# CONTRACTOR'S
# POCKET GUIDE

WAGONHEIM & ASSOCIATES

A FULL SERVICE COMMERCIAL AND CONSTRUCTION LAW FIRM

www.wtlawfirm.com

# TABLE OF CONTENTS

Construction is a tough business.

The companies that thrive are those which can combine excellence in their field with a working knowledge of contracts, cash flow, and the management of receivables. Construction contracts, and the laws by which they are enforced, are complicated – often using terms that are unfamiliar to the average person and written in such a way as to hide huge risks within convoluted run-on sentences.

Throughout the almost 20 years I have spent practicing construction law, I could not help but notice that clients would often come to me long after their best opportunity to help themselves had passed them by. Maybe they signed a contract they should not have signed. Perhaps they allowed payment talks to drag on past the expiration of their right to file a mechanic's lien. Or maybe they found themselves roped into a contract long after they had assumed the project was dead in the water.



This Pocket Guide is intended to help companies spot key issues and make their best moves to stop problems before they arise. In construction, perhaps more than in any other industry, an ounce of prevention is worth well more than a pound of cure.

Good luck.

Eliot M. Wagonheim

# WHAT TO LOOK FOR IN THE OTHER GUY'S CONTRACT

## OVERVIEW

Construction is a contract-dependent industry. Most contractors do not have the luxury of using their own contracts…so they have to evaluate a contract drafted by someone else. Unfortunately, too many contractors sign contracts without a complete understanding of what it is they're signing. What's more, signing the wrong contract, or failing to negotiate key (but often misunderstood) terms, can break a company and undo years or even decades of profits and hard work.

If there comes a time when you spot one or more of these company breaking issues in the written contract, change it. Get good advice and change it.

## "DON'T WORRY ABOUT THAT, WE NEVER ENFORCE IT."



People will tell you anything. Regardless of any verbal assurances you may hear, if a term or condition is not in the contract, it will not be there when you need it. Similarly, assurances that certain contractual terms will ***not*** be enforced are worthless unless they are in writing and signed by the person making the promise. The unfortunate fact is: ***Construction companies live and die by the written word.***

While not a substitute for sound legal advice, the following pages are intended to help companies spot the issues and navigate the dangers presented by signing the other guy's contract.

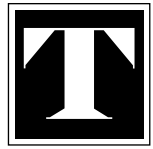
# BEFORE YOU SIGN SOMEONE ELSE'S CONTRACT...

**Scope of work.** Are you comfortable with the scope of work described in the contract? In order to know for sure, and before signing the agreement, you must review not only the narrative description, but also every specification division and section referenced in the narrative. Too many companies find themselves in agreement with the description, but completely unprepared to complete the entire specification section referenced by the contract. Remember, if it's in writing, it is a part of the contract. Remove or modify any written term with which you do not completely agree.

One of the larger pitfalls concerns the conflict between specifications and a narrative description of the scope of work which may appear in the contract. If the scope of work references or incorporates a specification section, you must assume that you are responsible for everything in that section ***unless you specifically exclude it in writing.***



The flip side of the coin is that many contractors assume that whatever is in their bid is part of the contract. This is usually not the case. Unless your bid is specifically incorporated into the contract as a Contract Document, the bid will be completely superseded by the executed contract – just as if the bid never existed.



**Time of completion.** Know the scheduling. What are the deadlines in the contract for substantial completion, Use & Occupancy, or final completion? Are they reasonable? Can you meet the requirements with available resources, with some "fat" built in for delays beyond your control? Are there liquidated damages assessed for each passing day on which a certain deadline is not met? These questions must be answered before you agree to the project.

To the extent possible, make sure the schedule is tied to an objective event or date. A term stating that "work must begin within 10 days of the issuance of a Notice to Proceed" could require you to start weeks or months later than you had projected. A better term would be "work must begin within 10 days of the issuance of a Notice to Proceed, ***but in no case later than X date."*** Similarly, the completion of the contract should be tied to objective standards like the issuance of a U&O or to meeting the requirements in the plans and specifications. Under no circumstances should a project only be concluded ***upon the satisfaction of the Owner.***



There are few more subjective terms than "satisfaction." If the satisfaction of the owner or higher-tier contractor determines whether payment will be made, odds are you can forget receiving 100% payment. More to the point…in a cash-strapped project…you will have to fight for every penny you receive under such a contract because people in a cash crunch are never "satisfied."

