Practical Issues in Construction Law

The Maryland State Bar Association©

MSBA Construction Law Committee

Presented by: Hon. Diane Leasure
Nicole Lentini
Paul Sugar
Matthew G. Hjortsberg
Michael W. Skojec

A View from the bench

Judge Diane O. Leasure (Ret.)

The difficulties judges have with construction law cases:

- A lack of substantive knowledge – many judges never litigated a construction law case when they were practicing attorneys.
- Complexity of issues – substantive and evidentiary.
- Challenges of part of the case being in arbitration and the rest of it being litigated in court.

The difficulties judges have with construction law cases (cont.)

- Extensive documentary evidence.
- Multiple parties and entities.
- Complicated discovery issues.
- Duration of the trial.

Practical tips

- As the Rules require, make a good faith and genuine effort to resolve discovery issues without the necessity of filing discovery motions.

  - Discuss discovery exchanges in substantial detail with opposing counsel

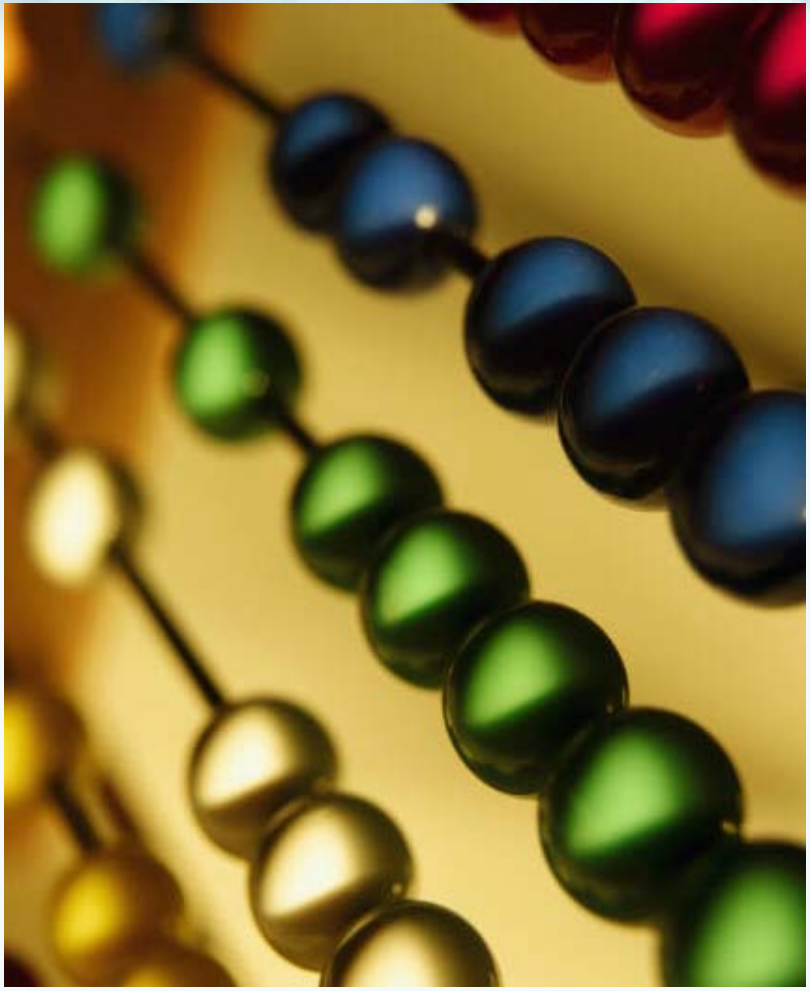
  - Consider mediation or arbitration for just the discovery plan for the case

Practical tips

- Use many demonstrative exhibits to explain the facts and the issues – parties, scope of the work, the issues you are asking the court or jury to decide, etc.

