Contracting & Construction Law

Construction Contracts

How contracts work:

Offer and acceptance: let’s make a deal

A building and construction contract must fulfill the same requirements as any other type of contract in regard to matters such as offer and acceptance, sufficiency of consideration, certainty, etc. Such a contract generally provides not only for the construction of the project, but also for many matters that are incidental to the project. Thus, it may provide for the carrying of liability, workers' compensation, and fire insurance policies, designating which party is responsible for obtaining particular insurance. A building and construction contract will typically specify the duties, responsibilities, and liabilities of each of the parties, as well as those of any employed architect or engineer. The amount and method of compensation is, of course, an important part of such a contract.

A building or construction contract, like other contracts, must be

- based upon an offer and acceptance
- between two or more competent parties
- must be for a sufficient consideration, and
- must be sufficiently certain.

However, even if a construction contract were to be so vague and indefinite as to be unenforceable when it was formed, the contractor's performance would make it mutual and enforceable against the *Owner*s.

What constitutes a *reasonable time for the acceptance* of an offer in the building industry must be determined by the nature of the contract, the work to be performed, the materials to be supplied, the weather conditions, the coordination of work to be done with the other activities of the bidder's business, the usages and customs in the trade, and all the other circumstances of the case.[1]

Written agreements: integration and merger

When the parties to a building contract have orally agreed to the terms of performance and the price, there is an express contract. A building contract does not come under the statute of frauds as a contract incapable of being performed within a year, even when the time for the performance is fixed at a period of over a year, since this does not prevent the contract from being capable of performance within a year. Therefore, in the absence of a statute providing otherwise, a contract to erect an addition to a building may be oral. However, a contractor's

failure to provide a homeowner with a written construction contract may be a violation of a state's consumer-protection statute.

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1 **13 Am. Jur. 2d Building and Construction Contracts § 1**

In the absence of a statute requiring a contract to be written or evidenced by writing, a valid contract may be partly written and partly oral. A verbal acceptance of a written offer forms a valid contract that is partly written and partly oral. The rule that all preliminary negotiations and agreements are to be deemed *merged* in the final settled instruments executed by the parties does not prevent a contract from being partly oral and partly in writing. This rule does not apply, however, where it appears from an inspection of the instrument that it was intended to express the full and complete agreement and intentions of the parties.[2]

Sample Contract Clause

Entire Agreement
This Agreement shall constitute the entire agreement between the parties and any prior understanding or representation of any kind preceding the date of this Agreement shall not be binding upon either party except to the extent incorporated in this Agreement.

Mutuality and consideration: can I enforce this?

Mutuality of obligation has been defined as the consent by both parties to a contract to pay, yield, or give up something in return for the benefits received. It has been held that there must be mutuality of obligation to form a contract or to render it enforceable, and mutuality of obligation is sometimes listed as an element required for the formation of a contract.[3]

However, it has also been held that a requirement of mutuality of obligation to every contract is too broad. and that *mutuality of obligation* is the same as consideration thus making mutuality of obligation is unnecessary if the contract is supported by consideration. Also, it has been held that, because a promise by one person is merely one of the kinds of consideration that will support a promise by another, mutuality of obligation is not an essential element in a contract unless the lack of mutuality would leave one party without a valid or available consideration for his or her promise.

According to the Restatement, if the requirement of consideration is met, there is no additional requirement of mutuality of obligation.

> If the requirement of consideration is met, there is no additional requirement of (a) a gain, advantage, or benefit to the promisor or a loss, disadvantage, or detriment to the promisee; or (b) equivalence in the values exchanged; or (c) "mutuality of obligation."[4]

However, there is authority that says mutuality is essential to the validity of a contract for services. Mutuality is present in such a contract where the parties are bound by reciprocal obligations, and where one party agrees to perform services and the other to accept and pay for them, the contract is mutual. [5]

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2 **17A Am. Jur. 2d Contracts § 171**
3 **17A Am. Jur. 2d Contracts § 21**

4 **Restatement of Contracts (Second) §79**
5 **17 C.J.S. Contracts § 114**

A contract for services may be mutual even though the obligations undertaken on one side are not equal to the obligations undertaken on the other side. Ordinarily, Courts do not consider the adequacy of the consideration given for a promise. On the other hand, where neither party or only one party is bound, mutuality is absent. Thus, where there is an agreement to perform, with no obligation to accept and pay, the contract is lacking in mutuality. Likewise, where one party is bound to perform work, but the other party is not obligated to furnish work for him or her to do, there is no mutuality.[6]

Mutuality (consideration) is required in building and construction contracts; there must be an obligation on the part of the builder to do the work, and an obligation on the part of his or her employer to pay for the work.

Expressed and implied obligations: did I say that?

Express and Implied Warranties

Warranties define a contractor's liability for construction defects. Warranties included in a construction contract are known as *express warranties*, while warranties that apply to all construction contracts, regardless of whether or not they are set forth in the contract, are known as *implied warranties.* Contractors may be sued for the breach of both express and implied warranties.[7]

Express warranties may set forth specific promises or general guarantees of quality and good workmanship. For example, a plumbing subcontractor may warrant new pipes against leakage for a period of twenty years. Conversely, a construction contract may simply include a general warranty of quality. A warranty of quality ensures that a builder will proceed with the proper materials and will use due care in completing the specified project.

Implied warranties include the Implied Warranty of Accuracy and the Implied Warranty of Suitability. The Implied Warranty of Accuracy warrants the precision of information contained within a project's plans and specifications. The Implied Warranty of Suitability warrants that a project's plans themselves are proper.

To establish a cause of action for breach of an implied warranty of habitability, the plaintiff must prove that the defendant built and sold the residence that the plaintiff purchased.[8] **There must normally be privity of contract.** A builder-vendor is generally one who owns land and builds or assembles a residence on that land for the purpose of sale to the general public.[9] Thus, the plaintiff must prove that the defendant constructed the residence and sold the residence and the lot on which it is located as a package. If the alleged defect is in the lot (*e.g.* bad drainage) on which the residence is located, an implied warranty of habitability may not apply if the lot was purchased from someone other than the defendant. When the

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6 ***Id.***

7 **13 Am. Jur. 2d Building, Etc. Contracts § 30**

8 ***Theis v Heuer,* 264 Ind 1, 280 NE2d 300 (1972); *Smith v Old Warson Dev Co,* 479 SW2d 795 (Mo 1972); *Humber v Morton,* 426 SW2d 554 (Tex 1968); *Rothberg v Olenik,* 128 Vt 295, 262 A2d 461 (1970).**

9 **67A Am. Jur. 2d Sales § 631**

doctrine of implied warranty of habitability is recognized, the builder-vendor of a new residence impliedly warrants that the residence will be that the home will comply with all normal expectations of the average home buyer.

The implied warranty of habitability is absolutely binding on the builder-vendor, absent valid defenses. Liability for breach of the warranty occurs irrespective of any fault on the part of the builder-vendor.[10] The reasons for implying a warranty of habitability in the sale of a new house are:

- The primary purpose of the transaction is to provide the purchaser with a habitable dwelling.
- The transfer of land is secondary;
- the seller holds itself out as an expert in such construction; and
- the prospective purchaser is forced to a large extent to rely on the builder's skill.[11]

An ordinary purchaser is precluded from making a knowledgeable inspection of the completed house, not only because of expense and unfamiliarity with building construction, but also because defects are usually hidden, rendering inspection practically impossible and rendering the purchaser at the mercy of the builder- vendor. The implied warranty of habitability applies whether the new structure is purchased prior to construction, during construction, or after construction but before occupancy.[12]

The implied warranty of habitability of a builder-vendor has not been extended to remote purchasers, except with regard to latent defects**.**[13]

A builder-vendor of a new dwelling may also be liable for breach of the warranty of workmanlike construction. The implied warranty of workmanlike construction does not render a builder-vendor liable for relatively minor imperfections.

An "as is" provision in the contract for the sale of a new home may preclude recovery for breach of implied warranties. Also, a builder-vendor may disclaim implied warranties if the disclaimer is printed conspicuously on the contract where it can be noticed by anyone signing the contract. [14]

Sample Contract Clause

Waiver and Disclaimer of Implied Warranty of Habitability

This waiver-**disclaimer** is attached to and made part of a contract dated *(date)* between *(name of seller-builder),* referred to herein as *Seller-builder* and *(name of Buyer)*, referred to herein as *Buyer,* for the sale of property located at *(address of property)* and the construction of a single-family home.

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10 **Id**

11 **77 Am. Jur. 2d Vendor and Purchaser § 283**

12 ***Id.***

13 ***Id.***

14 ***Id.***

1. **IMPLIED WARRANTY OF HABITABILITY**

Under the laws of *(name of state)*, every contract for the construction of a new home carries with it a warranty that, when completed, the home will be free of defects and will be fit for its intended use as a home. This law further provides that this implied warranty does not have to be in writing to be part of the contract and that it covers not only structural and mechanical defects but also any defect in the quality of work that may not be seen easily by the *Buyer*. However, the law also provides that a seller-builder and a *Buyer* may agree in writing, that this implied warranty is not included as part of their particular contract.

2. WAIVER-DISCLAIMER

Seller-builder disclaims and *Buyer* waives the implied warranty of habitability described in paragraph 1 above and they acknowledge, understand, and agree that it is not a part of the contract.

3. EXPRESS WARRANTIES

Included in the contract are express written warranties that are contained in paragraph(s) *{list numbers)* on page(s) *(list numbers)*. *Seller-builder* agrees to comply with the provisions of the express warranties and *Buyer* accepts the express warranties as a substitute for the implied warranty of habitability described in paragraph 1 above.

4. EFFECT AND CONSEQUENCES OF WAIVER-DISCLAIMER

Buyer acknowledges and understands that if a dispute arises with *Seller-builder* and the dispute results in a lawsuit, *Buyer* will not be able to rely on the implied warranty of habitability described in paragraph 1 above as a basis for suing *Seller-builder* or as the basis of a defense if *Seller-builder* sues *Buyer*. *Buyer* may, however, rely on the express written warranties referred in paragraph 3 above.

5. The undersigned *Buyer* has read and understands this document and had an opportunity to seek professional advice concerning its contents.

WITNESS our signatures as of _____the day _____,20_____.

(Name of Seller-Builder)

_____ By:_____

(Printed name) ***(Printed name & Office in Corporation)***

(Signature of Buyer) ***(Signature of Officer)***

Breach and Enforcement: finding materiality and damages

Standard contract law

Breach and **Remedies**

A breach of contract is a failure to perform the contract in the manner called for by the contract. A party is entitled to contractual remedies if the other party breaches a contract.

A breach does not always result in a lawsuit or mean the end of a contract. One party may be willing to waive or ignore the breach. A waiver can be by words or by conduct. Accepting a late payment on a note would be an example of a waiver by conduct. It is possible to make a waiver by silence. For example, failure to object to the manner of performance in a timely manner would be a waiver by silence.

A party who waives a breach gives up the right to damages or remedies regarding such breach, and cannot use the breach as a reason for not performing the contract.
A waiver may be express or implied. An example of an implied waiver would be accepting a defective performance without objection. A waiver only applies to the specific matter waived. A party is entitled to require the other party to strictly perform all other contractual obligations set forth in the contract.

If a party repeatedly breaches a contract in the same manner, and the other party repeatedly waives these breaches, this conduct may indicate that the parties have modified the contract. However, there may be a statute of frauds or Parol evidence problem in such a situation.

A party retains the right to recover damages caused by another party's breach if the party expressly reserves the right to damages at the time the party accepts a defective performance. The reservation of right should be, but does not have to be, in writing.

A contractor departed at a number of points from the specifications in a contract to build a house. The cost to put the house in the condition called for by the contract was approximately $10,000. The contractor was sued for $15,000 for breach of contract and emotional disturbance caused by the breach. How should the court hold? The *Owner* could recover $10,000 on the basis that that $10,000 would have to be spent in order to achieve the same position had there been no breach of contract. The *Owner* is not entitled to recover for mental or emotional pain or suffering. Generally, damages are the sum of money necessary to put a party in the same or equivalent financial position as the party would have been had the contract been performed. A party may recover compensatory damages for any actual loss that the party can prove with reasonable certainty.

Punitive damages are designed to punish. A Court uses punitive damages to make an example of a defendant in order to keep others from doing a similar wrong. Punitive damages are rare in a breach of contract case except bad faith insurance claims. Consumer protection laws sometimes permit consumers to recover punitive damages for breach of certain types of contracts.

Consequential damages would arise in a situation where the failure to deliver the truck harmed the business of the plaintiff since the plaintiff lost a delivery contract. In this situation, the plaintiff could possibly get consequential damages for loss of the delivery contract.

A non-breaching party has a duty to mitigate damages. In other words, a non-breaching party has the duty to take reasonable steps to minimize damages. The failure to mitigate damages may cause the victim to only be allowed to recover damages that would have resulted if mitigated. In our truck example, say the truck was purchased and was to be delivered on January 5, to allow the buyer to do a hauling job for $500.00. Delivery was late.

The hauling contract was lost. However, the buyer could have rented a truck for $150.00. However, he failed to do this. Therefore, his damages would only be $150.00.

In May, a homeowner made a contract with a roofer to make repairs to her house by July 1. The roofer never came to repair the roof and heavy rains in the fall damaged the interior of the house. The homeowner sued the roofer for breach of contract and claimed damages for the harm done to the interior of the house. Is the homeowner entitled to recover such damages? The homeowner can recover damages for the breach of contract, which ordinarily would be the difference between the contract price specified in the contract with the defendant and the reasonable cost of having another roofer perform the work. It is likely that the homeowner cannot recover for the rain damages unless the homeowner can show that it was not reasonably possible to procure any other roofer to repair the roof. In the absence of such proof, the duty to mitigate damages would bar the homeowner from recovering for the rain damages, as the Owner could have avoided such damage by hiring another roofer to perform the contract. As it was the rainfall that damaged the interior of the house, it is obvious that the homeowner had sufficient time to take steps to avoid the consequences of the roofer's breach of contract.

An appropriate remedy for a breach may be rescission of the contract. This places the parties in the position they would have been had the contract never been entered into. For example, money is returned to the buyer and the buyer returns the property to the seller. If performance has been involved, the performing party may get the reasonable value of his performance under an unjust enrichment theory. Suppose that pursuant to a contract for the sale of land, a buyer has taken possession and made substantial improvements. If the contract is rescinded, the buyer will return the land and the seller will return the money. However, the seller must pay the buyer the reasonable value of the improvements.

