Scribbles Squibs #17 - July 24, 2013 – What You Need To Know About Contracts: (Part One: The Essential Elements of a Construction Contract)

by Attorney Jonathan Sauer

I. What a Contract Is: Black's Law Dictionary defines a contract as: "An agreement between two or more parties creating obligations that are enforceable or otherwise recognizable at law." Put another way, a contract is simply some form of agreement to accomplish a certain result. You sign a purchase and sales agreement to buy a house. You sign an agreement to buy a car. You may sign an agreement to become employed or to *stay* employed. Signing a release and/or settlement agreement is entering into a contract – a release is a sale of your claim - the subject matter of which is contained in that release or settlement agreement. And, you become subject to a legally enforceable agreement (and, possibly, some very expensive results if someone thinks you have breached) when you marry.

Good judgment suggests that your contracts should always be in writing. But, I would be remiss in not pointing out that the Massachusetts General Laws provide that a writing is not required as long as the agreement is to be performed within one year from the making thereof. According to the internet, the Empire State Building was built in one year and forty-five days. Therefore, if it had been built in Massachusetts, written contracts would have been required. But, if the intention had been that from the date of the 'agreements' for this building that forty-six days of work were removed from this completion effort, oral contracts in Massachusetts would probably have worked. This for the largest building constructed in the United States (for a time)!

You've landed a piece of work. In this economy, good for you! Before it's time to think about when you are going to order the materials and for what period of time you will schedule a crew of whatever size, you've got to think about getting a written contract. But, truth to tell, what if you're not sure as to what a contract must contain? Here's a nine word contract which, with two signature lines, will be an enforceable written contract: "I will paint your house for nine thousand dollars." (hereinafter Paint Contract). As Ina Garten would say on The Food Network: 'How simple is that?' But, a question remains: is that really a *good* contract? The answer, of course, is 'no'. It's not a good contract because it doesn't describe what paint will be used. How many coats? A primer and a finish coat? Only one finish coat? When will the job begin and when will it end? When is the first payment due? When is the last payment due? Is there a warranty? Other questions suggest themselves. And, although painting is seen as low-tech and somewhat simple by some, I have found in my practice that 'coatings' are really a fairly complicated issue.

Granted, you can have an enforceable contract with as few as nine words. But, is it a good contract? By the questions listed above, it's clear that it is not. Maybe this discussion has

to start by a definition of terms. And the first terms requiring definition are what are the three elements of a contract?

II. What Are the Elements of a Contract?

A contract, for construction purposes, is a business arrangement which has three distinct elements. First of all, one of the parties must have made an *offer*. In other words, an offer to enter into a contractual relationship. Secondly, that offer must be *accepted*. Lastly, there has to be *consideration* for the mutual performances and promises stated in the contract.

(A) What is an Offer? An offer is the first event in setting up a potential contract. A proposal by a material supplier to a subcontractor or general contractor or by a subcontractor to a general contractor or by a general contractor to an owner is an 'offer' to enter into a contract, subject to the terms contained in the offer. An offer could be made by mail, by fax and by email. Presumably, it can also be made orally. This is not necessarily terrible, provided that the acceptance of the offer is made in writing, so that there is some record of what the deal actually consists of, reciting accurately the offer, acceptance and consideration. But, since acceptance of an offer might be possible by actions consistent with the offer, an oral offer can lead to any number of potential difficulties.

You have to think of offers as a potential series of documents or telephone conversations. When you make an offer to buy a house, this isn't official until it is in writing and a purchase and sales agreement has been signed, most likely based on the *last* offer. When you buy a car, you know that the salesman and sales manager and, especially, the business manager will make all kinds of offers or representations to you as to the terms and conditions, including price, of a vehicle you are hoping to buy. There can be numerous back and forth 'offers'. At some point, this is reduced to a writing, a sales contract, at which point you are legally obligated to buy that car once you have signed it.

A couple of things to be aware of. **Bids to a bidder on day of bid.** If you make an offer to a public bidder at or near bid day with the expectation that this bidder will use your bid as part of *its* bid, there is a Massachusetts legal case which says that you are bound to pay the difference to the party to whom your proposal was made between the amount of your bid and amount of the next lowest bid if you later choose to back out.

