general contractor and owner. Second, the subcontracts may tie a subcontractor to a dispute or other proceeding that does *not involve* him or his work. In other words, a subcontractor may be drawn into a large proceeding in which he is but one small actor in a much larger and more-complicated dispute. Lastly, general contractors may be *reluctant to change the terms* of such form subcontracts.

4. **General Contractor Form Subcontracts**

Many large local, regional, and general contractors have their own form subcontracts which they have specially-drafted for their own use. As a general rule, these subcontracts are heavily-laden with terms and conditions which *favor the general contractor*. In fact, some terms can be downright onerous to subcontractors. (Particular subcontract provisions to look out for are discussed later in these materials.) If a general contractor asks a subcontractor to sign its form subcontract, the subcontractor must be prepared to carefully read and think through the implications of the subcontract's provisions. *Before* signing, you should *flag* and attempt to *negotiate changes* to the most offensive provisions. Depending on the general contractor's willingness to making changes –and, more important, the nature of the provisions which the general contractor refuses to change-- subcontractors must *balance* the benefit of the work now (and future work with the general contractor) against the possibility that the subcontract's unfavorable terms will result in losses.

5. **Dealing With Your Suppliers**

a. **Use of Purchase Orders**

Purchase orders are another type of form contract. Often times, despite the use of purchase orders, subcontractors have little control

over the terms imposed by a supplier especially when a supplier is specified and requires their order form to be used before supplying the requested goods.

b. Common Problems and Issues

As noted above, the law regarding the sale of goods is governed by the Uniform Commercial Code (“UCC”). Under UCC § 2-201(1), “a contract for the sale of goods for the price of \$500 or more is **not enforceable** . . . unless there is some writing sufficient to indicate that a contract for sale has been made.” There are three exceptions to this rule, however: (i) goods that have been **specialty manufactured** for the buyer; (ii) if the party who is being sued **admits** in his pleading, testimony, or otherwise in court that a **contract for sale was made** “but the contract is not enforceable . . . beyond the quantity of goods admitted,” UCC § 2-201(3)(b); and (iii) if the goods have been **paid for** or **received and accepted**. UCC § 2-201(3)(c).

The entire purpose of the UCC is to find **enforceable contracts** for the sale of goods. As such, while under general principles of contract law a **major mistake** in the writing as to price, quantity or even a description of the item will likely invalidate the contract, mistakes in the sale of goods will not necessarily be fatal under the UCC (although a plaintiff may only recover the actual amount stated in the erroneous writing). Note that if the two parties are **merchants**, they will be bound to an enforceable contract even if they **do not sign the memorandum**. This situation occurs where one merchant receives a **signed confirmation** from the other merchant and **does not object** within ten (10) days after receiving the confirmation.

III. DEFINING AND INTERPRETING THE TERMS OF A CONSTRUCTION SUBCONTRACT

A. Determining Which Documents Constitute the Subcontract

As can be seen from the discussion above, contract documents can come in many different forms. Determining which documents constitute your subcontract is vitally important to understanding your legal rights and duties. As a starting point, most subcontracts attempt to define the subcontract documents. For example, Article 1.1 of the AIA A401 provides that:

1.1 The Subcontract Documents consist of (1) this Agreement; (2) the Prime Contract, consisting of the Agreement between the Owner and Contractor and the other Contract Documents enumerated therein; (3) Modifications issued subsequent to the execution of the Agreement between the Owner and Contractor, whether before or after the execution of this Agreement; (4) Other documents listed in Article 16 of this Agreement; and (5)

Modifications to this Subcontract issued after execution of this Agreement. The Subcontract represents the entire and integrated agreement between the parties hereto and supersedes prior negotiations, representations or agreements, either written or oral. An enumeration of the Subcontract Documents, other than Modifications issued subsequent to the execution of this Agreement, appears in Article 16.

Note that the above subcontract specifically makes the prime contract a part of the subcontract. Accordingly, the obligations the general contractor owes to the owner will “flow down” to the subcontractor. Second, the subcontract expressly provides that subsequent modifications to **both** the prime contract and the subcontract will affect the subcontract terms. Finally, the subcontract contains a section for “other documents” which the parties are free to list in a space provided in article 16 of the subcontract. These “other” documents include, but are not limited to, such items as:

1. documents generated during negotiations;
2. bidding documents;
3. proposals;
4. drawings and specifications;
5. shop drawings, product data, and samples;
6. project schedules;
7. the prime contract;
8. field tickets (i.e., if such tickets show extra work that is the subject of a change order);
9. lien waiver form; and
10. insurance certificates.

B. Typical Subcontract Provisions

In the construction industry, the subcontract documents are more than just “evidence” of an agreement. Subcontract documents also provide guidance for the *administration of the project* and the *prosecution of the work*. Well-drafted agreements integrate all the various contract documents (of the type discussed above) into a cohesive scheme completing the work and the general project administration. As such, it is crucial for all parties to fully understand their rights and obligations under the contract and to be prepared to fulfill those obligations during performance of the contract. To that end, the following are some of the more commonly encountered contract provisions which can greatly affect the success and profitability of the project.

1. Flow-Down or Pass-Through Provisions

These provisions are the provisions under which the rights and obligations of the prime contract “flow-down” (or are “passed-through”) to the subcontractor. While subcontractors are rarely successful in eliminating such clauses, subcontractors should insist upon reviewing the prime contract during contract negotiations and should strive to make clarifications or delete prime contract provisions which are inconsistent with the business terms of their agreement with the general contractor. The following are examples of such provisions.

- a. **FLOW-DOWN RELATIONSHIP:** Subcontractor is bound to the Contractor in the same way and to the same extent Contractor is bound to Owner by the terms of the Contract Documents and shall bear all rights and liabilities with respect to the Contractor as the Contractor has with respect to the Owner, except that the terms of this Subcontract shall govern any inconsistent provision herein and in the Contract Documents. Subcontractor shall not deal directly with or work directly for Owner, Architect or Engineers.
- b. **PASS THROUGH OBLIGATIONS:** In respect to work covered by this Subcontract, Subcontractor shall have all rights which Contractor has under the Contract Documents, and Subcontractor shall assume all obligations, risks and responsibilities which Contractor has assumed towards Owner in the Contract Documents, except as may be expressly modified herein. In case of a conflict between this Subcontract and the Contract Documents, the Subcontract shall govern.

2. Contract Documents Review and Site Inspection Provisions

The Subcontractor represents and agrees that it has carefully examined and understands this Agreement and the other Subcontract Documents, has investigated the nature, locality and site of the Work and the conditions and

difficulties under which it is to be performed, and that it enters into this Agreement on the basis of its own examination, investigation and evaluation of all such matters and not in reliance upon any opinions or representations of the Contractor, or the Owner, or of any of their respective officers, agents, or employees.

Under provisions like the above, where a subcontractor does not independently investigate the site but instead relies on documents or reports furnished by the general contractor (for the purpose of, say, assisting the subcontractor in bid preparation but which turn out to not properly represent on-site conditions), courts may hold that the subcontractor is barred from recovering for extra work relating to the unforeseen conditions. See e.g., Millgard Corp. v. McKee/Mays, 49 F.3d 1070 (5th Cir. 1995).

3. Scheduling Provisions

6.2 Schedule of Work. In a timely fashion, the Subcontractor shall provide the Contractor with any scheduling information proposed by the Subcontractor for the Subcontract Work. In consultation with the Subcontractor, the Contractor shall prepare the schedule for performance of the Contract (hereinafter called the "Schedule of Work") and shall revise and update such schedule, as necessary, as the work progresses. Both the Contractor and the Subcontractor shall be bound by the Schedule of Work. The Schedule of Work and all subsequent changes and additional details thereto shall be submitted to the Subcontractor promptly and reasonably in advance of the required performance. The Contractor shall have the right to determine and, if necessary, change the time, order and priority in which the various portions of the work shall be performed and all other matters relative to the timely and orderly conduct of the Subcontract Work.

©AGC Document No. 640, Standard Form Construction Subcontract, 1994.

EXAMPLE: A masonry subcontractor sued its general contractor for delay damages and acceleration costs based on the general contractor's breach of its *duty to cooperate* with the subcontractor and certain project delays. The contract contained a paragraph which stated "Subcontractor shall proceed with the work according to a progress schedule furnished by the Contractor, *without interference of the work of Contractor* . . . so that the Contractor . . . can complete the work in accordance with the project schedule." The contract also provided that the "Subcontractor acknowledges that it has been informed that the Contractor must complete the general contract [by a date certain] and it is therefore understood and agreed that the work shall be entirely completed on or before per CPM schedule. Time is of the essence in this subcontract." This schedule of work provision obligated the general contractor to properly schedule and coordinate the subcontractor's work, and its failure to do so supported a judgment in favor of the subcontractor.

See Bat Masonry v. Pike - Paschen Joint Venture III, 842 F. Supp. 174 (D. Md. 1993).

4. **Notice Requirements**

Notice provisions are among the most important provisions of a subcontract as compliance with these provisions will have a direct bearing on a subcontractor's claim for extra time or compensation. As such, beware of notice provisions in **Change Order** and **Claims** (time or money) clauses, and always strive to provide detailed notice within the time required. The following is an example of a notice requirement contained in the "**Extras and Omissions**" clause of a large general contractor's form subcontract:

- In the event of any dispute, controversy, or claim for additional compensation or time extensions, notice in writing shall be given to the Contractor no later than seven (7) days following the occurrence on which claim is based. Such notice shall describe the dispute, controversy or claim in detail so as to allow Contractor to review its merits. Any claim not presented within such time period shall be deemed waived by Subcontractor. Promptly thereafter, Subcontractor shall provide detailed information to substantiate such claim including supporting documentation and calculations, and including any information requested by Contractor.

This clause is immediately followed by a clause which states that the general contractor "may" submit such claims or claims to the owner provided that the "Subcontractor has given notice as set forth above **and in the form required by the General Contract**, and has presented the claim to Contractor in sufficient time for Contractor to review the claim . . . and present it to the Owner **within the time required by the General Contract.**" (Emphasis added). This example highlights the importance of requesting a copy of the prime contract because merely complying with the notice provisions in the subcontract is not enough to guaranty that the subcontractor has preserved his claim. Even AIA A401 requires that a subcontractor's claims which the general contractor would have to submit under the general (or "prime") contract must be submitted by the subcontractor "in sufficient time to permit the Contractor to satisfy the requirements of the Prime Contract." AIA Document A401, ¶ 5.3 (1997).

5. **Payment Clauses**

Payment clauses, for obvious reasons, play a vital role in every subcontract. Payment provisions typically address two situations: (1) "**progress payments**," and (2) "**final payment**."

a. **Progress Payments**

Progress payments are payments made to the subcontractor during the course of his work. Most progress payment clauses require the subcontractor to make an application for payment based upon a schedule of values which allocates the entire subcontract sum among the various portions of the subcontract work. These clauses also typically allow the general contractor or architect to withhold or nullify all or parts of the progress payment application until the general contractor or architect is satisfied that deficiencies in the subcontractor's work have been remedied.

b. Final Payment

Final payment warrants a clause to itself, and is generally self-explanatory. For example, the AIA A401 final payment clause provides that:

12.1 Final payment, consisting of the entire unpaid balance of the Subcontract Sum, shall be made by the Contractor to the Subcontractor when the Subcontractor's Work is fully performed in accordance with the requirements of the Subcontract Documents, the Architect has issued a certificate for payment covering the Subcontractor's completed Work and the Contractor has received payment from the Owner. If, for any cause which is not the fault of the Subcontractor, a certificate for payment is not issued or the Contractor does not receive timely payment or does not pay the Subcontractor within three working days after receipt of payment from the Owner, final payment to the Subcontractor shall be made upon demand.

12.2 Before issuance of the final payment, the Subcontractor, if required, shall submit evidence satisfactory to the Contractor that all payrolls, bills for materials and equipment, and all known indebtedness connected with the Subcontractor's Work have been satisfied.

c. Final Payment as Waiver

Subcontractors should pay particular attention to the final payment provisions of their subcontracts. Some general contractors may attempt to insert a provision under which the subcontractor contractually waives his right to make a claim once he accepted a check as "final payment." This is very important and potentially devastating if overlooked or ignored because it is not unusual for a "final" payment to be made while claims for delay, extra work, etc. are still under negotiation. Such clauses may look like the following

and may be inserted as part of an otherwise unobjectionable final payment provision:

- Acceptance of final payment by the Subcontractor shall constitute a waiver of any and all claims by the Subcontractor against the Contractor, the Owner, or the Architect.