**Other documents.** Construction contracts almost always incorporate other documents by reference. These documents may include drawings, specifications, General Conditions, and the Prime Contract between the Owner and the General Contractor. While it may be a pipe dream to think that one could review all of the documents in detail for every project, you should be aware that documents you have not reviewed could be part of your contract. So, take extra care to ensure that any terms you really care about (pricing, warranties, etc.) are specifically written in your agreement.

One strategy is to make sure that the important terms and documents are specifically identified as "controlling" in the event of a conflict. Let's say that your subcontract specifically states that there will be no liquidated damages assessed on the project. Unfortunately for the general contractor, however, the Prime Contract provides for liquidated damages of $1,000 per day. If your contract also provides that your contract will control in the event of a conflict between the Contract Documents, you will not be liable for liquidated damages. When you have not reviewed all of the documents listed as Contract Documents, make sure the ones you care about will determine in the event of a conflict.

**Payment.** Payment is where the rubber meets the road. Do not lose sight of the key payment terms even while you are reviewing the scope of work and scheduling provisions. Every contract should satisfy you as to:

(1) how much will you be paid – does the amount or calculation match your understanding?
(2) when will you be paid – is it after you complete your work, after the entire project is completed, or after the higher-tier contractor received its payment?
(3) what happens if you are not paid – are you entitled to interest and/or attorney's fees for pursuing payment rightfully due you?
(4) by whom are you supposed to be paid – can you trust that party to uphold its end of the bargain?



Of all these terms, the final one is the most overlooked. Who is responsible for paying you? Many owners create new partnerships or LLC's for every project. The LLC's never existed until the project came along. Consequently, there is no credit history and no assets to go after if things go wrong. This is one of the biggest business risks a contractor takes.

Consider adding a deposit, obtaining an additional party to sign as a guarantee of payment, or negotiating an advantageous payment schedule to insulate you from any undue risk. If you are not very familiar with the other side, find someone you trust in the industry who is. Look for credit references and use the connections provided your trade associations for assistance.

# WHAT YOU SHOULD KNOW ABOUT ...
# BIDS

## THE BID IS NOT PART OF THE CONTRACT

If the bid is not specifically "**incorporated by reference**" into the contract or attached as an exhibit and expressly listed as one of the **Contract Documents**, it disappears as soon as the contract is signed. Make sure any significant terms from the bid – scope of work exclusions, warranty information, pricing, etc. – are built into the contract.

## EXPIRATION DATE



Every bid you submit should have an expiration date. Many companies have found themselves tied to pricing and performance obligations long after they had committed resources elsewhere assuming the project was dead. In the interim, labor and supply costs have gone up, meaning a significant loss on the job even if everything were to go perfectly. Bottom line: Build in an expiration date that leaves enough time for your bid to be evaluated, but does not tie your company to a commitment it will be unable to keep.

# WHAT YOU SHOULD KNOW ABOUT ...
# SPECIFIC CONTRACTUAL TERMS

## CHANGES ON THE JOB

Changes during the project are seldom documented as neatly as standard AIA documents would portray. According to the AIA contracts and most other standardized agreements, a change to the original scope of work will be documented, as to price, time, and work, in a **Change Order** signed by the architect, upper-tier contractor or owner, and the contractor performing the work. Projects simply do not run like that in the real world.

In the real world, a contractor will receive an order to modify the original scope of work without time to draft the appropriate Request for Change Order and solicit the proper signatures – the work has to be done NOW! In these situations, every contractor should employ four of the most powerful words in the English language:

***This is to confirm…***



Absent the luxury of waiting for the paperwork to catch up with directives from the Owner or upper-tier contractor, a contractor should **ALWAYS** send out a letter, via facsimile and first class mail, confirming the instructions – including a description of the revised scope of work, timing, and (if possible) payment terms. The letter should display the fax number to which it was sent and should conclude by advising that the contractor will perform in accordance with the terms in the letter unless advised in writing (by some immediate, specified deadline).