Secondly, a court will generally only consider as the enforceable contract the last document which describes the deal to which both parties subscribe to and sign. Therefore, the various documents going back and forth between the 'offeror' (the party making the offer) and the 'offeree' (the party accepting the offer) lose legal significance at such point as a document appears to be the final and last document, even where some of the prior documents may have a signature on them. This is due to the 'parole evidence' rule. Namely, prior versions of the offer become legally irrelevant at such time as both parties have signed on the dotted line. This is of particular importance when a material supplier or subcontractor has made a proposal and the contracting party tenders to the 'offeror' a written contract not referencing the proposal. If that contract doesn't indicate clearly that the proposal is a 'contract document', that proposal no longer has any legal significance. (I can think of one specific subcontractor who actually went

out of business because it did not grasp this point on a number of jobs.) So, if you wish to have the terms of the proposal stated as part of 'the deal', it must be identified in the written contract as a contract document. You need a second thing, as well. Most companies bidding on particularly public work have seen bid documents which have somewhere in them an 'ordering of the documents'. In other words, plans might supersede specifications in the event of a conflict between the two. And, the specifications might supersede general conditions in the event of a conflict between the two. Similarly, if your proposal is important to you, it needs something additional to just being listed as a contract document in the contract you are being asked to sign. Namely, somewhere in the contract there has to be wording such as follows: "In the event that there is any conflict between the terms of the proposal, a true copy of which is attached hereto, with other terms of the contract between the parties as signed, both parties agree that the terms of the proposal will control as to any discrepancies."

By the way, my standard advice to subcontractors is to set the proposal up (with good terms and conditions on the back side) in such a way that makes clear your offer is specifically conditioned on using your proposal as the form of contract and your being asked down the road to sign another form of contract might cause revisions in the contract price.

B. What is an Acceptance? The second key item in a contract is that the offer has to be 'accepted'. While there is some case law stating that such acceptance need not be in writing (where the offeree has taken steps inconsistent with anything other than an acceptance of the offer), the acceptance should be in writing. An easy way to handle such difficulties is simply to say in your proposal that it can *only* be accepted by a writing with original (ink) proof of that writing to be received in three days from the date of the proposal. Massachusetts' law seems to accept that such acceptance could be by an email. Some thirty-seven years into this lawyer thing, my preference would be that the acceptance be in writing with something that looks like a signature, whether it be by fax, email or, preferably, by mail. (I was told a long time ago by a handwriting expert that a signature could not be verified on a fax because of the slight distortion a fax process does to the words in a document.) So, as a conservative lawyer, I want something in original ink. Once an offer is accepted, the only other thing necessary to create a contract is 'consideration', discussed below.

One other thing to know about an acceptance. If the acceptance either rejects some of the material terms of the offer or adds additional terms to the offer, a court might consider that 'acceptance' as a 'counter-offer'. And, in that event, the acceptance might be treated as a rejection of the offer, not as an acceptance of the offer. If the additional terms of the acceptance are relatively minor – not affecting the basic deal – a court could find that the offer has been accepted as to all of the terms of the offer and acceptance which are identical and as offers for additional terms by the party accepting the offer. And, under that scenario, the fact that the party accepting the offer has made additional terms part of its acceptance, good practice suggests (even requires) that the accepting party have the offeror at least initial all changes made to the offer by the accepting party as relates to additional terms. I realize that this sounds confusing. But, if you are purportedly accepting some aspects of the offer but either reject some aspects of the offer or wish additional terms added to the offer, a more intelligent thing to do would be to make it clear one way or another as to whether you consider yourself bound to the offer at this point or whether you are still negotiating.

C. What is Consideration? 'Consideration' is fairly simple. This is what a party gives or pays to the other contracting party based on that party's agreement to perform a certain act. Remember the Paint Contract? The painter's consideration given is an agreement to paint someone's house. The consideration the homeowner gives to the painter is a promise to pay the painter nine thousand dollars. Assuming that there are no change orders, the painter is happy when he receives the nine thousand dollars and the homeowner is happy when he/she gets the house painted. The contract has completely worked!

Now, I have to add a wrinkle. Under the law, these promises are often considered to be 'independent promises'. This means that the promise to paint might be considered as a separate promise from the promise to pay. This means that the failure of one party to fully perform his/her agreement as contained in those promises does not necessarily, in and of itself, mean that the other party is not under an obligation to perform its obligations under *its* promises. A good contract will make it clear that these two promises are *inter*dependent so that one party's failure to fully perform does not require the other party to fully perform in the presence of that failure.