EXAMPLE: A subcontractor was found to have waived his claim for additional work after project completion because he accepted two checks bearing the notation "for [project] retainage and all contracts paid in full" and had executed a final payment certification and lien release providing that he was releasing the general contractor "from any and all claims for any sums or amounts due or claimed to be due or which may in the future be claimed to be due for future work." See Melton Welding and Fab. Co., Inc. v. Triple E Constr. Co., Inc., 1994 Tenn. App. LEXIS 122 (1994).

EXAMPLE: A Construction contractor sued its owner for breach of contract under various theories. The owner defended against the claims, pointing out that the contractor had signed a release which stated "In consideration of payments made heretofore, or to be made based upon this invoice for labor, material, equipment, subcontract work, and any and all costs incurred for the performance of the contract work invoiced thus far, the Contractor hereby unconditionally and without reservation releases and indemnifies [the owner] . . . from any and all liens, claims, demands, penalties, losses, costs, damages and liability in any manner whatsoever." The court held that this provision applied to *all* work, including extra work and work not invoiced, and that the waiver defeated the contractor's claim for additional compensation. See Galin Corp. v. MCI Telecommunications Corp., 12 F.3d 465 (5th Cir. 1994).

d. Condition Precedent or "Pay-if-Paid" Clauses

As mentioned earlier, one of the largest rifts between general contractors and subcontractors (and the reason the AGC Document 600 was modified) is the use of condition-precedent payment (or "pay-if-paid") clauses. Under such clauses, regardless of the subcontractor's entitlement to payment for its work, the general contractor has no obligation to pay the subcontractor unless and until the general contractor is first paid by the owner. In other words, the general contractor need only pay its subcontractor "if paid" by the owner. Some subcontracts are fairly open about these condition-precedent clauses, while others, typically the in-house form subcontracts generated by individual general contractors, hide the clauses in otherwise uncontroversial portions of the subcontracts. For example, one large east coast general contractor has the following provision buried in its "payment" article:

- The Contractor shall be under no obligation to make any payment to the Subcontractor except to the extent that the Contractor has received funds from the Owner for the work invoiced by the Subcontractor; that is to say, the Subcontractor shall not be entitled to payment **if for any reason, including the Owner's financial situation or lack of available funds**, the Owner fails to pay the Contractor in accordance with the General Contract; such payment being a condition precedent to any obligation of Contractor to Subcontractor.

Note that under this clause, the contractor is under no duty to pay the subcontractor *even* if the failure of the contractor to receive payment is *solely the fault of Contractor*. Later on, in the same form subcontract, under a different subheading of the payment article, the subcontract again provides that:

- Notwithstanding any other provisions of this Agreement, Contractor shall be under no obligation to make any payment to the Subcontractor . . . except to the extent that Contractor has received funds from Owner, payment by Owner being a condition precedent to payment of the Subcontractor.

Such provisions, however, tend to be narrowly interpreted by most courts. Under New York's lien law, for example, any contract waiving the right to file or enforce a lien is void against public policy. In the case West-Fair Electric Contractors v. Aetna Casualty & Surety Co., 87 N.Y.2d 148, 153 (1995), *aff'd* 78 F.3d 61 (2nd Cir. App. Ct. 1996), the Court of Appeals of New York held that the lien law *prohibits* a pay-when-paid provision in a subcontract because such provision operates to transfer the risk of an owner's default from a general contractor to a subcontractor.

6. Claims

a. Generally

The AIA A201 General Conditions define "claims" as follows:¹

4.3.1 Definition. A Claim is a demand or assertion by one of the parties seeking, as a matter of right, adjustment or interpretation of Contract terms, payment of money, extension of time or other relief with respect to the terms of the Contract. The term "Claim" also includes other disputes and matters in question between the Owner

¹ NECA has published a valuable booklet titled *Guide to Electrical Contractors Claims Management*, ©1980. Although dated, the booklet gives a detailed overview of the causes and effects of schedule disruptions, types of damages generally available, and ways in which to categorize and calculate your damages.

and Contractor arising out of or relating to the Contract. Claims must be initiated by written notice. The responsibility to substantiate Claims shall rest with the party making the Claim.

4.3.2 Time Limits on Claims. Claims by either party must be initiated within 21 days after occurrence of the event giving rise to such Claim or within 21 days after the claimant first recognizes the condition giving rise to the Claim, whichever is later. Claims must be initiated by written notice to the Architect and the other party.

b. Categories of Claim Provisions

i. Additional Costs

The following is a typical “additional costs” clause taken from AIA A201.

4.3.5 Claims for Additional Cost. If the Contractor wishes to make Claim for an increase in the Contract Sum, written notice as provided herein shall be given before proceeding to execute the Work. Prior notice is not required for Claims relating to an emergency endangering life or property arising under Paragraph 10.6.

4.3.6 If the Contractor believes additional cost is involved for reasons including but not limited to (1) a written interpretation from the Architect, (2) an order by the Owner to stop the Work where the Contractor was not at fault, (3) a written order for a minor change in the Work issued by the Architect, (4) failure of payment by the Owner, (5) termination of the Contract by the Owner, (6) Owner's suspension or (7) other reasonable grounds, Claim shall be filed in accordance with this Paragraph 4.3.

ii. Additional Time

Claims for additional time -- delay claims -- are just as important as claims for extra cost, since a subcontractor's inability to finish his work per his original schedule can lead to costly backcharges and delay claims from the general contractor, liquidated damages from the owner which are "passed-through" to the subcontractor and extended general conditions and other delay-related costs.

Most subcontracts require delay claims to be made promptly once the subcontractor becomes aware of a project event which may affect the progress of the work. In addition, most subcontracts require claims that are the owner's responsibility to be filed in sufficient time to satisfy the prime contract's notice requirements. To this end, the following is an example of a typical general contract claim clause regarding additional time from AIA A201:

4.3.7 Claims for Additional Time

4.3.7.1 If the Contractor wishes to make Claim for an increase in the Contract Time, written notice as provided herein shall be given. The Contractor's Claim shall include an estimate of cost and of probable effect of delay on progress of the Work. In the case of a continuing delay only one Claim is necessary.

4.3.7.2 If adverse weather conditions are the basis for a Claim for additional time, such Claim shall be documented by data substantiating that weather conditions were abnormal for the period of time and could not have been reasonably anticipated, and had an adverse effect on the scheduled construction.

©AIA Document A201, General Conditions of the Contract for Construction, 1997.

Delay claims and changes clauses are discussed later in these materials in greater detail.

IV. ISSUES ARISING DURING ADMINISTRATION AND PERFORMANCE OF THE CONSTRUCTION PROJECT

A. Differing Site (or Changed) Conditions

1. Generally

The term "differing site conditions" describes any *on-site physical condition* that is substantially different from what the subcontractor reasonably

expected to encounter and which increases the amount of time and/or money required to complete the project.

In dealing with changed conditions, the courts have traditionally grouped differing site conditions claims into the following two categories:

- “Type I” conditions are conditions at the site that differ materially from the conditions indicated in the contract.
- “Type II” conditions are unknown and unusual physical conditions at the site which differ materially from those ordinarily expected to be found in work of the character shown in the contract.

2. “Type I” Conditions

A Type I condition depends on representations made in the contract documents as to the conditions the contractor is likely encounter. Under the *Spearin* doctrine, named after the 1918 U.S. Supreme Court decision where the doctrine was first established, an owner who issues bid documents is held to *impliedly warrant* the accuracy of the documents. Thus, a dispute regarding a Type I condition is, in a sense, no different from any other dispute arising out of an alleged error in the contract documents. The focus of a Type I conditions dispute is whether the contract contains a binding *affirmative statement* as to what type of conditions the contractor can expect to encounter on the project site. Having made an affirmative representation, the owner then naturally assumes the responsibility and risk for any damages which may result if the contractor relied upon that representation.

3. “Type II” Conditions

A Type II condition occurs when the contract does not purport to detail the conditions the contractor will encounter and unexpected conditions are discovered in the course of the work. In such a situation, the courts will attempt to determine what the contractor could have *reasonably expected* when bidding the project. In general, a contractor should have a valid claim for a Type II condition if two requirements are met: (1) the physical conditions encountered differ substantially from those *ordinarily encountered and generally recognized as inherent in the work* being performed; and (2) that difference in conditions causes a *change in the construction methods* required for the performance of the work which results in an *increase in the cost* of the work. If the above factors are met, a court might find that a Type II changed condition existed and that the contractor is entitled to an equitable adjustment of the contract.

4. Differing Site Conditions Clauses

The two types of differing site conditions are covered by the following clause, which is taken from AIA A201:

4.3.4 Claims for Concealed or Unknown Conditions. If conditions are encountered at the site which are (1) subsurface or otherwise concealed physical conditions or (2) unknown physical conditions which differ materially from those ordinarily found to exist and generally recognized as inherent in construction activities of the character provided in the Contract Documents, then notice by the observing party shall be given to the other party promptly before conditions are disturbed and in no event later than 21 days after first observance of the condition If the Architect determines that the conditions at the site are . . . materially different, the Contract Sum and Contract Time shall be equitably adjusted . .

. .

B. Changes, Change Orders and Extra Work

During the progress of any construction project, changes in the scope of the work are likely to occur. Most construction contracts anticipate these changes and include a “changes” clause. The purpose of a changes clause is to allow the owner to direct the contractor to make changes in the work without invalidating the contract or allowing the contractor to sue for breach of contract if he believes that a given change is beyond the scope of the original agreement. Hence, the changes clause provides a means for orderly administration of the changes which will inevitably occur in the scope of the contractor’s work. Subcontracts typically incorporate both the prime contract’s changes clause, and have subcontractor-specific changes clauses as well.

1. Types of Changes

a. Owner-Generated Change Orders

Where the owner makes changes in the design of the project after the general contract has been executed, the resulting change is an *owner-generated change*. Owner-generated change orders can also come about as the result of changes (i.e., additions, deletions, substitutions, etc.) made by the owner’s design team during the course of the project. While owner-generated changes may lead to entitlement issues regarding whether the change is actually a change in the scope of the work, the bulk of the disputes (if there are any at all) tend to result from the pricing of such change order work. Pursuant to industry custom and practice, as well as most subcontracts, subcontractor claims resulting from owner-generated changes are “passed-through” to the owner and the subcontractor is limited in its recovery to the amount the general contractor has received from the owner for such claims.

b. General Contractor-Generated Change Orders: “Constructive Changes”

These are changes to a subcontractor’s scope of work which do not arise from design changes but rather from the general contractor’s administration of the work. Typical examples may include acceleration, disruption, overtime, additional clean-up, or repair of damages caused by other subcontractors. Many subcontracts have different notice requirements and procedures for this type of claim.

c. Cardinal Changes

A “*cardinal change*” is a change that, by its *magnitude*, is *beyond the scope* of the subcontract. For instance, if an electrical subcontractor has a \$40,000.00 contract to perform electrical work and the general

contractor attempts to add \$150,000.00 of masonry work to the scope via the changes clause, the electrical subcontractor would probably be successful in refusing to perform the work under the “cardinal change” doctrine. As such, cardinal changes are not governed by contractual “change” provisions because changes clauses only govern changes that are *within the scope* of the contract. If a court finds that a cardinal change has occurred, the general contractor has breached the subcontract and the subcontractor does *not* need to perform the additional work. Importantly, however, courts rarely find cardinal changes and there is no bright-line rule to determine whether or when a cardinal change has occurred. As such, any allegation of a cardinal change must be analyzed on its own facts and circumstances, and courts will give primary consideration to the *magnitude and quality* of the changes ordered and their *cumulative effect* upon the subcontractor’s work (and the project) as a whole.

A subcontractor walks a fine line between fulfilling its duty to perform changes and refusing to perform since agreeing to change orders (bilateral modifications) of the contract can effectively waive its right to claim cardinal changes.

