

TWENTY-FOUR COMMON SUBCONTRACT QUESTIONS AND ISSUES

By Jonathan Sauer

This article discusses twenty-four basic questions/issues commonly involved with construction contracts, particularly with subcontracts. These are typically questions and issues that students raise at my contract seminars. Here we go!

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.

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 your 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.

Why should 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 you picked the wrong job or if problems develop - as they will - your memory and your contracting party's memory of what 'the deal' is frequently going to 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. Without a written contract, settling your bond claim will be more protracted.

Simply put, unless you are planning to be 'the thief' in the relationship, there are *no* good reasons not to have a written contract.

But it's all so complicated! 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! (Check the website: we have an article about this.)

My quick response is that if I needed a contract in the next ten minutes, I would grab an AIA form and cross off arbitration. These forms don't discriminate between subcontractors and general contractors and they are pretty fair.

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 will make a lot of sense. The Department of Corporations in Massachusetts will tell you over the phone whether your customer is a corporation, a limited liability company (LLC) or neither. You can also punch in “Massachusetts Secretary of State” on your browser and this will connect you directly to the Corporations website, where you can search databases. There is more information on line and, since you can search it yourself, there is less chance of there being an error in receiving the information.

If your customer is not a corporation or an LLC or an LLP, chances are he/she has had poor legal advice or is dumb as a stump or both. For, anyone willing to risk his house every day when this can easily be avoided 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.)

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. 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, 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). Whether preliminary agreement which contemplates execution of further document represents understanding of parties on all essential terms cannot be read from text of preliminary paper alone, as provisions of subsequent agreement, or subsequent events, may expose disagreement between parties about significant business terms. Vickery v. Walton, 26 Mass.App.Ct. 1030, 533 N.E.2d 1381 (1989). 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 elements of an enforceable or clearly-understood contract as well. These can include scheduling information, the submittal process and a variety of other details that can either make the job more difficult or make it difficult for you to get paid.

How to avoid your letter of intent from becoming 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.

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.”

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 for relatively small amounts of money – say, ten grand or less – having a proposal with specific terms on the front of it with some terms and conditions on the back can be a desirable 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 ten percent – and providing for reasonable counsel fees for collection efforts can prevent a lot of problems or at least 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. 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.

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. In other words, *unless they are incorporated into the contract*, a court will not ordinarily look at any specific offer or any specific acceptance or the various back and forth drafts. 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. For, otherwise, a court is ordinarily going to find - except in instances of fraud, which is hard to prove - 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, there needs to be a provision in the subcontract which expressly says: “John Doe Construction’s proposal dated October 2, 2002 is included in this Subcontract. 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.”

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 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 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, warranty or punch lists) will be owed by the subcontractor to the general contractor as is applicable to his work unless explicitly excluded in the subcontract. More on this later.

Therefore, we have to accept as a given that in many instances you will not be able to negotiate away each and every 'bad' subcontract provision.

At the same time, in many instances you will be able to negotiate some of the contract language - depending upon your leverage and how badly the general contractor wants you - and a primary purpose of this seminar will be to help identify some common 'difficult' clauses and discuss what they mean so that in those circumstances where you do have some negotiating ability, you can concentrate on those clauses which make sense for those particular subcontracts.

At the same time, even where you cannot affect specific subcontract language which you would prefer to change, being aware of the possible ramifications of having that language in the subcontract may be of assistance to you in the administration of the subcontract. For example, when there is a \$10,000.00 per day liquidated damage clause, that subcontract gets worked on first!

Does your contract have to be in writing?

There are several substantial legal and factual reasons to support having anything but the most simple (inexpensive) 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. This could mean that without a written contract, you might not have any remedy (be able to sue) in the event of breach.

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.” Pappas Industrial Parks, Inc., v. Psarros, 24 Mass. App. 596 (1987).

To satisfy the Statute of Frauds a writing must incorporate the promise that the plaintiff seeks to enforce. Harrington v. Fall River Housing Authority, 27 Mass. App. 301 (1989).

Let's take a look at the case of M.J. Pirolli & Sons, Inc. v. Mass. Equipment & Supply Corp., 401 N.E.2d 146 (1980).