Sometimes this interdependence is supplied by a court in reviewing a certain situation. So, for example, there is some case law in Massachusetts which says that a party does not have to finish its work if it is not getting paid. When counseling contractors as to whether it is the right thing to do for that contractor to pull off or not, I often make the point that what happens if the fact-finder (judge, jury, arbitrator) finds that your pulling off the job was not warranted, was not justified. If pulling off the job was unwarranted, the party which pulled off the job for non-payment could be found to be in breach of its contract. And – more on this later – Massachusetts law says that a party which does not substantially perform its contract can have no recovery on that contract. So, a party pulling off might not be getting paid because there was some problem with its performance, whether fully communicated to that party by the other party or not. Sometimes the party pulling off for non-payment may not agree that it has miss-performed some aspect of the job. Irrespective, the party pulling off might not only lose its chances of receiving payment but might also be liable to its contracting party for the increased costs of finishing the work of the contractor which pulled off. Perhaps, surprisingly, there is no innate principle of law I am aware of in Massachusetts which says that a party not getting paid has an automatic right to pull off. Granted, there are some case decisions saying so. But, there are not as many such decisions in Massachusetts as one might think. And, there is always the issue of whether or not the judge down the road after considering all of the facts decides that you have materially breached the contract by pulling off because you were not entitled to be paid at the time you pulled off.

In many ways, material suppliers, subcontractors and general contractors gamble each time they submit a proposal to perform a certain job at a fixed price. Deciding to pull off at some point during the job can be an even *bigger* gamble, particularly when the pull-off was not performed well. (e.g. The contract might require someone thinking of pulling off to give various prior written notices to its contracting party, which notices have to be in a certain order and meeting specific requirements before it has the right to pull off for non-payment.) This means this should not be a decision based in anger. Granted, one who has performed a service can feel

abused when payment is not made under the terms and conditions agreed to. This decision, however, must be coldly and soberly made, not influenced (as much as possible) by anger.

D. Letters of Intent. Now, once there is an offer and there is an acceptance to that offer and there is stated consideration, is there a contract at this point? In other words, are the parties legally and contractually bound to each other by the offer, acceptance and consideration without having in place a written contract? The answer to this in Massachusetts is 'it depends'. Basically – and doing a lot of summarizing – a court is likely to find that a contract has been entered into even without a signed contract if the offer and acceptance and consideration, on balance, indicate two things. First, that there are no substantive issues between the parties still waiting to be resolved as to the scope or price of the work. (For example, in the Paint Contract, the color of the paint would not be a substantive issue unless different colors had different price ramifications.) And, secondly, the offer and acceptance and consideration either indicate that the parties are not contemplating a further written contract ***or*** that the written contract is seen by both parties as simply being a formality and the form of the contract has already been chosen, such form not subject to any significant modification because of the nature and impartiality of the form of contract. So, for example, if the offer and acceptance and consideration indicate that the parties contemplate entering into the 'statutory subcontract' as described in MGL C. 149, s. 44F, since that contract is finite and well-understood, its execution could be seen as simply a formality and not as a substantive act. The same might be said about the AIA standard A-401 subcontract between a subcontractor and a general contractor.

If, on the other hand, such paperwork as exists indicates that there are still substantive job issues being discussed which are unresolved ***or*** that the form of the contract, which both parties contemplate signing, has not been agreed to, the parties are probably not yet contractually-bound. So, for example, this might be a situation where a subcontractor is unwilling to sign a general contractor's custom subcontract form, which has some terms and conditions stated in it not contemplated by the offeror (the subcontractor) in making the offer and not to its liking.

I've had clients who have been caught in potential letters of intent situations and claims. In one such case, the other party (a sub-subcontractor) went into court attempting to get a preliminary injunction against my guy (a subcontractor) to the tune of something in excess of four hundred thousand dollars as to future payments to be received from the general contractor on the project in question. That attempt failed for various legal reasons. My recollection is that to get rid of this case and exposure a few years down the road, we paid something like twenty-five thousand dollars to the sub-subcontractor for a release. Had the paperwork been different, *nothing* conceivably would have been owed. But, as I recall, notwithstanding the absence of an actual signed subcontract, the subcontractor had already given the sub-subcontractor written change orders. Since one can't give another change orders if there is no contract in place, this was evidence that could have caused great difficulty for the subcontractor, as a court/finder of fact would decide that the parties had already agreed to the basic deal. Otherwise, why would the subcontractor be giving change orders to the sub-subcontractor?

A tip here. In any contracting company of any size, there are several people working on any particular contract at any particular time. There is the estimator, the project manager, the superintendent and various corporate officers supervising (often, rather loosely) the activities of

the others. Obviously, a project manager should not be giving change orders to another contractor if there is no written deal yet in place. If other issues requiring change exist up to the point of the written execution of the contract, such changes should be included in the written contract and not dealt with as change orders. Much as the hip bone is connected to the thigh bone, each individual working on the contract/relationship between the parties has to make it clear to other individuals in the company working on other aspects of the contract what is going on as of any particular point, *especially* until it is clear that there is an actual written and signed contract.