EXAMPLE: In *Amertex Enterprises, Ltd. v. United States*, 108 F.3d 1392 (Fed. Cir. 1997), the Federal Circuit Appeals Court held that a contractor *waived* its cardinal change claim even though the government had issued over 100 changes to the contract specifications. The waiver occurred when the parties agreed to a revised payment scheme and delivery schedule. The court stated that “[n]otwithstanding the evidence supporting plaintiff’s plausible and *potentially convincing* cardinal change assertion, plaintiff’s position on the issue is fatally undercut by the bilateral modification made to the delivery schedule in 1988.”

In essence, courts may likely view a change order as evidencing a “meeting of the minds” which creates an enforceable contract and replaces any parallel provisions of the original contract. Additionally, by making the changes, a contractor or subcontractor may be found to have implicitly agreed that the changes were within the changes clause of the contract. Since there can *only* be a cardinal change where an owner or general contractor requires its contractor or subcontractor to perform *materially different duties* from those bargained for in the contract *as modified*, the change order can undercut any attempt to claim a cardinal change.

2. Responsibilities of the Subcontractor, Contractor, and Owner in Relation to the Changed Work.

a. Subcontractor's Duty to Perform Changes

Inevitably, conflicts regarding changes arise between the owner and contractor because neither the owner nor the architect is willing to acknowledge that the work is a change or that the contractor has a right to additional compensation and/or additional time to complete its work. This conflict originates from the natural tension that exists between the owner (and its design team) and the contractor (and its subcontractors) who are charged with the responsibility to turn the owner's design into reality. A further conflict may arise if a subcontractor completes a change at the order of the general contractor and yet is not paid when the owner refuses to recognize the legitimacy of the change.

Because owners typically reserve the right to make changes in the work a contractor generally has a *duty to perform* all owner-mandated changes. In turn, the subcontractor is usually bound to follow the owner's changes --delivered through the general contractor -- through a clause like the following:

5.2 The Subcontractor may be ordered in writing by the Contractor, without invalidating this Subcontract, to make changes in the Work within the general scope of this Subcontract consisting of additions, deletions or other revisions, including those required by Modifications to the Prime Contract issued subsequent to the execution of this Agreement, the Subcontract Sum and the Subcontract Time being adjusted accordingly. The Subcontractor, prior to the commencement of such changed or revised Work, shall submit promptly to the Contractor written copies of a claim for adjustment to the Subcontract Sum and Subcontract Time for such revised Work in a manner consistent with requirements of the Subcontract Documents.

©AIA A401 -- Standard Form of Agreement Between Contractor and Subcontractor (1997).

Under most changes clauses, the subcontractor *cannot* refuse to perform the additional work *even if there is a disagreement on entitlement and/or cost*. The only situation where a contractor or subcontractor may confidently refuse to complete a change is when (and if) the contractor or subcontractor can demonstrate that the extra work amounts to a "cardinal" change. Courts, however, are generally unwilling to find "cardinal changes." As a result, it is highly advisable to complete all "change" work properly ordered through the

subcontract. Failure to do so can expose a subcontractor to liability for breach of contract and the damages resulting therefrom.

b. Contractor's Duty to Compensate

Apart from the “construction change directive” procedure in the AIA A201, most changes clauses do *not* allow a contractor to be paid for the undisputed part of the change. Therefore, prudent subcontractors should amend the changes clause in their subcontract to provide that if ordered to complete a change, their work will proceed without disruption *but* they have the right to: (1) be paid for the *undisputed portion* of the change; and (2) recover, if possible, the balance of the cost of the change at the *conclusion of the project*. At minimum, changes clauses should provide for the parties to “agree to disagree” on disputed portions of the change, i.e., entitlement and direct and indirect costs. This will ensure that progress will not be disrupted due to a disagreement about the existence or scope of an alleged “change.”

3. Who has authority to order changes?

Another problem associated with change orders is the issue of who has authority to issue changes to the project. Occasionally, courts must decide whether a given party in the construction process - owner, construction manager, architect, or contractor- had the authority to issue a change order. In general, most changes clauses in prime contracts specifically limit the authority to issue a change order to the *owner*. In some instances, however, such as where the contract language is ambiguous, the *architect* may direct the contractor to perform a change. In any event, subcontractors need only answer to the party with whom they are in privity -- the general contractor. If the general contractor orders its subcontractor to make a change that is not authorized by the owner (perhaps the general contractor is wrongfully taking directions from the architect), in most circumstances the subcontractor *must* perform those changes. Thus, the general contractor bears the risk of having to compensate its subcontractor if the owner successfully disputes that it issued the change.

4. Changes Clauses: Notice Requirements and Other Required Procedures

The requirement of *written* notice for change orders is another widely-litigated issue. The typical changes clause requires that the subcontractor only perform changes in the work within the general scope of the subcontract upon the issuance of a “*written change order*.” Some subcontracts, however, go an extra step and require that subcontractors perform extra work when ordered to do so even if there is no agreement as to the cost of the change. For example, the form subcontract of a large general contractor requires that:

- In the event that the Contractor directs Subcontractor to perform extra or additional work, Subcontractor agrees that it will promptly perform or diligently complete such work ***whether or not Contractor and Subcontractor have agreed on the cost of such Work***. . . . The Contractor shall not be liable for payment for any extra work performed by the Subcontractor unless such work is first expressly authorized by the Contractor in writing. (Emphasis added)

This clause provides that if the parties cannot agree on a lump sum or unit price for the extra work, the subcontractor will do the work on the basis of its actual costs plus a set percentage fee for overhead and profit. Note however, that the last sentence of the above clause provides that notwithstanding the subcontractor's duty to "promptly" perform additional work when directed to do so, the subcontractor ***must*** insist that it receive ***written*** instruction to do so or it will ***forfeit its right to be compensated*** for the extra work.

For claims relating to changes which are ***not*** ordered by the contractor (delay, disruption, etc.) most subcontracts require the subcontractor to give the general contractor written notice of the claim and/or the events giving rise to the claim. Despite these requirements, it is not uncommon for subcontractors' to perform additional work with only verbal authorization from the general contractor. This practice of proceeding without written authorization is, again, risky as failing to adhere to a contractual notice requirement can doom a claim.

The AIA A401, Article 5.3, requires that all claims for additional costs, time extensions, and/or damages for delay must be made promptly by the subcontractor and that the claims be received by the general contractor "not less than two working days" before the time which the general contractor's claim must be submitted to the owner under the *prime contract*. The purpose of requiring that claims be submitted in such a fashion is to ensure that the owner has an opportunity to analyze the situation and, if necessary or possible, proceed with a less costly alternative. If the subcontractor or general contractor fails to provide proper notice, and instead performs the change order work and later bills for the extra work, the owner may claim that it was denied the ability to seek a less costly alternative to that which was actually performed. Thus, if a subcontractor does not timely submit his claim, the subcontractor risks not recovering for his work.

From the subcontractor's perspective, the importance of obtaining a written directive to perform change order work is amplified if the subcontractor believes that the additional work results from ambiguities or errors in the plans or specifications. For example, if the subcontractor is aware of an ambiguity in the specifications and nevertheless performs the "additional" work without first obtaining a written directive from the general contractor which resolves the error or ambiguity, a court may later find that the

subcontractor acted as a *volunteer*. In such a case, the subcontractor will likely ***forfeit the right to be compensated*** for the additional work which he “voluntarily” undertook.

Obviously, situations occur where strict enforcement of contract provisions calling for written authorization before payment is made for extra work may result in injustice to the subcontractor. For instance, the subcontractor might be required to perform substantial extra work in order to correct a clear error in the contract documents. However, if the owner or general contractor is unwilling to acknowledge the change as a legitimate extra, the subcontractor often has little choice but to proceed with the work under protest to maintain the project’s progress.

1. Constructive or Actual Notice

Contractual notice requirements are often strictly construed by the courts. In certain situations, subcontractors have successfully avoided the requirement of giving timely written notice by demonstrating that the general contractor had actual or constructive notice of the claim. Thus, even if it is obvious that the general contractor had actual verbal notice or is clearly aware of a changed condition or other extra work being performed on the job site, a prudent subcontractor will give detailed ***written*** notice of all claims as required by the subcontract. By giving such notice the subcontractor can remove a potentially large obstacle to recovering its claims.

C. Delay, Disruption, Acceleration and Other Claims

1. Delay

Many different types of claims may arise out of a construction contract. Among the most common types are delay, disruption and acceleration claims.

a. Generally

Delay claims involve a request for an ***increase in the time needed to complete*** the project and/or an increase in the contract price, for additional time-related costs incurred during a period of delay. The owner may seek *delay damages* from a contractor who may then seek collection from the responsible subcontractor.

Delay claims are among the most common of claims arising out of construction projects. As a result, subcontracts usually contain specific clauses relating to delay claims and the caselaw interpreting such clauses is highly developed. Two general categories of delays exist: (i) *excusable* or (ii) *inexcusable delays*. Delays are also categorized as (a) *compensable*, (b) *noncompensable*, or (c) *concurrent*.

i. Excusable Delays

If a subcontractor is delayed through no fault of its own, but also through no fault of the general contractor or owner, the delay is “excusable.” This generally means both that he will not be entitled to recover the extra costs for the extended performance necessitated by the delays that the owner and general contractor are precluded from assessing damages for delay against the subcontractor.

If the delay is *excusable*, but *not compensable*, the subcontractor will generally be entitled to a *time extension*, but not additional compensation.

ii. Inexcusable Delay

Inexcusable delays are delays which are the fault and responsibility of the subcontractor. A subcontractor cannot recover a time extension or additional amounts if he has caused an inexcusable delay and may even be liable to the owner or contractor for damages.

iii. Compensable Delays

For a delay to be compensable, the subcontractor must prove that the general contractor or owner was responsible. Examples of *compensable delays* include the general contractor’s:

- failing to provide access to the job site;
- failing to supply general contractor-furnished materials in a timely manner;
- failing to provide adequate plans and specifications;

- failing to respond to subcontractor inquiries in a timely manner.

See e.g., Rao Elec. Equip. Co. v. State, 321 N.Y.S2d 670 (Civ. App. Div. 1971); Litchfield Constr. Co. v. City of New York, 244 N.Y. 251 (1926); L.L. Hall Constr. Co. v. United States, 379 F.2d 559 (Ct. Cl. 1966).

iv. **Concurrent Delays**

Delays are deemed *concurrent* when both the general contractor *and* the subcontractor are partially responsible. In this situation, both parties will be found to have contributed to an overall project delay as a result of simultaneous delays to work activities within their respective control. Historically, courts were reluctant to apportion delay for the purposes of assessing damages, believing that if the party seeking damages was at all responsible for *any* of the delay, it had *forfeited* the right to recover damages. However, this has changed. The modern view is that damages will be *apportioned* where the delay is fairly attributable to both parties.

b. **Contract Delay Clauses**

The following is an example of one of the more subcontractor-friendly delay clauses.

13.3.1 If the Subcontractor is delayed in the performance of the Subcontract Work for any reason beyond the Subcontractor's control, and without the Subcontractor's fault or negligence, including delays caused in whole or in part by the Contractor, Owner, Architect or any other persons, entities or events, or if the Subcontract Work is delayed by order of the Contractor, Owner or an authorized representative of either, or if the Subcontract Work is delayed for any reason or cause for which the Contractor, Owner or Architect concludes has resulted in excusable delay, then the Subcontractor is entitled to an extension of the Subcontract Time in which to complete its work. Said extension shall be set forth in a Subcontract Change Order for such time as the parties may agree is reasonable.

13.3.2 Claims relating to time shall be made in accordance with applicable provisions of the Subcontract Documents. This Article 13 does not preclude recovery of damages for delay by either party.

c. No Damages For Delay Clauses

“No damages for delay” clauses are inserted into contracts and subcontracts to *forfeit* a contractor’s or subcontractor’s claim for delay-related *monetary* damages by restricting that party’s remedy for delay damages to a *time extension* only. Because of its harsh effects, courts will strictly construe such provisions against the owner or general contractor. Likewise, the party looking to enforce a no-damages provision (the owner or general contractor) generally *bears the burden* of proving a particular delay damage claim falls within the ambit of the contract provision.

