TWENTY-FOUR COMMON SUBCONTRACT QUESTIONS AND ISSUES (revised August, 2011)

By Jonathan Sauer

This article discusses twenty-four basic questions/issues commonly involved with construction contracts, particularly with subcontracts. But, where the issues discussed pertain to contracts generally, this article should be helpful to general contractors, as well. These are typically questions and issues that students raise at my contract seminars.

Many potential readers might look at the length of this and think it might be too much to read. I'll say only four things in response to that. First, the root of the word 'contractor' is 'contract'. A greater understanding of your contracts can only be helpful to your business. Secondly, you do construction work – and leave your homes every day – primarily, if not solely, with the intention that you are trying to make money to support yourself and your families. Unfamiliarity with the topics discussed might threaten that goal, particularly if you can't get paid for the work you do. Thirdly, and, as Benjamin Franklin opined, 'an ounce of prevention is worth a pound of cure'. Knowing what to do *before* a problem is in your face generally gives you more options than *after* the fact. And, lastly, isn't it more cost-effective to get and digest this information without cost rather than go to your lawyer's office and receive the same information at an hourly rate, possibly after your rights have been irrevocably damaged by your actions and inactions?

Here we go!

1. What is a contract?

Let's start with something simple. What is a contract?

In legal terms, a contract is when one party makes an **offer** to do something and the other party **accepts** that offer. These are critical concepts to contract making: offer and acceptance. And, related to offer and acceptance is the issue of 'consideration'. In other words, the promises made, one to another, must be for something valuable, which typically is a certain payment for a certain performance of work.

A contract - from a written standpoint - is one or more pieces of paper, signed by the parties to be charged and expressing agreement on the fundamental aspects of the undertaking. "I will paint Joe Blow's house for four thousand dollars using one coat primer and one coat exterior satin latex paint." This is the fundamental deal: what you are going to pay for what the other guy is going to do. If both parties signed a piece of paper with these words, you would have a written contract.

2. Why <u>should</u> the contract be in writing?

If it is *not* in writing, then it isn't clear what the terms of it are. If you picked your customer wrong or if you picked the wrong job or if problems develop - as they will,

frequently, as we all know - your memory and your contracting party's memory of what 'the deal' is frequently will vary. Neither your lawyer nor the judge is going to be sympathetic: this is a 'beginner's' mistake. Without a written contract, you can't file a mechanic's lien because a 'written contract' is a statutory requirement in the mechanic's lien law. Without a written contract, settling your bond claim will be more protracted, as bonding companies always are concerned with claimants mixing unbonded work claims into and with bonded work claims. And, without a written contract specifically delineating what work will be performed and for what money on a certain contract, bonding companies can't as easily separate out bonded work (and claims) from unbonded work (and claims). And, it is telling that various statutes which require certain kinds of contracts to be in writing are frequently referred to as 'statutes of fraud'.

There is more than a little blarney in most trials. Without a written contract, some people will move far away from the truth in their testimony as to what the deal was. Simply put, unless you are planning to be 'the thief' in the relationship, there are *no* good reasons *not* to have a written contract.

One says: it's all so complicated! And, there are so many forms! I don't have any one to type it! (Next thing I know, you'll be asking me to write letters for changed conditions!)

My quick response is that if I needed a contract in the next ten minutes, I would grab an AIA A401 form and cross off all references to arbitration. These forms don't discriminate between subcontractors and general contractors and they are pretty fair as between a subcontractor and general contractor, as they are owner and architect oriented. Of course, the ideal form of subcontract would be if a subcontractor generates a pretty good proposal and then simply has the general contractor sign it. Then, the signed proposal would be your contract.

Earlier, I referenced the following statement: "I will paint Joe Blow's house for four thousand dollars using one coat primer and one coat exterior satin latex paint." While this is far from perfect, this sentence identifying a specific house signed by the painter and the general contractor would be a legally sufficient contract. Certainly, additions for when the work will be done, some provisions as to when payments will be made and what kind of paint would be used might be desirable. But, that statement has 'the Big Three': offer, acceptance and consideration.

3. Who is your customer?

Lawyers cringe when a subcontractor brings in a claim against "John Jones Co." or John Jones Construction. Since your client might be a sole proprietorship, a corporation, a limited liability company, a limited liability partnership or possibly another form, knowing this up front is useful information. The Secretary of State of Massachusetts has a website that is fairly easy to navigate, which is http://www.sec.state.ma.us/. A tremendous amount of information is available there.

If your customer is not a corporation or an LLC or an LLP, chances are he/she has had poor legal advice or is as dumb as a stump or both. For, anyone willing to risk his house every day when this can easily be avoided (by incorporating or becoming an LLC) may be a few screws short of a hinge. Knowing, for example, that your customer is or is not a corporation can affect how you might negotiate the contract. For example, Massachusetts has a homestead exemption of five hundred thousand dollars for one's principal residence. If your customer is a person acting as a 'd/b/a' - in other words, in a personal capacity - he or she quite likely could be judgment proof (meaning, not having an ability to pay any court judgment issued against him/her), particularly if a homestead has been filed.

Another thing you might look at is to look up a particular person's name, which can be done on this website. If John Jones is listed as a principal with several corporations, this could raise warning signals, as this might be some indication that Mr. Jones is used to running with one corporation for a while and then replacing it with another when circumstances get too difficult, such as having serious business problems, excessive trade debt, too many judgments against him, tax liens, etc. It is not unheard of for a general to extend subcontractors out on payments from 30 days to 60 days and then from 60 days to 90 days, keep the money, and file bankruptcy as a no-asset liquidation. It is surprisingly difficult to get any official associated with a bankruptcy to look into this or get excited about this.

There is a resource known as PACER – Public Access to Court Electronic Records – which anyone can subscribe to, which will give you information as to a party's federal district court, federal appellate court and bankruptcy filings. More information concerning this can be found at http://www.pacer.gov/. You have to make small payments for documents you copy.

If I am looking up a particular person or company, I would be more interested in state superior and district court filings rather than federal district court filings. The Massachusetts Trial Court has access to superior court filings. To the best of my knowledge, one has to be a lawyer to have access to this. But, typically, civil clerk's offices for various superior courts will have either index cards or a computer indicating what cases are on file for what parties and one doesn't have to be a lawyer to look at that information.