In any case, the contractor should always pay close attention to how each contract deals with the issue of changes on the job. Can unilateral changes be enforced? How will pricing be set? What input will each party have as to scheduling? These terms must be understood before the project gets underway and pressure comes to bear for an immediate decision.

## CLAIM

Whenever a contractor believes it is entitled to extra money or time, it can be said to have a "claim." The key question is what the contractor is going to do with it. If the contractor wants to pursue it, care should be taken to comply with all claim notice provisions in the contract. Most contracts provide that the failure to file a written claim (or at least provide some written notice of the triggering event) will cause the contractor to lose the right to pursue it. So when in doubt, put it in writing.

## CONSEQUENTIAL DAMAGES

Consequential damages are damages that arise as a consequence of some triggering event. An example might be a retail store's lost profits resulting from a delay in opening for business. The lost profits would be consequential damages. A contract which provides for the recovers of consequential damages opens the door to some very significant exposure – especially if consequential damages are referenced in the indemnification provision. Delete or specifically exclude references to consequential damages whenever possible.



## CONTRACT DOCUMENTS

Most contractors have never seen all of the items listed as "Contract Documents." In many cases, the "Prime Contract" between an Owner and a General Contractor is made a part of every Subcontract…and subcontractors rarely, if ever, know what it says. The Prime Contract could contain provisions for liquidated damages, mandatory arbitration, mechanic's lien waivers (not valid in MD, but enforceable in some states, and a host of other material terms. Bottom line: know your Contract Documents.

## DISPUTE RESOLUTION

**Arbitration**, rather than "**litigation**" (filing suit in court) is the preferred way of resolving claims and disputes in the construction industry. A ruling from an arbitrator is just as binding as a verdict handed down by a judge in court, but that's where the similarity ends. Arbitration takes place before a person or panel chosen by the parties in the dispute. The arbitrators are experienced in the industry and generally knowledgeable about the subject matter of the dispute. The proceeding is not nearly as formal as that of a court trial and the arbitrator is not necessarily bound by state law in reaching his/her decision. While often less expensive than litigation for larger claims, arbitration can be a lot more expensive than a District Court claim (claims less than $25,000). We often recommend that mandatory arbitration provisions "carve out" or make an exception for claims less than $25,000 so that they can be tried, faster and less expensively, in District Court.

Many dispute resolution provisions also require "mediation" before either arbitration or litigation. **Mediation** is a non-binding, informal procedure in which the parties to the dispute meet with a trained mediator to discuss and work through their issues. A skilled mediator can be incredibly effective in guiding the parties to reasonable (and sometimes creative) ways of resolving their differences.



## EXTRA WORK ITEMS/CHANGES IN THE WORK

Few projects proceed exactly as laid out in the drawings and specifications. For this reason, most every construction contract not only provides for **Change Orders** (documents signed by all necessary parties as to work, pricing and/or time), but also extra work items assigned by the owner, general contractor, or higher tier subcontractor. Regardless of form, all instructions to perform work beyond what is stated in the contract **must be in writing**. If, as often happens, the paperwork lags behind the construction schedule, the contractor performing the work should <u>always</u> follow up with a "this is to confirm" letter.

## FINAL PAYMENT

Many final payment provisions make payment to the subcontractor contingent upon the general contractor's receipt of final payment from the owner. Much like pay-when-paid provisions (discussed later), these provisions could, if not properly drafted, force a substantial delay in payment to the subcontractor due to a backcharge assessed by the owner against the general contractor for issues completely unrelated to the subcontractor's work. The subcontractor will want to limit final payment provisions to refer specifically to its own scope of work.

## INDEMNIFICATION



Indemnification is not only one of the most overlooked contractual provisions, but it is also one of the most dangerous. In its most basic sense, an indemnification provision spells out the occasions on which one company will serve as the other's insurance company. As a consequence, it is imperative that contractors limit any indemnification provisions to the greatest extent possible.