In this case a supplier of building materials brought an action against the general contractor seeking to recover payment for various materials which the supplier had delivered to the original mason subcontractor on a construction project prior to the original subcontractor's insolvency and replacement by another subcontractor. Apparently, the defendant and general contractor had made promises to the supplier to the effect "I'll see that you get paid." The Appeals Court held that this claim was barred by the Statute of Frauds.

(In the same vein, most 'joint check agreements' are not worth the paper they are printed on. Look to the website for some model forms.)

Therefore, in virtually all cases with no imaginable exceptions, your subcontracts with subcontractors and general contractors - as a material supplier, second tier subcontractor or first tier subcontractor - 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.

A contract to be enforceable need not be complicated in terms of terms, pages or forms. The basic idea of a contract is that there is an "offer" and an "acceptance." The law wants to see a meeting of the minds as to the essential terms of the deal between two parties. What this means simply is that one can demonstrate fundamental agreement in writing as to the fundamental terms of the performance. In a construction context, this would usually mean agreement as to the following terms: Price; nature of the performance (what is to be done); the time for performance (when the work begins and when it ends). In different situations more might be required, but these are really the only fundamentally essential terms in any construction contract.

It is not necessary that both parties sign the same document to constitute a legally enforceable contract. But, *somewhere*, there needs to be a signature by each party *to the same terms*.

Let's assume that you make a quotation in writing to a general contractor to perform a certain item of work. The quotation may not even be on a written purchase order form. It might say simply, reduced to fundamental terms: "I will perform the HVAC work at the new Boston Garden for the price of \$3 million." If the general contractor were to write you a letter stating that it accepts the terms of your proposal

without changing any terms, a legally enforceable contract has been entered into, notwithstanding that it is on two separate pieces of paper.

From a factual standpoint, apart from whether or not a contract is legally enforceable - by not being in writing - you should want it to be in writing for any number of other reasons. A bonding company wants to see a separate contract for each separate job as it will assume otherwise that there might be some unbonded work in the claim. Regarding mechanic's liens, there is case law (and statutory law) which provides that for a supplier to bring an action against a contractor and a subcontractor enforcing a mechanic's lien, there can be no mechanic's lien where there is no preexisting written agreement for the job for which the lien is sought to be enforced. Having a series of purchase orders and invoices issued from time to time without any preexisting written agreement imposing an obligation on either the supplier or the subcontractor or both of them does not satisfy the requirement for a mechanic's lien that there be a written contract between the supplier and subcontractor. Gettens Electric Supply Co., Inc. v. W.R.C. Properties, Inc., 21 Mass. App. 658 (1986).

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 numerous other reasons, **do not** work in the construction area without at least a simple written document signed by both parties, even if on separate papers, 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! Verbal orders don't - and shouldn't - go!

How do I get my contracting parties 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 scope and price (and, delivery, if I can have a third term, especially if it was discussed). 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’ to make sure that you got the terms right so you can begin processing their order. Once they have signed the document – and you signed it when you sent it to them – you now have a written contract.

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 not - or understand what is in them, you will be bound by the documents incorporated into your contract. Here’s what the lads and lasses in the black robes have had to say about this:

In absence of fraud, a person who signs 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 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 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). Where what is given to a person purports on its face to set forth terms of a contract, a person assents to its terms by accepting it, whether he reads it or not, and is bound by any limitation of liability therein contained, in absence of fraud; but where what is received does not purport to be a contract the person receiving it is not bound by limitation of liability unless actually known to him. Polonsky v. Union Federal Sav. & Loan Ass'n, 334 Mass. 697, 60 A.L.R.2d 702, 138 N.E.2d 115 (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 conditions which are not by their terms exclusively restricted to the general contractor.

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).