On occasion, when doing contract reviews for a general that the subcontractor has never heard of (or that I have never heard of), I will check the county where that general does business and see how many court cases that company has. In one case, I found a rather large number of cases where the general contractor was sued as a defendant, which might be some evidence of chronic payment issues.

4. What is a letter of intent and how does it differ from a contract?

How is a contract different from a 'letter of intent'? Well, a letter of intent under some circumstances might be considered a contract and under others, not. (Hey, if the

law business were easy, then any one could do it!) When the parties have agreed that there will definitely be a later contract and that the letter of intent is preliminary only, *most* of the time this is not sufficient to establish a contract.

Here's the law on letters of intent. For an enforceable contract to be created, the parties must have progressed beyond the stage of imperfect negotiation. Situation Management Systems, Inc. v. Malouf, Inc., 430 Mass. 875, 724 N.E.2d 699 (2000). A purported contract which is no more than an agreement to agree in future on essential terms or one which does not adequately specify essential terms ordinarily will be unenforceable. Air Technology Corp. v. General Elec. Co., 347 Mass. 613, 199 N.E.2d 538 (1964). Even though an action may be brought upon a contract which contemplates another more formal contract, an agreement to enter into a contract which leaves terms of that contract for future negotiation is too indefinite to be enforced. Caggiano v. Marchegiano, 327 Mass. 574, 99 N.E.2d 861 (1951).

There is a commercial that says: "life is messy: clean it up!" While (they tell me) it is hard to be a little bit pregnant, it is not hard to have some elements of a contract but be missing some other elements of an enforceable or clearly-understood contract as well. These can include scheduling information, how and when you will get paid, the submittal process and a variety of other details that can either make the job more difficult or make it more difficult for you to get paid.

5. How do you avoid having your letter of intent being enforced as a contract?

How do you avoid this type of problem? The appellate courts have indicated what language should be used in a letter of intent to *keep* it a letter of intent.

For example, in Goren v. Royal Investments, Inc., 25 Mass.App.Ct. 137, 140, 516 N.E.2d 173 (1987), on pages 142-143, the Appeals Court gave some suggested language for parties trying to make it clear the letter of intent is not final:

"A proviso of that sort should speak plainly, e.g., "The purpose of this document is to memorialize certain business points. The parties mutually acknowledge that their agreement is qualified and that they, therefore, contemplate the drafting and execution of a more detailed agreement. They intend to be bound only by the execution of such an agreement and not by this preliminary document."

6. Can/will your proposal become a contract?

Technically speaking, a proposal is an 'offer' to enter into a contract. The other requisite element to form a contract is to have an 'acceptance' of the offer. An acceptance which suggests additional terms may be treated in one of two ways. If the suggested additional terms are relatively minor and more details than anything else, then the 'acceptance' will be seen as creating a contract with regard to what is in the offer as accepted, with the additional terms being seen as an offer *as to those terms.* In other words, they are not part of the 'contract' until the other party signifies in some way –

usually initialing changes – that it accepts them. If, on the other hand, the additional terms significantly vary from the offered terms or include a significant change of scope or price, then the purported 'acceptance' becomes a 'counter-offer' which is legally a rejection of the offer. In other words, legally speaking, the 'counter-offer' becomes a new 'offer'.

For subcontractors who tend to do the same thing job in and job out, having a proposal with specific terms on the front of it with some terms and conditions on the back can be a desirable form of contract if you get your contracting party to sign it as accepting it. Putting in, for example, interest provisions higher than the Massachusetts statutory rate – generally twelve percent for contract actions – and providing for reasonable counsel fees for collection efforts can prevent a lot of problems or at least potentially shorten their duration.

Where, however, in response to a tendered proposal (offer), a general contractor sends you a contract form which is at significant variance to the terms of your proposal – i.e. it doesn't mention the proposal – then the proposal becomes simply an offer that was never accepted and the tendered subcontract becomes the general contractor's 'offer' which if you sign becomes the contract. In other words, the proposal, at that point, can lose *all* contractual significance and becomes meaningless. Subcontractors seem to assume that a proposal's terms always have *some* validity, even when they sign subcontracts which don't reference the proposal. This isn't the case, at all, unless the subcontract which one signs specifically lists the proposal as one of the contract documents with a *further* provision that any conflict between the terms of the printed subcontract form and the proposal results in the proposal's language controlling. In other words, to keep the value of a proposal in a situation where one signs a subcontract with contrary language, the proposal must be listed as having a higher contractual priority in the event of conflict with other aspects of the subcontract.

7. Incorporation by reference into your subcontract of your proposal.

Since the enforcement of a contract can be rather strict and draconian, courts take the position that they will only enforce what seems to be the *final* deal. It is for that reason that the courts have fashioned 'the parole evidence' rule that says, in essence, that in enforcing a contract's obligations, the court will only look at the final expression of the parties' wishes and not at earlier or prior drafts. In other words, *unless they are incorporated into the contract*, a court will not ordinarily look at any specific offer or at any specific acceptance or the various back and forth drafts which preceded the final document.

I had a specialty subcontractor who went out of business, in part, because it had a great proposal that had all of the right language in it but it consistently signed general contractor-generated subcontracts which didn't even list the proposal as a contract document, let alone make it a higher priority contract document. Then, when issues would arise, this subcontractor would try to hold the general contractor to the proposal and found that he couldn't. And, this happened on too many contracts where there was

too much economic disparity between the terms of the subcontract form and the terms contained within the proposal.

Many subcontractors have absolutely *killer* proposals (which, from a legal standpoint, are "offers"). The proposal limits the work to be performed by excluding certain things, includes interest for late payments, attorneys' fees if the subcontractor has to sue and other kinds of wonderful things. The only problem becomes when the general contractor sends you a subcontract which does not list the proposal as a contract document. In the ordinary situation, if you want the proposal to have continuing vitality and meaning, you have to have it expressly included in the contract itself as one of the contract documents. For, otherwise, a court is ordinarily going to find - except in instances of fraud, which is much harder to prove than you might imagine - that you 'waived' the terms of your proposal. (A waiver is an intentional relinquishment of a known legal right.) And, so there is no confusion as to which contract document has the highest priority and controls a conflict, there needs to be a further provision in the subcontract which expressly says: "John Doe Construction's proposal dated October 2, 2010 is included in this Subcontract as a contract document. In the event of any discrepancy or contradiction between the terms of that proposal and any other part of this Subcontract, the express language of the proposal will control."