Specific performance is an action to compel a party who breached a contract to perform the contract as promised. The subject matter of the contract must be unique, or an action for damages would be the proper remedy. Actions for specific performance are usually allowed with regard to:

- A contract involving the sale of particular real estate; and
- A contract for sale of a particular business.

Specific performance is not allowed regarding a contract for the sale of personal property unless the property is unique in some way like an antique, coin collection, or art objects.

In general, a contract may limit the remedies that a non-breaching party may obtain. For example, Johnston purchases a new truck from Acme Truck Sales. The contract may limit Johnston's remedies to having Acme repair the truck or replace the truck if it is defective.

Sample Contract Clause

NOTWITHSTANDING ANYTHING TO THE CONTRARY, IN NO EVENT SHALL CONTRACTOR LANDLORD OR TENANT BE LIABLE TO THE OTHER FOR ANY INDIRECT, SPECIAL, INCIDENTAL, EXEMPLARY, PUNITIVE OR CONSEQUENTIAL DAMAGES OF ANY KIND, INCLUDING WITHOUT LIMITATION ANY LOSS OF PROFITS, LOSS OF BUSINESS, LOSS OF USE OR DATE, INTERRUPTION OF BUSINESS, WHETHER BASED ON CONTRACT, TORT (INCLUDING NEGLIGENCE), WARRANTY,

GUARANTEE OR ANY OTHER LEGAL OR EQUITABLE GROUNDS, EVEN IF SUCH PARTY HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES.

A contract may state the amount of liquidated damages to be paid if the contract is breached. Upon a party's breach, the other party will recover this amount of damages whether actual damages are more or less than the liquidated amount. For example, the parties to a construction contract stipulate that damages are to be paid of $1,000.00 per day that the construction exceeds its contracted completion date. Another example would be with regard to a contract for the sale of land where the contract provides that the earnest money paid will be the sole remedy upon breach of contract by the buyer.
Courts will honor liquidated damage provisions if:

(i) Actual damages are hard to determine (e.g., breach of a restrictive covenant).
(ii) The amount is not excessive when compared with probable damages.

If the agreed-upon liquidated damage amount is unreasonable, the Court will hold the liquidated damage clause to be void as a penalty. In such situations, you have to prove the actual damages if the clause was declared to be void.

Breach and enforcement: find materiality and damages

Failure of Owner to make payment: A failure by the Owner to pay an installment of the contract price as provided in a building or construction contract is a substantial breach of the contract, and gives the contractor the right to consider the contract at an end, to cease work, and to recover the value of the work already performed. Rescission is a remedy for the unjustified failure to make progress payments due under a construction contract, since the failure to make payments for work in progress goes to the root of the bargain, and defeats the object of the parties in making the agreement. However a slight deviation, either in the time or the amount of progress payments, does not justify the rescission or abandonment of a building contract.[15]

Effect of payment

That the *Owner* has paid for a building constructed does not prevent him or her from recovering for defects subsequently discovered, although such payment is evidence to be considered on the question of waiver. Payment does not amount to a waiver of known defects, when it is made in reliance on the builder's promise to remedy them. [16]

Effect of payment—Partial payment; progress payments

In the absence of any stipulation in the contract specifically governing the question, whether a partial payment of a private building or construction contract constitutes an acceptance or waiver of defects is dependent on the circumstances.[17] A partial payment may be considered in connection with other conduct of the party employing the contractor in determining whether

15 **13 Am. Jur. 2d Building, Etc. Contracts § 107**

16 **13 Am. Jur. 2d Building, Etc. Contracts § 65**
17 ***Id.***

there has been a waiver. A partial payment, without more, does not constitute an acceptance or waiver of defective construction.[18]

On the other hand, a partial payment with actual or constructive knowledge of the defect may constitute an acceptance or waiver of the defects, depending on the circumstances of the case. If the defects are known at the time of the partial payment and the payment is made without the *Owner*'s consent to the defects and under protest, or pursuant to the contractor's agreement to remedy the defects, there is no acceptance or waiver of the defects.[19]

Economic waste rule
Some authorities hold that the measure of an Owner's damages for a contractor's breach of the contract is the cost of repair or completion in accordance with the contract, unless such repair or completion would result in economic waste.

The economic waste doctrine in general means that the cost of completion as required by the contract greatly outweighs the benefit to the Owner to do so; for example, where the cost of replacing the plumbing in a completed building costs might greatly outweigh the benefit to the Owner.[20]

When repairing or reconstructing a structure would constitute unreasonable economic waste, the usual measure of an *Owner*'s damages for the contractor's breach of contract is the difference in value between the structure as built and the structure as contracted for. [21]

Failure of Owner to make payment
As indicated above, a failure by the Owner to pay an installment of the contract price as provided in a building or construction contract is a substantial breach of the contract, and gives the contractor the right to consider the contract at an end, to cease work, and to recover the value of the work already performed. However a slight deviation, either in the time or the amount of progress payments, does not justify the rescission or abandonment of a building contract.[22]

Regarding accepting late or partial payments, an agreement like the following may be helpful:

Non-Waiver Agreement between Contractor and *Owner* Regarding Accepting Late Payments

Agreement made on the ***(date),*** between ***(name of Owner)*** of ***(street address, city, county, state, zip code)***, referred to herein as ***Owner,*** and **(*Name of Contractor),*** a corporation organized and existing under the laws of the state of _____, with its *Principal* office located at ***(street address, city, county, state, zip code)***, referred to herein as ***Contractor.***

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18 ***Id.***
19 **13 Am. Jur. 2d Building, Etc. Contracts § 66**
20 **13 Am. Jur. 2d Building, Etc. Contracts § 82**
21 ***Id.***
22 **13 Am. Jur. 2d Building, Etc. Contracts § 108**

Whereas, *Owner* is three months behind in payments pursuant to the construction agreement with *Contractor;* and

Whereas, *Contractor* has the right to cease work on the project and sue *Owner* for breach of contract; and

Whereas, *Owner* has offered to pay 50% of the amount due in the next ten days and the balance ten days after that if *Contractor* will continue work on the project;

Now, therefore, for and in consideration of the mutual covenants contained in this agreement, and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties agree as follows:

Owner understands and agrees that *Contractor's* continuing to work on the project is not a waiver of the payment requirements under the contract. *Owner* agrees that any further late payments other than those made pursuant to the agreement may result in a breach of contract action against *Owner* by *Contractor* and the abandonment of the project for such breach.

WITNESS our signatures as of the day and date first above stated.

(Name of Contractor)

_____ By: _____

(Printed name) ***(Printed name & Office in Corporation)***

(Signature of Owner) ***(Signature of Officer)***

Delay

A delay in the performance of a building contract does not terminate or justify rescinding the contract, and, as a general rule, the rescission of a contract for delay will not be permitted unless time has been made the essence of the contract.[23] However, when time is of the essence of a contract, and one of the parties is not ready and able to perform his or her part of the agreement on the day fixed, the other party may elect to consider it at an end, unless he or she has previously waived the performance within the agreed time. When the contractor is obligated to complete the construction of a building by a time certain but fails to do so, the purchaser is not limited to the remedy of rescission; he or she may instead affirm the contract and seek damages.[24] *Bevis Const. Co. v. Kittrell, 139 So. 2d 375 (Miss.1962)*.

In ***Bevis Construction Co. v. Kittrell,*** 243 Miss. 549, 139 So. 2d 375 (1962), this Court stated:

> **[S]ubstantial performance is not literal, full or exact performance in every slight or unimportant detail, but performance of all important particulars; and that substantial**

23 ***Id***

24 ***Id***

performance exists where the building or structure as a whole is not impaired, where it can be used for its intended purpose after erection, where the defects can be remedied without any great expenditure and without material damage to other parts of the structure and may without injustice be compensated for by deductions from the contract price. ***Id.*** at 558-59,

Generally; conditions precedent to action

An action lies for the payment of installments accruing under an entire building contract as they become due, so the contractor need not wait until the building is completed before bringing the suit for them.[25]

When a construction contract does not require the *Owner* to allow the contractor an opportunity to cure defects, the *Owner* is not required to offer the contractor such an opportunity before bringing suit for breach of contract.[26]

Upon the breach of a building or construction contract by the *Owner*, the contractor may elect to pursue one of three remedies:

- acquiesce in the breach, treat the contract as rescinded, and recover in *quantum meruit* so far as he or she has performed;

- refuse to acquiesce in the breach, keep the contract alive for the benefit of both parties, being at all times ready and able to perform, and at the end of the time specified in the contract for performance, sue under the contract; or

- treat the breach or repudiation as terminating the contract and sue for the profits he or she would have realized if he or she had not been prevented from performing.[27]

Sample count in suit for rescission

COUNT SIX
RESCISSION AND RESTITUTION

30. Plaintiff re-alleges paragraphs 1 through 23 of this complaint.

31. On or about ***(date of contract)*****,** when the contract was executed, both plaintiff and defendant were mutually mistaken as to the accuracy of defendant's plans and specifications and the accompanying topographical site survey. Acting on this mutual mistake, plaintiff and defendant entered into the subject contract anticipating that the cost of the ***(description of project)*** and the time for its completion as set forth in the contract were reasonable.

32. In actuality, defendant's plans and specifications and accompanying topographical site survey contained serious inaccuracies which have caused the construction period and cost

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25 **13 Am. Jur. 2d Building, Etc. Contracts § 113**

26 ***Id***

27 **13 Am. Jur. 2d Building, Etc. Contracts § 112**

of construction to substantially exceed that which was contemplated by the parties at the time of the execution of the contract.

33. Because of the above-mentioned mistake, the parties, in effect, abandoned the contract of ***(date of contract)*****,** and proceeded to construct the project on a day-to-day basis, substantially redesigning and implementing new plans and specifications as the *[description of project]* progressed.

34. *By reason of the above, the contract should be rescinded* and plaintiff should recover $_____, which amount is the reasonable value, over and above amounts previously paid to plaintiff, for its services in furnishing the labor, materials, subcontracted work, and overhead expenses in constructing the ***(description of project).***.

Petition for Rescission of Contract
Failure of Contractor to Obtain Building Permit

3. On ***(****date of contract)*, plaintiff and defendant entered into a written contract in which defendant agreed to provide all labor and materials and to construct *(description of building)*, on real property located at *(street address of property)*, in the City of *(name of city)*, State of *(name of state)*.

4. In return and compensation for defendant's labor and materials, plaintiff agreed to pay defendant the sum of $_____, payable in progress payments on the following terms: ***(terms of payment)*****.** Plaintiff made the first payment under the contract on *(date of first payment)*, in the amount of $_____. A copy of the contract is attached as **Exhibit A**, and incorporated by reference.

5. The contract provides, in Paragraph _____, that defendant, as the contractor, was required to comply with all applicable governmental laws, rules, and regulations relating to the work described in the contract. Defendant was further required to obtain all necessary permits, at the expense of the *Owner*.

6. On *(date)*, defendant attempted to obtain a required permit from the building department of the City of _____, _____County of to commence construction of the described building for plaintiff. However, the building permit was denied by the building department on *(date of denial)*.

7. Defendant failed to perform his part of the contract by failing to obtain the required permit to be able to commence construction of plaintiff's building.

8. On *(date)*, plaintiff notified defendant that plaintiff was rescinding the contract due to defendant's failure to obtain the required permit. A copy of the notice of rescission is attached as **Exhibit B**, and incorporated by reference.

9. On (*date of request)*, plaintiff requested that defendant return to plaintiff the amount of the initial payment made by plaintiff, in the amount of $_____. However, defendant refused, and continues to refuse, to pay any part of that sum to plaintiff.

WHEREFORE, plaintiff requests judgment against defendant:

1. Rescinding the contract between plaintiff and defendant, dated *(date)*;

2. Awarding damages in the amount of $_____, with legal interest on that amount from *(date)*; ;

3. Awarding costs incurred; and

4. Granting such other and further relief as is just and equitable.

Specific performance

Contracts for building or construction will not be specifically enforced, partly because damages are an adequate remedy at law, and partly because of the incapacity of the court to oversee the performance, especially if the performance of the contract would extend over a considerable period of time and would include a series of acts. However, it has also been held that specific performance of construction contract should not be denied simply because it involves the construction of a building. The critical inquiry in an action by a plaintiff seeking specific performance of a construction contract is whether, if specific performance were granted, the court would be required to become involved in the prolonged supervision of the building's construction if disputes arose.[28]

Even if specific performance of a promise to build a building on property is not awarded, the court may order specific performance of the promise to convey the premises, and enter a monetary decree for the cost of the completion of the improvements in accordance with the contract.[29]

Complaint for Damages, Specific Performance of Contract, and Appointment of Special Master to Oversee Construction against Contractor and Agents Breach of Contract to Construct House

4. On *(date of contract)*, defendants entered into a contract with plaintiff for the purchase and construction of a home on real property situated in *(location of property)*, and more particularly described as follows:

(legal description of property).

5. A copy of the contract is attached, marked "Exhibit *[designation of exhibit]*," and incorporated by reference.

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28 ***Id***

29 **13 Am. Jur. 2d Building, Etc. Contracts § 114**

6. On *(date)*, and prior to the signing of the contract, defendant real estate agent informed plaintiff that defendant contractor was the moving force behind the corporation and that defendant contractor would be involved in the construction of plaintiff's home.

7. On *(date)*, all defendants, as *Principal*s of defendant contractor, accepted from plaintiff check No. _____ drawn on *(name of bank)* in the amount of $_____, as payment for the house plans for the house. A copy of the check is attached, marked **Exhibit A** and incorporated by reference.

8. On *(date)*, all defendants, as *Principal*s of defendant contractor, wrongfully accepted and deposited in *(name of bank)* check No. _____ in the amount of $_____ from plaintiff, as payment of an earnest money deposit for the house.

9. At various times between *(begin date of meeting)*, and *(last date of meeting)*, defendants met with plaintiff and discussed their joint responsibility, progress, and involvement in building plaintiff's house pursuant to the terms and conditions of the contract.

10. On *(date)*, defendant contractor informed plaintiff that plaintiff would need to agree to pay approximately $_____over the purchase price called for in the contract or defendant contractor would not construct the house. Plaintiff refused to pay the additional $_____ and demanded that the house be constructed pursuant to the terms and conditions of the contract.

11. By virtue of defendants' statements, actions, and acceptance of monetary gain, defendants real estate agent and real estate broker are parties to the contract by ratifying it.