The following is an example of a no damages for delay clause in a prime contract:

- Notwithstanding anything to the contrary in the Contract Documents, an extension in the Contract Times, to the extent permitted under Paragraph 12.1, shall be the sole and exclusive remedy of the Contractor for any: (1) delay in the commencement, prosecution or completion of the Work; (2) hindrance or obstruction in the performance of the Work; (3) loss of productivity; or (4) other similar claims (collectively referred to in this paragraph as Delays) whether or not such Delays are foreseeable. In no event shall the Contractor be entitled to any compensation or recovery of any damages, in connection with any Delay, including, without limitation, consequential damages, lost opportunity costs, impact damages, or other similar remuneration. The Owner's exercise of any of its rights or remedies under the Contract Documents (including, without limitation, ordering changes in the Work, or directing suspension, rescheduling or correction of the Work or terminating this agreement for its convenience), regardless of the extent or frequency of the Owner's exercise of such rights or remedies, shall not be construed as active interference to the Contractor's performance of the Work. If the Contractor submits a progress report indicating, or otherwise expressing an intention to achieve completion of the Work prior to any completion date required by the Contract Documents or expiration of the Contract Times, no liability of the Owner to the Contractor for any failure of the Contractor to so complete the Work shall be created or implied.

EXAMPLE: In Marriott Corp. v. Dasta Constr. Co., 26 F.3d 1057 (11th Cir. 1994), a contractor was held *not entitled to relief* even though evidence showed the owner was responsible for certain delays because the prime contract contained a no damages for delay clause which obligated the contractor to submit a written request for a time extension before it could recover delay damages. The clause in question provided that the "Owner . . . shall not be held responsible for any loss or damage sustained by Contractor, or additional costs incurred by Contractor, through delay caused by Owner . . . or [its] agents or employees, or any other Contractor or Subcontractor, or by abnormal weather conditions, or by any other cause, and Contractor agrees that the sole right and remedy therefor shall be an extension of time."

In that case, which was governed by Florida law, the general contractor's failure to request an extension of time proved fatal to its claim. This is because Florida law allows for a recovery of damages only if the owner *wrongfully* refused to grant a time extension. The U.S. 11th Circuit Court of Appeals noted that under Florida law a no damages for delay clause would be effective unless the delays for

which time was requested were occasioned by the ***fraud, concealment, or active interference*** of the owner. Absent such conduct, and because the general contractor's failed to request a time extension, it could not recover on its claim. The court noted that although the terms of the no damages for delay clause "may seem one-sided, [the general contractor] was aware of these provisions at the time it bid . . . and had the opportunity to increase its proposed contract price to account for the risks it would be assuming. . . [and] failed to seize upon this opportunity."

d. **Exceptions to Enforcement of No Damages for Delay Clauses**

Many states recognize exceptions to a "no damages for delay" clause. Generally, a ***subcontractor*** looking to avoid the clause's effects ***has the burden of proving that an exception applies***. The most widely-recognized exceptions include delays which are either:

- caused by ***bad faith*** (fraud, misrepresentation, or active interference) of the owner or general contractor;
- ***not contemplated*** by the parties at the time the contract or subcontract was signed;
- of ***unreasonable*** duration (extreme length); or
- attributable to the ***inexcusable ignorance or incompetence of the Owner or the Owner's agent*** (i.e., the architect or engineer).

See e.g. *J&B Steel Contractors v. C. Iber & Sons, Inc.*, 642 N.E.2d 1215 (Ill. 1994).

2. **Disruption**

Disruption claims are based on events that preclude a contractor from completing its work in the manner that was expected at the time the subcontract was executed. In such situations, the theory is that disruption by outside forces controlled by the general contractor or owner has caused the subcontractor's forces to not work as efficiently as anticipated. In other words, the work required a ***greater number of less efficient manhours*** than would normally be necessary to perform the same work. Examples of potential disrupted events include: (a) ***incorrect drawings*** supplied by others to the subcontractor, (b) ***changes*** in the scope of the subcontract work, (c) a ***failure*** by the general contractor ***to respond*** to its subcontractor's questions, (d) failure by the owner and/or general contractor to ***approve shop drawings***, and (e) interference from other trades.

In short, Claims for *disruption* are based on the subcontractor's loss of planned efficiency in the performance of its subcontract work. Disrupting events often cause a contractor to resort to costly and inefficient practices such as the use of *overtime*, the *stacking of trades*, *out-of-sequence* work, and *field installation* of material that should have been completed *offsite*. While many subcontracts include provisions that attempt to prohibit damages for delay, few subcontracts expressly preclude damages for disruption.

Finally, a disruption claim can result from other changes in the work or changes which disrupt the manner by which the subcontractor *planned to perform* its work. Thus, while the subcontractor may not have encountered acceleration, it may suffer a *loss of efficiency* due to the changes in its scope of work. In this case, the subcontractor should be entitled to compensation for the extra costs provided he can show that the changes negatively impacted the progress of his work.

3. Acceleration

Acceleration is an *increase* in the *speed of the contractor's performance* beyond that anticipated or scheduled at the time the contract was bid. *Acceleration* usually requires the subcontractor to increase the number of work hours over a given time period either by working overtime, hiring additional manpower, or both. Acceleration typically occurs as the result of either: (1) an *explicit order* from the contractor to the subcontractor to accelerate, or (2) a directive from the contractor to the subcontractor that requires the work to be completed on time even though the subcontractor is otherwise entitled to a time extension because of excusable delay. The latter is termed a "*constructive acceleration*" and allows the subcontractor to recover its acceleration costs.

- a. *Directed acceleration* occurs when the subcontractor is expressly ordered to accelerate the work by the General Contractor.
- b. *Constructive acceleration* occurs when the subcontractor is forced to increase the pace of work to meet a project schedule that has not been extended even though the project has been delayed. The elements of constructive acceleration include:
 - (1) an *excusable* delay
 - (2) *notice* of the excusable delay and a *request for a time extension*
 - (3) *refusal* to grant the extension within a reasonable time
 - (4) an *order*, either express or implied, *to accelerate*
 - (5) *actual acceleration* by the subcontractor

There are two types of acceleration which are generally *not* recoverable as a change or extra: first, when the subcontractor *voluntarily* accelerates his

work to take advantage of a contractual bonus for early completion or to make up for his own inexcusable delays; and secondly, when the acceleration occurs to recover from the subcontractor's own deficient performance.

4. Suspension of Work

If the owner or general contractor suspends a subcontractor's work, assuming the contract does not have a no damages for delay clause, that subcontractor is entitled to recover *delay damages*. Occasionally, a court will hold a no damages for delay clause inoperative if it can be persuaded that the suspension of work was ***not within the contemplation of the parties*** when the contract was signed. For example, if the owner fails to obtain the necessary public approvals to begin construction, and does not communicate this to the contractor who then mobilizes to comply with a notice to proceed, courts have allowed the contractor to recover delay damages notwithstanding a no damages for delay clause. Additionally, some courts have held that where the suspension is of such *excessive duration* as to be beyond contemplation of the parties, the suspension is a material breach of contract that permits the contractor or subcontractor to refuse to perform unless granted an equitable adjustment to his contract or subcontract.

D. Making A Claim

1. Complying with Contractual Notice Requirements

Given the extreme importance of notice requirements, it is vital for subcontractors to read their subcontracts carefully and endeavor to fully comply with all notice requirements. Such requirements are frequently tied to the ***prime contract***. For example, as noted earlier, the subcontractor generally has an obligation to forward all claims to the general contractor that it, the subcontractor, has for additional costs, extensions of time and damages for delays or other causes. A claim which will affect or become part of a claim which the contractor is required to make under the prime contract within a specified time period (or in a specified manner) normally must be made in sufficient time to permit the contractor to satisfy the requirements of the prime contract. Since failing to comply with both one's subcontract *and* the prime contract requirements may result in a *forfeiture* of the claim, it is important to be familiar with, and understand the prime contract's notice requirements and to provide notice in the form required by both the prime and subcontracts.

2. Subcontractor's Duty to Continue Performance Notwithstanding Disputes

As a general rule, subcontractors have a duty to continue their contract performance even when disputes may be ongoing with regarding to asserted

changes or delays for which the subcontractor is seeking compensation. This is because stopping work can greatly impact the overall schedule.

3. Importance of Prompt Notice

One of the most important things a contractor can do to ensure recovery on a delay claim is to give *immediate notice* of the delays and keep detailed and accurate records of its increased costs. Most construction contracts have a “notice of costs” provision which requires the contractor to provide the owner with prompt notice of any claims and the costs associated with the claims. Most typical notice provisions require the contractor to give the required statement in writing and follow such statement with an itemized statement of the details and amounts of such damage that the contractor has verified. Unless such statements are made and delivered within the times required by the provisions, the claims may be forfeited.

Thus, it is prudent practice for a subcontractor who encounters delays to *immediately* assess its daily field overhead costs (together with any other delay costs) and inform the general contractor, in writing, of the nature and extent of these costs.

4. Payment Claims

A *failure to receive payment on-time* may also damage the subcontractor by impacting its ability to perform other projects or cause it to incur additional financing charges. As a result, interest can generally be charged on late payments.

5. Changes in Scope

Claims typically arise out of changes to a contractor’s scope of work. These claims essentially boil down to disagreements over whether there has been a change in the scope of work and/or the cost of performing the changed work or the amount of any necessary time extension.

Some of the more common causes of compensable changes to the subcontractor’s scope of work include (a) an adjustment in construction drawings, (b) a change in materials to be used, (c) value engineering changes, (d) changes necessitated by unanticipated field conditions, and (e) design error. Such changes are generally handled through a *change order*. However, a formal change order *may* result in the subcontractor releasing the contractor from delay, disruption, or acceleration claims if the entire effects of the change on other work are not fully understood by the subcontractor. Thus, care must be taken when submitting change orders to expressly note that the change order covers only those damages and expenses known and quantifiable at that time.

V. TERMINATION OF THE CONTRACT

In the context of construction contracts, termination can be defined as the *severing of all or part of a contractual relationship prior to the completion* of the work in question. Termination is the most extreme action that can be taken on a construction project and, as such, frequently spurs lawsuits over whether such action was justified and the damages due the terminated subcontractor.

The power to terminate a contract, and the procedures to be followed to effectuate a termination, are provided by an *express contract clause* or, if one of the party's breach is *material*, by the common law *right to terminate*. There are two types of termination: (1) *termination for convenience* and (2) *termination for breach* of a contractual duty or obligation (termination for cause).

A. Termination for Convenience

A termination for convenience clause allows one or more of the parties to a contract to terminate their contractual relationship where prospective performance is no longer desired or termination is deemed to be beneficial by the party terminating the contract. Termination for convenience has no basis in common law and is purely a creation of contract. Thus, absent a contractual provision affording the right to terminate for convenience, no such right exists.

1. Generally

Termination for convenience clauses are often inserted by owners into contracts. Developments in the law in recent years have shifted some of the risks of cost overruns from contractors to owners. For example, an owner might be liable for a price adjustment when unexpected site conditions, delays, or suspensions are encountered. Faced with a project that will cost more than anticipated, an owner might prefer to abandon a project rather than complete it. To allow themselves the right to terminate a contract for reasons other than the contractor's breach, termination for convenience clauses are used. A typical clause may read:

Upon thirty days written notice to the contractor, the owner may without cause and without prejudice to any other right or remedy, elect to abandon the work and/or terminate the agreement. In such event, the contractor shall be paid for work executed and reasonable expense sustained plus a reasonable profit.

In the absence of such a clause, an owner who simply abandoned a project would be liable for breach of its contract with the contractor and would likely be liable for the contractor's damages, which would include the cost of the work completed and the profits the contractor would have made if it was allowed to complete the project. Owners use termination for convenience clauses to limit the contractor's damages to costs plus a reasonable profit on work actually completed. By doing so, the owner escapes liability for the

profit the contractor would have realized if the entire project had been completed as planned.

The standard AIA contract gives the owner the right to terminate the general contract for convenience. Paragraph 14.4.1 of the AIA A201 general conditions states: “The Owner may, at any time, terminate the Contract for the Owner’s convenience and without cause.”¹ Unlike many contracts, however, the AIA forms do not limit the general contractor or subcontractor to recovering profit on work actually completed. In the event the owner terminates the general contract for convenience, both the general contractor and any subcontractor “shall be entitled to receive payment for Work executed, and costs incurred by reason of such termination, along with reasonable overhead and profit on the Work not executed.”² Thus, the AIA forms allow contractors to recover both lost profits and overhead expenses on work that had not yet been executed at the time of the termination.