8. Incorporation by reference of various contract documents into your contract.

This introduces a concept, which I will try to emphasize, reemphasize and re-re-reemphasize (if there is such a word!) throughout the course of this article: a subcontractor in many (most) circumstances is bound to the general contractor as is the general contractor bound to the awarding authority or owner in terms of the general conditions and the provisions of the general contract.

What does that mean? What that means is that, depending on the language of your subcontract, most subcontracts have provisions such as that contained in the statutory subcontract (used by filed subbidders on public work) under paragraph 1(a):

> "The Subcontractor agrees to be bound to the Contractor by the terms of the herein-before described plans, specifications (including all general conditions stated therein) and addenda No. . . ., and . . . , and . . ., and to assume to the Contractor all the obligations and responsibilities that the Contractor by those documents assumes to the . . . hereinafter called the "Awarding Authority", except to the extent that provisions contained therein are by their terms or by law applicable only to the Contractor."

Put simply - but with some exceptions - general conditions which require the general contractor to assume obligations to the owner (liquidated damages, schedule issues, warranty or punch lists) will also be owed by the subcontractor to the general contractor as is applicable to his work unless explicitly excluded in the subcontract. Stated another way, if your subcontract references other contract documents applicable to the project by identifying them, the fact that you have never seen them and don't even

have them won't help you. Those further identified contract documents are 'incorporated by reference' into your subcontract simply by their identification in the subcontract as contract documents. In the main, it would be no defense in such a situation for the subcontractor to say he never saw them or even that the general contractor never provided them. If they are identified in the subcontract, the subcontractor is generally bound to them.

9. Does your contract <u>have</u> to be in writing?

There are several substantial legal and factual reasons to support having all contractual dealings reduced to writing.

The first reason - a legal one - is the requirement of the so-called 'Statute of Frauds.'

Chapter 259, Section 1 of the General Laws provides in pertinent part as follows:

> "No action shall be brought: . . . Fifth, Upon an agreement that is not to be performed within one year of the making thereof; Unless the promise, contract or agreement upon which such action is brought, or some memorandum or note thereof, is in writing and signed by the party to be charged therewith or by some person thereunto by him lawfully authorized."

What this simply means is that something which is forbidden by the Statute of Frauds can not be sued upon. My sense would be that from a statute of frauds standpoint, you could have an unwritten construction contract that could be enforceable, provided the contract work would necessarily be completed in one year. My question, though: why would you *want* one?

The statute of frauds could mean that without a written contract, you might not have any remedy (be able to sue) in the event of breach. Conveyances of real estate by statute must be in writing. Mechanics' lien rights are dependent on your having a written contract. The Uniform Commercial Code has various provisions relating to writings within the context of someone dealing with fungible (i.e. consumer) goods (i.e. retailers).

The purpose of the statute of frauds is to suppress fraud, i.e., "cooked up claims or agreement sometimes fathered by wish, sometimes imagined in light of subsequent events, and sometimes simply conjured up." <u>Pappas Industrial Parks, Inc., v. Psarros</u>, 24 Mass. App. 596 (1987). To satisfy the statute of frauds, a writing must incorporate the promise that the plaintiff seeks to enforce. <u>Harrington v. Fall River Housing Authority</u>, 27 Mass. App. 301 (1989).

Therefore, in virtually all cases with no imaginable exceptions, subcontracts between subcontractors and general contractors and those involving material suppliers, second tier subcontractors as well as first tier subcontractors, should be in writing. And,

if your original contracting party becomes insolvent and either the general contractor or the owner attempts to keep you performing, enter into a written agreement with that substituted party containing the basic ideas of the original deal, especially including a promise to pay. (For valuable information concerning the general uselessness of joint check agreements, see Article number 13 on my website, "Joint Check Agreements".)

It is not generally necessary that both parties sign the same document to constitute a legally enforceable contract. For example, an offer could be on one piece of paper (such as a proposal) and the acceptance could be on another piece of paper or even by email. But, *somewhere,* there needs to be a signature by each party *to the same terms* to demonstrate that there has been, in fact, a meeting of the minds.

Not having an agreement in writing means that there are no demonstrable terms to the agreement between the parties. When was the work supposed to be done by? What was the price? Were certain alternates taken into consideration when the price was submitted? Is the general excused from paying you if he doesn't get paid for your work himself?

For these and for numerous other reasons, in the construction industry one should never work without at least a simple written document signed by both parties, even if on separate pieces of paper, demonstrating a fundamental agreement as to the basic terms of performance of work, price and time.

Remember that an unwritten contract is worth the paper it is *not* printed on! It another words, it is worth next to nothing. Verbal orders don't - and shouldn't - go! And, since change orders are seen by the courts as little additional contracts, they also should be in writing for most of the same reasons, including to demonstrate that they are clearly subject to the other subcontract terms and provisions and are not separate agreements.

10. How do I get my contracting party to give me a written contract?

First of all, I would say that any legitimate contracting party wants its agreements to be in writing. The last thing anyone wants to do once they are "in the soup" is to wonder which version – if *any* version – of an oral contract a judge might enforce.

There are industries which tend to have fewer contracts, such as agreements with truckers. Some parties don't understand the necessity for a written contract. Some don't know what forms to use. Some want to maintain the flexibility of changing – *inventing?*- the terms when things don't go well.