12. Defendants never commenced construction of the house in accordance with the terms and conditions of the contract, despite repeated demands by plaintiff.

13. Plaintiff has performed all parts of the contract to be performed by *[him/her]* and all contingencies were met under the contract. Plaintiff remains ready, willing, and able to perform under the terms of the contract.

14. The contract concerns a specific and unique parcel of land. The construction of a house on such parcel of land is the type of duty that the court can oversee through the appointment of a special master. Plaintiff is entitled to specific performance under the terms and conditions of the contract.

SECOND CAUSE OF ACTION
CLAIM FOR DAMAGES

16. As a direct and proximate result of the actions of defendants, plaintiff has suffered damages in the amount of $_____, if he were to buy a comparable parcel of land and engage another contractor to build the house in accordance with the terms and conditions of the contract.

Wherefore, plaintiff requests relief from the court as follows:

1. Appointment of a master to supervise the construction of a home in accordance with the terms and conditions of the contract;

2. Compensatory damages of $*[dollar amount of compensatory damages]*;

3. Costs of suit; and

4. Such further relief as the court deems just and equitable.

B. Allocating responsibility and risk

Allocation of Risk

The contractor, architects or design professionals, and *Owner*s need to know how to balance the contingencies of risk with their specific contractual, financial, operational and other contractual requirements. In order to achieve this balance, proper risk identification and risk analysis is required. The parties to a construction contract tend to look at risks individually with a lack of foresight and do not realize the potential impact that other associated risks may have to them in the event of a breach of contract. An Owner tends to focus on the financial aspects of the contract. The contractor attempts to limit the risks associated the quality of work through insurance or through indemnification, The design professional attempts to limit his or her financial obligation for mistakes to errors in the plans and specifications, negligent inspection of the contractors work, and his or her negligent approval of payment to the contractor during the course of a project. While the deign professional attempts to shift their or risk for defects in the sufficiency of the construction plans and specifications for a project, and the contractor is required review and verify the adequacy of the plans and specification, the Owner is ultimately the party that suffers in event a mistake or error causes a delay. The construction contract should apportion responsibility and accountability between the parties and provide adequate recourse in the event a dispute arises. Construction contracts should be designed and written to allocate risk between the parties to the contract

1. The contract documents: what's in, what's out?

A building and construction contract often incorporates by reference the plans, drawings, and specifications and the general conditions of the contract and, thus, does not need, in itself, to be a long and complicated document. In such a situation, it is sufficient to state the agreement, describe the project, identify the parties, set the price and the method of payment, designate the time for completion, and specify the other documents involved, incorporating them into the contract by such reference.

At some point, whether in the contract itself or in a collateral instrument, there must be spelled out many details, such as the duties of the contractor in regard to liability insurance and workers' compensation insurance, the responsibility for supervision of the project, and the contractor's liability for his or her decisions. Provisions may be inserted for damages for delay, with or without a corresponding bonus for early completion. Other provisions that may be included relate to changes in the project, adjustments in the contract price, arbitration of disputes, and the conditions under which subcontractors may be used.[30]

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30 **4 Am. Jur. Legal Forms 2d Building, Etc. Contracts § 47:39**

2. Scope and price: what are you doing and how much is it worth?

In drafting the provisions of a building and construction contract relating to the payment of the contract price, attention must be given to the conditions that the contractor must fulfill to entitle him or her to receive payment, the frequency of payment, and the amount of each payment. The contract should also provide for retention by the Owner of a portion of the contract price for settlement of claims.

3. Payment provisions: when do you pay? Payment Clause and Variations

There are several key provisions in every construction contract that need to be considered in addition to risk allocation and it is important to define the meaning of such terms and to touch on the differences of each of term in the context of the construction contract.

Price

The cost of the project is vital to a construction project and an *Owner* needs to understand the different payment variations and types of contracts in determining whether a bid proposal for a contract is economically feasible for an *Owner*. Below is a definition of three types of variation of price in a construction contract: (i) cost plus; (ii) lump sum payment; and (iii) guaranteed maximum price contracts.

Cost Plus

Cost-plus agreements have the contractor's profit defined in the contract itself, as well as the estimated construction expense. If the actual expenses come in lower than the estimate, then the Owner reaps a savings. In the event of a cost overage, the Owner has to pay more for the project. Cost plus contracts places the risks of cost overruns upon the Owner, not the contractor, who enjoys the security of knowing his exact profit. In this type of contract the contractor may have little incentive to be efficient on-site, but the Owner has the satisfaction that the ultimate project will be to his exact standards even if the expenses run high.

Lump Sum

In Lump-sum contracts the contractor provides his services for a set price, and the Owner agrees to pay that agreed upon price either upon completion of the work or pursuant to a schedule. If a lump sum contract is utilized, the Owner will pay a set amount, and the contractor bears the risk of loss if there are unexpected expenses, or the possibility of gain if the project comes in under-budget. There is incentive for the contractor to be more efficient in this type of contractual arrangement because of the possibility of economic gain in the event a project comes in under budget.

Guaranteed Maximum Price Contracts

A guaranteed maximum price contract is a contract under which the contractor is compensated for actual costs incurred plus a fixed fee subject to a ceiling price. The contractor is responsible for cost overruns, unless the guaranteed maximum price has been increased based on formal change orders as a result of additions or alterations to the scope of work requested by the *Owner*. Any savings resulting from cost savings are returned to the *Owner*. In other words, if the actual cost for performing the work, plus the contractor's fee exceeds the guaranteed maximum price contract, the contractor is responsible to pay the difference. If the cost for the work plus the contractor's fee is less than the guaranteed maximum price contract, the contractor returns the total savings to the *Owner*. As with the

lump sum contract, the *Owner* knows the total cost of construction prior to the beginning of construction. However, unlike the lump sum contract in which any savings are kept by the contractor, the *Owner* receives the benefit of any savings due to efficient project control.

Scope of Work

The intent of the plans, specifications, and special provisions of a construction contract is to set forth the obligations of the contractor undertakes to do, in full compliance with the plans, general conditions, and specifications, together with all authorized alterations, supplemental agreements and extra work orders.

The Contractor should perform all items of the work covered and stipulated in the contract, specifications, and plans, in a satisfactory and acceptable manner. The scope of work is in essence the contractor's obligation which outlines the amount he or she is to be paid for that work. The description of the work to be performed by the contractor is critical to the construction contract. The scope of work should be clear, precise and complete. Generally, the scope of the work can best be described by reference to drawings and specifications that have been issued to the contractor for work. The scope of work for a construction contract will vary based on whether there is one contractor that is responsible for the entire project or whether there are several contractors that are responsible for different phases or certain aspects of the scope of the work. The terms that are important in relation to the scope of work are design build and design-bid build contracts.

Design Build

Design-Build is a construction project where in contrast to "design-bid-build", which will be discussed below, is where the design and construction aspects are contracted for with a single entity known as the design-builder or design-build contractor. The design-builder is usually a general contractor, but in many cases it is also the design professional (architect or engineer). This type of contract or project is used to minimize the risk for an Owner and to reduce the delivery schedule by overlapping the design phase and construction phase of a project. Where the design-builder is the contractor, the design professionals are typically retained directly by the contractor, which could create added risk for the Owner. Cost estimating for a design-build project is sometimes difficult because design documents are often preliminary and may change over the course of the project. As a result, design-build contracts are often written to allow for unexpected situations without penalizing either the Design-Builder or the Owner. This uncertainty requires the Owner to rely a great deal on the competence of the design professional. The opinion of the construction professionals must be trustworthy, accurate, and reasonably verifiable in order to minimize the Owner's risk.

Design Bid-Build

Design-Bid-Build is a method by which the completion of the project is by several different contractors, in which there is one general contractor who contracts with several sub-contractors for each aspect of the design and construction of a project. The Owner usually retains a design professional to design and produce plans and specifications. The design professional will work with the Owner to identify the Owner's needs, and develop based on those needs a conceptual or schematic design. This design is then developed, and the design professional will usually bring in other professionals such as a mechanical, electrical, and plumbing, a fire engineer, structural engineer, sometimes a civil engineer, and often a

landscape professional to help review and complete the documents, which will become the drawings and specifications.

These documents are circulated by the design professional or the Owner to various general contractors who will submit bid proposals on the project based on the complexity of the design. The various general contractors bidding on the project obtain copies of the documents, and seek bids from multiple sub-contractors, on the various sub-components of the project. Sub-components include items such as the concrete work, structural steel frame, electrical systems, and landscaping. Based on the bids submitted to the contractor by the subcontractors, the contractor puts together one comprehensive bid to submit to the Owner and design professional. Once bids are received from the contractors, the design professional and Owner review the bids. If the bids fall in a range acceptable to the Owner, the Owner and design professional discuss the suitability of various bidders and their proposals. The project is usually awarded to the lowest bid by a qualified contractor.

Completion and Close Out Provisions

The completion and closeout of a project means different things to each party to a construction contract. To the contractor, it means completion of its duties and obligation under the contract by completing the punch list, and collecting the final payment. To the design professional it should mean that the design results in a completed project that substantially conforms to the plans and specifications, and that the completed project functions as intended to meet the *Owner*'s needs. To the *Owner*, however, closeout means the transfer of the project and building into their hands which could bring about anxiety about the operation and *Owner*ship of the completed project.

Some construction contracts have a "best efforts" completion date while others have a specific completion date which the contractor is obligated to meet. In very large or complex contracts or projects the contractor is usually required to meet different milestone dates throughout various phases of the project. Closeout provisions and completion dates should be considered together with any delay provisions or time extensions. All construction projects inevitably suffer something or some event that causes delays in the completion of work. However long the delay is, the parties to the construction contract need to allocate who bears the risk of any delay in completion of the project, and what, if any, time extensions will be granted to the contractor before they will be liable for damages to the *Owner* or will be held in breach of the contract.

In any event the contractor usually gets final payment when there is "substantial completion" of the project and the project can be used for its intended purpose, which should be approved based on the inspection of the design professional. Some *Owner*s have specific requirements that have to be met as part of "substantial completion" which based on the specific needs of the *Owner*, may extend beyond the use of finished project for its intended purpose. Any specific requirements should be built into the contract or such requirements will not be part of the contractor's obligation.

Pay if Paid and Pay When Paid

Parties are generally free to negotiate the terms of their contracts, and are generally permitted to negotiate and allocate the risks under their contracts, including the risk of non-

payment. The terms “pay-when-paid” and “pay-if-paid” are commonly used in the construction industry and are distinct clauses.

Under a “pay-if-paid” provision in a construction contract, receipt of payment by the contractor from the *Owner* is an express condition precedent to the contractor’s obligation to pay the subcontractor. A “pay-if-paid” provision in a construction subcontract shifts the risk of the *Owner*’s non-payment under the subcontract from the contractor to the sub-contractor.
Under a “pay-when-paid” provision in a construction contract, a contractor’s obligation to pay the subcontractor is triggered upon receipt of payment from the *Owner*. The contractor’s obligation to make payment to the subcontractor is suspended for a reasonable amount of time for the contractor to receive payment from the *Owner*. A “pay-when-paid” clause creates a timing mechanism only, it does not create a condition precedent to the obligation to make payment, and does not shift the risk of the *Owner*’s nonpayment to the subcontractor.

Change Orders

The Architect generally will prepare Change Orders for the *Owner*'s approval and execution in accordance with the Contract Documents, and shall have authority to order minor changes in the work not involving an adjustment in the Contract Sum or an extension of the Contract Time which are not inconsistent with the intent of the Contract Documents, provided, however, that the Architect shall give prompt notification of such minor changes to the *Owner*'s designated representative. Change Orders which increase the Contract Sum, or Contract Time, or change the intent of the Contract Document shall be submitted by the Architect to the *Owner* for approval before any action is taken.

Contracts should include the following change order provisions:

- treating the *Owner*’s right to add or subtract from the scope of the work or to change the work;
- the form of change orders;
- the Contractor’s obligation to respond to a request for a change order;
- the procedure for adjusting the Contract Sum, including the profit and overhead to which the

Sample Construction Contract Change Order

No.: ***(change order number)***
Dated: ***(date of change order)***
Owner's Project No.: ***(Number)***
Engineer's project No.: ***(Number)***
Project: ***(Name of Project)***
Owner: ***(Name of Owner)***
Contractor: ***(Name of Contractor)***
Contract date: ***(date of contract)***
Contract for construction of ***(Give a Brief Description of Building to be built)***

To: ***(Name of Contractor)***
You are hereby directed to make the changes noted below in the subject contract.
Witness my signature this ***(date).***

_____

Name and Signature of Owner

- Nature of change: ***(Give a description of change).***
- Enclosures: *(Describe amended plans, drawings, and specifications accompanying the Change Order)*.
- Changes resulting in the following adjustment of contract price and contract time: ***(Describe)***
- Contract price prior to this change order: $_____.
- Net ***(increase or decrease)*** resulting from this change order: $_____
- Current contract price including this change order: : $_____
- Contract time prior to this change order**: *(number)*** calendar days.
- Net ***(increase or decrease)*** resulting from this change order: ***(number)*** calendar days.
- Current contract time including this change order: ***(number)*** calendar days.

The above changes are approved this ***(date).***

_____

Name and Signature of Architect or Engineer

The above changes are accepted this ***(date).***

_____

Name and Signature of Contractor

Warranties and standards of care: it's not my fault

The standard of care

Unless the parties expressly agree otherwise, the contractor will normally be to expected to exercise *reasonable skill.* The law implies a warranty of adequacy on the builder's services. A common mistake is to confuse this warranty of adequacy with the builder's "call-back warranty. The warranty of adequacy, in general terms, is the builder's guarantee that construction materials and equipment are new and free from defects, and that constructions services are of a good and workmanlike quality. The call-back warranty is the builder's agreement that if defects in the project should become apparent after completion, most commonly for a period of one year following mechanical completion, the builder will return to the site to make any necessary repairs or adjustments.

The call-back warranty is for a limited period of time, but the warranty of adequacy has no time limit. If a latent defect does not manifest itself until two years after completion of the project, the *Owner* should still have a claim for breach of the warranty of adequacy. This warranty attaches at the time that the defective work was incorporated into the project and does not expire except as set forth in the applicable statutes of limitations.

Time: is it "of the essence"?

Some contracts will provide that "time is of the essence", which may support an action for breach of contract where the contract is not completed within a reasonable (or specified)

time. This is often seen in construction contracts, where it is important that work be resolved such that a home*owner* or business can return to normal life or operations. For example,

Time is of the essence for the completion of the work described in this contract. It is anticipated by the parties that all work described herein will be completed within two (2) weeks of the date of execution, and that any delay in the completion of the work described herein shall constitute a material breach of this contract.