A broad indemnification provision will often require that a contractor provide indemnification from any and all damages arising out of its work ***or in connection therewith***. Inasmuch as all of the work being conducted on this project is "connected to" the contractor's work, the provision is far too broad. Care should be taken to limit the scope of these types of provisions as they could single-handedly turn a profitable job into a financial disaster.

## LIQUIDATED DAMAGES

A liquidated damages provision will provide that charges will be assessed against the contractor for each day the contractor has failed to reach a certain completion milestone beyond a certain deadline. Amounts vary and often range anywhere from $100 per day to several thousand. Regardless of the amount, liquidated damages add up quickly and should be avoided, pared down, or limited in scope to the extent possible.

## NOTICE



Notice provisions (and there are many of them) have the dual hazards of: (1) possibly eliminating claims; and (2) making the average person's eyes glaze over. Most contracts contain strict limitations on what kinds of notice (for items such as differing or unforeseen site conditions, delay claims, specification errors, or extra work items) are required and deadlines as to timing. This is one of the first items in a fairly short list that must be reviewed with project managers for each contract under their supervision ***before they set foot in the trailer.***

## PAY WHEN PAID/PAY IF PAID

Pay-when-paid or pay-if-paid are generally enforceable in Maryland and basically provide that a subcontractor will not receive payment unless or until the owner pays the general contractor. These provisions are dangerous to a subcontractor and essential to a general contractor. A subcontractor will want to eliminate them (if possible), while a general contractor would insist on keeping them to avoid having to subsidize the owner's project.

There are two primary options in these types of clauses: (1) the subcontractor's payment would be contingent upon receipt by the general contractor of payment from the owner *for the subcontractor's work*; and (2) the receipt of payment from the owner is for all work, and is not specifically limited to the subcontractor's work. The second option is normally also used in Final Payment provisions. The difference between these two options is that under option number 2, the general contractor may attempt to withhold payment from the subcontractor if it was backcharged for issues unrelated to the subcontractor's work.

## PERSONAL GUARANTEE

It may be rare, but some construction contracts seek a personal guarantee from the contractor's owner or president. Such guarantees are to be given at your own peril. In fact, while there are very few blanket statements in law, we can say that we have **never** recommended that a client sign a contract with a personal guarantee.

Construction is a tough business; and construction projects are comprised of a lot of moving parts. There is virtually no limit to the number of ways a project can head south. When this occurs with a personal guarantee on the line, decades of long hours and meticulous work can be wiped out in the blink of an eye.

## TERMINATION



Those provisions which concern the conditions under which the contract may be terminated deserve special attention. Many contracts contain what is known as a "termination for convenience" provision which enables the higher-tier contractor to terminate the contract without cause, virtually for any reason whatsoever. Care should be taken to understand and, if necessary, modify the amount of payment that will be rendered to a contractor terminated for convenience, as well as the deadline by which payment must be received.

Other termination provisions – those which concern the failure of a contractor to perform adequately – should also be examined. A general contractor or higher-tier contractor will want maximum flexibility, while a subcontractor should insist upon written notice ***and an opportunity to cure the deficiency.***

## WARRANTY

The terms of your warranty should never be left to chance. Whether you are disclaiming any warranty or offer an extended period of coverage, make sure your precise terms are expressly stated in the contract. Many contracts provide that the warranty required by the Prime Contract will be incorporated into each subcontract. Subcontractors should not allow this incorporation, but instead should insert a provision specific to their company and trade. Failure to do so could break the bank sometime down the road.

# WHAT YOU SHOULD KNOW ABOUT ...
# GETTING PAID

## OVERVIEW

Maryland law provides construction contractors with an array of weapons for use in their fight to get paid. Like most aspects of the construction industry, the successful pursuit of payment takes knowledge, time, and skill. The pages which follow are dedicated to those companies determined enough to benefit from the fruits of their labor to understand their rights and fight for their money.

In all but the smallest of claims, consultation with experienced legal counsel, well-versed in construction law, is a must. Very few of the breach-of-contract remedies provided to contractors by Maryland law lend themselves to use by the lay-person. Nevertheless, knowledge of these remedies is, in and of itself, a very powerful tool in the hands of the experienced contractor. This section of our Guide is intended to provide you with that knowledge.