  - Drawings and plans
  - Critical path charts
  - Actual mock-ups

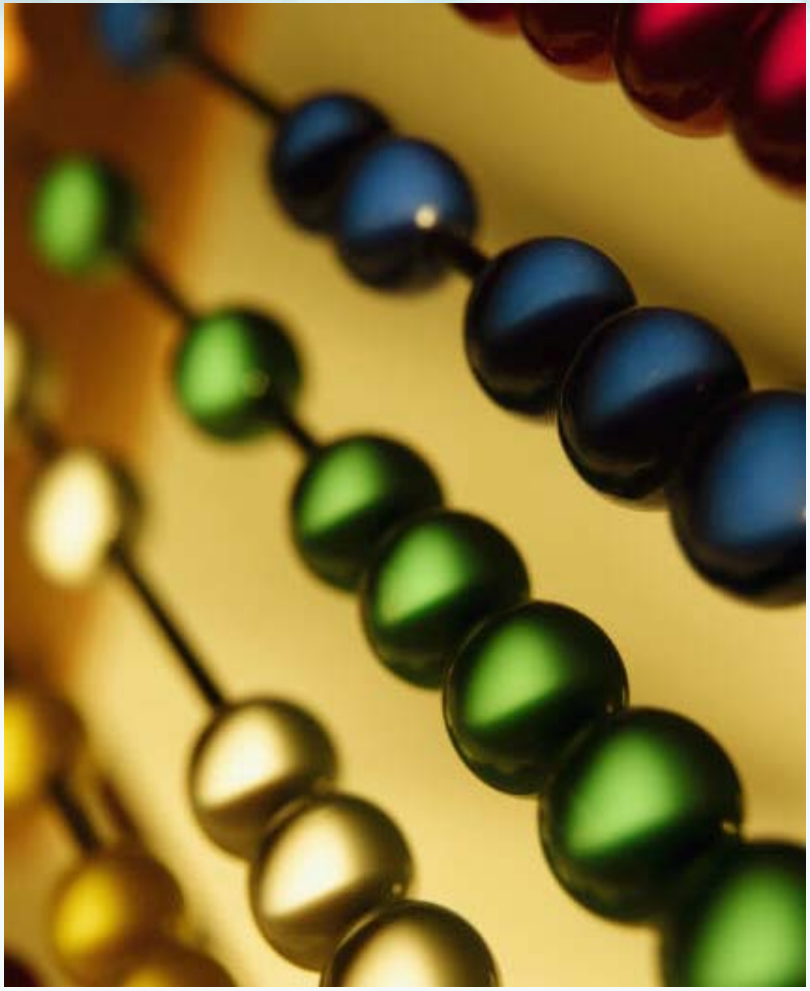
Practical tips (cont'd)



- Do the math! Prepare charts/demonstrative exhibits outlining the type and amount of damages you are requesting be awarded.

  - Construction damages are complicated, i.e. delay damages

Practical tips (cont'd)



- Prepare and file a Trial Memorandum that explains the substantive construction issues and addresses the legal issues and provides the court with the relevant case law.

Practical tips (cont'd)

- Discuss stipulations with the opposing party to limit the disputed issues and shorten the length of the hearing or trial.
- Submit exhibit binders to the court and/or jury and attempt to resolve document authenticity and admissibility issues in advance of the hearing or trial.
- Keep it simple!

Technical Defenses to Construction Claims

Nicole Lentini
Semmes, Bowen & Semmes

Introduction

- Before a trier of fact may consider the merits of a construction claim, a defendant may raise threshold technical and/or procedural defenses.

- Such defenses typically allege that a plaintiff has failed to fulfill a legal or contractual prerequisite to proceeding with its claim.

- Alternatively, a defendant may assert that a plaintiff has somehow waived its right to an adjudication of its claim on the merits.

Notice & Deadlines

- Contractual Clauses
  - **Written Notice**
  - **Change Orders**
  - **No delay for Damages**
  - **Payment Clauses**
  - **Arbitration and Waiver of Right to Arbitrate**
- Statute of Limitations
- Anti-Indemnity Statutes
- Notice Requirements

Written Notice of a Claim

- Most construction contracts contain provisions requiring a party to give the other party notice of the occurrence of unexpected events that could cause a party to suffer unanticipated costs.