Others may specifically provide that time is not of the essence. For example:

The parties agree that time is not of the essence in the completion of the work described in this contract. All parties shall act to complete the work described within a reasonable time.[31]

It has been stated that the tendency of judicial authority at law as well as in equity is to regard the question as one of construction to be determined by the intent of the parties, and to hold that time is not ordinarily of the essence of the contract unless made so by express stipulation or unless there is something connected with the purpose of the contract and the circumstances surrounding it which makes it apparent that the parties intended that the contract must be performed at or within the time named.[32] In other words, as in other cases of contract construction, the ultimate criterion as to whether time is of the essence of a contract is the intention, actual or apparent, of the parties, and before time may be so regarded there must be a sufficient manifestation, either in the contract itself or the surrounding circumstances, of that intention.[33]
As a general rule, time is not of the essence of a building or construction contract, in the absence of a provision in the contract making it so; the mere statement of a date in such a contract does not make time of the essence. Thus, a failure to complete the work within the specified time does not, by itself, terminate the contract, but only subjects to contractor to damages for the delay.[34]

The non-completion of a building within the time specified by the contract does not forfeit a right to recover the contract price when the contract provides for liquidated damages to be deducted from the price if the building is not completed within the specified time because, under such a provision, time is not of the essence of the contract in the sense that a failure to complete within a fixed period forfeits the right to recover for work already done at the date fixed for completion, or yet to be done at that time.[35]

Subcontracting : accepting pass-through responsibilities and rights

The construction industry has witnessed a proliferation of claims for damages for delay, acceleration and other impact costs arising out of problems relating to the scheduling and co-

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31 **Common Contract Clauses b**y Aaron Larson, http://www.expertlaw.com/library/business/contract_clauses.html
32 **17A Am. Jur. 2d Contracts § 471**
33 ***Id***
34 ***Id***
35 ***Id***

ordination of design and construction. These types of damages are difficult to assess, from both factual and legal perspectives, and require an analysis of causation and responsibility. The review process may be further complicated where a contractor not only puts forward his own claim against the *Owner*, but also seeks to "pass through" the claims of his subcontractors.

A "pass-through" claim may be defined as a claim by a party who has suffered damages (in this case, a subcontractor) against a responsible party with whom he has no contract (namely, an *Owner*), and which are presented through an intervening party who has a contractual relationship with both (namely, a contractor).

The respective rights and obligations of both the contractor and the subcontractor, and the procedures for presenting a pass-through claim to an *Owner*, are often contained in a "pass-through agreement", which purports to allocate both the expenses incurred and the benefits derived when such a claim is advanced. Among other things, the terms of the agreement may provide specifics as to how the claim is to be presented to the *Owner*, and how the obligation to pay legal fees is to be shared. The agreement may also deal with authority and control issues relating to the conduct of the litigation, including decisions regarding appeals; may outline settlement rights and obligations; and may establish terms as to how and when any monies recovered from the *Owner* will be paid to the subcontractor. Significantly, the agreement may also contain an acknowledgment of the subcontractor's claim, and often contemplates a preliminary partial payment by the contractor to the subcontractor.

BE AWARE OF KILLER CLAUSES

Conditional payment: pay-if-paid vs. pay-when-paid
"Pay when paid" and "pay if paid" clauses are contingent payment clauses. "Pay when paid" clauses mean that payment from the general contractor to the subcontractor is conditioned upon prior receipt of payment from the *Owner* to the general contractor. Typically, the subcontract provides that that payment is due to the subcontractor within a certain period of time after receipt by the general contractor of payment from the *Owner*. For example, a typical "pay-when-paid" clause might read: "Contractor shall pay subcontractor within seven days of contractor's receipt of payment from the *Owner*."

A "pay if paid" provision in a subcontract provides that the general contractor is only obligated to pay the subcontractor if it is paid by the *Owner*. For example, a typical "pay-if-paid" clause might read: "Contractor's receipt of payment from the *Owner* is a condition precedent to contractor's obligation to make payment to the subcontractor; the subcontractor expressly assumes the risk of the *Owner*'s non-payment and the subcontract price includes this risk." If the *Owner* never pays the general, then the general contractor is not required to pay the subcontractors. Therefore, the subcontractor assumes the risk of non-payment by the *Owner*. This type of clause affords the greatest protection to the general contractor. Florida case law indicates that "pay if paid" provisions are strictly construed and have the best chance of being upheld if they are explicit and clear and set a condition precedent to payment of the subcontractor, as opposed to merely fixing a reasonable time for payment to the subcontractor. In other words, the pay-when-paid provision must clearly state that the subcontractor will be entitled to receive payment from the contractor only if the contractor receives payment from the *Owner*.

Pay if paid clauses are not enforceable in all states because they may be considered waivers of the contractor's lien rights. There is a growing legislative and judicial trend finding "pay if paid" provisions against public policy and unenforceable. In those states, contractors must pay subcontractors within a reasonable period of time for their work.

Delay damages: limitations, waivers, and impossible notice requirements.
No Damage for Delay
Many construction contracts contain a provision exonerating the *Owner* from responsibility for delay damages. This is called a "no-damages-for-delay" clause. If a contract specifically provides that there will be no damages for delay, the contractor will receive payment for normal delays in the progress of the work and may be entitled to only extensions of time for completion. Florida follows the majority of jurisdictions which hold that no damages for delay clauses are legal and enforceable. There are several exceptions that render a no-damages-for-delay clause unenforceable. The clause will not be enforced if the delay is caused by active interference, concealment, or fraud on the part of the party seeking to enforce the provision. Active interference can involve intentional action, such as where a property *Owner* delays the approval of plans and changes and orders that construction stop until such plans and changes are approved. Active interference can also involve inaction, such as where an engineer has early knowledge of a design floor and subsequently fails to apprise the contractor. A no-damages-for-delay clause can be waived, for example, when a party continues to render performance based upon a verbal assurance that the provision will not be enforced.

Waiver of Lien and Bond Rights
Although form construction contracts sometimes contain a waiver of lien and bond rights provision, Florida law prohibits waiving the right to claim a lien in advance. It allows a lien right to be waived only to the extent of labor, services, or materials already provided. A waiver made before the labor, services, or materials have been provided is not enforceable. However, in many states, the waiver of lien and bond rights in advance of payment at the time of contract is enforceable. Contractors, subcontractors and design professionals should never agree to a contractual waiver of lien rights and file appropriate liens or stop notices in a timely manner. Also, if a payment bond exists for the project you should notify the bonding company of non-payment.

Acceptance of Final Payment as Waiver
Under an acceptance of final payment as waiver clause ("acceptance of a final payment

Delay damages: liquidated damages, Eichleay damages, and the cost of time
Delay occurs when a construction project or some part of it is not completed on the date originally agreed to by the parties. Claims for delay may be made by the *Owner* even where extensions of time have been granted. The Contractor has a non delegable duty to timely perform, and will not be relieved of this obligation because of delays caused by subcontractors. Of course, a Contractor can recover delay damages from a subcontractor, and vice-versa. Delay claims can also be made by a Contractor against an *Owner*. For example a Contractor who is capable of finishing a job on time is entitled to delay damages if the *Owner*'s interference slows the Contractor's performance.

A Contractor may also recover from an *Owner* where the subcontractor claims additional compensation from the Contractor because of delay caused by the *Owner*. Generally to recover, privity is required. Non-privity subcontractors cannot claim against the *Owner*, and their claims are of a pass through nature, made against the Contractor who then claims against the *Owner*, Privity cannot be established by incorporation of the prime contract into the subcontract. Delay claims by non-privity subcontractors can be recovered, if at all, under a third party beneficiary theory if the subcontractor is an intended beneficiary of the prime contract.

Delays may be categorized as: non-excusable, excusable, and concurrent. The legal obligations and rights associated with the concept of excuse arise from the implied duty in the construction contract that one party will not delay, hinder, or interfere with performance of the other party. This implied duty prevents one party from availing itself of its own wrongdoing. Non excusable delays occur due to a party's fault. Where a Contractor is at fault, the *Owner* may require acceleration of the work schedule, with the added costs borne by the Contractor. Additionally, the Contractor may be responsible for actual or liquidated damages.

*Owner*s may also delay a Contractor's performance. Examples of such delays include:

- failure of the *Owner* to provide site access
- failure of the *Owner* to supply correct plans or specifications
- failure to provide necessary rights of way,
- untimely relocation of undisclosed utility facilities by *Owner* or other prime Contractor.

Since neither party is at fault, no breach of the implied duty of cooperation in the contract results, and, therefore, no damages are recoverable. Under such circumstances, an extension of time is appropriate. For example, an unforseen cement shortage would entitle the Contractor to a time extension, as would an injunction obtained by a third party which temporarily shuts down the project. A strike or labor dispute may constitute an excusable delay. Also, an act of God, known as *force majeure*, may excuse delay. It must result from natural causes without human intervention, and be such that it could not have been prevented by the exercise of reasonable care and foresight.

Concurrent delays involve the premise that where both parties to a litigation caused delay, then neither party can recover damages for that period of time when both parties were at fault. The burden rests with the party claiming damages to apportion and show entitlement to damages. However, where there are several factors attributable to the delay, of which the defendant's breach is a substantial one, the court may not burden the plaintiff with the duty to apportion.

Once the defendant is shown to be a substantial factor in causing the plaintiff's damages, then the defendant must show that other causes (i.e., other Contractors) are responsible for the damages. The party claiming damages has the burden of proving they are reasonable, and once this is established, the adverse party must persuade the court that they are not.

Eichleay damages

This formula requires that a contractor show: (1) proof of a delay or suspension of contract performance for an uncertain duration which disrupts the contractor's stream of revenue

needed to pay its fixed home office overhead costs; and (2) an inability to take on additional work which would provide a substitute stream of revenue to pay for those costs.

The *Eichleay* formula, first articulated in *Eichleay Corp.*, ASBCA No. 5183, 60-2 BCA 2688, *affd. on reconsideration*, 61-1 BCA 2894, is intended as a mechanism for computing the compensation a contractor can appropriately recover for unabsorbed overhead due to a Government caused suspension or delay. The formula first determines the pro rata share of the contractor's total overhead that is allocable to the delayed contract. It then converts that into an amount per day, and finally the appropriate daily rate is multiplied by the number of days for which compensation is owed.

The U.S. Court of Appeals for the Federal Circuit has handed down two decisions clarifying when federal contractors may recover *Eichleay* damages for unabsorbed home office overhead. The decisions spell out the elements that contractors must prove to qualify for Eichleay damages. And, they make clear that mere disruption of work plans, inefficiency or re-sequencing will not entitle the contractor to *Eichleay* damages.

Differing Conditions: Knowing What You Don't Know.

Differing site conditions are generally defined as unforeseen site conditions that are discovered after the contract has been executed and are different from those set forth in the plans and specifications or are different from those that should be encountered at the site. The differing site conditions can be underground conditions or differing conditions that may be found in remodeling an existing structure. An example of an unforeseen condition in an existing structure would be the discovery of asbestos that must be abated before the work proceeds.

Many contract forms require the Contractor to conduct a site inspection and relieve the *Owner* of liability for changes associated with site conditions that the Contractor should have discovered.

Many post-Katrina contractors have encountered unexpected increases in the cost of labor and materials. These changes might serve as the basis for an equitable adjustment of the Contract sum.

Indemnification and Defense of Claims: Insuring Others from their Own Acts

Effect of Indemnitee's own fault

A contract of indemnity is interpreted according to the usual rules of contractual interpretation. However, an indemnitor's obligation to indemnify the indemnitee from the indemnitee's own negligence must be stated clearly and unequivocally in the contract. The following indemnity provisions have been held to require the indemnitor to indemnify the indemnitee from the indemnitee's own fault:

[Subcontractor shall] indemnify and hold [Contractor] harmless from all claims, suits, actions, losses and damages for personal injury, including death and property damage, even though

caused by the negligence of [Contractor], arising out of [Subcontractor's] performance of the work contemplated by this agreement. *Perkins v. Rubicon,* 563 So.2d 258 (La. 1990).

Contractor assumes the entire responsibility and liability and will protect, indemnify and hold harmless [*Owner*], its agents, servants and employees from and against any and all losses, expenses, demands and claims made against [*Owner*], its agents, servants and employees, by Contractor or its subcontractors, or any employee, agent or servant of Contractor or its subcontractors or any other third person because of injury or alleged injury (including death), whether caused by [*Owner*]'s negligence or otherwise, arising from any source while Contractor or its subcontractors, or any employee, agent or servant of Contractor or its subcontractors are on premises owned, operated or leased by [*Owner*] or under the control of [*Owner*], or while Contractor or its subcontractors, or any employee, agent or servant of Contractor or its subcontractors are performing under this agreement, and Contractor agrees to defend any suit, action or cause of action brought against [*Owner*], its agents, servants or employees, based on any such alleged injury, and to pay all damages, costs and expenses, including attorneys' fees, in connection therewith or resulting therefrom." *Polozola v. Garlock,* 343 So.2d 1000 (La. 1977).

Dispute Resolution: Making Strategic Choices

Contractual stipulation for arbitration or alternative dispute resolution

Arbitration is a process in which the disputing parties choose a neutral third person, or arbitrator, who hears both sides of the dispute and then renders a decision. An arbitrator is more like a judge than a mediator. The parties go into arbitration knowing that they will be bound by the decision. Arbitration, however, is unlike litigation in that the parties choose the arbitrator, the proceedings are conducted in a private manner, and the rules of evidence and procedure are informal. Also, in arbitration, the arbitrators tend to be experts in the issues they are called on to decide. Arbitration has been the widest used Alternative Dispute Resolution process in the business world, and would be especially desirable where the parties do not want to litigate an issue, but do want a binding decision. They can go into arbitration knowing that they can get a quick, and relatively inexpensive decision.

Sample contract clause

SECTION 10
SUBMISSION OF DISPUTES

Owner and contractor agree to submit all claims, controversies, demands, disputes, differences, and matters, now pending between them, or contemplated by either of them, relating to or arising from the above-mentioned construction contract between *Owner* and contractor and performance under the contract, to arbitration, who shall, subject to the provisions of this agreement, arbitrate the following matters:

A. Whether contractor breached his agreement with *Owner* by failing to perform work under that agreement to the standard of skill practiced by qualified contractors in *(county)*, *(state).*

B. Whether contractor failed to provide the quality of materials as called for in the plans and specifications relating to such agreement.