This legal principle is referenced in the case of Handy v. Bliss, 204 Mass. 513 518-519, 90 N.E. 864 (1910). As stated by the Court, the general principles in construction cases are:

“To entitle the plaintiff to recover in a case of this kind there must be an honest intention to perform the contract and an attempt to perform it. There must be such an approximation to complete performance that the owner obtains substantially what was called for by the contract, although it may not be the same in every particular, and although there may be omissions and imperfections on account of which there should be a deduction from the contract price. It is not necessary that the work should be complete in all material respects, nor that there should be no omissions of work that cannot be done by the owner except at great expense or with great risk to the building. There may be omissions of that which could not afterwards be supplied exactly as called for by the contract without taking down the building to its foundations, and at the same time the omission may not affect the value of the building for use or otherwise, except so slightly as to be hardly appreciable. Notwithstanding such an omission, there might be a substantial performance of the contract.”

Can a subcontractor pull off the job in the event of non-payment? (Second question: should the subcontractor pull off the job in the event of non-payment?)

Absent such specific provision allowing for you to stop work, to make sure that you have preserved your right to sue under a subcontract, it is almost always necessary for you to complete your performance under that subcontract or such aspects of your performance as are not specifically excused by an act or omission on the part of your contracting party. Some of the AIA subcontract forms specifically give a subcontractor the *contractual* right to stop work for non-payment upon giving various notices.

Ordinarily, unless your contract specifically provides for it or unless a failure of payment is to the point where only fraud can explain it, the fact that your contracting party is late paying you may not be legal justification for pulling off the job. In fact, in many instances, pulling off the job can be seen as an act of abandonment, which would be a material breach of contract *on your part*. The reason you can't ordinarily pull off for non-payment is pretty complicated. I'll summarize it as well as I can. The law

deems an obligation to perform as (ordinarily) an ‘independent covenant’ from the obligation to pay, which is another ‘independent covenant’. From a legal standpoint, unless there is something in the contract which makes these two clauses *interdependent*, they are as two ships passing in the night, deserving of individual respect and enforcement individually and independently.

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. 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 thus constitutes an abandonment, which is a material breach of contract. It is axiomatic in the contract world that one should not easily allow another (i.e. the general contractor) to finish your work 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 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 included some non-contractual work or expenses, including improvements to the design performed by the completion contractor.

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 when it has not completed its work for the fair value of the work completed.

The words “*quantum meruit*” from the Latin mean simply “how much it is worth;” it 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 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. In such a case, 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 requires a subcontractor absent specific allowance in its subcontract of terms otherwise constituting sufficient excuse not to perform, to complete its subcontract before suing on the same.

Under what circumstances can (should) a subcontractor pull off the job for other issues?

Whether or not a subcontractor has a sufficient cause to cease performing in any given factual circumstance is one of the most common and often complex issues confronting both a subcontractor and the subcontractor’s lawyer! The purpose of this fairly short article is not to give you a definitive list as to those circumstances which will justify non-completion or acts which do not constitute non-completion. It is sufficient to say for these purposes 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 completed the project, you might be liable to the general contractor for its damages for non-completion. Therefore, unless you have specifically left something material out of your bid price, it is generally axiomatic that no other contractor can complete your subcontract cheaper than you can.

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 obviate 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 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 fact, there is a Massachusetts case which says that in an action by a surety on an indemnity agreement, defenses claiming that the

surety did not act in ‘good faith’ is not a legal defense at all.) 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.

What are “pay-when-paid” clauses and when are they effective and when are they not effective?

When does the general have to pay you, his subcontractor? Generally speaking, this will depend on a whole variety of factors, including whether or not you are a subcontractor on public work or not. As pertains to public work, there are time limits by which the awarding authority must pay the general contractor and the concept of “forthwith,” which is the time requirement a general contractor must comply with in paying subcontractors once the general contractor has received monies for those subcontractors’ line items, applies.

Two questions suggest themselves.

First, let’s suppose that the general contractor through either negligence, mean-spiritedness or otherwise fails to requisition monies from the owner for your line items, notwithstanding your timely and proper requisition to the general contractor.

Or, let’s assume that the general contractor does requisition monies for your account but that the owner neglects or refuses to pay.

Let’s additionally assume that in either case the general contractor has a provision in his purchase order to you, the subcontractor or materials supplier, with one of those hardly readable provisions on the back side of the purchase order which says something to the following effect: “Last Chance Construction Company’s responsibility to make payments under this purchase order is limited to payment of those funds received for this subcontractor’s account from the owner.”