- These contracts normally contain provisions requiring a party who intends to assert a claim for damages due to unanticipated occurrences to provide written notice within a relatively short period of time after the event or occurrence.

Notice - Purpose

- Timely notice of claims is a matter of fundamental fairness. Fairness inherent in timely notice permits the recipient of the notice to: (1) assess the implications and potential liability that may be created; (2) investigate whether the claimed item truly is “extra” to the original contractual undertaking; (3) document costs incurred in performance of the extra work; and (4) fairly adjust the contract price before memories fade, documents are lost and the facts recede into the construction haze.

1 Bruner & O’Connor Construction Law § 4:35 (2002).

Notice Provisions: Federal Acquisition Regulation ("FAR")

- … written notice stating (1) the date, circumstances, and the source of the order and (2) that the Contractor regards the order as a change order.

- except for an adjustment based on defective specifications, no adjustment for any change under paragraph (b) of this clause shall be made for any costs incurred more than 20 days before the Contractor gives written notice as required.

- (e) The Contractor must assert its right to an adjustment under this clause within 30 days after (1) receipt of a written change order under paragraph (a) of this clause or (2) the furnishing of a written notice under paragraph (b) of this clause, by submitting to the Contracting Officer a written statement describing the general nature and amount of proposal, unless this period is extended by the Government.

AIA Document A201-2007

- Places limitations on claims by both parties

- Claims by either the Owner or Contractor must be initiated by written notice to the other party and to the Initial Decision Maker with a copy sent to the Architect, if the Architect is not serving as an Initial Decision Maker. Claims by either party must be initiated within 21 days after occurrence of the event giving rise to such Claim or within 21 days after the claimant first recognizes the condition giving rise to the Claim, whichever is later.

  Paragraph 15.1.2

Enforcement of Notice Provisions

- Failure to comply with these notice provisions will often cause the loss of rights otherwise provided by the contract or by law.

- In *Caroline County v. J. Roland Dashiell & Sons. Inc.*, 358 Md. 83 (2000), the failure of the contractor to make claims within 21 days after occurrence of an unanticipated event as required by the AIA A201 resulted in substantial unrecoverable losses. In so holding, the court noted that the contractor's written notice stating it might file a claim for delay was inadequate.

- As with so many of these key contract provisions, it is of utmost importance that a contractor strictly comply with the notice provisions in a construction contract.

- Failure to do so is one of the most common causes for the loss of rights otherwise provided by a contract.

Beware

- Owners and/or general contractors impose lengthy and detailed claim notice requirements as preconditions for recovery.

- Contract drafters are tempted to create increasingly complex claim notice provisions anticipating that contractors will fail to comply and lose their rights to get paid for the work performed.

- Onerous notice provisions
  - impose a costly burden of documentation without allowing for any exceptions for small claims
  - Enforcement of notice provisions causes a contractor to forfeit its right to payment for work performed merely because failure to submit paperwork within a certain form or within a specified number of days.

Change Orders

- It is common for construction contracts to provide that they may only be modified in writing.
  - Change Orders should be prepared by the Architect and signed by the Owner, Contractor and Architect. AIA, A201-2007, paragraph 7.2.1.
- If a contractor asserts a compensable change, the responding party may contend that the contractor assumed the risk of the extra cost by proceeding with work before a formal Change Order was signed.
  - Defense is more persuasive if the claims involves direction to make changes in scope or character of work. 2 Bruner & O'Connor Construction Law § 5:19.
    - Theories have been used to circumvent defenses: work was to correct defects in owner's design; written authorization are not necessary for delay damages.
    - An underlying principle is that a formal written authorization from the project owner should not be a pre-requisite to compensation resulting from acts or omissions involving the owner's own fault.