2. Procedures

When an owner decides to terminate a contract for convenience, it typically needs to give the contractor *written notice* of its decision. The timing and requirements of such notice are normally expressly established by the contract. Upon receipt of such notice, the contractor usually must cease work and terminate all subcontracts.

The AIA A401 contains the following termination-related provisions applicable to subcontractors:

7.2.2 If the Owner terminates the [general contract] for the Owner’s convenience, the Contractor shall deliver written notice to the Subcontractor.

7.2.3 Upon receipt of written notice of termination, the Subcontractor shall:

- .1** cease operations as directed by the Contractor in the notice;
- .2** take actions necessary, or that the Contractor may direct, for the protection and preservation of the Work; and
- .3** except for Work directed to be performed prior to the effective date of termination stated in the notice, terminate all existing

¹ AIA Document A201, para. 14.4.1 (1997 edition).

² AIA Document A201, para. 14.4.3 (1997 edition); AIA Document A401, para. 7.2.4 (1997 edition).

Subcontractor-subcontracts and purchase orders and enter into no further Subcontractor-subcontracts and purchase orders.³

B. Termination for Cause (or Default)

The second situation in which a termination may arise is when one of the parties to a contract has failed to perform. The right to terminate in such cases stems from either a termination for cause clause or, in the case of a material breach, from a common law right to terminate.

³ AIA Document A401, paras. 7.2.2 and 7.2.3 (1997 edition).

0. **Termination for Default Clauses**

Most, if not all, construction contracts and subcontracts provide for the possibility of termination for default. Subcontractors should carefully review any such clauses incorporated into their subcontract as well as any similar provisions in the general contractor's contract with the owner.

The AIA A401 permits subcontractors to terminate a subcontract for the same reasons and under the same circumstances the prime contract can be terminated by the general contractor. These reasons and circumstances will normally be set forth in the general conditions of the general contract. If the AIA A201 general conditions are incorporated into your subcontract, the reasons for termination are set forth in paragraph 14.1.1, which states:

14.1.1 The Contractor may terminate the Contract if the Work is stopped for a period of 30 consecutive days through no act or fault of the Contractor or a Subcontractor, Sub-subcontractor or their agents or employees or any persons or entities performing portions of the Work under direct or indirect contract with the Contractor, for any of the following reasons:

- .1 issuance of an order of a court or other public authority having jurisdiction which requires all Work to be stopped;
- .2 an act of government, such as a declaration of national emergency which requires all Work to be stopped;
- .3 because the Architect has not issued a Certificate for Payment and has not notified the Contractor of the reason for withholding certification . . . or because the Owner has not made payment on a Certificate for Payment within the time stated in the Contract Documents; or
- .4 the Owner has failed to furnish to the Contractor promptly, upon the Contractor's request, reasonable evidence [that financial arrangements have been made to fulfill the Owner's obligations under the Contract].¹

The AIA A401 also gives the subcontractor the right to terminate for the nonpayment of amounts due for sixty (60) days or longer. In the event that the subcontractor terminates, it is entitled to recover from the general contractor payment for executed work and proven losses with respect to

¹ AIA Document A201, para. 14.1.1 (1997 edition).

materials, equipment, tools, and construction equipment and machinery, including reasonable overhead, profit and damages.²

Under the AIA A401, the general contractor is also entitled to terminate the subcontractor for cause if the subcontractor “persistently or repeatedly fails or neglects to carry out [its] work in accordance with the Subcontract Documents or otherwise to perform in accordance with [the] Subcontract”³ To do so, however, the contractor must first give the subcontractor two written notices and wait for seven (7) days after the subcontractor’s receipt of the second notice.

C. Common Law Right to Terminate for Material Breach

If a contract contains a termination for cause clause exclusively setting out the breaches of contract that are grounds for termination, the contract will determine whether the exercise of the right to terminate is justified. If the contract contains no explicit termination for cause clause, or if the termination clause of a contract is nonexclusive, a party to a construction contract may terminate its contract based upon a “*material breach*.” The right to terminate for material breach arose from the common law, which is the body of law developed by judicial decisions over the years. The theory underlying this right is that a party should be able to terminate a contract where the purpose of the contract has been defeated or frustrated by another party’s conduct. Minor breaches do not justify termination because they do not frustrate a contract’s purpose.

Termination for material breach is relatively common in the construction industry. Whether a breach was material or minor is a question of fact to be decided based upon the particular circumstances of each case. Some courts characterize a material breach as one involving a substantial failure of one party to perform its duties. Determining whether a breach is material typically turns on such factors as: the extent to which the injured party is deprived of the expected benefits of the contract; the extent to which the injured party can be adequately compensated for the benefits that he has been deprived of; the likelihood that the party failing to perform will cure his failure; and the extent to which the conduct of the party failing to perform comports with standards of good faith and fair dealing.

² AIA Document A401, para. 7.1.1 (1997 edition).

³ AIA Document A401, para. 7.2.1 (1997 edition).

D. Breach by the Subcontractor

Even when termination is justified, the consequences of a decision to terminate are far reaching. Thus, when considering the possibility of a termination for cause, every owner and contractor should consider such things as: (a) the likelihood of being able to replace the terminated party with another contractor; (b) the effect that a termination may have on the cost and scheduling of other work; (c) the legal cost of having to defend any challenge to the decision to terminate; (d) the amount of liability if the contract is found to have been wrongfully terminated; and (e) whether alternatives exist that would be more effective to complete the project on time and within budget.

This section addresses the grounds upon which a general contractor might terminate a subcontractor. Often, the decision to terminate is based on several overlapping grounds.

1. Defective Work

It is commonly-accepted that the failure of work to substantially comply with the requirements of the contract is a material breach of contract. The types of defective work that will justify termination are innumerable and will depend on the circumstances of the work and the customs of the trade.

Subcontractors should be aware that refusing to correct defective work is usually considered a material breach.

2. Delay

Besides the failure to perform the work properly, the failure to perform work in a *timely manner* may also be a material breach of contract. Termination for delay is often based on a contractor's repeated refusal or failure to provide adequate labor or materials to a job. Whether a termination for delay is justifiable will depend on the facts of each case and the provisions of the contract. Generally, termination is not justified where the delays are not the contractor's fault or where the contract provides for an extension of time for excusable delays. For example, with a six month performance period, a subcontractor who is two months behind schedule after four months had expired would certainly seem to have committed a material breach. Prior to effectuating a termination, however, the general contractor must determine if there are outstanding requests for extensions of time that might make up for the delay and must evaluate each such request. If the general contractor were to terminate the contract and then find that the subcontractor's requests for an extension were reasonable, a court may find that the contract was wrongfully terminated.

If a subcontract contains no completion date, the subcontractor may not be terminated until it has had a reasonable opportunity to perform. What

constitutes a reasonable opportunity to perform will turn on the surrounding circumstances, industry customs, and local practices.

If a subcontract contains a completion date and also states that “time is of the essence,” the contract may be terminated if it is not substantially performed by the specified date. If a general contractor fails to promptly terminate a subcontract after a default, or if the time for completion is extended, courts may deem that the right to terminate for delay has been waived.

If a subcontract contains a completion time but does not state that time is of the essence, it is less clear whether failure to complete on time is material breach. On the one hand, the failure to strictly comply with the completion time may not be a material breach so long as the contract is substantially performed within a reasonable time of the completion date. Subcontractors should be aware, however, that the courts may imply a “time of the essence” provision into a contract from the conduct of the parties, even though the contract does not expressly make such a statement.

3. **Abandonment**

Abandonment of a contract is a material breach. An abandonment of contract consists of a *present, positive, unequivocal refusal to perform*; a mere threat to abandon is not sufficient. In one case, a court determined a subcontractor abandoned a project when the subcontractor had no employee employed at the time of termination, the subcontractor’s equipment was for sale and the subcontractor left the job site with no intention of returning to resume the work. See, M. Shapiro & Son Constr. Co. v. Battaglia, 83 A.2d 204 (Conn. 1951).

Ordinarily, a subcontractor will have to show that exceptional circumstances existed in order to justify its departure from the project prior to achieving substantial completion. As such, subcontractors, particularly personnel in the field, should take care to document all events that interfere with or preclude their forces from performing their work. Such events include instances of owner or contractor interference, stop work orders, and the failure to make the project site ready or available for work.

A contractor who wishes to abandon a project because of the actions of another party will not be able to justify the abandonment unless it objected to those actions when they occurred. Thus, subcontractors must register their complaints regarding interfering actions. Subcontractors who “hold back” such complaints in an effort to maintain a pleasant working relationship risk waiving the ability to terminate their subcontract and stop work.

4. **Wrongful Termination**

A wrongful termination of contract is itself a material breach of contract that will allow the innocent party to terminate the wrongful terminator and recover damages. Wrongful termination often occurs where the terminating party erroneously believes that it has an adequate basis for terminating its contract. If a subcontractor wrongfully terminates its subcontract with a general contractor, the general contractor will itself be entitled to terminate the subcontract and recover damages against the subcontractor. Similarly, if a general contractor wrongfully terminates a subcontractor, the subcontractor will be entitled to recover damages against the general contractor.

5. **Failure to Pay Sub-subcontractors and Suppliers**

Where a subcontractor has contractually promised a general contractor, either expressly or impliedly, that it will pay its sub-subcontractors and suppliers, the failure to make such payments is a breach of its subcontract with the general contractor. If that breach is material, then the general contractor may justifiably terminate the subcontract.

When a subcontractor is terminated for failure to make required payment, the general contractor will ordinarily not be liable to pay the subcontractor's sub-subcontractors or suppliers because it is not in privity with such entities and such entities are not intended beneficiaries of its contract with the subcontractor. However, a general contractor may bind itself to paying parties in contract with its subcontractor by contractually promising to assume and become liable for the obligations of its subcontractor (e.g., through joint check agreements).

6. **Disregard of Laws and Ordinances**

A subcontractor who has repeatedly run afoul of applicable laws or ordinances runs the risk under many contracts of being terminated for its misdeeds. Though not a commonly invoked clause, most often such termination occurs in the context of a subcontractor who has repeated safety (OSHA) or environmental violations.

E. **Breaches by the General Contractor**

A general contractor who breaches a *material duty* to a subcontractor is likewise subject to having its subcontract terminated for cause. The terminating subcontractor, in turn, may be able to recover damages occasioned by the general contractor's breach. In addition, if the general contractor's material breach compels the subcontractor to abandon the project, the subcontractor may use that breach as a defense to any action brought against it.

1. **Failure to Pay**

The obligation to pay contractors for their work is one of the most important in the construction industry. At common law, the failure to pay an installment due was a material breach of contract, for which the contractor is entitled to end the contract, cease performance and recover the value of its work prior to the breach. In accordance with the common law, most major standard form contracts give the subcontractor the right to terminate if the general contractor fails to make a payment when due.

Today, however, some courts hold that the mere failure to make a progress payment does *not* constitute a material breach that entitles the subcontractor to stop work. Such courts would hold that the failure to make a progress payment must either interfere with the ability of the subcontractor to perform its work or be so serious as to clearly constitute a material breach. Determining whether a failure to pay is a material breach will depend on the facts of each case. In one case, the government's failure to make progress payments in a timely manner was found to not be a material breach because there was no evidence that the contractor's ability to perform was impaired by the payment delays. See, Jones Plbg. & Heating, Inc., 86-1 BCA para. 18,659 (1985).

2. **Interference with Performance**

A general contractor's *intentional interference* with a subcontractor's performance constitutes a breach of contract. The materiality of the breach is, again, a factual issue to be determined by the court. Ordering a subcontractor off the job site prior to completion of work, refusing site access to the subcontractor to perform its work or correct defects, and failing to coordinate the work of other subcontractors are typical examples of conduct that may qualify as *material interference* with performance.

When one party materially interferes with a contract, the other party must generally stop work and bring suit. If the party whose performance has been interfered with continues to perform without objection, the court may find that party has waived the interference and forfeited its right to collect damages.