What do you do when forty-five days after submitting a substantial requisition (or materials invoice) to your contracting party, your contracting party tells you that it has not even passed on that requisition (or materials invoice) to its contracting party or that its contracting party has not paid?

Enter the realm of the “pay-when-paid” clause! Namely, is language in a contract to the effect that payment will be made under that contract only when your contracting party gets paid binding on your rights to get paid?

Massachusetts’ law is somewhat critical of “pay-when-paid” clauses, but there is authority to support these clauses when the language in the clause is reasonably clear to operate as a ‘risk transference’ from the general contractor to the subcontractor of the risk that the owner will not paid.

One of the leading modern cases on this subject is the case of A.J. Wolfe Company v. Baltimore Contractors, Inc., 244 N.E.2d 717 (1969). This was an action at law brought by a subcontractor against a general contractor for amounts due under the subcontract and for extras. The Supreme Judicial Court, which is the highest court in the Massachusetts state court system, held that a provision of the subcontract that payment would be made by the contractor to the subcontractor on monthly requisitions for progress payments as received by the contractor from the owners as merely setting the time of payment and not creating a condition precedent to payment by the contractor to the subcontractor.

The specific language in question was as follows: Payments were to be made “. . . and within 10 days after (the owner’s) payment of such monthly progress payments. . . (has) been received by . . . (Baltimore).”

The Supreme Judicial Court said on pages 720-1 of the decision that:

“We interpret Art. II(a) merely as setting the time of payment and not as creating a condition precedent to payment. In the absence of a clear provision that payment to the subcontractor is to be directly contingent upon the receipt by the general contractor of payment from the owner, such a provision should be viewed only as postponing payment by the general contractor for a reasonable time after requisition (and completion of the subcontractor’s work mentioned in the requisition) so as to afford the general contractor an opportunity to obtain funds from the owner.”

In other words, the general contractor would be required to make payment irrespective of whether or not payment had been received from the owner and language as to when payments were to be made was to simply set forth a time period during which the general contractor could make a requisition to the owner for that subcontractor’s work. Such a clause is typically referred to as a ‘timing clause’.

Nine years later, the Appeals Court decided the case of Bayer & Mingolla Industries, Inc. v. A.J. Orlando Contracting Co., Inc., 370 N.E.2d 1381 (1978).

This was a case where a subcontractor brought an action against a general contractor on a state construction project for release of retainage held by the general contractor, inter alia. The Appeals Court held that where more than 65 days had passed since the subcontractor’s substantial completion and where there was no dispute as to the quality of the work performed by the subcontractor, the entire balance of retainage was due the subcontractor and was not contingent upon final payment from the owner. The pertinent portion of this decision is on page 1382 as follows:

“The plaintiff is correct in its contention that the phrase ‘upon receipt of final payment by the owner’ should be interpreted as setting a time for payment which is sufficient to give the general contractor an opportunity to obtain funds from the owner, and not as creating a condition precedent

to payment where there is a dispute between the owner and the general contractor not involving the subcontractor. (Case citation). The defendant attempts to distinguish the Wolfe case on the grounds that it involved progress payments whereas the present case involves retainage. That argument is unpersuasive. The court in Wolfe, at 366 n. 8, 244 N.E.2d 717, cited with approval the case of Eastern Heavy Constructors, Inc. v. Fox, 231 MD. 15, 19-20, 188 A.2d 286 (1963). In that case, in which a retainage was to be paid to a subcontractor within ten days after final payment by the owner to the general contractor, the court upheld a decision awarding the subcontractor the full amount retained, although the general contractor had not yet been paid in full by the owner, on the basis that the subcontractor's remuneration should not depend upon a dispute between the owner and the general contractor as to matters not concerning the subcontractors."

A more recent Massachusetts case on this issue in the case of Jeremiah Sullivan & Sons, Inc. v. Kay-Locke, Inc., 459 N.E.2d 837 (1984).