Here's a tip. Courts enforce contracts not based on what their titles are but on what their *content* is. So, here's a suggestion, which takes advantage of the fact that other than contracts, particularly people 'of a certain age' don't want to know or talk about computers. Someone calls you asking you to supply labor and materials and you come to agreement over the telephone. You send them a form entitled "Order

Acknowledgement". Then, list in this form, simply, what the basic terms are, including at least scope and price. Tell your contracting party that no one gets labor or materials out of your shop without a computer-generated order number and one of these forms has to be inputted into the computer to get the number. Tell your contracting party that you just want them to counter-sign the 'Order Acknowledgment' for *his* protection, to make sure that you got the terms right and that everyone's interests are protected and so you can begin processing their order.

11. What happens if when I bid the job or when I sign the job I haven't had a chance to review all of the contract documents?

The short answer is that if your contract references or incorporates by reference various documents, whether you read the document or even have the document - or not - or understand what is in them, you will be bound by the documents incorporated into your contract by reference. Here's what the lads and lasses in the black robes have had to say about this:

In the absence of fraud, a person who signs a written agreement is bound by its terms regardless of whether person reads and understands those terms. Tiffany v. Sturbridge Camping Club, Inc., 32 Mass.App.Ct. 173, 587 N.E.2d 238 (Mass.App.,1992). In the absence of fraud, one who signs a written agreement is bound by its terms whether he reads and understands it or not, or whether he can read or not. Cohen v. Santoianni, 330 Mass. 187, 112 N.E.2d 267 (Mass.,1953) Where what is given by one to another purports on its face to set forth terms of a contract, one who receives it, whether he reads it or not, by accepting it assents to its terms and is bound by any limitation of liability therein contained, in the absence of fraud. Kergald v. Armstrong Transfer Exp. Co., 330 Mass. 254, 113 N.E.2d 53 (Mass.,1953) Ignorance through negligence does not relieve a party from his contractual obligations, unless the negligence is not inexcusable. Century Plastic Corp. v. Tupper Corp., 333 Mass. 531, 131 N.E.2d 740 (Mass.,1956).

Therefore, be on the lookout for language in your contracts such as "the subcontractor agrees to be bound to the general contractor in the same way that the general contractor is bound to the owner." Whether in a public context - such as within the context of the statutory subcontract - or within a private work context, a court will enforce against a subcontractor provisions in the general contract which are not by their terms exclusively restricted to the general contractor, if the general contract obligations and documents are listed in the subcontract.

In the public works context, there is a case that says a bidder's bid can not be withdrawn without penalty when the bidder fails to bid all aspects of its work as identified on relevant plans and specifications.

12. The necessity for a subcontractor to substantially perform its subcontract in order to be able to sue to get paid and attempt to recover under that subcontract.

Without exhaustively defining the following statement, generally speaking, it is Massachusetts law that in order to collect on a contract, it is necessary in *most* instances for a subcontractor to have substantially performed that subcontract.

Here's what the lads and lasses in the black robes have to say about that:

Contractors cannot recover on the contract itself without showing complete and strict performance of all its terms. Andre v. Maguire, 305 Mass. 515, 516, 26 N.E.2d 347 (1940). Cf. J.A. Sullivan Corp. v. Commonwealth, 397 Mass. 789, 794, 494 N.E.2d 374 (1986).

Substantial performance of the contract might not be legally required in certain circumstances. For example, if a general contractor terminates a subcontractor wrongfully, the subcontractor might be entitled to recover for the value of the work he did even though he didn't finish. Or, a subcontractor who rightfully pulled off a job for non-payment, might also be entitled to recover for the value of the work he did even though he didn't finish.

But, the general rule, as set forth above, will apply in most other circumstances.

13. Can a subcontractor pull off the job in the event of non-payment? (Second question: <u>should</u> the subcontractor pull off the job in the event of non-payment?)

Ordinarily, unless your contract specifically provides for it or unless a failure of payment is to the point where only fraud can explain it or there is clear, demonstrable evidence that your contracting party has no intention of paying you *at all*, the fact that your contracting party is late paying you on any particular requisition may not be legal justification for pulling off of the job. In fact, in many instances, pulling off the job can be seen as an act of abandonment, which could be considered to be a material breach of contract *on your part*.

The reasons you can't, generally, pull off the job for non-payment are pretty complicated. I'll summarize them as well as I can. The law deems an obligation to perform as (ordinarily) an 'independent covenant' from the obligation of the other party to the contract to pay, which is another 'independent covenant'. From a legal standpoint, unless there is something in the contract which makes these two clauses *inter*dependent, they are usually regarded as being deserving of individual respect and enforcement individually and independently. Put simply, the fact that one doesn't fulfill its obligations under a contract does not automatically excuse another for not performing its obligations under the same contract.

Having said that, there are a couple of Massachusetts cases which indicate a subcontractor *can* pull off for lack of proper and timely payment.

In Drinkwater v. D. Guschov Co.196 N.E.2d 863, Mass. 1964

the Supreme Judicial Court said:

"By any evaluation of the evidence the plaintiff was entitled to substantially more than the $11,000 which he had received. This underpayment was a material breach of the contract and justified the plaintiff's stopping work prior to the completion of the contract. C. C. Smith Co., Inc. v. Frankini Constr. Co., 334 Mass. 379, 384, 135 N.E.2d 924."

As stated by the Court in C. C. Smith Co. v. Frankini Const. Co. 334 Mass. 379, 384, 135 N.E.2d 924, 926-927 Mass. 1956:

". . . . But under the law of contracts and apart from the question of security the petitioner was not obliged to pursue either of these courses. Frankini had broken its contract with the petitioner by not making the payments to it as called for by the subcontract. The finding of the master in the petitioner's favor against Frankini and the decree below thereon establish that the petitioner was not in default. In these circumstances the petitioner could treat the contract as still subsisting but could withhold further performance until it had received the payments in arrears. Restatement: Contracts, § 276, Illustration 5. Williston, Contracts (Rev.Ed.) § 848. Hence its failure to perform between December 8, 1953, and August 11, 1954, when the authority abrogated its contract with Frankini, was justified."