3. **Delay**

Where a general contractor delays its subcontractor for an unreasonable period of time, the subcontractor may terminate the subcontract. Such delay usually takes the form of a suspension of work. If incorporated into a subcontract, the AIA A201 general conditions, for example, enumerate exactly what causes of work stoppage justify terminating a subcontract.

4. **Failure to Issue Written Change Order for Extra Work**

At least one court has held that a general contractor's failure to issue a written change order for extra work was a material breach where the subcontract entitled the subcontractor to such written order. In such cases, prudent subcontractors should not proceed with the extra work until the general contractor gives them a written directive or order instructing that the work proceed. For such a directive or order to issue, the parties need not agree as to whether the work was within the scope of the original subcontract or even whether the extra work entitles the subcontractor to a price adjustment.

5. **Wrongful Termination**

Just as when the subcontractor wrongfully terminates a subcontract, a general contractor's wrongful termination constitutes a *material breach*. A contractor who has been wrongfully terminated is placed in the same position as a contractor who has rightfully terminated and is entitled to damages in accordance therewith. In one reported case, a court found that an electrical subcontractor was wrongfully terminated by the general contractor when the subcontractor's failure to timely perform its work was caused by events which were not the subcontractor's fault, including the fact that materials were not timely delivered to the site and the fact that the general contractor had not satisfactorily coordinated the project work. See, Tribble & Stephens Co. v. Consolidated Services, 744 S.W.2d 945 (Tex. App. 1987).

E. **Termination Procedure**

Most subcontracts delineate the procedure that the general contractor must follow before actually terminating its subcontractor. The AIA A401 is typical in that it provides that the Contractor must give the subcontractor *written notice* of the default or neglect which forms the basis of the termination and must allow the subcontractor the *opportunity to correct* the alleged problems before he can be terminated. Specifically, the A401 Subcontract provides the subcontractor with seven (7) days after receiving *written notice* from the general contractor in which to "commence and continue correction of such default or neglect with promptness." If the subcontractor fails to commence and continue such correction within that seven (7) day window, the Contractor must send another written notice. Seven (7) days after the subcontractor receives the second notice, the general contractor has the *right to terminate* the Subcontract and charge all reasonable completion costs to the subcontractor.

F. **Damages**

In order to recover for any of the claims outlined above, contractors will need to prove the amount of damages sustained. Furthermore, contractors must also prove

the causal link between the event giving rise to the claim and the type and amount of damages being sought.

1. **Methods of Calculating Costs**

Damages can be calculated in a number of different ways. Courts tend to favor those methods that return the closest approximation of a contractor's actual unavoidable costs.

- a. ***Actual cost method:*** The most reliable method to calculate damages is the “actual cost method.” Using this approach, the amount sought to be recovered is based upon the contractor's actual costs, as shown by its bills, invoices, cancelled checks or other such documentation. By utilizing a cost accounting system, a contractor can effectively itemize and track its extra costs on a project. The “actual cost method” is favored by the courts as it is considered a fair, reliable and straight-forward method of calculating damages.
- b. ***Total cost approach:*** Under this approach, the claimant quantifies the ***total cost*** it incurred on the project and subtracts that cost from what it had originally *estimated* it would cost to perform the job. The contractor's damages are the excess of actual over-expected costs. The total cost approach to damages is not favored by courts and will normally be used only if no other method of calculating damages is reasonably feasible.
- c. ***Modified total cost approach:*** Under this approach, the claimant again subtracts planned project costs from actual costs. However, the claimant then adjusts the resulting difference downward to eliminate costs that the claimant incurred by its own fault.
- d. ***Quantum meruit method:*** This pricing methodology may be used when the project has been changed so substantially that the original cost estimate can no longer be fairly applied. This methodology assumes that the project is, in effect, a ***different project*** and, as a result, the claimant is entitled to ***all reasonable costs*** to perform the work, including overhead and profit.

2. **Components of Damages for Certain Claims**

a. **Delay Damages**

Three types of delay damages are common:

- i. ***Direct Damages*** are damages that naturally flow from the delay, such as lost rental value, interest rate differences between construction loan and permanent loan financing, additional construction management and/or design consultant fees, overhead, and potential claims from other contractors

- ii. **Consequential Damages** are those damages that arise from special circumstances and were foreseeable to the parties at the time they executed the contract, and may include *lost profits* on sales, *increased production costs* during the period of delay, *penalties* from financing commitments, and other such costs.
- iii. **Liquidated Damages** are frequently provided for in construction contracts when it would be difficult to compute the amount of damages. Liquidated damages clauses provide for an established amount of damage per day of delay.

b. Categories of Delay Damages " \1 4

A claim for delay may seek damages arising from the following sources:

- i. **General Conditions** : salaries for supervisors, clerks, engineers, and managers; the cost of maintaining a field office, such as costs related to field trailers, onsite vehicles, toilets and fencing.
- ii. **Idled Equipment** : the cost of having to keep equipment available to the project during a period of work stoppage. These costs may be calculated in two different ways. If the equipment is rented, the actual rental rate that was paid for the equipment is used. If the equipment is owned, the contractor may use its own internal rate or an accepted industry rate.
- iii. **Unabsorbed Home Office Overhead** : a share of a contractor's home office overhead may be claimed in a delay situation.

c. Disruption Damages

The theory behind disruption damages is that the disrupting events caused the subcontractor to *lose efficiency* (or productivity) in performing its work, which in turn manifests itself in higher labor and equipment costs as more labor and equipment are needed to complete the job in accordance with the project schedule. Usually, disruption damages can be computed by comparing the contractor's historical cost of performance to its actual costs or by applying a percentage mark-up to its costs based on industry published materials. Another cost that may be recovered with a disruption claim is the increased cost of mobilization and demobilization of forces, which often results from the necessity of shifting work away from disrupted tasks to other undisrupted areas in order to keep the work progressing.

d. Acceleration Damages

Examples of acceleration damages (which often result in lost efficiency) include:

- i. *Overtime labor costs*;
- ii. *Additional labor costs*;

- iii. *Additional equipment costs;*
- iv. *Additional supervision costs;*
- v. *Increased overhead costs;*
- vi. *Increased labor and equipment costs because of inefficiency;*
- vii. *Increased lower-tier subcontractor costs.*

e. Differing Site Conditions

Damages resulting from a differing site conditions claim may include:

- i. *the cost of procuring additional materials;*
- ii. *the cost of new or different materials or equipment; and*
- iii. *the cost of performing a changed scope of work.*

f. Changes in Scope

There are essentially two broad types of damages that may result from a change in the scope of work:

- i. Direct Costs :** a contractor's actual cost for the labor, materials, equipment, insurance and bond premium necessary to perform the changed work; and
- ii. Indirect Costs :** the higher costs resulting from having to work around the changes to the project, such as out-of-sequence work, trade-stacking, project delay, and acceleration.

g. Damages for Termination

i. Termination for Convenience

If a subcontract contains a termination for convenience provision, a subcontractor terminated pursuant to that clause is generally entitled to recover:

- (1) the *reasonable cost* of his work actually performed;
- (2) a *fair and reasonable profit* on his completed work; and
- (3) *cancellation charges incurred on materials ordered or delivered to the project.*

It may also be possible to recover a reasonable profit for work that would have been performed had the contract not been terminated, though the contract must expressly give the subcontractor a right to recover this profit.

ii. Termination for Default

If a subcontractor rightly terminates its subcontract for default (based upon the general contractor's breach) or if the subcontract is wrongfully terminated by the general contractor, the subcontractor may recover damages. The types of damages available will differ according to whether the subcontractor has started work on the project.

- (1) If the termination occurs before the subcontractor has performed any work, the subcontractor may be entitled to recover its *anticipated profit* on the project. In addition, if the subcontractor has incurred any preparatory costs, such as the cost of *preparing its bid* or *mobilizing* crews and equipment, it is generally entitled to recover those costs.

(2) If the termination occurs *after* work has begun, the contractor is entitled to recover its unpaid *cost-of-performance*, as well as its expected overhead and profit on the project.

3. The Importance of Contemporaneously Documenting Damages

a. Generally

The unspoken reality which undergirds all the above types of damages is that unless such damages are *effectively documented* it will be very difficult, if not impossible, for a claimant to recover those damages through settlement or litigation. Although there are ways to “prove” damages after-the-fact, through such devices as the *total cost approach* (which is discussed above in greater detail) such devices are disfavored by courts. Additionally, general contractors or owners are much more likely to settle claims where the claimant has persuasively documented the actual costs incurred. As such, it is vital that subcontractor’s *contemporaneously compile and document costs* as they are incurred. As noted earlier, cost accounting systems which itemize and track extra costs on a project are an invaluable way to account for additional expenses.

b. Awareness of Type of Events That May Give Rise to a Claim

A vital component of contemporaneously compiling and documenting costs is, of course, *recognizing* a potential claim. Thus, potential claimants should be aware of the types of events during project performance that may lead to a claim. Such events include:

- Changes to plans and specifications;
- Delayed approval of shop drawings;
- An untimely response to submittals;
- Differing site conditions;
- Problems with site access;
- Unusual weather conditions;
- Interference by other trades;
- Late design revisions;
- Labor or material shortages;
- Suspension and/or stop-work orders.

Thus, the subcontractor who ***quickly identifies*** potential claims not only gives himself a great advantage by being able to timely comply with his contract's ***notice provisions***, but also gives himself the opportunity to persuasively establish the documentation that will enhance his claim's credibility. As such, oftentimes it is the subcontractor's ***early recognition and response*** to potential events that determines the likelihood of his recovering for additional costs or time.

WRAPPING UP THE CONSTRUCTION PROJECT

A. Substantial Completion

1. What constitutes substantial completion?

The AIA A201 General Conditions define substantial completion as “the stage in the progress of the Work when the Work or designated portion thereof is sufficiently complete in accordance with the Contract Documents so the owner can occupy or utilize the Work for its ***intended use***.” AIA Document A201, ¶ 9.8.1 (1997). (emphasis added). When applied to subcontract work, this essentially means that the subcontractor has finished all but the clean-up and punchlist work. Substantial completion differs from final completion in that final completion occurs when ***all*** work, including the punchlist, is complete.

Most construction contracts contemplate this two-step approach to the completion of a project. Achieving substantial completion is significant to a subcontractor because doing so, as discussed below, protects him from certain claims by the general contractor. Moreover, substantial completion entitles a subcontractor to payment of most of his contract balance. However, it is not until final completion that the contractor is entitled to final payment of the entire contract balance.

2. Consequences of Reaching Substantial Completion

a. Contract Consequences

Upon substantial completion, the contract time ends and the subcontractor is generally entitled to receive the subcontract balance less amounts withheld by the owner for retainage or punchlist work. Typically, the general contractor will

withhold these sums to pay for the correction of deficiencies, completion of the architect's comprehensive list of unfinished or incorrect work (the "punchlist"), and the settlement of claims. Sums may also be withheld as protection against lien claims until lower-lien waivers are provided. Subcontractors must be careful not to waive their rights to such withheld amounts by accepting a reduced payment as "final" payment. In addition, the subcontractor may not receive the contract balance upon substantial completion if the contract requires that certain conditions be satisfied first, including the architect's certification of substantial and/or final completion and the acceptability of the work, or the subcontractor's certification that his subcontractors and suppliers have been paid.

b. Insurance Consequences

Once substantial completion is achieved, the burden for maintenance and upkeep of the project, as well as the risk of loss or theft, is normally shifted to the owner.

c. Effect on Damages

Upon substantial completion, the general contractor no longer has the remedies of termination or contract rescission available to him, nor may he generally recover additional liquidated or delay damages. Similarly, however, a subcontractor generally loses his right to rescind the contract and seek unjust enrichment damages against the general contractor or owner once its work is substantially complete. Finally, and importantly, the period in which contractors may file *lien or bond claims* often begins to run upon substantial completion.