C. Subject to an affirmative finding by the arbitrators of paragraphs A or B above, what amount of damages contractor owes *Owner* by reason of such breach or nonperformance, as set forth below.

SECTION 11
DETERMINATION OF DAMAGES

A. In determining damages, if any, owed by contractor to *Owner*, the arbitrators are directed to assign to each item of substandard work, if any, an amount equal to the reasonable cost of correcting such item to conform to the general standard of skill or quality practiced by building contractors in *(county and state),* in performing the item in question, and the total cumulative cost of all such items shall be the damages, if any, to which *Owner* shall be entitled from contractor.

B. The parties stipulate that the above-stated proration of damages as to each such substandard work item, if any, is required of the arbitrators for the purpose of contractor's seeking recourse against any third persons or particular subcontractors, to the extent of any such damages contractor may suffer by virtue of an award being made by the arbitrators respecting such substandard work item pursuant to this agreement.

SECTION 12
TERMS AND CONDITIONS OF ARBITRATION

Any dispute under this Agreement as described in Section 10 shall be required to be resolved by binding arbitration of the parties hereto. If the parties cannot agree on an arbitrator, each party shall select one arbitrator and both arbitrators shall then select a third. The third arbitrator so selected shall arbitrate said dispute. The arbitration shall be governed by the rules of the American Arbitration Association then in force and effect. The arbitrators shall have full power to make such regulations and to give such orders and directions as they shall deem expedient in respect to a determination of damages in the matters and differences referred to them.

A. DUTIES OF ARBITRATORS

The arbitrator shall view the premises and shall inspect any plans and drawings and inspect any documents relating to the construction of the above-mentioned Project.

B. The arbitrator shall have full power to order mutual releases to be executed by the parties, and, if either of the parties fail to execute a release, such orders shall have the effect of a release, and may be duly acknowledged as such.

C. If either party or a witness for either party shall fail to attend the arbitration hearing, after such written notice to such party as the arbitrators deem reasonable, the arbitrator may proceed in the absence of such party or witnesses without further notice.

SECTION 13
MISCELLANEOUS MATTERS

A. Neither party shall unreasonably delay or otherwise prevent or impede the arbitration or the making of an award.

B. All costs and expenses of the **arbitration** shall be borne and paid by the parties in equal shares.

C. The parties agree that neither of them will, before or during such arbitration, commence or prosecute any civil action against the other relating to any of the matters in controversy, and that the award to be made by the arbitrator shall be valid and binding on the parties, and they agree to observe and perform each part of such orders.

Payment Security: Waiver of Future Lien and Bond Claims

The purpose of non-waiver language is to protect a party who excuses the other party's non-compliance with contract terms, and to prevent the parties' course of conduct under the contract from resulting in the loss of enforceability of the actual terms of the contract:

The failure by one party to require performance of any provision shall not affect that party's right to require performance at any time thereafter, nor shall a waiver of any breach or default of this Contract constitute a waiver of any subsequent breach or default or a waiver of the provision itself.

For example, if a contract requires monthly payments but the party owing payments only pays every other month, in the absence of a non-waiver clause, after a year of acceptance of the late payments a court would be likely to hold that the bimonthly payments do not constitute a breach of the contract. With a non-waiver clause, the party to whom the payments are due would typically be able to enforce the monthly payment provision, despite the course of conduct which was inconsistent with the contract language.

Attorney fees: the American Rule and Reciprocal Contract Rights

In a breach of contract lawsuit, courts generally do not make the losing party pay for the winning parties' attorney's fees. However, there are exceptions. If you are the prevailing party in an action for breach of contract, you may be able to recover reasonable attorney's fees in addition to the other damages that the court will award you ***if*** the contract provided for such an award or there is a state statute.

In some states, attorney's fees may be mandated by statute, meaning that they are automatically awarded to the prevailing party according to the law, provided that the winning party:

- prevails in court and is awarded damages for the breach;
- presents evidence that the fees incurred in the case were reasonable;

- satisfies any requirements that the court may have for how this evidence is to be presented

The *Principal* grounds under which the American common law would permit attorney's fees to be awarded are the "bad faith" theory. The "bad faith" theory allows an award where a party has willfully disobeyed a court order or has "acted in bad faith, vexatiously, wantonly, or for oppressive reasons." *F.D. Rich Co. v. Industrial Lumber Co.,* 417 U.S. 116, 129 (1974);

Payment security: waiver of future lien and bond claims

A *Surety* bond is a three-party contract. One party, the *Surety*, promises, in accordance with the terms of a bond, to answer for the default of another party, the *Principal*. The third party, the obligee. is protected by the bond. Typically, the *Principal* and *Surety* will promise to perform or pay the obligee up to a stated amount of money for damages if the *Principal* fails to perform its contract obligations. A fourth party, the *Surety* bond producer or “bonding agent.” is not actually a party to the bond, but is a resource to the other parties and may have a facilitating role in a claims situation.

When a prime contractor furnishes the bonds, the project *Owner* will be the obligee and the prime contractor will be the *Principal*. When the prime contractor requires the bonds from a subcontractor, the subcontractor will be the *Principal* and the prime contractor will be the obligee.

Although the *Surety* is almost always an insurance company. the *Surety* bond is not a typical insurance policy. The *Surety* provides financial assurance of its *Principal*’s performance. The *Surety* does not “assume” the primary obligation, but is secondarily liable. The *Principal* remains primarily liable for performance of its contract. The *Principal* must reimburse the *Surety* for any loss the *Surety* may suffer by virtue of the *Surety* having extended *Surety* credit to back the *Principal*’s performance. The obligee is protected by the bond against financial loss as a result of the *Principal*s default. The bond does not, however, guarantee that disputes will not arise between the obligee and the *Principal*.

A *Surety* bond assures that the bond *Principal* will perform its contract or pay what it owes. If there is a legitimate dispute between the *Principal* and obligee, the *Surety* is not normally in a position to resolve it. That does not mean. however, that the *Surety* will turn its back on a project dispute or disagreement. Disagreements can become disputes. Disputes can become breaches of contract. Breaches of contract can become defaults that result in termination of contracts. Everyone involved in the *Surety* process is interested in avoiding that progression.

There are three primary types of *contract bonds-bid* bonds, *performance bonds*, and *payment bonds.* A bid bond provides financial protection to an obligee if a bidder is awarded a contract pursuant to the bid documents, but fails to sign the contract and provide any required performance and payment bonds. The bid bond helps to screen out unqualified bidders and is necessary to the process of competitive bidding.

A performance bond provides assurance that the obligee will be protected if the *Principal* fails to perform the bonded contract. If the obligee declares the *Principal* in default and terminates the contract, it can call on the *Surety* to meet the *Surety*’s obligations under the bond.

Bonds differ in terms of the types of options available to the *Surety*, and to the obligee, in the event of a default. A payment bond provides assurance that the *Principal* will pay for labor and material furnished for use on the bonded contract. Payment bonds are provided primarily for the benefit of the *Principal*'s suppliers and subcontractors on a project. With that benefit come certain obligations to notify the *Surety* or the contractor of non-payment in a timely manner. In many states, the time periods for sending notices or enforcing claims are set by state laws. There are also laws governing payment bond claims on federal projects.

While most bond forms are simple documents, often no more than two pages in length, the rights and liabilities of all of the parties to a *Surety* bond: the *Principal*. *Surety*, and obligee, can he quite complex. With *Surety* bonds, as with other contracts, it is crucial to read the bond to determine the respective rights and obligations of the parties.

What Should an Obligee Expect in a Performance Bond Default Situation?
A performance bond provides assurance that the obligee will be protected if the *Principal* fails to perform a bonded contract. It is a financial "safety net." The performance bond does not guarantee that there will be no disputes or disagreements. While bonded contractors are pre-qualified, the bonding process does not guarantee peace and harmony when disputes arise. An obligee should not expect otherwise.

The most frequent complaint by obligees in default situations is the speed at which decisions are made and action taken. Most contracting parties are slow to declare a default. They often provide opportunities to the *Principal* to cure a perceived default. They may tolerate imperfect or slow performance for extended periods of time while the other party promises improvement. By the time a default is actually declared, the obligee may be at wit's end. Perfectly rational general contractors that would never think of giving a subcontractor less than two weeks to properly price and scope its work for a bid in a very controlled situation find themselves demanding that the *Surety*. an insurance company without a tool box to its name, mobilize in the midst of controversy, properly assess the status of the work, present a plan for the completion of a half-complete building, and commence productive work in less time. It simply cannot happen.

The *Surety* may ultimately be liable for the delay, hut it has very limited ability to avoid or greatly shorten the time impact of a default, no matter how good its intentions. Early communication with the *Surety* vastly improves the *Surety* claims process. A *Surety*'s ability to limit the impact of a default is directly related to whether or not the obligee has kept the *Surety* informed of the status of the project, how quickly the obligee provides needed information when a default is declared, and the level of cooperation of both the *Principal* and the oblige. Some performance bonds, including the American Institute of Architect's form, require a meeting among the obligee, *Principal*, and *Surety* prior to any declaration of default. Even if the bond does not require it, such a meeting is almost always useful. If there are such serious problems on the job that the obligee is considering a termination for default, the *Surety* should want to know about it, and the obligee should want to involve the *Surety*. *Surety* claims professionals are experienced in dealing with troubled projects, and the *Surety* can often help avoid a default termination. It is at this initial meeting stage that the professional bond producer may be of great value to the process, as a confidant of both the *Surety* and the *Principal*.

If the bonded contractor is otherwise competent but does not have the capital necessary to complete the project. the *Surety* may advance funds to finance completion by the *Principal*. If that occurs, the obligee should be willing to make future payments as joint checks or as otherwise requested by the *Surety* to assure that funds from the bonded contract are used only to pay obligations on the contract. The *Surety* and the obligee have a common interest in seeing that contract funds are not diverted from a bonded project.

One of the often unseen benefits of *Surety* bonding is the situation where a *Surety* takes control of contract funds and provides additional capital to a failing contractor to prevent a default in the first instance. This may happen without the obligee even knowing that a problem existed. This happens more often than many obligees realize.

If the obligee does decide to terminate the bonded contract and call upon the *Surety*. the *Surety* and the obligee generally have a number of options. Some bond forms spell out the options and make them part of the agreement. Some forms are silent on the subject of performance default options. Whether or not the bond spells out the options, or even if the options in the bond are limited, it always makes sense to explore all possible options for the resolution of disputes and the completion of bonded work.

One option is for the *Surety* and the obligee to agree on a replacement contractor to complete the bonded work. This is often referred to as the *Surety*'s "tender option," because the *Surety* "tenders" a new contractor to the obligee. If the replacement contractor's price exceeds the balance remaining in the bonded contract, the *Surety* will fund the excess either by paying the replacement contractor as the work proceeds or by paying the obligee the amount of the overrun in return for a release. Under normal circumstances, the obligee and the *Surety* will insist that the replacement contractor provide new bonds to guarantee its performance of the completion work. One advantage of this tender option is that the obligee can deal directly with the new contractor in administering the project.

A second option in the event of a default is for the *Surety* itself to assume or "take over" responsibility for completing the remaining work. The *Surety*, of course, would then hire construction professionals to manage and perform the completion. Although it is possible on a given job that a consultant or construction manager is all that is needed and the original subcontractors can perform the completion work, it is more common for the *Surety* to hire a completion contractor. The delivery method by which the work is completed will depend largely on the status of completion. A *Surety* is more likely to elect this option for a job that is well along in performance.

If this second takeover option is used, the *Surety* and the obligee will enter into a "Takeover Agreement" spelling out their respective rights and obligations in connection with completion of the work. Although some have suggested that a Takeover Agreement is unnecessary, and that the *Surety* should just show up and commence work. the better practice is to avoid misunderstandings and disputes later on by entering into a definitive written agreement.

A third option following default of the *Principal* is to advise the obligee that the *Surety* elects not to be involved in the completion work. This is usually an available option, regardless of the options spelled out in the bond. A responsible *Surety* that elects this course of action

should do so promptly, so that the job is not unduly delayed. The *Surety* of course, remains exposed to liability for the costs to complete in excess of the remaining contract balance. And, because this option leaves the *Surety* with little or no control over the manner in which the work will be completed, such an option is only reluctantly taken by the *Surety*. The most common situation in which the *Surety* elects this option is if it believes the default termination of the *Principal* was unjustified in the first instance or that the obligee's demand or position is overreaching. The obligee that can ill afford to finance completion and seek reimbursement later is well advised to consider the reasonableness of its initial demands.

Other options are limited only by the facts, the resources, and the creativity of the parties involved. These range from up-front cash settlements, to continued performance by the original contractor, possibly with additional monitoring, to various combinations o all of the available options. The obligee or the *Surety* that insists that the default be remedied only in one way may often miss opportunities for savings in time, money, and heartache.

What Should A Payment Bond Claimant Expect?

A payment bond, sometimes called a "Labor and Material Payment Bond." is required by the obligee, but the bond is primarily for the benefit of the *Principal*'s suppliers and subcontractors. The bond obligates the *Principal*, whether a contractor or subcontractor, to pay for labor and material furnished for use in performance of the bonded contract. The claimants are usually limited to subcontractors or suppliers to the bond *Principal* or sub-subcontractors or suppliers to a subcontractor of the *Principal*. The following is a sample.

Labor and Material Payment Bond

Agreement made on the ***(date),*** between ***(name of Principal)*** with its *Principal* office located at ***(street address, city, county, state, zip code)***, and ***(name of Surety)*** with its *Principal* office located at ***(street address, city, county, state, zip code)***, referred to herein as

1. OBLIGATION

A. The parties are obligated to *(name of Owner)*, at ***(street address, city, county, state, zip code)***, referred to herein as *Owner* for the benefit of claimants as defined below, in the amount of $*(dollar amount])*, for the payment of which *Principal* and *Surety* bind themselves, their heirs, representatives, successors and assigns, jointly and severally, firmly by this agreement.

B. *Principal* has by written agreement, dated *(date)*, entered into a contract with *Owner* for *[description of work]* in accordance with the drawings and specifications prepared by *[name of architect]*, which contract is made a part of this agreement by reference, and is referred to as the *Contract.*

2. CONDITION

The condition of this obligation is such that if the *Principal* shall promptly make payment to all claimants as defined in **Section One** of this agreement for all labor and material used or reasonably required for use in the performance of the contract, then this obligation shall be void; otherwise it shall remain in full force and effect.