Now, even though there is some decisional law which says a subcontractor can pull off for lack of payment, such an action should be considered very carefully and, ordinarily, not exercised. This is because if a subcontractor pulls off for lack of payment and a court later on determines that the subcontractor was not entitled to be paid *at that time*, pulling off the job could be construed as an abandonment, which would be a material breach of contract on *your* part. Also, it is axiomatic in the contracting industry that one should not often allow another (i.e. the general contractor) to finish your work by use of a new subcontractor for a couple of reasons. First of all, generally speaking, no one can finish *your* work cheaper than *you* can: you have the benefit of the learning curve and you know where all of the dead bodies are buried (or *not* buried). Also, if you allow your contracting party to finish your work, it will be very difficult after the fact to determine whether or not the price of completion by the general contractor included some non-contractual work or expenses, including improvements to the design performed by the completion contractor. If you are bonded, not completing your work may invite a claim against your performance bond. And, not completing a public work could mean that you will almost necessarily get a lower DCAM rating for the job. And, other awarding authorities in the future, if they learn of a lower rating on a job, might consider this as some evidence of your not being a 'responsible' subcontractor, which could affect future work. Determinations of responsibility are not capable of being overturned unless they are "arbitrary, capricious or illegal", which is almost an impossible standard to meet.

14. What does 'quantum meruit' mean?

Subcontractors have heard of the concept of "*quantum meruit*" and think that *quantum meruit* is an alternative cause of action under which a subcontractor can be paid for the fair value of the work it completed when it has not completed its work.

The words "*quantum meruit*" from the Latin mean simply "how much it is worth." This does not excuse, in the main, a failure to perform by a party claiming under a contract. What it attempts to do is to offer an alternative theory of damages when there has been very substantial performance of the subcontract by the complaining party but where there have been relatively minor acts of noncompliance or relatively minor items not completed by the plaintiff. Or, this might be applied to a situation where a subcontractor was prevented from completing its contract for reasons not of its own doing, such as being wrongfully terminated. Where this doctrine is applicable, the law allows a claim to be made in *quantum meruit* for the fair and reasonable value of the labor and materials installed by a subcontractor. The concept of *quantum meruit* nonetheless generally requires a subcontractor to complete its subcontract work before suing on the same. As stated in some case law, a construction company claiming *quantum meruit* must prove that it: (1) substantially performed the work; and (2) possessed a good faith intent to finish it.

15. Under what circumstances can (should) a subcontractor pull off the job for other (non-payment) issues?

Whether or not a subcontractor has a sufficient reason to cease performing in any given factual circumstance is one of the most complex issues confronting both a subcontractor and a subcontractor's lawyer! It is sufficient to say that, generally speaking, it is almost always better to complete a subcontract and sue afterwards for such additional monies or other remedies you feel entitled to.

A reasonable question is "why?" The answer to this question is that perhaps your claim of breach on the other party's part will not be accepted by a judge or appellate court considering your case. If you have "guessed wrong" and have not substantially performed your subcontract, you not only might not be entitled to be paid. You might be liable to the general contractor for its damages for your non-completion, including such additional monies the general contractor had to pay a completion contractor over the amount of your contract.

To the extent that you are a bonded subcontractor, and speaking as someone with a great deal of bonding company experience, your bonding company will want to see the contract for which it has a performance bond completed to avoid a possible performance bond claim against the surety company. Although you might hope in any specific situation that you can control your bonding company's actions in an incomplete job situation, as a practical matter, almost all agreements of indemnity allow a bonding company to take such action as it deems necessary concerning both unpaid labor and materials suppliers you might owe as well as with regard to incomplete jobs, holding the bonding company only to the standard that it acts in reasonable good faith, a standard not hard for the bonding company typically to meet. In other words, if you don't protect the

surety bond on bonded contracts, you may not like how the surety decides to protect itself. Generally, a surety company does not need its principal's concurrence with how it pays claimed unpaid suppliers and subcontractors and whether or not it completes your work or not. I have even seen some indemnity agreements which say that the surety has the right to sign the principal's (the contractor's) name to documents, meaning that the surety can sign your name to settlement agreements even when you vehemently oppose such action. Also, of course, it is extremely negative and unfavorable to your future bondability 'going into claim'.

16. What are "pay-when-paid" clauses and when are they effective and when are they <u>not</u> effective?

This is a very complex subject, affected by recent legislation. For a detailed analysis of this, please see in the "Construction Articles" section of my website – www.sauerconstructionlaw.com - the following article: "Massachusetts Pay-When-Paid Clauses and the New 2010 Prompt Payment Statute."

17. What is a 'no damage for delay' clause?

Typically, this is a clause that says something such as the following: "Subcontractor agrees that if its work is delayed or suspended by the general contractor for any reason, the subcontractor's sole remedy will be for a time extension."

Massachusetts general common law allows for claims for delay damages. (In fact, there is a Massachusetts case commenting favorably on the "Eichleay Formula", which computes claims for general and administrative overhead claims, as opposed to purely job costable expenses, such as super, trailer, project manager, etc.)

In the case of <u>Wes-Julian Construction Corporation v. Commonwealth</u>, 351 Mass. 588 (1967), the contract in question had essentially a "no damage for delay" clause.

The Court stated on page 594:

"In the absence of a specific contract provision to the contrary, the respondent would be bound to refrain from causing delay in the petitioner's commencement or performance of the contract, and the petitioner could recover for breach of contract for such delays."

Later, there was some argument by the contractor that the contractor might be entitled to recover for delay damages even in the presence of a no damages for delay clause in the presence of "arbitrary, capricious or fraudulent actions . . . (or action) in bad faith or under such a gross mistake as to be tantamount to fraud."

The Court stated on pages 596-597:

"Even if we assume that the judge was warranted in finding that the conduct of the respondent was 'arbitrary and capricious,' the petitioner is not entitled under this contract to recover damages for delay caused by the respondent in view of the specific provisions of the contract regarding delay."

In 1990, the Appeals Court "chipped away" at this type of holding. The case in question was the case of Fred J. Findlen v. Winchendon Housing Authority, 28 Mass. App. Ct. 977 (1990).

The construction contract in question had a sweeping provision disclaiming any liability by the owner for job delays. There would be no payment for unavoidable delays, although there would be a time extension.

As stated by the Appeals Court on page 978, ". . . a clause which exculpates the awarding authority from liability for damages arising out of delay is enforceable. (Cases cited) The general rule is subject to an exception if arbitrary and capricious conduct on the part of the awarding authority produces the delay and the authority declines even to extend the time for contract completion."