3. Final Completion and Final Payment

a. Effect on Claims

i. Contractor's Waiver of Certain Claims

Once the owner accepts the work, a subcontractor is generally barred from making any further claims against the general contractor, except perhaps those previously made in writing and still unsettled at the time of acceptance. Similarly, his acceptance of the work prohibits the general contractor from requiring its subcontractor to perform extras or correct work or recovering remedies against the contractor for default. The subcontractor remains liable, however, for latent defects in the work, and for breach of warranty.

ii. Subcontractor's Release of Certain Claims " \ 5

A subcontractor's receipt of final payment from the general contractor generally has the same effect on the subcontractor's claims as acceptance of the work has on the contractor's claims. That is, final payment bars further claims by the subcontractor, except perhaps those already pending. Additionally, the general contractor might still seek damages for the subcontractor's defective work or breach of warranty and for liens filed by sub-subcontractors and suppliers.

iii. Conditions Affecting the Right to Final Payment

Final completion ordinarily gives contractors the right to final payment. In some cases, however, final payment will be delayed even though final completion has been achieved.

(a) Conditional payment clauses

As noted earlier, conditional-payment clauses can preclude a subcontractor from receiving payment for completed work. The clauses can even operate to preclude payment *after* a subcontractor has achieved final completion. Conditional payment clauses are discussed in greater detail above.

(b) Close-out requirements

Construction contracts often condition final payment on the general contractor's providing to the owner certain "close-out" materials. These conditions are usually passed-through to the project subcontractors. Such conditions include subcontractor waivers of lien rights and claims (discussed further below), and delivery of warranties, operations manuals, and as-built drawings. Unless and until these required items are provided, the owner and/or general contractor generally has the right to withhold final payment.

(c) **Waiver of liens and claims**

In order to protect itself from unexpected encumbrances on its property, owners generally require general contractors to provide lien waivers executed by his subcontractors before it will release final payment. Accordingly, a subcontractor will generally be required to furnish lien and/or claim waivers to his general contractor as a condition to the general contractor's giving the subcontractor its final payment.

B. Post-Completion Obligations

The risks associated with performing construction work do not evaporate upon completion of a project. At a minimum, a contractor will continue to remain liable for injuries caused by work it performed *negligently*. Additionally, when a contractor is subject to *warranty obligations*, either by agreement or by operation of law, the contractor may be called upon either to repair or to pay for the repair of defects in its work. This section addresses the nature of a contractor's post-completion warranty obligations and the effect of statutes of limitation and statutes of repose on post-completion liability.

1. Warranties

In the construction industry, a contractor's warranty is an assurance or guaranty that its work is of a particular character, quality or fitness and that such work will remain as such for a particular period of time. Warranty obligations arise either from a contractor's express promise or are implied by law.

a. Express Warranties " \14

An "express" warranty is an explicit promise (or guaranty) written into a contract by the party performing the work (the "warrantor") that its work will have certain qualities. On construction projects, most warranty repairs are performed due to express contractual warranties. A breach of warranty can occur even if the warrantor/contractor was not negligent in performing its work. It is important to understand the distinction between an express warranty of the *quality of materials or performance* and an express warranty that a specific *result* will be achieved by the promisor. Contractor warranties are typically the former. The latter is more properly described as a "*performance specification*," which some courts consider a contract term which describes the scope of work and is not an express warranty.

Warranting the Work: A typical warranty provision only requires the contractor to warrant that his work will conform to applicable plans and specifications. Thus, if the plans and specifications provided to the contractor are defective and do not achieve the owner's intended result, the owner ordinarily has no warranty claim against the contractor. A contractor who has not prepared the plans and specifications ordinarily warrants only that he will do his work in accordance with the plans and specifications. As such, a contractor's warranty should not constitute a basis for a transfer to the contractor of responsibility for defective plans and specifications provided by the owners.

Warranting the Result: If a contractor goes further than warranting that his work will be in compliance with the plans and specifications and, instead, warrants his work will achieve certain performance criteria, the contractor has warranted the results achieved by the work. This situation occurs primarily on design-build contracts and in situations where the contractor guarantees that its work will meet certain performance specifications. As such, a warranty that guarantees certain results will be achieved entails a higher degree of risk for the contractor because, in giving such a warranty, the contractor assumes the risk that, if the project drawings are defective, he will bear the cost to remedy the work to achieve the intended result.

b. Implied Warranties

In the construction field, implied warranties are warranty obligations that courts impose as a by-product of the mere fact that a construction contract has been performed. Courts impose such warranties to ensure that a construction professional's work achieves a ***minimum level of skill and care***. These obligations exist outside any contract and irrespective of whether the parties intended them to take effect. In general, implied warranties take the form of (1) an ***implied warranty of workmanlike construction*** and (2) for residential construction, an ***implied warranty of habitability***. Under either warranty, a construction professional essentially has a duty to exercise reasonable care to avoid foreseeable harm, both economic and physical, to the purchaser.

Sometimes contractors attempt to limit their implied warranty liability by inserting clauses in their contracts by which the parties explicitly ***waive all warranties***, express and implied, except for those warranties expressly contained in the contract documents. Such a waiver will generally be enforced against commercial customers, but will generally ***not*** be enforceable against residential customers. The reason for this distinction is that the law presumes commercial entities to be more sophisticated, to have more bargaining power, and to be better able to protect themselves than individual consumers.

c. The Privity Doctrine and Express Warranties

Because express warranties often arise from an express contractual promise, such warranties may be limited to the original parties to the contract. Where a third party to the contract subsequently purchases the property under warranty, the lack of “privity” (a ***direct relationship*** between the subsequent purchaser and the warrantor) may negate the warrantor's obligations. The critical factor is whether the warranty was ***assigned or transferred*** to the subsequent purchaser at the time of the sale. While courts typically look to the ***intent of the parties*** to determine whether the parties intended to transfer warranty rights, without an express contractual assignment of warranty rights, it is generally difficult for subsequent purchasers to enforce an express warranty given to the original purchaser.

WARRANTY EXAMPLE: Joe, from *Joe's Electric*, enters into a subcontract for the wiring of a large office complex being erected. After working out the details, the general contractor, *MeanCo.*, sends *Joe's Electric* a contract to execute containing the following warranty clause:

The Subcontractor warrants to the Owner, Architect, and Contractor that the materials and equipment furnished under this Subcontract will be of good quality and new unless otherwise required or permitted by

the Subcontract Documents, that the Work of this Subcontract will be free from defects not inherent in the quality required or permitted, and that the Work will conform to the requirements of the Subcontract documents. Work not conforming to these requirements, including substitutions not properly approved or authorized, may be considered defective. The Subcontractor's warranty excludes remedy for damage or defect caused by abuse, modifications not executed by the Subcontractor, improper or insufficient maintenance, improper operation or wear and tear under normal usage. This warranty shall be in addition to and not in limitation of any warranty or remedy required by law or the Subcontract documents.

After signing the contract, *Joe's Electric* completes its work and leaves the jobsite. Three months later, however, *Joe's Electric* receives a significant backcharge from *MeanCo*. The backcharge is based on the project owner's assertion that *Joe's* work experienced numerous problems and contained numerous defects. The owner refused to allow *MeanCo* to retain *Joe's Electric* to fix the work and instead hired one of *Joe's* high-end competitors — the *Five Star Electrical Contractors Corp.* — to remedy the defects. The owner and *MeanCo* are now backcharging *Joe's Electric* under the warranty clause of the subcontract.

Under the subcontract, can the Owner and *MeanCo* hire a separate company and backcharge *Joe's Electric* without first giving it an opportunity to fix any problems with its work?

d. Retaining the Right to Correct Defective Work

As the preceding example illustrates, contractors who warrant their work should expressly preserve in the contract their right to correct any defective work themselves. The failure to do so may result in the corrective work being let to a different contractor, at a higher price. The AIA General Conditions contain a clause that addresses this problem and that subcontractors may wish to expressly incorporate into their subcontracts. It provides:

[I]f . . . any of the [Contractor's] Work is found to be not in accordance with the Contract Documents, the Contractor shall correct it promptly after receipt of written notice from the Owner to do so unless the Owner has previously given the Contractor a written acceptance of such condition. . . . During the one-year period for correction of Work, if the Owner fails to notify the Contractor and give the Contractor an opportunity to make the correction, the Owner waives the rights to require correction by the Contractor and to make a claim for breach of warranty.

Prudent contractors and subcontractors should insist that language similar to the above be inserted into any warranty clauses in their contract. While in certain situations it may be possible to argue that an owner and/or general contractor must give notice and an opportunity to cure to the original subcontractor before contracting with a third-party to correct nonconforming work, with proper drafting and attention to detail in the contract negotiation stage, a subcontractor can successfully prevent any argument about the issue.

2. Statutes of Limitation and Statutes of Repose

Every state has passed laws that limit the time period in which a plaintiff may file a lawsuit against construction professionals. These statutes come in two forms: statutes of limitation and statutes of repose. Although both forms establish time limits in which to bring a claim, they are substantially different with respect to when the limitation period begins to run.

a. Statutes of Limitation

The theory behind statutes of limitation is that courts should not enforce old claims. These statutes require plaintiffs to bring their claims within a reasonable and defined period of time after they have accrued. Failure to do so precludes the plaintiff from bringing the claim.

The time when a claim accrues varies from state to state. In general, the limitations period begins to run from the time that the actionable conduct (i.e., the tort or breach of contract) is (1) committed (the “date of breach” rule) or (2) discovered by the injured party (the “discovery rule”). The difference between these two alternatives can be significant. Take the following example:

EXAMPLE: An electrical contractor substantially completes a building on March 1, 2001. On January 1, 2011, due to faulty wiring, an electrical fire breaks out which causes significant property damage for which the building’s owner must expend a substantial sum of money to repair. Assume the state has a six (6)-year statute of limitations for breach of contract actions and runs its statute of limitations from the date the breach is committed. If the owner wishes to bring a claim against the electrical subcontractor on the alleged grounds that the fire resulted from the subcontractor’s faulty workmanship, when would the applicable limitations period begin to run? When would it expire?

EXAMPLE: Now assume the above facts are true but that the state adheres to the “discovery rule,” under which its six (6)-year statute of limitation would begin to run from the date of discovery of the contractor’s breach. When would the limitations period begin to run? What is the latest time that the owner could bring a breach of contract suit?

As the foregoing examples illustrate, statutes of limitation vary greatly in their effect. In those states that adhere to the discovery rule, subcontractors can be subject to suit for an indefinite period of time because there is no connection between the time the work is performed and the time that the statute of limitations expires. If a defect is not discovered for one hundred years, in theory, the subcontractor would still be subject to a law suit. Of course, a plaintiff attempting to sue a subcontractor based on work performed one hundred years earlier would have several serious obstacles to proving liability. Moreover, as discussed below, a state’s statute of repose may bar such a suit.

b. Statutes of Repose

Statutes of repose set an *absolute limit* after which a lawsuit cannot be maintained. Whereas the operative event that begins the running of a statute of limitations is either the date of the injury or of the discovery of the injury, the operative event that triggers a statute of repose is the date of *substantial completion* of the construction project. The theory underlying statutes of repose is the perceived unfairness of subjecting construction professionals to the economic burdens of litigation long after their work on a project has been completed. By enacting a statute of repose, legislatures set a definite date on which a contractor’s or subcontractor’s exposure to legal liability will end.

The practical difference between a statute of limitation and statute of repose can be illustrated by returning to the previous example involving the electrical fire on January 1, 2011. In a “discovery rule” jurisdiction, a six (6)-year statute of limitations provided the injured plaintiff (the owner) with six years from the date of the discovery of the injury (i.e. until January 1, 2017) to file a lawsuit against the contractor. If the state also had an eight (8)-year statute of repose for suits based on improvements to real property, however, the owner would only have eight (8) years from the date of substantial completion (March 1, 2001) to bring any suit. Thus, because the statute of repose would expire on March 1, 2009, the owner would have no cause of action against the contractor for the fire on January 1, 2011.

c. Statutes of Limitation and Warranties

Subcontractors should be mindful that the time period to bring an action based on breach of an express warranty will likely be based on the appropriate state's statute of limitation, not on the expiration of the warranty period. Thus, a general contractor need not necessarily bring suit for breach of warranty within the warranty period. Courts have held that the applicable limitations period for breach of an express warranty is based on the general statute of limitations for breach of contract actions. Accordingly, if a subcontractor refuses to repair an item under warranty for one year in a state that has a five-year statute of limitations for breach of contract the general contractor will have five years after the subcontractor's refusal to make the repair in which to sue.