3. CLAIMANT DEFINED

Claimant is defined as one having a direct contract with *Principal* or with a subcontractor of

Principal for labor, material, or both, used or reasonably required for use in the performance of the *Contract,* "labor and material" including that part of water, gas, power, light, heat, oil, gasoline, telephone service or rental of equipment directly applicable to the contract.

4. ACTION ON SUMS DUE CLAIMANT

Principal and *Surety* jointly and severally agree with *Owner* that every claimant who has not been paid in full before the expiration of a period of *(number)* days after the date on which the last of such claimant's work or labor was done or performed, or on which the last of such materials were furnished by claimant, may sue on this bond for the use of claimant in the name of *Owner*, prosecute the suit to final judgment for such amount as may be justly due claimant, and have execution, provided, however, that *Owner* shall not be liable for the payment of any costs or expenses of any such suit.

LIMITATIONS ON SUIT BY CLAIMANT

No suit or action shall be commenced under this bond by any claimant:

A. Unless claimant shall have given written notice to any two of the following: *Principal*, *Owner*, or *Surety*, above named, within *(number)* days after claimant did or performed the last of the work or labor, or furnished the last of the materials for which the claim is made, stating with substantial accuracy the amount claimed and the name of the party to whom materials were furnished, or for whom the work or labor was done or performed. Such notice shall be served by mailing the notice by registered mail, postage prepaid, in an envelope addressed to *Principal*, *Owner*, or *Surety*, at any place where an office is regularly maintained for the transaction of business, or served in any manner in which legal process may be served in the state in which the project is located, except that such service need not be made by a public officer;

B. After the expiration of *(number)* years following the date on which *Principal* ceased work on the contract; or

C. Other than in a state court of competent jurisdiction in and for the county or other political subdivision of the state in which any part of the project is situated, or in the United States District Court for the district in which any part of the project is situated, and not elsewhere.

D. PAYMENTS MADE

The amount of this bond shall be reduced by and to the extent of any payment or payments made in good faith under this bond, inclusive of the payment by *Surety* of mechanics' liens which may be filed of record against the improvement, whether or not claim for the amount of such lien be presented under and against this bond.

The parties have executed this agreement as of the day and year first above written.

Signatures

(Acknowledgments)

Selecting the Right Contract Forms

Evaluating form and substance: looking for bias in contract language
Every construction contract has a built-in bias. There's no such thing as a standard construction contract that's fair to everyone and fits every job in all states. For many reasons, a contract like that doesn't exist. It can't. The law in every state is different. The disclosures required vary with the type of work – residential, commercial, industrial, public or private. What's fair in one context may be completely unfair under a different set of circumstances.

Just as bias varies in contracts, risk varies from job to job. The danger zone for every construction contractor is where bias and risk intersect:

- An undercapitalized *Owner*,
- An inexperienced designer,
- An aggressive building inspector,
- Demanding specifications,
- Short deadlines.

A job with any of these characteristics includes obvious risk. By the time you've walked the job site, studied the plans and bid the work, you probably recognize other risks that should be considered. It's a shame if what you know about risk in the job (the *Owner*, the plans, the work) isn't written into the contract. You need a construction contract with bias neatly tailored to avoid known risks.

Sample contract.

Contract For Construction of a Commercial Building

Agreement made on the ***(date),*** between ***(Name of Owner)*** of ***(street address, city, county, state, zip code)***, referred to herein as ***Owner,*** and ***(Name of Contractor),*** a corporation organized and existing under the laws of the state of _____, with its principal office located at ***(street address, city, county, state, zip code)***, referred to herein as ***Contractor.***

For and in consideration of the mutual covenants contained in this agreement, and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties agree as follows:

I. Description of Work
Contractor is duly licensed in the state of ***(name of state)*** and shall perform the following described work, in accordance with the contract plans and specifications (the ***contract documents***), at ***(street address, city, county, state, zip code):***

(Description of Work to be Done)

II. Contract Price
A. *Owner* agrees to pay *Contractor*, for the work described, the total price of $_____.

B. Payment of this amount is subject to additions or deductions in accordance with the provisions of this contract and of the other documents to which this contract is subject.

III. Progress Payments

A. *Owner* shall make progress payments on account of the contract price to *Contractor*, on the basis of applications for payment submitted to ***(e.g., architect/engineer)*** by *Contractor* as the work progresses, and on the ***(e.g., architect/engineer)'s*** certificate for the same, in accordance with ***(describe the contract document that establishes the basis for a progress payment).***

B. Progress payments may be withheld if:

1. Work is found defective and not remedied;

2. *Contractor* does not make prompt and proper payments to subcontractors;

3. *Contractor* does not make prompt and proper payments for labor, materials, or equipment furnished to *Contractor;*

4. A subcontractor is damaged by an act for which *Contractor* is responsible;

5. Claims or liens are filed with regard to the project; or

6. In the opinion of ***(e.g., architect/engineer)***, *Contractor's* work is not progressing satisfactorily.

IV. Final Payment

A. *Owner* shall make final payment to *Contractor* within ***(number)*** days after the work is completed, if the contract is at that time fully performed; ***however,*** final payment shall **not** be made or deemed due until *Contractor* has delivered to *Owner* a complete release of all liens arising out of the contract, or receipts in full covering all labor, materials, and equipment for which a lien could be filed, or in the alternative a bond satisfactory to *Owner* indemnifying him or her against any and all such liens.

B. *Owner,* by making payment, waives all claims except those arising out of the following

1. Faulty work appearing after substantial completion has been granted;

2. Work that does not comply with the *contract documents;*

3. Outstanding claims of lien; or

4. Failure of *Contractor* to comply with any special guarantees required by the *contract documents.*

C. *Contractor,* by accepting final payment, waives all claims except those that *Contractor* has previously made in writing, and which remain unsettled at the time of acceptance.

V. Starting and Completion Dates

Construction under this contract shall begin on ***(e.g., date of commencement of construction)*****,** and be completed by ***(e.g., date of completion)*****.**

VII. Contracts Documents

A. The *contract documents* on which the agreement between *Owner,* ***(e.g., architect/engineer)***, and *Contractor* is based, that contain the plans and specifications in accordance with which the work is to be done, and that provide for the method of payment of the contract price are as follows:

1. This agreement, with supplementary agreements and conditions attached to this agreement;

2. The plans and specifications, with addenda attached to such plans and specifications, issued before execution of this agreement, and any amendments made after the effective date of this agreement;

3. Written interpretations of the *contract documents* and directives to be made from time to time by the ***(e.g., architect/engineer)***; and

4. Work change orders issued, or to be issued.

B. The *contract documents* together form the contract for the work described in this agreement. The parties intend that the documents include provisions for all labor, materials, equipment, supplies, and other items necessary for the execution and completion of the work, and all terms and conditions of payment. The documents also include all work and procedures not expressly indicated in such documents necessary for proper execution of the above-described project.

C. The *contract documents* are to be separately executed in triplicate by *Owner* and *Contractor. Contractor,* by executing the documents, represents that *Contractor* has inspected and is familiar with the work site and the local conditions under which the work is to be performed. If by inadvertence any of the *contract documents* are not signed, ***(e.g., architect/engineer)*** shall identify them.

VII. Designation of *(e.g., Architect/Engineer)*

The ***(e.g., architect/engineer)*** for above-described project is ***(name),*** having an office at ***(street address, city, county, state, zip code)***.

VIII. Duties and Authority of *(e.g., Architect/Engineer)*

The duties and authority of the ***(e.g., architect/engineer)*** are as follows:

A. General Administration of Contract.

The primary function of the ***(e.g., architect/engineer)*** is to provide the general administration of the contract. In performing these duties the ***(e.g., architect/engineer)*** is *Owner's* representative during the entire period of construction.

B. Inspections, Opinions, and Progress Reports.

He/she shall keep familiar with the progress and quality of the work by making periodic visits to the work site. He/she will make general determinations as to whether the work is proceeding in accordance with the contract. He/she will keep the *Owner* informed of such progress, and will use his/her best efforts to protect the *Owner* from defects and deficiencies in the work. He/she will not be responsible for the means of construction, or for the sequences, methods, and procedures used in such construction, or for *Contractor's f*ailure to perform the work in accordance with the *contract documents.*

C. Access to Work Site for Inspections.
He/she shall be given free access to the work at all times during its preparation and progress. However, he/she is not required to make exhaustive or continuous on-site inspections to perform his/her duties of checking and reporting on work progress.

D. Interpretation of *Contract Documents* -- Decisions on Disputes.
He/she will be the initial interpreter of the *contract document* requirements, and make primary decisions on claims and disputes between *Contractor* and *Owner.* All of his/her decisions are subject to arbitration as provided in this agreement.

E. Rejection and Stoppage of Work.
He/she shall have authority to reject work that in his /her opinion does not conform to the *contract documents,* and in this connection to stop the work or a portion of such work, when necessary.

F Payment Certificates.
He/she will determine the amounts owing to *Contractor* as the work progresses, based on *Contractor's* applications and his/her inspections and observations, and will issue certificates for progress payments and final payment in accordance with the terms of the *contract documents.*

IX. Responsibilities of Owner
A. *Owner* shall:
- give all instructions to *Contractor* through ***(e.g., architect/engineer)*;**
- shall furnish all necessary surveys for the work, and
- shall secure and pay for easements for permanent structures or permanent changes in existing structures or facilities on the work site, or which are necessary for its proper completion.

B. *Owner* reserves the right to let other contracts in connection with the project. *Contractor* shall cooperate with all other contractors to the effect that their work shall not be impeded by his/her construction, and shall give such other contractors access to the work site necessary to perform their contracts.

X. Responsibilities of Contractor
Contractor's duties and rights in connection with the above-described project are as follows:
A. Responsibility for and Supervision of Construction.
Contractor shall be solely responsible for all construction under this contract, including the techniques, sequences, procedures, and means, and for coordination of all work. *Contractor*

shall supervise and direct the work to the best of his/her ability, and give it all attention necessary for such proper supervision and direction.

B. Discipline and Employment.
Contractor shall maintain at all times strict discipline among his/her employees, and *Contractor* agrees not to employ for work on the project any person unfit or without sufficient skill to perform the job for which he or she was employed.

C. Furnishing of Labor, Materials, etc.
Contractor shall provide and pay for all labor, materials, and equipment, including tools, construction equipment, and machinery, utilities, including water, transportation, and all other facilities and services necessary for the proper completion of work on the project in accordance with the *contract documents.*

D. Payment of Taxes
Procurement of Licenses and Permits.
Contractor shall pay all taxes required by law in connection with work on the project in accordance with this agreement including sales, use, and similar taxes, and shall secure all licenses and permits necessary for proper completion of the work, paying the fees for such licenses and permits.

E. Compliance with Construction Laws and Regulations.
Contractor shall comply with all laws and ordinances, and the rules, regulations, or orders of all public authorities relating to the performance of the work under and pursuant to this agreement. If any of the *contract documents* are at variance with any such laws, ordinances, rules, regulations, or orders, he or she shall notify ***(e.g., architect/engineer)*** promptly on discovery of such variance.

F. Responsibility for Negligence of Employees and Subcontractors. *Contractor* assumes full responsibility for acts, negligence, or omissions of all his/her employees on the project, for those of his/her subcontractors and their employees, and for those of all other persons doing work under a contract with him or her.

G. Warranty of Fitness of Equipment and Materials.
Contractor represents and warrants to *Owner* and to ***(e.g., architect/engineer*** that all equipment and materials used in the work, and made a part of the structures on such work, or placed permanently in connection with such work, will be new unless otherwise specified in the *contract documents,* of good quality, free of defects, and in conformity with the *contract documents.* It is agreed between the parties to this agreement that all equipment and materials not so in conformity will be considered defective.

H. Furnishing of Samples and Shop Drawings.
Contractor agrees to furnish at ***(e.g., architect/engineer)'s*** direction all samples and shop drawings for his or her consideration and approval as to conformance with the specifications of the *contract documents* and his or her concepts of design called for in such specifications.

I. Clean-up.

Contractor agrees to keep the work premises and adjoining ways free of waste material and rubbish caused by his/her work or that of his/her subcontractors. *Contractor* further agrees to remove all such waste material and rubbish on termination of the project, together with all his/her tools, equipment, machinery, and surplus materials. *Contractor* agrees, on terminating his/her work at the site, to conduct general clean-up operations, including the cleaning of all glass surfaces, paved streets and walks, steps, and interior floors and walls.

J. Indemnity and Hold Harmless Agreement.

1. *Contractor* agrees to indemnify and hold harmless *Owner* and ***(e.g., architect/engineer)***, and their agents and employees, from and against any and all claims, damages, losses, and expenses, including reasonable attorneys' fees in case it shall be necessary to file an action, arising out of performance of the work in this contract, that is (a) for bodily injury, illness, or death, or for property damage, including loss of use, and (b) caused in whole or in part by *Contractor's* negligent act or omission, or that of a subcontractor, or that of anyone employed by them or for whose acts *Contractor* or subcontractor may be liable.

2. This agreement to indemnify and hold harmless is not applicable to liability of ***(e.g., architect/engineer)*** or that of his or her agents or employees, arising out of preparation or approval of reports, opinions, surveys, maps, drawings, designs, or specifications, or out of their giving or failure to give instructions, which giving or failure to give is the primary cause of the injury or damage.

K. Payment of Royalties & License Fees; Hold Harmless Agreement. *Contractor* agrees to pay all royalties and license fees necessary for the work, and to defend any and all actions and settle all claims for infringement of copyright or patent rights, and to save owner harmless in connection with any such actions and claims.

L. Safety Precautions and Programs.

Contractor has the duty of providing for and overseeing all safety orders, precautions, and programs necessary to the reasonable safety of the work. In this connection, *Contractor* shall take reasonable precautions for the safety of all employees and other persons whom the work might affect, all work and materials incorporated in the project, and all property and improvements on the construction site and adjacent to the construction site, complying with all applicable laws, ordinances, rules, regulations, and orders.

XI. Time of Essence; Extension of Time

A. All times stated in this agreement or in the *contract documents* are of the essence.

B. The times stated in this agreement or in the *contract documents* may be extended by a change order from ***(e.g., architect/engineer)*** for such reasonable time as he/she may determine, when in his/her opinion *Contractor* is delayed in work progress by changes ordered, labor disputes, fire, prolonged transportation delays, injuries, or other causes beyond *Contractor's* control or which justify the delay.