The court on page 838 cited both the Wolfe case and the Bayer & Mingolla case with approval noting that the latter case held that a 'similar provision did not create a condition precedent to payment where there is a dispute between the owner and the general contractor not involving the subcontractor. The Appeals Court on page 838 talked of "clarity of language" necessary to establish a condition precedent. Moreover, in reviewing the record on appeal, the Appeals Court was looking for evidence that it was "clearly understood (by the parties) as a condition to payment" before finding a condition precedent.

In considering these three Massachusetts cases, it appears to me that the Massachusetts appellate courts have tightened up or restricted somewhat the ability to enforce a "pay when paid" provision. In the Wolfe case, the court would enforce such a provision where there was a clear provision that payment to the subcontractor would be directly contingent upon the receipt by payment to the general contractor from the owner. This rule was tightened up in the Bayer & Mingolla case as requiring the reason for non-payment to be involved with that subcontractor's trade. The general contractor would not have to make payment when (but only when) the dispute between the owner and the general contractor pertained to matters involving the subcontractor. This tightening up of the law was made more clear in the Sullivan case.

It is my sense that a court will generally enforce a "pay-when-paid" clause if the risk of loss of the owner's not paying is clearly transferred to the subcontractor (by the general contractor) or to the materials supplier (by a subcontractor or a general contractor).

What kind of language should you be looking for? What are the operative words? The following type language is probably a legally-enforceable pay-when-paid clause:

“General contractor’s obligation to pay the subcontractor will be triggered when, and if, the general contractor receives funds from the owner as to the subcontractor’s line items.”

That language “and if” gives notice fairly clearly that the subcontractor is assuming the risk of the owner’s not paying the general contractor.

The following clause will most likely be enforced as a pay-when-paid clause: “In accepting this purchase order, the subcontractor acknowledges and agrees that the general contractor’s obligation to pay the subcontractor is strictly limited to when the general contractor has received monies from the owner on the subcontractor’s line items.” This language is a little more subtle than the prior example but will most likely accomplish the same result.

The key thing to keep in mind when evaluating a tendered subcontract or purchase order is to look for language which predicates or establishes as a condition precedent to your getting paid a payment received by your contracting party from its contracting party. Or, in other words, is the general contractor telling you that he will only pay you when and if the owner pays him?

Pay-when-paid clauses, while not favored in Massachusetts, are generally legally enforceable if clearly-enough drawn. Therefore, you should train those in your organization whose job it is to review tendered purchase orders and subcontracts for sufficiency to look at the language contained in the payment provisions to see if there is any attempt by your contracting party to transfer the risk of nonpayment from another to you. If that language is fairly clearly there, you could have difficulties convincing a court at some point in time that your contracting party is in breach for nonpayment.

As a practical matter, the presence of a fairly clear-cut pay-when-paid clause might be a factor you wish to take into consideration as to whether or not you want to do business with the party tendering this kind of language. As a practical matter, however, we see these clauses very frequently in custom drawn subcontracts, along with ‘no damage for delay’ clauses (only remedy a time extension, not money where there is a delay or suspension) and ‘unilateral right of termination’ clauses (the general contractor can terminate the further performance of the subcontract for *any* or *no* reason and not be subject to breach of contract lawsuits for lost profits.) These types of clauses are part of the subcontract culture in Massachusetts and, probably, more generally.

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.”

As to actual damages for delay to be sought by a contractor, one of the important earlier cases discussing this is Charles I. Hosmer, Inc. v. Commonwealth, 302 Mass. 495,

499-503 (1939). In this particular case, the Supreme Judicial Court discussed some of the issues involved with making a delay claim.

As stated on pages 499-500:

“A party to a contract, who is not precluded by its terms from asserting a claim for damages due to delay in commencing or in completing performance, may recover if he can show that the delay was a breach of some express provision of the contract or of an implied obligation imposed upon the other party to the contract not to interrupt or hinder the progress of the first party.”

In the Hosmer case, there was a provision in the contract that, essentially, there would be ‘no damages for delay’ but that the contractor would be entitled to additional time to complete the work.

As stated by the Supreme Judicial Court on page 502: “Such a provision negatives any pecuniary compensation for delay.”