In this particular case, although the awarding authority did give time extensions, the authority paid some monies on account of delay and the Court found that this constituted a waiver of the "no delay damages" clause. Moreover, by the authority paying delay damages to the contractor, the awarding authority would have an obligation to indemnify the general contractor for monies it had to pay a subcontractor for delay damages in a separate action.

The rationale for this decision was that, as stated on page 978:

"Parties to a written contract may, of course, alter it subsequently, by oral modification, by their joint conduct, or, ideally, by a writing subscribed to by the persons to be bound."

One of the best cases to be familiar with in this area is the case of Farina Brothers Co., Inc. v. Commonwealth, 357 Mass. 131 (1970), a decision of the Supreme Judicial Court. The Supreme Judicial Court confirmed an auditor's (another term for a 'master', which is a lawyer who acts like a judge in hearing certain cases) finding for the contractor for delay damages against the Commonwealth of Massachusetts. Article 68 of the contract provided that there would be no damages for delay but that the contractor would be entitled to a time extension in the event of delay.

In discussing the testimony, the auditor had found that the contractor was repelled and insulted by the chief construction engineer who blatantly informed him that he did not care about what was happening and would do nothing to carry out the obligations of the department.

Also, there was no extension guaranteed, even though the facts warranted a time extension.

As stated by the Supreme Judicial Court on pages 138-139:

"In circumstances such as here appear, however, the Commonwealth in effect has used the delay provisions to whipsaw the contractor. So employed, they cannot absolve the Commonwealth of liability. If, as may be the case, delay is to occur during performance of the contract the collateral provisions relating to appropriate extensions should come promptly into play. In the present instance their application was unconscionably delayed in a manner to deprive the contractor of such protections as the Blue Book afforded to it. Adherence to these standards by both parties is required. The evidence supports the conclusion that agents of the Commonwealth by intentionally obstructing the application of those standards caused damage to the contractor . . . "

On page 140 of the decision, the Court continued in this vein:

"In sum, we hold that the Commonwealth cannot hide behind the specifications of its contract dealing with delay and, in the circumstances of this case, deny recovery to a contractor who has been put upon to the extent here shown. We have dealt not with the question of damages caused by delay itself which was the main subject of the Wes-Julian case. We have dealt rather with damages caused the contractor by failure to grant seasonable extensions for performance made necessary by delay and failure of the Commonwealth to assist the contractor properly in rescheduling work. It remains only to say that the Commonwealth cannot expect unfailing and honest performance by contractors when it administers its contracts as this one appears to have been administered."

Thus, it appears that under particularly egregious circumstances, a court might allow a contractor delay damages even in the presence of a 'no damage for delay' clause. However, one signing a contract with such a clause must assume that it most likely will be effective in the vast majority of situations.

One important thing for those working in the public arena on public contracts to be aware of. There is a statutory right for delay damages under various circumstances as contained in C. 30, s. 39O of the General Laws. Therefore, even though there may not be a *contractual* right for delay damages in the contract documents, there may be a *statutory* right to claim for delay damages under this statutory section, which is generally included in virtually all public bid documents. This section requires, however, that the awarding authority issue a writing "to suspend, delay, or interrupt all or any part of the work for such period of time as it may determine to be appropriate for the convenience of the awarding authority." And, for there to be delay damages, this period of 'suspension, delay or interruption' has to be for a period of more than fifteen days. Many public owners – particularly larger municipal and state agencies - are aware of this provision and studiously avoid writing any such letters.

One last note. I have collected more than six figures on settlements twice for delay claims where the contract specifically precluded them by having clear and unequivocal 'no damage for delay' claims. Since there are doctrines such as "waiver" (defined above) and "estoppel" (that it would be unfair in the circumstances to preclude a certain action because of action or inaction by the other party), it may be that you might have a possible, even viable, claim for delay damages even in the presence of a 'no damage for delay' clause. And, as hard as it might be to imagine in the current construction economic environment, in the two cases referred to above, each of which involved a state agency, the state agency sometimes does try to do 'the right thing', which was involved with concluding each of those matters. So, you may wish to consult with someone knowledgeable in this area before giving up on a claim for delay.

18. What are 'termination for convenience' clauses?

One provision that we have been seeing increasingly more frequently is a provision which essentially allows a party to terminate a contract upon one's own unilateral determination without warning and without grounds and without consequence as to being exposed to claims for breach of contract damages. Such clauses, when invoked properly, are attempts to put the court system out of business!

Since those who place these provisions in contracts do not necessarily want to advertise to their contracting parties that they intend on reserving the right to unilaterally terminate an ongoing contract without penalty (and without cause), one should examine all portions of a contract document to see whether or not there is such a provision. This type of provision need not be contained just in the basic contract form but could be contained in supplementary general conditions, special general conditions or the general conditions themselves.

Here's an example of what it might look like:

> "Upon seven days' written notice to CONTRACTOR and ENGINEER, OWNER may, without cause and without prejudice to any other right or remedy of OWNER, elect to terminate the Agreement. In such case, CONTRACTOR shall be paid (without duplication of any items). . .for completed and acceptable Work executed in accordance with the Contract Documents prior to the effective date of termination, including fair and reasonable sums for overhead and profit on such Work . . . for expenses sustained prior to the effective date of termination in performing services and furnishing labor, materials or equipment as required by the Contract Documents in connection with uncompleted Work, plus fair and reasonable sums for overhead and profit on such expenses; . . .for amounts paid in . . .for reasonable expenses directly attributable to termination. CONTRACTOR shall not be paid on account of loss of anticipated profits or revenue or other economic loss or any consequential damages arising out of such termination."

This is more generous than most of these clauses that I see. Most of them limit the other party's 'damages' to the value of the acceptable labor and materials incorporated into the work up to the point of the termination for convenience.

Legal writers reference this type of clause as an "option to terminate" or as a "termination for convenience" provision. Why are they there? They allow contracting parties to get out of disadvantageous contracts, contract with someone they find with a better price and/or get rid of difficult subcontractors possibly without any financial ramifications (damages).