Change Order Releases

- Defense is that claim has been settled or released by a change order.
  - Accord and satisfaction
  - Waiver
- Verify that release language is co-extensive with what was actually negotiated.
- If one party refuses to pay sums unless the other party waives or releases other claims for which no payment is made, such conduct may reasonably be treated as a material breach of the duty to pay for work performed.

No Damages for Delay Clauses

- The time set for completion of a project and its various phases is almost always a critical part of the contractual undertaking of all of the parties.
- These disputes concern the causes of any delays, the contractor’s responsibility to achieve the required schedules, and the costs to be assessed as a result of missed deadlines.
- Generally, an owner will be liable to his contractor if the contractor incurred extra costs due to delay caused by an owner's decision to change the design of a project and/or the refusal to make decisions in a timely fashion.
- It is not unusual, therefore, for owners, to include "no damage for delay" clauses in their contracts.
- These provisions seek to exclude any monetary compensation for the costs of owner-caused delays and consequently to entirely shift such risks to the contractors.

No Damages for Delay

- The potential for unfair application of a “no damage for delay” clause is obvious.

- However, the courts of Maryland have upheld such clauses as written.
  - ***State Highway Admin. v. Greiner Engineering Science, Inc.*, 83 Md. App. 621 (1990), cert. den. 321 Md. 16 (1990).**

- The only exceptions to enforceability are delays due to intentional wrongdoing or gross negligence, or delays which result from fraud or misrepresentation.

Failure to Exhaust Contractual Remedies

- Most contracts establish administrative procedures that must be followed prior to litigation or arbitration.
  - Claims must be first submitted to an “Initial Decision Maker”, who is generally the architect unless someone else is designated for the role. AIA, A201-2007, paragraph 15.2.1.
  - Exhaustion of these procedures can last years.
  - Assumes that both parties are participating promptly and in good faith.

Pay-if-Paid/Pay-when-paid Clauses

- These clauses allow a contractor to enter into an agreement with its subcontractor whereby the subcontractor's liability to pay only arises if it is paid and/or its obligation to pay only incurs when it is paid by the owner.

- Can act as a condition precedent to a party's obligation to pay, a condition which is utterly beyond the control of the putative payee.

- These clauses are controversial.

"Pay when paid" Clause

- *"Pay when paid" clause example:*
  - "Contractor agrees to pay subcontractor for said work ... as the work progresses, based upon estimates approved by contractor and architect ... and payment by owner to contractor. ... Final payment shall be made within 30 days after the completion of the work included in this subcontract, written acceptance of the same by the architect and owner, ... and full payment therefor by the owner."

- Maryland Courts have held that such clauses do not impose on a subcontractor the risk of an owner's insolvency or of a dispute over work in which the subcontractor was not involved. Rather they merely postpone the subcontractor's right to payment for a "reasonable period" after completion of the project.
  - *P.G. Construction Co.*, MSBCA 1642, 4 MSBCA ¶312 (1992) ("Pay when paid" clause required subcontractor to wait a "reasonable time" after work satisfactorily completed before being able to recover from general).

Pay if Paid Clause

- *"Pay if paid" clauses:* "Monthly and final payments will be made to the trade contractor within five (5) days after receipt of payment by the construction manager from the owner. The retained percentage will be forwarded as soon as received by the construction manager from the owner. It is specifically understood and agreed that the payment to the trade contractor is dependent, as a condition precedent, upon the construction manager receiving contract payments, including retainer from the owner."
- Because of the "condition precedent" language, the Maryland Court of Special Appeals has ruled that such a clause does transfer to a subcontractor the risk of the owner's insolvency so that a contractor is not obligated to make payment to a subcontractor unless and until payment is received from the owner. Id. (concluding that, due to "pay if paid" clause, subcontractor not entitled to recover from general when owner ran out of money); *see also Architectural Systems, Inc. v. Gilbane Building Co.*, 760 F. Supp. 79 (D. Md. 1991).

Payment Clauses Cont.