Be aware of this potential problem. If you are put into the position of accepting someone's offer, if there are outstanding substantive issues ***or*** the form of contract or whether or not there will *be* a contract is not resolved, make sure the paperwork reflects that. So, for example, the following might be used: "The parties have not resolved (using the Paint Contract) whether there will be one coat of primer and three coats of a finish coat or only one finish coat, which they see as a substantive issue. In addition to this, the form of contract has not been agreed to between the parties and it is the parties' intention that there be a signed written contract and that they not be legally and contractually bound until these issues are resolved."

Here is some rather succinct language from a decision in a Massachusetts Appeals Court case as to how such language might be written to keep a letter of intent from becoming a contract:

> "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."'

Another comment on letters of intent. Sometimes subcontractors will receive a letter from a general contractor stating, in effect, that this letter constitutes an intention to *award* the contract to the subcontractor. Often, the subcontractor will commence performing simply on the strength of that letter even where there are still substantive issues to be resolved as to the 'offer' and/or 'acceptance' and/or 'consideration' and/or form of contract. If one thinks about it, the more work the subcontractor performs on such a basis, the less likely the subcontractor will be to pull off the job and the greater the general contractor's negotiating position will be, as the subcontractor will want to protect its rights (and need) to get paid for outstanding requisitions for work done. Also, it will be more likely, under these facts, for the subcontractor to give in on some of the outstanding terms and issues just to make sure it gets paid for the value of the work performed to date.

Stating this another way, working off of such a letter gives the general contractor all of the leverage. The leverage that a non-yet-performing subcontractor naturally has – I don't start the work until we have agreed on all substantive terms and the form of contract – has been lost as, first and foremost, the subcontractor's primary concern is to protect its outstanding receivables. Even if a subcontractor starts working on such a basis because the job has a short

duration or the general really needs immediate work to be done, one should be aware of the old saying attributed to writer Ann Clare Boothe that: 'no good deed goes unpunished'.

It may be that in any situation, the difference between a letter of intent and an actual contract might be relatively small. But, they say that close only counts in horseshoes and hand grenades.

III. CONCLUSION: We have discussed issues pertaining to offer, acceptance, consideration and letters of intent. Our next *Squib* will deal with issues as to the different forms of contracts – i.e. lump sum contracts and unit price contracts – and how the differences in such contracts govern things such as change orders.

(These materials are intended as general information only, not specific legal advice. When confronted with a legal problem you don't understand, seek the assistance of legal counsel. Construction law is something that most 'general' lawyers don't do a lot of. At Sauer & Sauer, we ***only*** *practice construction law and attempt to assist our clients with their contractual needs and issues whenever possible.)*

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1. No charge to non-clients for quick answers to *general* Massachusetts construction law questions.

2. We guarantee our billing rate for five years in writing for all new clients through the end of this year who mention this offer at engagement.

3. As trials can be expensive, take a great deal of management time and the result of which is uncertain, we make our best efforts towards seeing whether something short of a trial – such as mediation – might be possible for resolving the matter. If a trial is necessary, however, we have a lot of experience trying cases.

4. We endeavor to maintain, wherever possible, future business relationships with your contracting party by emphasizing a fair and reasonable approach to disputes, which often helps promote earlier (and cheaper) case resolutions than does 'mean and angry'. And, while you might say now 'I'd never work for that guy again', a lot of experience over the years suggests otherwise. Given the right job, he'd be given another chance, particularly if it was a good job!

5. We try to defer until later in the case the more expensive elements of discovery – i.e. depositions – in order to try less expensive discovery first. We recently obtained a 1.5 million dollar settlement for a subcontractor against a bankrupt general

contractor's payment bond surety on three projects without a single deposition ever being taken and without our client's even having to answer and sign interrogatories.

6. Being a smaller firm, our attention is focused *solely* on our clients and their problems, not on feeding the overhead of a fancy office and many partners, associates and support staff. We only have to feed our five dogs, most of which, however, are *quite large!* (If you ever meet The Worm, be respectful and, perhaps, a bit wary. After all, Rotties *can* be difficult! Especially around meal times. For big dogs like this, it is almost *always* around meal times! Or, close enough.)

7. Satellite offices in Boston and Worcester for more convenient meetings.