Further, some ideas which might become prophetic in later years (and cases) were discussed by the Court on page 503:

“The petitioner did not introduce any evidence showing the reasons or causes of any of the delays alleged in its petition. The characterization of the action of the Department of Public Works as negligent, unreasonable or due to indecision is not enough to avoid the pertinent provisions of the contract. The respondent or the officials in charge of the work are not charged with arbitrary, capricious or fraudulent action, nor with acting in bad faith or under such a gross mistake as to be tantamount to fraud.”

A more recent case on this issue is the case of Wes-Julian Construction Corporation v. Commonwealth, 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 reasonable 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 unflinching 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.

One important thing for those working in the public arena on public contracts. There is a statutory right for delay damages under various circumstances as contained in C. 30, s. 390 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.

One last note. I have collected more than six figures twice for delay claims where the contract specifically precluded them. Since there are doctrines such as “waiver” (defined above) and “estoppel”, it may be that you might have a viable claim for delay damages even in the presence of no damage for delay damage. You may wish to consult with someone knowledgeable in this area before giving up on a claim for delay.

What are 'termination for convenience' clauses?

One provision that we have been seeing increasingly more frequently in the contracts of the large and/or sophisticated and/or of those in a position to essentially dictate terms is a provision to allow a party to essentially terminate a contract upon one's own unilateral determination without warning or grounds and without consequence as to being exposed to claims for breach of contract damages.

The first thing to keep in mind is that those who place these provisions in contracts do not necessarily want to let their contracting parties (victims?) know, in advance, that they intend on reserving the right to unilaterally terminate an ongoing contract without penalty (and without cause). Therefore, and even more creatively drafted (and placed) than the artful phrasing of a "no damage for delay" or "pay-when-paid" clause, 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.

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."

Ordinarily, one cannot walk away from the performance of a contract without suffering the consequences of being liable for breach of contract damages. You see, each party is legally entitled to the benefit if its bargain: you are to perform this amount of work for me at this price.

What are those damages? An older Massachusetts case defines them as follows: "Upon any breach of contract, whether of warranty or otherwise, the defendant is liable for whatever damages follow as a natural consequence and the proximate result of his conduct, or which may reasonably be supposed to have been within the contemplation of the parties at the time the contract was made as a probable result of a breach of it." Thus, future prospective profits may be recoverable. Also, in Massachusetts - and by statute - a party who suffers a breach on the part of his contracting party is entitled to

interest at the rate of 12% from the date of breach or from the date of initiation of court action to recover damages. Of course, the increased costs of completing the other party's performance - if applicable - which amounts are in excess of those monies remaining in the contract are also damages to be recovered.

Legal writers reference the type of clause under discussion in this article as an "option to terminate". 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). Much of the law on this subject comes from the federal procurement process. People might design a building and then wait several years for funding to build it, only discovering in the construction process that they no longer need the building or, at least, the building that was designed.

Traditionally, this type of clause was found in leases, employment contracts and other kinds of contracts, such as so-called "requirement contracts". "Requirement contracts", such as is codified in the Uniform Commercial Code, enacted in Massachusetts as Chapter 106 of the General Laws, which provides that there may be: "A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale." (Chapter 106, § 2-306(2) of the General Laws.)

Massachusetts has enforced requirements contracts for a period of time. Where there seems to be litigation concerning these types of contracts is where there is a question as to whether or not one party or the other exercised good faith or where one party or the other either insisted upon (or refused to accept) a quantity that was "unreasonably disproportionate" (too little or too much) to either stated estimates or to normal or otherwise comparable prior requirements. In the construction context, many of the cases deal with material suppliers, such as suppliers of concrete.

It seems to us that for a fixed scope contract with a fixed price whereby a contractor is to supply both labor and materials to accomplish a certain goal, the employment by the party drafting the contract of an "option to terminate" is inappropriate, particularly where the circumstances under which a party might exercise this option are not fully disclosed and/or the clause is not negotiated but simply "buried" somewhere in the contract documents.

When confronted with such a clause in the contract, a resisting party might attempt by negotiation to mute its 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.