## ARBITRATION

(See "Dispute Resolution" on page 14)

## BOND CLAIMS

A "bonded project" is one in which a company, often the general contractor, posts a **Payment Bond** to ensure the project owner that everyone will be paid, absent a backcharge. Bonds are required by federal and state statutes on larger publicly owned projects, such as bridges, schools, military installations, etc. Private owners may also elect to require that a bond be posted in order to avoid the prospect of mechanic's liens filed against the project.

A Payment Bond is essentially an insurance policy against which a contractor or supplier can file a claim seeking payment for work performed or materials supplied to the project. The Bonds, themselves, will spell out the specific terms and deadlines for filing a claim, but they most often specify that: (1) payment to the claimant must be 90 days past due; and (2) the bond claim must be filed within one year of the conclusion of the project.



The first step in making a claim for payment under a Payment Bond is obtaining a copy of the Bond, itself. No contractor likes to release its Payment Bond information, so expect a runaround when you ask for it. Bonds on public projects may be obtained from either the company which posted it (called the "**Principal**") or the public institution under a Freedom of Information Act request – basically a letter on steroids. Persistent written requests to the Principal should also do the trick.

The actual bond claim is made through a detailed letter directed to the insurer (called the "**Surety**") which provides all information relevant to your claim and is delivered in the manner specified in the Bond. With the exception of minimal claims, it is often best to have an attorney prepare and forward the claim.

Should the Surety deny or fail to act on the claim, suit may be filed directly against the Surety.

## BREACH OF CONTRACT ACTIONS

The purpose of a contract is to allow each party to enforce the other's obligation to perform. If a company refuses (for any reason) to pay for work or materials as required by the contract, that company is in "breach." The written contract will control whether breach of contract actions are filed in court or in arbitration. In the absence of a written term requiring that disputes (such as an action for non-payment) proceed to arbitration, breach of contract actions are filed in court – Maryland District Court, Circuit Court, or U.S. Federal Court.



In a breach of contract action, the aggrieved party can seek whatever the contract allows. Some contracts will not only allow a claim for the amount of money due for the work or materials, but also interest and attorney's fees incurred in bringing the case.

If filed in court, breach of contract actions can be accompanied by one or more of the other types of claims described in this Guide.

## MARYLAND PROMPT PAY STATUTE

(§9-302, ET. SEQ. REAL PROPERTY ART., MD CODE ANN.)

True to its name, the so-called "Maryland Prompt Pay Act" establishes that a contractor or subcontractor who performs work or supplies material under contract shall be entitled to prompt payment of undisputed amounts by the earlier of:

1. Seven days after the passage of contractual deadlines for payment;
2. Thirty days after the day on which the occupancy permit is granted; or
3. Thirty days after the day on which the owner takes possession.



The Act provides for the addition of interest and, if the court determines bad faith exists, attorney's fees to the prevailing party. For this reason, an additional count filed in a breach of contract action citing violation of the Maryland Prompt Pay Statute is recommended, especially in those instances where the contract does not enable the prevailing party to recover interest and attorney's fees.

## MARYLAND TRUST FUND STATUTE

(§9-201 REAL PROPERTY ART., MD CODE ANN.)

The Maryland Trust Fund Statute is one of the most powerful collection weapons available to any creditor in any industry under the laws of the State of Maryland. In a nutshell, it enables a contractor owed money to pursue collection – not only against a company, but also against that company's owners, directors, and managing agents ***personally.***

The Statute was enacted in order to protect subcontractors from losses due to improper use of funds by those above them in the food chain. Funds received by a general or upper tier contractor in payment for a subcontractor's work or materials are deemed to be held in trust – much in the same way as an attorney or title company may hold funds in escrow, although the Statute does not require a separate account. If the contractor receiving the trust funds fails to pass them on to the subcontractor, for any reason other than a legitimate backcharge, the contractor as well as its owners, directors, and managing agents may be held personally liable.



In any given set of circumstances, the Statute may also allow a contractor to recover payments due even when the upper tier contractor which received the funds files for bankruptcy. (This is the actual intention of the Statute; although bankruptcy judges in Maryland are inconsistent in their application.)