When confronted with such a clause in the contract, a resisting party might attempt by negotiation to lessen its potential effect by making such a right a "conditional power" which could only be exercised by the happening of a certain condition precedent and that any attempt to exercise the power prior to the specified event(s) would be either inoperative or wrongful, causing the party exercising it to be liable for breach of contract damages. Also, if the clause has to stay in, you might attempt to negotiate a broader definition of what would be allowable costs were this to happen. For example, rather than limit the recoverable monies to only the fair and reasonable value of installed work, you might try to include restocking fees for equipment and materials ordered but not used. Various federal cases have allowed as recoverable costs the costs to terminate underlying subcontracts.

19. What are the most important contract provisions to read and understand?

The basic 'deal', obviously, has to be clearly set forth. What work are you going to do and when and how much are you going to get paid for doing it? Reviewing a lot of contracts, I am frequently surprised to find that subcontracts for significant undertakings don't always adequately describe these points. Assuming that the 'deal' is acceptable in terms of form, one has to understand the "changes" clause (or clauses) and the "disputes" clause (or clauses), which would either be contained in the general contract or, more usually, in the general conditions or supplementary general conditions.

The changes clause primarily indicates how claimed changes to the contract and differing site conditions are to be submitted, particularly when the party claiming the same is looking for an equitable adjustment to the contract (money and/or time). Typically, these provide what notice must be given and when such notice must be given and in what form such notice should be to lay the groundwork to preserve a claim under the contract.

The disputes clause tells you how the 'changed condition' or other item of dispute will be handled: in court, in arbitration, in mediation or some combination of these methods and in what order they are to be pursued. For example, some contracts provide that before suit can be initiated, the claiming party must have first attempted mediation.

Where Massachusetts is fairly tough in requiring prompt notice of claims, knowing what your obligations are in this department are very important, as notice periods tend to be very short: anywhere from one day to two or three weeks.

20. What is a subcontractor's obligations with regard to indemnifying the general contractor in personal injury situations?

To the extent that a subcontractor is required by any contractual provision to indemnify a general contractor or others for the negligence of anyone other than the subcontractor or the subcontractor's employees, agents or its subcontractors, this is greater than what is required in Massachusetts by the provisions of Chapter 149, section 29C of the General Laws, which provides as follows:

> "Any provision for or in connection with a contract for construction, reconstruction, installation, alteration, remodeling, repair, demolition or maintenance work, including without limitation, excavation, backfilling or grading, on any building or structure, whether underground or above ground or on any real property, including without limitation any road, bridge, tunnel, sewer, water, or other utility line, which requires a subcontractor to indemnify any party for injury to persons or damage to property not caused by the subcontractor or its employees, agents or subcontractors, shall be void." (Emphasis added)

Therefore, on the go in, at least a portion of broader requirements is going to be potentially unenforceable as a matter of law to the extent that indemnification is for acts and omissions other than the acts and omissions of the subcontractor. In other words, where the general contractor is demanding indemnification where it has contributed to the harm, the subcontractor's obligation may be limited to what the statute provides. The reader should be cautioned, however, that this is one of the more frequent appellate construction issues and there are usually several cases each year which consider, evaluate and tweak this issue. There has been some case law which seems to suggest that a subcontractor might be deemed to have waived a restriction to only those obligations contained in C. 149, section 29C if it agrees to greater indemnity.

Insurance subjects and matters which could be covered by insurance, such as most indemnification provisions involving negligence, should be looked at by your insurance agent before you sign the contract. Addressing these matters after you begin working – or when a situation develops - probably is too late. Your insurance agent isn't there merely to bind coverage. He/she is there to service the account and checking general contractor-requested indemnity and insurance provisions against your own coverage is part of his/her job.

Keep in mind that insurance provisions are material provisions of a contract and a failure to provide the kinds of coverages in the amounts indicated in the contract might be considered to be breaches of contract, which might support a termination for this ground alone. Increasingly, I am seeing contracts which provides for what rating the insurance company must have with A. M. Best, which is a company which rates insurance

companies. So, for example, if the rating required is an "A" rating and you supply insurance from a company with a "B" rating, you are technically in breach of contract.

21. What are liquidated damages? When are they enforceable?

Liquidated damage clauses provide, in essence, that a general contractor will be entitled to receive from the subcontractor (or the owner from the general) so many dollars for each calendar day that the subcontractor (or general contractor) exceeds its contract time without proof of special or actual damages. This is not in and of itself necessarily harmful to a subcontractor's interests, as actual damages for delay, in some circumstances, could be more. And, a damaged party can only obtain liquidated damages, if provided for by contract, or consequential damages, where the contract doesn't have a liquidated damages clause. Generally, you can be liable for one or the other but not for both.

The concept of liquidated damages, therefore, has some sense of inherent fairness in that a subcontractor will not generally be aware (or, as aware) of the particular consequences of not meeting a completion date as the general contractor and owner might be. By specifying a certain sum for each calendar day of late completion, at least the subcontractor can have an accurate understanding of his potential downside for failure to meet a contract date. If you are assessed liquidated damages, before agreeing to pay them, discuss with a knowledgeable person the 'doctrine of concurrent delay', which may limit the application of liquidated damages in certain situations.

Under Massachusetts law, a liquidated damages provision will be enforced where actual damages are difficult to ascertain and where the sum agreed upon by the parties at the time of execution of the contract represents a reasonable estimate of those damages. The clause will not be enforced where the sum is unreasonable or grossly disproportionate to real damages. In Re: Lipman Brothers, Inc., 35 B.R. 178 (Bankruptcy, 1983).

22. What are 'sealed contracts'? How do they differ from 'unsealed' contracts?

A sealed contract is usually created when the signature paragraph to a contract contains words such as the following: ". . . the parties have executed this Agreement under Seal . . ." Or, a general recitation somewhere in the document which says that: "this contract is executed as a sealed instrument". Or, above the signature line, one finds: "witness my hand and seal".