If "the party of the first part" - that is the guy with the money, the lawyers on retainer and a printed contract - *insists* on having an option to terminate contained in the contractual agreement, then it is appropriate - indeed, in most instances, necessary - to further add what specific costs will be compensable in the event that such clause is exercised.

Then, what are the kinds of costs that one should be looking for in attempting to dilute the otherwise potentially disastrous effect of an improvident or singularly selfish exercise of an option to terminate clause? One might look to the Federal Acquisition Regulations (FAR) for guidance as to what types of costs are typically compensable in the event that the government elects to terminate for its own convenience. These regulations are contained in the Code of Federal Regulations. With these ideas as guidance, one should extrapolate to one's own proposed contract such as of the following provisions make sense as areas of negotiation as to dealing with the effects of a termination for convenience clause in *your* contract.

The types of costs which can be compensated for include: the costs of performing the work terminated, including initial costs and preparatory expense allocable thereto; the cost of settling and paying termination settlement proposals under terminated subcontracts that are properly chargeable to the terminated portion of the contract; a sum to reflect the profit the contractor would have earned on the contract, which either will not be payable or will be reduced if it can be demonstrated that the contractor would have sustained a loss on the entire contract had it been completed; the reasonable cost of settlement of the work terminated, including accounting, legal, clerical and other expenses reasonably necessary for the preparation of termination settlement proposals; storage, transportation and other costs reasonably necessary for the preservation, protection or disposition of the termination inventory; restocking charges for ordered materials.

Apart from these types of costs, a contractor entering into a contract with an option to terminate provision should give some consideration to whether or not the disputes clause applicable to performance of the contract is sufficient to determine what the allocable costs should be in the event of the exercise of this clause. It may be that there should be a more immediate (and less expensive) way of determining at least the major incurred costs, so that a contractor already suffering the loss of income from the reduced contract need not wait, for example, three years for a case to come to trial (or, for that matter, necessarily have to incur the costs of litigating to determine these costs). It may be appropriate, for example, to designate arbitrators to establish the fair value of the work in place, which arbitration clause might contain specific references for how long the arbitrators have to do their work, and what appellate rights there are, if any, from their determination.

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

The basic 'deal', obviously, has to be clearly set forth. Assuming one does that, one has to understand the "changes" clause (or clauses) and the "disputes" clause (or

clauses). The first one primarily indicates how claimed changes to the contract and differing site conditions are to be handled, particularly when the party claiming the same is looking for an equitable adjustment to the contract (money). Typically, these provide what notice must be given and when such notice must be given to lay the groundwork to preserve a claim under the contract. And, 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.

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.

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 is void and unenforceable in Massachusetts because of Chapter 149, section 29C of the General Laws, providing 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 this language is going to be 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 reader should be cautioned, however, in 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.

I suspect that actual practice among some subcontractors is to generally ignore insurance provisions and to nearly completely ignore indemnification provisions. These are things which must be arranged in advance of contract performance to protect yourself from possible business-threatening claims.

While I would want any subcontractor to take this most seriously, I would specifically encourage those subcontractors involved with hazardous activities such as

electricians, excavators and demolition contractors to especially be sensitive to these particular issues. In today's civil tort litigation, seven figure (million dollar) verdicts are no longer uncommon and I have personal knowledge of some cases where seven figure or near seven figure awards have been given for injuries as relatively small as losing a finger with some damage to a hand.

Insurance subjects and matters which could be covered by insurance, such as most indemnification provisions involving negligence, should be addressed by an insurance agent before you begin working; to address these matters after you begin working 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.

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 so many dollars for each calendar day that the subcontractor exceeds its contract time without proof of special damages. This is not in and of itself or by definition innately harmful to a subcontractor's interests.