XII. Subcontractors

A. Contractor agrees to furnish ***(e.g., architect/engineer)***, prior to the execution of this agreement, with a list of names of subcontractors to whom he/she proposes to award the principal portions of the work to be subcontracted by him /her.

B. A subcontractor, for the purposes of this agreement, shall be a person with whom *Contractor* has a direct contract for work at the project site.

C. *Contractor* agrees not to employ a subcontractor to whose employment ***(e.g., architect/engineer)*** or *Owner* reasonably objects, nor shall *Contractor* be required to hire a subcontractor to whose employment he/she reasonably objects.

D. All contracts between *Contractor* and subcontractors shall conform to the provisions of the *contract documents,* and shall incorporate in them the relevant provisions of this agreement.

XIII. Mandatory Arbitration

Any dispute under this Agreement shall be required to be resolved by binding arbitration of the parties hereto. If the parties cannot agree on an arbitrator, each party shall select one arbitrator and both arbitrators shall then select a third. The third arbitrator so selected shall arbitrate said dispute. The arbitration shall be governed by the rules of the American Arbitration Association then in force and effect.

XIV. Insurance

A. Contractor's Liability Insurance.

Contractor agrees to keep in force at his/her own expense during the entire period of construction on the project such liability insurance as will protect him/her from claims, under workers' compensation and other employee benefit laws, for bodily injury and death, and for property damage, that may arise out of work under this agreement, whether directly or indirectly by *Contractor,* or directly or indirectly by a subcontractor. The minimum liability limits of such insurance shall not be less than the limits specified in the *contract documents* or by law for that type of damage claim. Such insurance shall include contractual liability insurance applicable to *Contractor's* obligations under this agreement. Proof of such insurance shall be filed by *Contractor* with *Owner* within a reasonable time after execution of this agreement.

B. Owner's Liability Insurance.

Owner agrees to maintain in force his/her own liability insurance during the construction on this project, and reserves the right to purchase such additional insurance as in his /her opinion is necessary to protect him/her against claims arising out of the *Contractor's* operation, without diminishing *Contractor's* obligation to carry the insurance specified in this agreement on *Contractor's* part to be carried.

C. Property Damage Insurance on Work Site.

Owner agrees to maintain at his/her expense during construction of the project property damage insurance on the work at the site to its full insurable value, including interests of *Owner, Contractor,* and subcontractors, against fire, vandalism, and other perils ordinarily included in extended coverage. Losses under such insurance will be adjusted with and made payable to *Owner* as trustee for the parties insured as their interests appear. *Owner* shall file

a copy of all such policies with *Contractor* within a reasonable time after construction begins under and pursuant to this agreement.

D. Waiver of Work Site Property Damage Claims to Extent of Insurance Coverage.
Owner and *Contractor* waive all claims against each other for fire damage or damages from other perils covered by insurance provided in **Subparagraph C.** of this Section. *Contractor* agrees to obtain waivers of such claims by all subcontractors.

XV. Correcting Work
When it appears to *Contractor* during the course of construction that any work does not conform to the provisions of the *contract documents, Contractor* shall make necessary corrections so that such work will so conform, and in addition will correct any defects caused by faulty materials, equipment, or quality of performance in work supervised by him or her or by a subcontractor, appearing within ***(period of time)*** from the date of issuance of a certificate of substantial completion, or within such longer period as may be prescribed by law or as may be provided for by applicable special guaranties in the *contract documents.*

XVI. Work Changes
A. *Owner* reserves the right to order work changes in the nature of additions, deletions, or modifications, without invalidating this agreement, and agrees to make corresponding adjustments in the contract price and time for completion.

B. All changes will be authorized by a written change order signed by *Owner* or by ***(e.g., architect/engineer)*** as *Owner's* agent. The change order will include conforming changes in the agreement contract and completion time.

C. Work shall be changed, and the contract price and completion time shall be modified only as set out in the written change order.

D. Any adjustment in the contract price resulting in a credit or a charge to *Owner* shall be determined by mutual agreement of the parties, or by arbitration, before starting the work involved in the change.

XVII. Termination
A. *Contractor's Termination.*
Contractor may, on ***(number)*** days written notice to *Owner* and ***(e.g., architect/engineer)***, terminate this agreement before the completion date specified in this agreement when for a period of ***(number)*** days after a progress payment is due, through no fault of *Contractor,* ***(e.g., architect/engineer)*** fails to issue a certificate of payment for the same, or *Owner* fails to make the payment. On such termination, *Contractor* may recover from *Owner* payment for all work completed and for any loss sustained by *Contractor* for materials, equipment, tools, or machinery to the extent of actual loss plus loss of a reasonable profit, provided he or she can prove such loss and damages.

B. *Owner's* Termination.
Owner may, on ***(number)*** days notice to *Contractor,* terminate this agreement before the completion date specified in this agreement, and without prejudice to any other remedy he or she may have, when *Contractor* defaults in performance of any provision in this agreement,

or fails to carry out the construction in accordance with the provisions of the *contract documents.* On such termination, *Owner* may take possession of the work site and all materials, equipment, tools and machinery on the work site, and finish the work in whatever way he or she deems expedient. If the unpaid balance on the contract price at the time of such termination exceeds the expense of finishing the work, *Owner* will pay such excess to *Contractor.* If the expense of finishing the work exceeds the unpaid balance at the time of termination, *Contractor* agrees to pay the difference to *Owner.*

C. On any such default by *Contractor, Owner* may elect not to terminate this agreement, and in such event he or she may make good the deficiency of which the default consists, and deduct the costs from the progress payment then or to become due to *Contractor.*

XVIII. No Waiver

The failure of either party to this Agreement to insist upon the performance of any of the terms and conditions of this Agreement, or the waiver of any breach of any of the terms and conditions of this Agreement, shall not be construed as subsequently waiving any such terms and conditions, but the same shall continue and remain in full force and effect as if no such forbearance or waiver had occurred.

XIX. Governing Law

This Agreement shall be governed by, construed, and enforced in accordance with the laws of the State of _____.

XX. Notices

Any notice provided for or concerning this Agreement shall be in writing and shall be deemed sufficiently given when sent by certified or registered mail if sent to the respective address of each party as set forth at the beginning of this Agreement.

XXI. Entire Agreement

This Agreement shall constitute the entire agreement between the parties and any prior understanding or representation of any kind preceding the date of this Agreement shall not be binding upon either party except to the extent incorporated in this Agreement.

XXII. Modification of Agreement

Any modification of this Agreement or additional obligation assumed by either party in connection with this Agreement shall be binding only if placed in writing and signed by each party or an authorized representative of each party.

XXIII. Assignment of Rights

The rights of each party under this Agreement are personal to that party and may not be assigned or transferred to any other person, firm, corporation, or other entity without the prior, express, and written consent of the other party.

XXIV. Counterparts

This Agreement may be executed in any number of counterparts, each of which shall be deemed to be an original, but all of which together shall constitute but one and the same instrument.

WITNESS our signatures as of the day and date first above stated.

(Name of Contractor)

By:_____ _____

(Printed or typed name) ***(Printed or typed name)***

(Name and Office in Corporation) ***(Name of Owner)***

AIA contract Documents: the Architects' Tried and True Forms

The most widely used standard construction form contracts in the construction industry are documents produced by the American Institute of Architects (AIA). This is because AIA contract documents are consensus documents that reflect advice from practicing architects, contractors, engineers, *Owner*s, *Surety* bond producers, insurers and attorneys. AIA documents balance the interests of all parties, so no one interest, including that of architects, is unfairly represented.

Where practices are inconsistent or no guidelines for practice exist, AIA documents provide a consensus-based model for practitioners to follow. These construction forms and documents are revised regularly to accommodate changes in professional and industry practices, insurance and technology and are revised and updated to incorporate changes resulting from court interpretations and rulings, legal precedent and business feedback.

All of the documents use the common meaning of words and phrases. Industry and legal jargon is avoided whenever possible and they can be easily modified to accommodate individual project demands. Such changes are easily distinguished from the original, printed language. The General Conditions contain a set of definitions, contractor duties (including supervision, safety, warranty, and scheduling), a methodology for payment and dispute resolution, arid a recitation of the roles of the architect and/or construction manager during the construction process. They are part of the General Contract and, to some extent, are incorporated in each of the parties' contracts (in theory, a lodestar which, if followed, would lead to a successful project).

Regrettably, there is some difference of opinion as to the selection of the means to that end. Not every participant uses AlA contracts, or revises them the same way, and as a consequence, the separate contracts the *Owner* has with his architect and contractor, and their contracts with their consultants and subcontractors, may impose obligations inconsistent with the General Conditions, or operate to relieve them of obligations which appear to be assigned to them in the General Conditions.

EJCDC Contract Documents – the Engineers' Alphabet Soup

The Engineers Joint Contract Documents Committee (EJCDC) develops and updates fair and objective standard documents that represent the latest and best thinking in contractual relations between all parties involved in engineering design and construction projects.

EJCDC includes the American Society of Civil Engineers, the American Council of Engineering Companies, NSPE's Professional Engineers in Private Practice Division, Associated General Contractors of America and the participation of more than fifteen other professional engineering design, construction, *Owner*, legal, and risk management organizations.

EJCDC Issues Interim Payment Bond Forms Approved by the *Surety* and Fidelity Association of America and the National Association of *Surety* Bond Producers

Engineers Joint Contract Documents Committee, has published a revised edition of its standard payment bond form. The new form, EJCDC C-615(A), is intended to be used on an interim basis as a substitute for EJCDC's standard payment bond form, EJCDC C-615, pending a full review and reissuance of the standard form. The interim form addresses a concern regarding the misapplication of the standard form's section on the time limit for the *Surety*'s response to a claim on the bond. That concern arose as a result of court decisions in a few jurisdictions and led users and sureties to request a revision of the form.

Strategic considerations: who has the money?

While most contractors are generally not directly involved with the financing of a construction project, understanding the process of financing and how it relates to a construction business is extremely important. The following outlines many of the most common sources for obtaining construction loans.

Commercial Banks:
Commercial Banks make single-family short-term and a limited number of long-term loans. They are generally the largest construction lenders on multifamily and commercial projects. They also make short-term loans to mortgage banks and to real estate investment trusts (REITs).

Savings and Loan Associations:
Savings and Loan associations are the largest of all lenders of both construction and permanent or long-term loans on single family housing. They also make a considerable number of construction loans for multifamily residences such as apartment houses and condominiums.

Mutual Savings Banks:
Mutual Savings Banks are generally located within the northeastern United States. Their mortgage investments are generally concentrated in single family permanent mortgages. They tend to make only a limited number of construction loans, but do make long-term loans to mortgage bankers and to real estate investment trusts which in turn make construction loans.

Mortgage Banking Companies:
Mortgage Banking companies make a significant number of loans for construction and land development but are mainly intermediaries between borrowers and lenders.

Life Insurance Companies:
Life insurance companies do a minimum amount of temporary construction lending. Their principle commitments are long-term loans on commercial and multifamily projects.

Real Estate Investment Trusts:
These trusts provide long-term mortgages on commercial and multifamily projects and a limited amount of construction loans.

Government Agencies:
Approximately every sixth house built in the United States is financed by the GI loan program. The Veterans Administration (VA) makes construction loans on housing for veterans, their dependents, and other beneficiaries of deceased veterans. The Federal Housing Administration (FHA) insures mortgage loans made by approved lending institutions, however, FHA does not lend money.

Other Sources for Loans:
Finally, miscellaneous sources of loans which should not be overlooked include individuals, syndicates, service organizations, and Community Housing Authorities.

Lenders need assurance that a contractor is financially responsible, of good character and reputation, and able to carry out the work stipulated in the specifications and construction documents.

A full financial statement from the contractor stating his or her assets and liabilities, investments, property owned, life insurance and other pertinent information, including a credit report is generally requested by the lender. In addition, a complete set of drawings, plans, and specifications as well as the names of all the subcontractors and their specific tasks are also generally required.

Contractor's final cost estimate. Once this is in place, the lender submits the of construction and compares it with the contractor's final cost estimate. Once this is in place, the lender submits the application to the loan committee for approval.

Remedies and Procedure in Actions Involving Building and Construction Contracts

A. Contractors Remedies
Upon the breach of a building or **construction** contract by the Owner, the **contractor** may elect to pursue one of three remedies: (1) acquiesce in the breach, treat the contract as rescinded, and recover in quantum meruit so far as he or she has performed; (2) refuse to acquiesce in the breach, keep the contract alive for the benefit of both parties, being at all times ready and able to perform, and at the end of the time specified in the contract for performance, sue under the contract;[or (3) treat the breach or repudiation as terminating

the contract and sue for the profits he or she would have realized if he or she had not been prevented from performing. [36]

While an action at law ordinarily affords an adequate remedy, when the breach goes to the root of the contract and deprives the injured party of what he or she contracted for in such a way that an action for damages will not put the parties in status quo, the rescission of the contract will be allowed in equity.[37]

Owner
The purpose of damage awards in breach of contract actions involving residential construction or repair is to place the injured party as nearly as possible in the position that he or she would have occupied if the contract been properly performed. Otherwise stated, the buyer of construction or repair services is entitled to the benefit of the bargain, or is entitled to have that for which he or she contracted, or its equivalent.

With this purpose in mind, two major approaches to measuring damages in construction or repair contract cases have been generally recognized. Depending on the circumstances of the case, the plaintiff buyer is entitled either to the cost of repairing the defective structure and making it conform to the contract, or to the difference in value between the defective structure and the structure as it would have been had the contract been properly performed. The determination of which measure of damages will be used in a particular case is not based on any uniform rules. Generally, it has been said that the cost of repair measure is preferable, unless the cost to repair the defects in the structure is "disproportionate" to the increase in value in the structure that the repairs would produce. In that case, the difference in value method is generally considered preferable. Some courts state the rule as providing that the cost of repairs will be the preferred measure unless repair of the structure would result in "economic waste" by requiring its extensive dismantling or destruction; in such a case, the difference in value measure is employed.

Sometimes, both measures of damages may be applied in the same case. For example, in *Eastlake Construction Co v Hess,* 102 Wash2d 30, 686 P2d 465 (1984),the court concluded that the cost of repair was the proper measure of damages for certain defects in the structure that could easily be remedied (*e.g.*, repairing the roof, replacing balcony guardrails, replacing non-vented kitchen hood fans, replacing interior doors, and installation of television cable and light fixtures). However, for other defects that were not easily remedied without substantial disturbance of work already completed (*e.g.*, installation of foam insulation under concrete floors, replacement of plastic waste pipes with case iron, replacement of nonconforming felt under siding, and redoing of inadequate caulking and exterior stain), the court remanded for a determination as to whether the difference in value measure of damages would be more appropriate.