## MECHANIC'S LIEN CLAIMS

(§9-102, ET. SEQ. REAL PROPERTY ART., MD CODE ANN.)

A mechanic's lien is a lien created by state statute to allow a contractor to secure payment for work performed or materials supplied to an improvement on real property. The lien can be attached not only to real estate improvements, but also to certain fixtures and equipment. The importance of a mechanic's lien is that it enables a contractor to reach the owner of a project even in cases where someone in between – be it a general contractor or upper tier contractor – went into bankruptcy or out of business.

Value

In order to file a mechanic's lien, one must adhere to very strict deadlines and conditions. Moreover, not all projects are "lienable." One may not file a mechanic's lien on a public project or on a project encompassing less than fifteen percent (15%) of the value of the property. (This does ***not*** mean that the filing contractor's claim must be equal to 15% of the value of the property, just that the project of which it is a part must meet that threshold.)



Time Deadlines

A **Mechanic's Lien Notice** must be served upon the property owner within **120** days of the last day on which the claimant last performed work on or supplied materials to the project. While the Notice has to meet very specific requirements in order to be found valid, it is not filed in court – it is simply a letter (with attachments) served on the property owner. A contractor's failure to serve a valid Notice on the property owner by the deadline will result in a loss of lien rights. The actual Mechanic's Lien Petition must be filed in the appropriate court within **180** days of the last day on which the claimant last performed work on or supplied materials to the project. Miss the deadline by one day and you miss your right to file the claim.

## MECHANIC'S LIEN CLAIMS (CONTINUED)

Type of Project

*Commercial*

Non-residential projects such as office buildings, restaurants, and retail shops, undertaken for a private developer, are "commercial" and subject to the mechanic's lien statute. Provided the project meets the value threshold and filing deadlines have not expired, a contractor can file a mechanic's lien claim.

*Residential*

While a mechanic's lien may be filed on residential construction, recovery is much more limited than in commercial projects. A contractor in a residential project may only recover the amount of money which has not already been paid by the owner to the upper-tier contractor. In other words, Maryland law may act to force the owner of a commercial project to pay twice for the same work – once to the upper tier contractor and once to the successful mechanic's lien claimant – but it will not force that same hardship on the owner of residential property.



*Public*

Public projects are those undertaken for federal, state, or local governments. Examples of public projects are public schools, bridges, and military bases. Public projects are not lienable. Instead, contractors must resort to filing a breach of contract action for non-payment against their upper-tier contractor or filing a bond claim if a bond was posted on the job.

# WHAT YOU SHOULD KNOW ABOUT ...
# WAGONHEIM&ASSOCIATES

- W&A serves as counsel to contractors, subcontractors, owners, and developers throughout the mid-atlantic region, providing guidance on virtually every issue likely to face our clients on a day-to-day basis: bids and bidding procedures, protests, contractual drafting and analysis, problems on the job, pursuit of payment, defense of backcharges, litigation, mediation, and arbitration.

- W&A has an excellent track record of success in litigation and dispute resolution, including arbitration, mechanic's lien claims, bond claims, breach of contract actions, mediation, delay and scheduling claims, and general litigation.



- W&A is a full-service commercial and construction law firm, advising our clients on general business issues including succession planning, contractual formation, mergers & acquisition, stockholder issues, employment, collection, and general litigation.

- Wagonheim & Associates is a business law firm rated "AV" (excellent to pre-eminent) by Martindale-Hubbell, the country's most prominent and respected law firm rating service.

# Eliot M. Wagonheim

*ewagonheim@wtlawfirm.com*

- Admitted to practice in MD and PA
- Published author of The Art of Getting Paid
- Over 15 years experience representing construction contractors, sureties, insurance carriers, and commercial clients in both litigation and arbitration
- Extensive experience in jury and bench trials before State and Federal courts, as well as in arbitration and mediation under AAA and other organizations
- Representation of clients throughout the construction process from contractual review and drafting through the bidding process to on-the-job damage control and the collection of final payment.
- Duke University (1984), B.A.
- University of Maryland School of Law (1987), J.D.