- Maryland courts have also noted, however, that conditions precedent can be implied when in the absence of specific language such as in the example cited above. *Richard F. Kline, Inc. v. Shook Excavating & Hauling, Inc.*, 165 Md. App. 262, 270 (1995); *New York Bronze Powder Co., Inc. v. Benjamin Acquisition Corp.*, 351 Md. 8, 17 (1998).

- These “pay when paid” and “pay if paid” clauses may not include a requirement that a subcontractor waive its right to assert a mechanic’s lien or to file a payment bond claim because the Legislature has added a provision to the Mechanics’ Lien Law making void as against public policy any clause that includes such a waiver. MD. CODE ANN., REAL PROP. § 9-113(b).

Arbitration

- Arbitration clauses are often used in construction contracts.

- However, an arbitration clause can be inadvertently waived
  - By filing a lawsuit
  - Heavy involvement in litigation filed by other party.

Statute of Limitations and Repose

- Claims barred by the running of the statutes of limitation and repose are common in the construction industry because of the multitude of latent defects that can arise.

- Statute of Limitation – limit the timeframe that a potential defendant may be brought to trial for a past event.

- Statute of Repose – set a deadline for within which an event must occur for it to be actionable. If the event happens outside the timeframe a suit cannot be bought.

- Both are classic technical defenses with the power to void a claim entirely. They tend to be rigidly applied.

Anti-Indemnity Statute

- Most construction contracts contain clauses which indemnify the owner, the architect and others from damages resulting from personal injury, property damage, and from liens or defaults arising out of the performance of the indemnifying party.

- In practical terms this often means that a person providing the indemnification must pay litigation costs and damages awarded against the person to be indemnified regardless of whether the indemnifying party was negligent and even where the other party was itself negligent.

Anti-Indemnity Statute

- The Maryland legislature enacted a law which makes null and void any agreement in a construction contract that indemnifies another against liability for damages due to personal injuries or property damage caused by the sole negligence of the indemnifying party.
  - **MD. CODE ANN, CTS. & JUD. PROC. § 5-401.**
  - ***Heat & Power Corp. v. Air Products & Chemicals, Inc.*, 320 Md. 584 (1990) (applying statute in action by contractor's employee against property owner).**

- While there are limits to the permissible scope of indemnity clauses, it should be assumed that they also will be enforced as written and may shift significant risks to unsuspecting parties.

- Consequently, all contracting parties should be careful in considering the broad scope of indemnity clauses.

Anti-Indemnity Cont.

- Any indemnity clause in a contract must be carefully reviewed before execution, as it will likely be enforced by the courts if it does not violate Section 5-401.

- It should also be understood that liability under such clauses may not be covered by certain insurance policies.

Improper Notice Defense

- Very technical defenses
  - Mechanic's Liens
    - A mechanic's lien is a legal right or interest that a creditor (e.g., contractor, subcontractor, supplier) has in property "that secures payment for labor or materials supplied in improving, repairing, or maintaining real or personal property." BLACK'S LAW DICTIONARY 933, 935 (7th ed. 1999).
    - 48 MD. CODE ANN., REAL PROP. § 9-101, *et seq*.
  - Miller Act/Little Miller Act
  - Payment Bond

MANAGING MARYLAND MECHANICS' LIENS RISKS – FROM THE PROPERTY OWNER'S PERSPECTIVE

Paul S. Sugar

PRACTICAL CONSIDERATIONS

- Under Maryland statute, no lien is created until the property owner is given opportunity to present a defense to the claim at a show cause hearing and the Court enters an order.

- Mechanics' liens entered against property are subordinate to any prior encumbrances.

- Mechanics' lien is ineffective on property subject to a prior contract of sale.

- No "defense of payment." Owner may have to pay twice for the same work.

THE BASICS

- A statutory remedy to assure payment to those who provide labor and materials to construct or improve a building, as defined. RP 9-101, et seq.

- Statute establishes a lien on the building and applicable land in favor of builders to the extent builders are not paid for labor and materials provided. Ultimately, the land and improvements may be sold to satisfy the debt.