Massachusetts, in the construction context, recognizes *two* levels of formality of contracts: unsealed contracts and sealed contracts. The concept of a sealed contract originated in England where certain contracts when bearing the impression of sealing wax on or around the signature have an inherent presumed increased degree of formality. For sealed contracts in Massachusetts, one can sue on them (or be sued on them) for a period of twenty years rather than the six year period normally provided for actions on Massachusetts contracts.

Another difficult aspect of sealed contracts is that a judge asked to enforce the contract is not supposed to look at the adequacy of the underlying consideration given for either party's signature on the contract. Presumably, with a common or unsealed contract, a judge can make such an inquiry (although my experience is that they don't generally do so.)

This has potential practical significance where I am seeing lien waivers and releases coming in with a provision that the document is to be treated as a contract under seal. Where the typical 'partial lien waiver' or 'partial release' generally releases a lot more than mechanics' lien rights for the particular requisition for which it is given, limiting the scope of the judge's inquiry as to the sufficiency of the consideration for the execution of the lien waiver or release increases the power of the party requiring the lien waiver and release and weakens the position of the signatory to such documents if ever there is a challenge to the document in question.

23. Don't guess on whether your insurance is sufficient: your agent gets paid commissions to 'service the account' and your questions about coverage are part of the deal.

As I indicated above, in any subcontract situation, a subcontractor must give the indemnification and insurance requirements to his insurance agent and make sure that the subcontractor's insurance is sufficient to meet indemnification and/or insurance requirements of the subcontract. This is particularly so where the indemnity language extends to 'defending, holding harmless and indemnifying' certain parties, such as the owner and architect. As stated above, failing to meet the insurance requirements of the subcontract could cause the subcontract to be deemed as breached and, therefore, justify termination of the subcontractor. Many of the larger general contractors have sufficient staff with sufficient expertise to check insurance coverages from insurance certificates and are not reluctant to advise subcontractors when they are technically in breach of contract for failing to meet the insurance requirements. And, if for whatever reason you are not able to bind coverages high enough to meet the requirements of the contract and job, finding this out *prior* to signing the contract will be a lot less painful than finding this out while performing the job.

Subcontracts often require 'contractual liability' coverage, which may not always be a standard part of an insurer's comprehensive general liability policy. In many instances it is often good for a subcontractor to have excess umbrella coverage above and beyond the underlying comprehensive general liability insurance. For example, if a subcontractor ordinarily carries a $1 million comprehensive general liability insurance policy, he might also carry another $5 to $10 million in umbrella coverage to cover him for a really big "hit."

Other types of coverage within the excess (umbrella) coverage might be helpful. For instance, it may be very worthwhile for a subcontractor to make sure that his excess coverage has a 'first dollar defense' or 'drop down' provision. These two types of

provisions require the excess carrier to defend the subcontractor in tort litigation should a claim be made against the subcontractor and for whatever reason the primary insurer does not come in and defend. Often times, when there are claims made against subcontractors, insurance companies for a whole host of reasons will refuse to provide a defense under the comprehensive general liability policy. By having a 'first dollar defense' or 'drop down provision' in the excess coverage policy, the subcontractor (insured) is guaranteed that another insurer may come in and at least pay for the cost of defense of the litigation, which with a serious injury can be rather substantial. I was involved in a seven figure electrocution (personal injury) case where having the drop down provision was extremely beneficial to the subcontractor at issue. Among other things, the cost to defend any significant personal injury matter will run anywhere from the mid to high five figures to six figures.

24. The issue of change order work without the change order

Most change order provisions in contracts require the subcontractor, prior to the commencement of changed or revised work to submit promptly to the contractor written copies of a claim for an equitable adjustment (for money) and/or for contract time. Then, after getting such a provision in writing at the general's insistence within the contract, many generals then seem to do their level best to try to get you to work without complying with their own requirement!

From a legal standpoint, a subcontractor should try to get prior written direction to perform changed work from the general contractor before doing so. At bare minimum, a subcontractor performing an extra or changed piece of work should confirm this to the general contractor as closely as possible to the commencement of performance of this work. Among other issues, if there is no written direction from the general contractor to do what the subcontractor considers to be extra work, there might be an issue at some later point between the general and the sub as to whether or not that piece of work was, indeed, extra work or was only contract work.

I recognize, after saying this, that the realities of the construction business are going to dictate in many instances against having the proper paperwork in place prior to doing the work. In my view, simply having a general contractor's superintendent sign a so-called "extra work order" indicating the names of individuals, times of performance and materials used in performing an alleged extra item of work is not sufficient for these purposes. General contractors may later argue that a superintendent in signing these types of documents is simply verifying that labor and materials were performed by a subcontractor on the date indicated. And, that such signature does not constitute an acknowledgment that the performance of such labor and materials was extra work and/or that the prices added on to the labor and material represent an acknowledgment of the value of this work.

Of course, the best thing to do is to comply with what the contract says.
If forced to perform extra work without a change order, there are a few things to do.

First of all, keep detailed records of the labor and material required to perform the change order as compared with that involved with the regular contract work. This might involve assigning a different job number or work item number for the piece of extra work as compared with base contract work. Secondly, take a lot of pictures and videos of the changed condition, if applicable. Thirdly, since by case law there is no inherent right of a superintendent to order extra work at the job – unless provided for by the specific contract – when ordered to do something that is an extra, try to give the general's office written faxed or email notice before performing the claimed extra work. Something like this: "Your superintendent, John Jones, has instructed this company to install fourteen widgets in Room 111. This is extra work and this company will seek a change order for both money and additional time for doing this work. (If known at this time, you might add: 'The approximate cost of doing this work is 'x' and the approximate additional time required to do this work is 'y'.') This company will commence performing this work three days from the date of this letter (email) (fax) unless otherwise instructed by your company in writing." By giving the general advance written notice sent to a corporate officer or to the project manager, there is probably some duty to respond on the part of the general if it doesn't concur with the suggested plan. Fourthly, whenever possible, insist on your contract rights. Whatever you do – or don't do – at the job will be measured ultimately against the document you signed if the matter goes legal.

(The purpose of this information is for general education only and for the purpose of discussing the issues involved. This information is not intended to be specific legal advice and should not be considered as being legal advice. For any legal problem/question, consult competent counsel of your own choosing.)

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