Absent the specific provision for a liquidated damages clause, general contract rules suggest that a party which breaches a contract is responsible for all consequences which flow from the breach, introducing the concept of consequential damages. Thus, in a particular circumstance the costs in actually remedying a breach might be relatively insignificant, while the consequences of that breach might be disproportionately large. Assume, for an example, that a life-safety subcontractor for one reason or another fails to order a long-lead item necessary to achieve certification of a nursing home. It may be that if the general contractor has to order this part (or the subcontractor orders this part and completes the work itself) that the actual costs to the general contractor for doing this work might be relatively insignificant. If, on the other hand, the owner was deprived of income from the nursing home for a period of 6-8 weeks (and/or had to pay for staff for the same period), the consequential damages could geometrically be larger than the costs of providing the missing items.

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 downside for failure to meet a contract date.

Massachusetts will generally enforce a liquidated damage clause. If, however, the liquidated damage clause does not appear to approximate a prior and good faith expectation of attempting to liquidate consequential damages in advance, but, rather, the figure constitutes a penalty, a Massachusetts court will ***not*** enforce the same. The following are some judicial statements on the subject.

In regard to situations in which liquidated damages provided for in a default provision of a contract are unreasonably and grossly disproportionate to the real damages from a breach, the damages recoverable are limited to actual damages. Begelfer v. Najarian, 409 N.E.2d 167 (1980).

Where actual damages for breach of contract are difficult to ascertain and where a sum agreed on by parties for payment in event of breach represents a reasonable estimate of the actual damages, such a contract will be enforced. A-Z Service Center v. Segall, 138 N.E.2d 266 (1956).

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).

What are ‘sealed contracts’? How do they differ from ‘unsealed’ contracts?

This is indicated when the signature paragraph contains words such as the following: “. . . the parties have executed this Agreement under Seal . . .” Or, in the signature paragraph: “witness my hand and seal”. Or, a general recitation somewhere in the document that: “this contract is executed as a sealed instrument”.

Massachusetts, in effect, recognizes *two* levels of formality of contracts: unsealed contracts and sealed contracts.

Now, I am not talking about the seals at Sea World! I am talking about a rather archaic Massachusetts concept – which started in the Old Country across the Pond - that certain contracts when signed with the impression of sealing wax have an inherent presumed increased degree of formality so that one can sue on them for twenty years rather than the six year period normally allowed for on actions on Massachusetts contracts.

Many contract forms include provisions for execution “under seal.” Merely having that language in the signature paragraph can extend the limitations period (the time within which suit can be brought) from a period of six years to a period of twenty years without anything further.

As six years is plenty of time to commence an action against a subcontractor (or, for that matter, an action by a subcontractor against a general contractor), I would try to x out these words - “under Seal”- to keep the limitations period to within six years.

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. Indeed, 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.

Indemnification often requires 'contractual liability' coverage, which may not 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 because of a failure of completely understanding the situation, ignorance or for good and valid 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.

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 for contract time. Then, after getting such a provision in writing at the general's insistence, many generals then do their level best to try to get you to work without complying with their own requirement!

From a legal standpoint, it is hard to visualize a situation where a subcontractor should perform changed work without having, at minimum, written direction from the general contractor to do so. If there is no written direction to do what the subcontractor considers as extra work, there might be a difference of opinion at some later point in the job between the general and the sub as to whether or not that piece of work was extra work or not. If at all possible, there should be a fundamental agreement on price and any extra conditions involved with performing the changed work - including any necessary extension of time to complete the subcontract work, including the change - before the work is actually done.

I recognize, after saying this, that the realities of the construction business are going to dictate in many instances - probably the majority of 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 do not represent an acknowledgment of the value of this work. Calling your lawyer *after* you have a problem of this kind is not unlike contacting the health club and a nutritionist after one has one's first heart attack; it is very late, perhaps too late to do much good.

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. 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 by the specific contract - when ordered to do something that is an extra, try to give the general's office written faxed notice of the fact in advance of your performing the 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 possible, 'The approximate cost of doing this work is 'x' and the approximate additional time necessary to do this work is 'y'.') This company will perform this work in three days unless otherwise instructed by your company in writing." By giving the general advance written notice sent to a corporate officer or 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, insist on your contract rights. Whatever you do - or don't do - at the job will be measured against the document you signed. Two of the best pieces of advice I could give you are: don't ever violate the industry practices/standards of your trade; do what your contract tells you to do.

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