- Builder does not have to be in privity with owner of land to obtain a lien. May be a subcontractor or supplier at any tier.

THE BASICS, continued

- “The law is remedial and shall be so construed to give effect to its purpose.” RP 9-112.
- However, because the remedy is created by statute, party seeking lien must comply strictly with the procedural requirements of statute or the lien will be denied. Winkler Construction Co. v. Jerome, 355 Md. 231 (1999).
- The relief granted under the statute is narrowly circumscribed, even when liberally construed.

  Scott & Wimbrow, Inc. v. Wisterco Investment, Inc., 36 Md. App. 274 (1977).

THE BASICS, continued

- What is subject to lien – “Every building erected and every building repaired, rebuilt, or improved to the extent of 15% of its value. . .” RP 9-102. The lien extends to “the land covered by the building and to as much other land, immediately adjacent and belonging in like manner to the owner of the building, or may be necessary for the ordinary and useful purposes of the building. RP 9-103.

THE BASICS, continued

- “Owner” whose property is subject to lien is defined to include “owner of land” and “tenant for life or for years.” RP 9-101(F). Lien applies only to extent of a tenant’s interest. RP 9-103(c)(2).

- Lien may be obtained against individual condominium units, common elements or entire building. Md. Condominium Act, RP 11-118.

EFFECT OF TRANSFER OF TITLE

- LEGAL TITLE – Property is not subject to a lien if, prior to the establishment of a lien, legal title has been granted to a bona fide purchase for value. RP 9-102(d) The filing of a mechanics' lien petition is notice to a purchaser that a lien may be perfected. RP 9-102(e). Doctrine of *lis pendens* does not apply if a petition is filed after a bona fide purchaser acquires an interest in the property as a mortgagee. *Taylor Electric Company v. First Mariner Bank*, 191 Md. App. 482 (2010).

- EQUITABLE TITLE – Property is not subject to a lien if prior to filing a mechanics' lien petition, the owner enters into a contract of sale with a purchaser. *Himmighoefer v. Medallion Industries, Inc.*, 302 Md. 270 (1985).

OWNER'S MANAGEMENT OF RISK

Preconstruction

- Record debt instrument.
- Designate boundaries. RP 9-103(b).

Before construction commences – Owner may designate boundaries and record with Clerk of the Circuit Court. Binding on all persons.

After construction commences – Owner or anyone having a lien or encumbrance by mortgage, judgment or otherwise entitled to establish a mechanics' lien may file a petition for the Court to designate boundaries.

OWNER'S MANAGEMENT OF RISK (continued)

Construction Contract Provisions

- Lien waivers – progress and final payment from general contractor and subcontractors.
- Sworn statement that subcontractors have been paid.
- Indemnify and defend Owner from mechanics' liens.
  - Owner right to settle with lien claimant.
  - Right to withhold payment.
  - Bonding obligation.

OWNER'S MANAGEMENT OF RISK (continued)

Construction Contract Provisions, cont'd

- Advance waiver of lien by general contractor.
- Joint checks.
- Direct payment.

OWNER'S MANAGEMENT OF RISK (continued)

Construction

- Enforce your contract rights.
- Notice of intention to claim a lien RP 9-104.
  - Anyone not in privity with Owner must serve notice to at least one of the Owners.
  - Notice must be given within 120 days after completing work or furnishing materials.
  - Contents of notice must comply with statute. See form at RP 9-104.

OWNER'S MANAGEMENT OF RISK (continued)

- If notice is received:
  - Withhold payment from general contractor in amount "Owner ascertains to be due to subcontractor giving the notice." RP 9-104(f)(1).
  - May also withhold any amount provided by contract indemnity provision.
  - Demand compliance with contract indemnity provision, whether or not Petition has been filed.
  - Provide unpaid subcontractor with details of contractor's payment bond.

OWNER'S MANAGEMENT OF RISK, continued

- Neither the notice nor the filing of a petition creates a lien. The petition does create *lis pendens*.
- There is no lien on the property until the Court enters a final order establishing the lien.
- When the general contractor is paid in full or its claims are otherwise settled, contractor shall give Owner a signed release of lien from each material supplier and subcontractor. RP 9-114.