VII. CONCLUSION

As can be seen from the above contract law and the particulars of construction contracts involve many complex variables which can potentially effect the final outcome of any dispute. Despite this complexity, and the necessity of running any and all contractor dispute-related questions through a construction attorney, subcontractors can do much to improve their bottom line and bargaining power in any dispute by learning the basics of contract formation and enforcement and how it effects, or can effect, their specific jobs.

With a proper understanding of these principles electrical subcontractors can do much to avoid or, at a minimum, mitigate the business and legal risks they face on every project. These materials have identified some of the more common issues that project personnel should be aware of in order to efficiently identify and take precautions against such risks.

THE PRECEDING MATERIALS ARE OFFERED FOR INFORMATIONAL PURPOSES ONLY. NOTHING CONTAINED IN THESE MATERIALS SHOULD BE CONSTRUED AS LEGAL ADVICE. BEFORE ACTING UPON ANY INFORMATION CONTAINED HEREIN, THE READER SHOULD ALWAYS FIRST CONSULT WITH AND OBTAIN THE OPINION OF LEGAL COUNSEL.

Glossary of Terms

Assent:

A necessary element which must exist to form a valid contract ((1) assent, (2) consideration, and (3) no defenses to contract formation). "Assent" is the "meeting of the minds," or agreement, between the contracting parties to enter into a contract

Bid:

An offer to perform a contract for work and labor or for supplying materials or goods at a specified price. Public contracts are often awarded through a competitive bidding process by which bids are submitted as the result of public notice and advertising and then compared against one another.

Bid Shopping:

A general contractor's use of the lowest bid already received to pressure other subcontractors into submitting even lower bids. *Black's Law Dictionary*, 162 (6th ed. 1990).

Bond:

A construction industry bond is a legal instrument which secures a debt or obligation owed from one entity to another. A performance bond protects owners against loss due to the inability or refusal of a contractor to perform its contract. A payment bond protects contractors against loss due to the inability or refusal of an entity higher up the contractual chain to pay for work performed.

The "principal" on a bond is the entity who owes the underlying debt or obligation that the bond secures. The "surety" is the party who issues the bond and guarantees the performance of the principal in the event the principal fails to pay the debt or perform the obligation secured by the bond. Finally, an "obligee" is the party to whom the debt or obligation is owed and who benefits from the obligations undertaken by the principal and surety.

Common Law :

A body of principles and rules deriving their authority solely from past usages and customs, particularly the ancient unwritten law of England, or from the judgments and decrees of courts recognizing and enforcing such usages and customs. It is a body of law that develops and derives through judicial decisions, as distinguished from legislative enactments. *Black's Law Dictionary*, 276 (6th ed. 1990).

Condition Precedent :

An event that must happen or be performed *before* some right dependent thereon accrues or some act dependent thereon is performed. *Black's Law Dictionary*, 293 (6th ed. 1990). In the construction industry, conditions precedent are often encountered as a payment term under which a subcontractor's right to be paid for work performed is conditioned upon the general contractor first receiving payment for such work from the owner.

Consequential Damages:

Damages that do not flow directly and immediately from the act of a party, but only from some of the consequences or results of such act. *Black's Law Dictionary*, 390 (6th ed. 1990).

Consideration:

"Consideration" is a contract law term which basically can be viewed as a 'legal detriment' (either doing or not doing something which you have a right to do) on the part of the person giving consideration. Consideration is, when looked at from the standpoint of the person who receives the benefit of consideration, essentially what *induces* the parties (the cause, motive, price, or impelling influence) to enter into a contract. Consideration is one of the basic, necessary elements needed for a valid contract to exist. *Black's Law Dictionary*, 306 (6th ed. 1990).

Contract:

An agreement between two or more persons which creates an obligation to do or not to do a particular thing. Black's Law Dictionary 322 (6th ed. 1990). A promise or a set of promises, the breach of which the law gives a remedy or the performance of which the law in some way recognizes as a duty. Restatement (Second) of Contracts § 3.

Bilateral Contract:

A contract in which both contracting parties must fulfill obligations towards each other. An example of a bilateral contract is a contract for the sale of materials or delivery of services, where one party becomes bound to deliver the materials or perform the services, and the other party becomes bound to pay for such materials/services. Bilateral contracts are formed by the exchange of promises between the parties (i.e. a promise to perform in exchange for a promise to pay) as opposed to unilateral contracts, which are formed by the exchange of a promise for an act. *Black's Law Dictionary*, 163 (6th ed. 1990).

Unilateral Contract:

A contract in which one party (the promisor) makes an express promise of performance without receiving express promise in return from the other party (the promisee). In unilateral contracts, neither party is bound until the promisee accepts the offer of the promisor by performance of the proposed act. *Black's Law Dictionary*, 325 (6th ed. 1990).

Damages:

Money compensation sought or awarded as a remedy for a breach of contract or for tortious acts. *Black's Law Dictionary*, 389 (6th ed. 1990).

Economic Loss:

Economic losses have been generally defined as damages for inadequate value, the cost of repair and replacement of a defective product or the consequent loss of profits or use.

Economic Loss Doctrine:

A legal rule accepted in many jurisdictions standing for the proposition that negligence claims may not be asserted in actions between commercial parties when the resulting damages are solely economic in nature.

Incorporation By Reference ("flow-down" clauses):

A method of making one document become a part of another separate document by referring to the former in the latter and declaring that the former shall be considered a part of the latter as though it were fully set out therein. If one document is copied in its entirety into another document, it would be referred to as "actual incorporation." *Black's Law Dictionary*, 766 (6th ed. 1990).

Indemnity:

An undertaking whereby one party agrees to indemnify another upon the occurrence of an anticipated loss. *Black's Law Dictionary* 769 (6th ed. 1990).

Irrevocable Offer:

An offer which cannot be revoked or recalled by the offeror without liability. *Black's Law Dictionary*, 830 (6th ed. 1990).

Letter of Intent:

A letter that reduces to writing the preliminary understanding of parties who intend to enter into a contract. *Black's Law Dictionary*, 904 (6th ed. 1990).

Liquidated Damages:

Liquidated damages is the sum of money that a party to a contract has agreed to pay if it breaks some promise. Such damages usually takes their form as a set sum which the contractor must pay the owner for each day the project is delayed past the contract completion date. Liquidated damages clauses are generally enforceable if they represent an good-faith effort to pre-estimate the amount of damages that would ensue from a breach. *Black's Law Dictionary*, 391 (6th ed. 1990).

Mechanic's Lien:

A legal claim created by statute to provide a contractor who furnishes labor or materials to improve real property with a remedy for the collection of the value of his efforts should he not be paid by the owner or general contractor. The security interest created by mechanic's lien statutes attaches to the improved property itself and allows (if the owner or general contractor refuses to satisfy the lien) for the lien property to be sold and the lienor to take its payment from the proceeds of that sale.

Miller Act:

A federal statute that requires the posting of performance and payment bonds before an award may be made for a contract beyond a certain amount for the construction, alteration or repair of a public building or public work. Many states have enacted similar statutes, which have been collectively referred to as the "little Miller" acts. Since public property cannot be liened, the Miller Act (and state little Miller Acts) provide construction professionals with a lien-like security necessary to ensure that they will be paid for their work.

Mistake: In contract law, there are two kinds of mistake:

Mutual Mistake - A situation where both or all parties to a contract each labor under the same misconception regarding a material fact, the terms of the contract, or the provision of a written instrument intended to embody the contract. Such mistakes justify the reformation of the contract. *Black's Law Dictionary* 1021 (6th ed. 1990).

Unilateral Mistake - A mistake or misunderstanding as to the terms or effect of a contract, made by one of the parties but not by the other(s). *Black's Law Dictionary*, 1531 (6th ed. 1990).

Negligence:

A specific tort defined as the failure to use such care as a reasonably prudent and careful person would use under similar circumstances. The doctrine of negligence rests on a duty imposed on every person to exercise due care in his conduct toward others from which injury may result. *Black's Law Dictionary*, 1032 (6th ed. 1990).

Notice:

Notice is knowledge of a fact that has been actually communicated to or indirectly derived by an authorized person. Actual notice of a fact occurs when the person sought to be affected by the notice knows of the existence of the particular fact in question. Constructive notice is knowledge of a fact that is imputed by law to a person (even though he may not have actual notice), when that person has knowledge of other facts that would naturally lead an honest and prudent person to make inquiry and to discover the noticed fact by proper diligence. *Black's Law Dictionary*, 1062 (6th ed. 1990).

Parol Evidence Rule:

A legal rule of evidence under which a written agreement which the parties intend to be the final expression of their agreement may not be altered or contradicted by any *prior* written or oral agreement unless there is fraud, duress, or mutual mistake. *Black's Law Dictionary*, 1116 (6th ed. 1990). Essentially, with a few exceptions, the Rule means that whatever the parties may have agreed on before signing a contract, if that agreement is not reflected in the written contract a court will not enforce it.

Privity of Contract:

The legal relationship that exists between two or more parties in contract with one another. Traditionally, privity of contract has been essential for a plaintiff to maintain an action on any contract against a defendant.

Quantum Meruit:

“As much as deserved.” An equitable doctrine, based on the concept that no one who benefits by the labor and materials of another should be unjustly enriched thereby. A theory of recovery, by which the law will imply a promise to pay a reasonable amount for labor and materials furnished, even in the absence of a valid contract. *Black’s Law Dictionary*, 1243 (6th ed. 1990).

Statute of Frauds:

The “statute of frauds” (SOF) refers to the class of contracts which *cannot* be oral contracts. The SOF requires that five types of contracts be in writing: (1) suretyship contracts (contracts to answer for the debt or duty of another); (2) executor-administrator contracts to answer for the duty of the decedent; (3) contracts made in consideration of marriage; (4) contracts for the sale of land; and (5) contracts that cannot in any circumstances be completed within one year of their making.

Uniform Commercial Code (UCC) and the Statute of Frauds:

The UCC provides that a signed writing is required for several different types of contracts, most notably contracts for the sale of goods worth more than \$500.

Statute of Limitations:

Statutes enacted by either the federal government or the states that establish maximum time periods during which certain legal actions can be brought or rights enforced after they have accrued. *Black’s Law Dictionary*, 927 (6th ed. 1990). A cause of action normally accrues at the time the tort or breach was committed or discovered. Once the statute of limitations for a particular cause of action has run, that cause of action may no longer be brought.

Statute of Repose:

While a statute of limitations extinguishes the right to prosecute an accrued cause of action after a certain period of time, a statute of repose limits potential liability by limiting the time during which a cause of action can arise. A statute of repose absolutely terminates any right to bring an action once a certain period of time has elapsed after completion of work, regardless of whether any cause of action has yet accrued. *Black’s Law Dictionary*, 1411 (6th ed. 1990).

Termination:

The ending of a contract, usually before the contract’s anticipated term expires. Contract termination may be by mutual agreement of the parties or by the unilateral exercise of one party due to the default of the other party or pursuant to its contractual right to terminate for its own convenience.

Third-Party Beneficiary:

One who is not a party to a contract, but for whose benefit a contractual promise was made. *Black’s Law Dictionary*, 1480 (6th ed. 1990).

Tort:

A private or civil wrong or injury for which a court will provide a remedy in the form of an action for damages. Tort is a broad theory of legal recovery, encompassing numerous varieties of particular causes of action. An action grounded in tort involves a violation by the defendant of some duty imposed by general law upon all persons occupying a particular relationship to the plaintiff. There must always be a violation of some duty owing to the plaintiff, and generally such duty must arise by operation of law and not by mere agreement of the parties. *Black's Law Dictionary*, 1489 (6th ed. 1990).

Uniform Commercial Code ("UCC"):

A set of uniform laws which governs commercial transactions which involve the sale or lease of goods. The UCC has been adopted in whole or in substantial part by all states. *Black's Law Dictionary*, 1531 (6th ed. 1990).

Waiver:

A "waiver" is the intentional or voluntary relinquishment of a known right. A waiver is essentially unilateral as it results from some act or conduct of the party against whom it operates. In other words, no act of the party who will benefit from the waiver is necessary to complete the waiver. *Blacks Law Dictionary*, 1580 (6th ed. 1990).

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