Construction Law: Owner Issues

Construction Management Contracts

- Construction Management Agreements
  - “At-Risk” Agreements
  - “Not At-Risk” Agreements

Construction Management Agreements

Problem:

CM's often get paid based on a percentage of the total price of the job; the more expensive the job, the larger the contractor's take.

Therefore, there is less incentive to keep the cost of the job low and save the owners money.

Construction Management Agreements

"Not At-Risk" Agreements

- Construction Manager is owner's agent
- Owner holds multiple contracts to multiple contractors
- Benefits:
  - Builder Selection Flexibility
  - Faster Delivery
  - Maximum Owner Advocacy
  - Early Budget Input Control
- Construction Manager acts as consultant

Construction Management Agreements

"At-Risk" Agreements

- Owner holds one contract with Construction Manager
- Construction Manager holds multiple contracts with the contractors
- "Guaranteed Maximum Price" to owners
- Benefits:
  - Incentive for Construction Manager to make sure project completed below GMP
  - Estimating with larger contingency
  - Tends to attract bondable, more reliable contractors
  - Reduced risk of litigation post-construction
- Is More expensive for owners, but paying for reduced risk

Construction Management Agreements

Comparison

	CM Agent	CM "At-Risk"
Selection based on qualifications	Yes	Yes
Single source responsibility for Owner	No	Yes
Owner hold one construction contract	No	Yes
Represent Owner's interests throughout process	Yes	Yes
Early known price for Owner	Yes	Yes
Multiple contractors	Yes	Yes
Hidden risks borne by…	Owner	CM

Differing Site Conditions

Type 1: Erroneous Contract Indications

- Conditions differ materially from what was “indicated” in the contract
- More common
- Type 1 conditions exist where…
  - Plans/specs are incorrect
  - Where terminology used in contract docs is ambiguous
- Example: Anticipated one type of subsurface condition but another actually existed

Differing Site Conditions

Type 1: Erroneous Contract Indications

- To be successful on a Type 1 claim, contractor must show…
  - Conditions indicated differ material from actual conditions
  - Conditions encountered were reasonably unforeseeable
  - Contractor reasonably relied on contract documents
  - Contractor actually suffered damages

Differing Site Conditions

Type 2: Extreme or Unusual Conditions

- Condition is unknown, unusual and differs materially from what is ordinarily encountered in the performance of that type of work
- Less common
- Condition is extreme or unusual if it was unknown to contract…
  - After contractor studied contract documents
  - After contractor inspected the site
  - Despite the contractor's experience with that particular kind of work

Differing Site Conditions

Type 2: Extreme or Unusual Conditions

- To be successful on a Type 2 claim, contractor must show…
  - Did not know about physical condition before-hand
  - Could not have anticipated condition from inspection/experience
  - Condition varied from norm in similar work
  - Contractor actually suffered damages

Differing Site Conditions

Comparison

Type I: Erroneous Contract Indications	**Type II**: Extreme/Unusual Conditions
Conditions Differ from what's listed in contract docs (plans, spec, etc.)	Conditions differ significantly from what should be expected in that area
Successful claim must show: 1. Actual conditions materially differ from those indicated in contract 2. Reasonably unforeseeable for contractor 3. Contractor reasonably relied on contract documents 4. Contractor actually suffered damages	Successful claim must show: 1. Contractor didn't know about condition 2. Condition could not have been anticipated from inspection/experience 3. Condition varied from norm for similar contracting work 4. Contractor actually suffered damages
	Contractor must have (1) studied contract documents, (2) inspected the site, and (3) acted as a reasonably contractor would have done in that situation

No Damages for Delay

- No Damages for Delay Provisions are enforceable in Maryland
  - **Exceptions recognized by Md. case law**
    - Intentional misconduct
    - Gross negligence
    - Fraud, misrepresentation

Questions