Occasionally, it appears that a decision to use the cost of repair measure of damages may be influenced by the ratio of repair costs to the present value of the structure. In *Trenton Construction Co v Straub,* 310 SE2d 496 (W. Va. 1983), for example, the court awarded the plaintiffs the cost to install an absent vapor barrier in the concrete foundation of their home

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36 **13 Am. Jur. 2d Building, Etc. Contracts § 112**
37 **Id**

($8,000). The court noted that the market value of the home was nearly $200,000, and concluded that the ratio of the cost of repair to the value of the home was not so great as to be "disproportionate."

In cases in which the defendant's performance has no objective value at all, the preferred measure of damages may be the amount of the plaintiff's payments to the defendant together with the cost of placing the property in the condition it was in before the contract was made. Such an award was made in *Levan v Richter,* 152 Ill App3d 1082, 105 Ill Dec 855, 504 NE2d 1373 (1987), in which a swimming pool constructed by the defendants on the plaintiffs' property failed to hold water from the first day and was therefore considered worthless. The award in such a case is, in fact, based on a "difference in value" measure of damages. However, in this instance the measure is the difference in value of the plaintiff's property with the defective structure and its value without the structure at all. This approach reflects a recognition that the presence of the defective structure on the property may actually result in a decline in the property's overall value. Since the structure is entirely useless, the degree to which it has depressed the value of the property is roughly equal to the cost to remove it.

Generally, the court will not order the cost of repairing the worthless structure in such a case, because this would result in an award disproportionate to the benefit to be received by the plaintiff if the structure were properly built to begin with. For example, in the swimming pool context, the repair cost would include both an amount equal to the cost of totally removing the worthless structure and also an amount equal to the cost of rebuilding it in the proper fashion. The courts will likely determine that this was too great a windfall to settle on the plaintiffs and too great a penalty for the defendants to bear, particularly in light of the fact that the costs of building swimming pools had greatly increased in the interim period between the breaches of contract and the bringing of the actions.

Regardless of what measure of damages is used to compensate the plaintiff in a breach of residential construction or repair contract, the award generally cannot exceed the original price of the contract. The reason for this, of course, is that to do so would result in the plaintiff getting more than the benefit of the bargain. Where the breach of contract involves defects in particular components of the structure, an award based on the cost to repair such components should not exceed the original price or quality of the components. Where the cost to repair the defective performance is greater than the original cost because of inflation in the period between performance and discovery of the breach, a higher award may be justified, provided it results in a structure of the same general quality as that originally agreed upon.

Generally; Complaint or Petition

When a complaint seeks general actual damages and contains specific allegations of the unauthorized deficiencies in the construction, it sufficiently states a claim for damages for the negligent construction and for a **breach** of contract. An allegation that a general contractor performed under a written construction contract which provided for payment as the work progressed, and that the Owner failed to pay, is sufficient to support a judgment for **breach** of contract.

An "express warranty" cause of action brought by the Owners of homes against the builders is properly dismissed when it fails to state the terms of the warranties and the *Owners'* reliance on those warrantees.

When Performance is Excused or Prevented because of Defendant's Breach

When there is an excuse from or prevention of rendering a full performance because of the defendant's **breach**, it is the plaintiff's burden to give the jury the necessary data from which they can compute the resulting damages; this consists of (1) the contract price and (2) what it will cost the plaintiff to complete the performance.[38]

THE REMEDIES FOR NON-PERFORMANCE

A. Contractors' Remedies Against the Owner

When the *Owner* has breached the construction contract, there are several remedies available to the Contractor. First, the Contractor may in some cases stop performance of its work for the *Owner*'s non-payment if the contract so provides. If the contract does not contain a consequential damages waiver, the Contractor may seek consequential damages in some cases. Of course, the Contractor can sue the *Owner* for breach of contract. Suing an Owner for breach of contract is an action at law, the remedy for which is the recovery of money damages. In most contract lawsuits, however, there are limits on the amount that the Contractor may recover. A Contractor's recovery of damages for an Owner's breach of contract is generally intended to place the Contractor in the position it would have been in but for the breach. In other words, the Contractor gets to recover what was spent as a direct and proximate result of the Owner's breach. Such damages are said to be "compensatory" in that they compensate the plaintiff for what was spent because of the breach. There are even further limits on compensatory damages. The damages recoverable are limited to those that would have been reasonably foreseeable by the parties at the time of contracting.

Contractual Remedies Against the Sub-Contractors

In the event a Subcontractor breaches the contract with the Contractor, the Contractor may terminate the contract, seek damages, and/or withhold payment, depending on the circumstances. Depending on the nature of the breach, the Contractor typically seeks monetary damages to recover for the Subcontractor's breach. These damages could include cost to repair defective work, liquidated damages for delays, and consequential damages stemming from both. As a final option, the Contractor may sue its Subcontractor for breach of contract, breach of warranty, and negligence, in some cases.

Mechanic's Liens

Basis for the Right to Lien; Protecting the Right to Lien

Simply stated, a lien is a claim on the property of another as security for the payment of a debt. In the construction context, the mechanic's lien secures payment for labor or material furnished for the construction or repair of a house, building, or fixtures. Under the law most states, the lien also extends to improvements, land reclamation from overflow or railroads, and to each lot of land necessarily connected therewith. The lien does not extend to abutting

38 **13 Am. Jur. 2d Building, Etc. Contracts § 123**

sidewalks, streets, and utilities that are considered public property. Also, demolition or removal of improvements or structures is generally not lienable unless it can be considered "clearing of the land" as specifically defined within the Property Code. Additionally, mechanic's liens do not attach to personal property. Construction improvements generally are "fixtures" and are considered permanent improvements to real property which may have a mechanic's lien recorded against them.

The Owners' Remedies for Non-Performance

In the event a Contractor fails to perform its obligations, the *Owner* typically has several remedies available. Depending on the contract, the *Owner* may : 1) Stop or suspend the work upon written notification of default; 2) Withhold payment; 3) Terminate the contract, usually upon further written notification; 4) Self-perform any work not performed or performed defectively; and/or 5) Seek damages against the Contractor including actual damages, liquidated damages, consequential damages, and/or expenses including attorney's fees. Because Construction contracts vary as do the projects with which they are associated, several other remedies may be available to the *Owner* upon the Contractor's default. Some of these include issuing joint checks to Subcontractor's to whom the Contractor has failed to pay; deducting damages from payments to the Contractor, and withholding Certificates of Substantial and Final Completion.

Statutory Framework for Residential Construction Defect Disputes

The Mississippi State Board of Public Contractors is the contractor licensing authority for the state and is comprised of ten members appointed to staggered terms by the Governor. The Board members select the Executive Secretary for the agency and are responsible for setting policy for the licensing standards.

The Board includes: two road contractors; two building contractors; two residential builders; one electrical contractor; one plumbing or heat & air conditioner contractor; one water and sewer contractor; and one roofing contractor. There is also a five member residential standing committee

The MSBOC protects consumers by licensing and regulating Mississippi's construction industry. There are more than 12,000 licensed contractors in the state, with multiple licensing classifications. In addition to educating consumers about contractors and construction law, MSBOC activities include administering examinations to test prospective licensees, issuing licenses, investigating complaints against licensed and unlicensed contractors, issuing citations, suspending or revoking licenses, and seeking administrative, criminal, and civil sanctions against violators. In FY 2007/08 MSBOC obtained more than $250,000.00 in construction fines.

The MSBOC Statewide Investigative Team works to eliminate unlicensed contractors working in Mississippi. Focused- specifically targeted operations are conducted weekly around the state.

Special Problems: Licensing Violations; Residential Defect claims; Claims against Design Professionals

A house is generally a homeowners' single most valuable financial investment and one of the most important emotional investments. To them it is more than bricks and mortar; it is the place where they live, rest, and raise their families. Unfortunately, hundreds of thousands of unsuspecting homeowners realize their new homes suffer from some type of construction defect that will cost thousands of dollars to repair, depreciate the value of their home, or force them to leave their home.

Construction defects cover a broad spectrum from minor problems like popped nails and peeling paint to situations when a house must be bulldozed. Some cases involve leaky windows that have led to toxic-mold contamination. Other problems include faulty design, code violations, cracked foundations, substandard workmanship, and unsafe structures.

The number of construction-defect cases has surged in recent years because houses are being constructed in record numbers to meet the high demand for housing. Many general contractors are inexperienced and others mass produce thousands of houses. The home construction industry is intensely competitive. Many builders respond to the competition with low bids for contracts, then cut corners, and frequently employ unskilled or overworked subcontractors and poorly supervise subcontracted work. At a time when government regulation is more important than ever, government inspection departments do not have the funding to adequately inspect homes and often approve below-par construction. The combination of these factors results in homes that are built with serious defects.

Types of Construction Defects

Construction defects usually include any deficiency in the performing or furnishing of the design, planning, supervision, inspection, construction or observation of construction to any new home or building, where there is a failure to construct the building in a reasonably workmanlike manner and/or the structure fails to perform in the manner that is reasonably intended by the buyer. Some of the most common and high-cost construction defects include:

- Structural integrity - concrete, masonry & division, carpentry, unstable foundations
- Expansive soils
- Mechanical
- Electrical
- Water intrusion (often resulting in toxic mold)
- Thermal and moisture protection
- Doors, windows and glass
- Finishes

Construction Defect Litigation

Generally, courts categorize construction defects in one of four categories: design deficiencies, material deficiencies, construction deficiencies, or subsurface deficiencies.

Design Deficiencies: Design professionals, such as architects or engineers, who design buildings and systems do not always work as specified, which can result in a defect. Typical

design deficiencies relate to building outside of the specified code. Roofs are an example of a typical design defect that result in water penetration, intrusion, poor drainage, or inadequate structural support.

Material Deficiencies **:** The use of inferior building materials can cause significant problems, such as windows that leak or fail to perform and function adequately, even when properly installed. Window leaks can result from many things including, rough framing not being flush with outside at openings, improperly flashed windows, improperly applied building paper, window frame racked during storage/moving, lack of sheet metal drip edge above window header, etc. Common manufacturer problems with building materials can include deteriorating flashing, building paper, waterproofing membranes, asphalt roofing shingles, particle board, inferior drywall and other wall products used in wet and/or damp areas, such as bathrooms and laundry rooms.

Construction Deficiencies: Poor quality workmanship can result in a long list of defects. A typical example is water infiltration through some portion of the building structure, which may create an environment for the growth of mold. Other problems include cracks in foundations or walls, dry rotting of wood, electrical and mechanical problems, plumbing leaks, or pest infestation.

Subsurface Deficiencies: Expansive soil conditions are typical in California and Colorado, as well as other parts of the country. Many houses are built on hills or other areas where it is difficult to provide a stable foundation. A lack of a solid foundation may result in cracked foundations or floor slabs and other damage to the building. If subsurface conditions are not properly compacted and prepared for adequate drainage, it is likely the property will experience problems such as improperly settling to the ground (subsidence), the structure moving or shifting, flooding and in many cases more severe problems such as landslides.

Legal Theories

The typical construction defect cases is based on the contracts between the homeowner and developer and the contracts between the contractor and subcontractors, including suppliers, architects and engineers, involved in building the home. The goal is to require the party who is responsible for the defect to remedy the situation. The complaint against the defendants typically alleges negligence, breach of contract or warranty, strict liability, and in some instances fraud or negligent misrepresentation may be alleged.

Negligence

The law imposes the obligation upon the developer/general contractor/ subcontractor to exercise the reasonable degree of care, skill and knowledge that is ordinarily employed by such building professionals. The duty of care is extended to all who may foreseeably be injured by the construction defect, including subsequent purchasers. Developers and general contractors are responsible for the negligence of their subcontractor.

Breach of Contract

Homeowners can sue the builder/developer, under theories based upon privity of contract, for breach of any obligation set forth in the purchase and sale documentation, and/or the escrow instructions. Typically, this is something that goes beyond a failure of the builder to build the project in accordance with the plans and specifications.

When such claims are made, courts often invoke the doctrine of substantial performance, which typically requires the builder to pay the contract price with the deduction for the reduced market value of the home/unit caused by the failure of the builder to strictly comply with the plans and specifications.

Breach of Warranty

Similar to breach of contract theories, the purchase documentation between the developer and the homeowner often sets forth warranties regarding the condition of the property. If there is an issue as to breach of an express warranty, the principles of contract apply

Courts have held that builders and sellers of new construction should be held to what is implied, that the completed structure was designed and constructed in a reasonable workmanlike manner. A builder/vendor is subject to the theory that a home was built for sale to the public to be used for a specific purpose. Privity of contract is not always required under this particular theory of liability. In some states, homebuyers may waive or builders may disclaim implied warranties. If disclaimers are involved, they are strictly construed against the seller/developer. Typically, waivers are difficult to enforce.

Strict Liability Claims

In most jurisdictions, the implied warranty of habitability imposes strict liability on the general contractor. The theory of strict liability against a general contractor evolved from products liability law. In a strict liability case the plaintiff does not have to prove the general contractor or developer was negligent in the construction of the home. They do have to prove the defendant was involved in the mass production of housing, a defect in the house exists, damages were proximately caused by the defect, and the defendant caused or created the defect.

Fraud and Negligent Misrepresentation

Fraud is alleged on the grounds that the developer intentionally misrepresented the quality of construction in false statements or advertisements. It must be shown the developer had not intention of following the design plans and specifications as promised. Negligent misrepresentation is based on proving the developer asserted something as factual, but had not reasonable basis for believing the information to be true.

Remedies Against Subcontractors and Vendors

One of the serious risks of being a general contractor is that the general contractor is directly liable to the subcontractors and vendors, even if the Owner fails to pay the general contractor. An Owner may refuse to pay the general contractor or construction manager

because of a defect in the work of one subcontractor, and the general contractor will remain liable to all of the other subcontractors and vendors whose work was properly performed. The general contractor can end up being the de facto banker and guarantor for the Owner.

Licensing Problems in Mississippi

After Katrina millions of people returned to New Orleans and the Gulf Coast of Mississippi in order to rebuild and resume their lives, and many succeeded. But almost all struggled, and some were thwarted or endured unfair treatment along the way. Predators and abusive home repair contractors pocketed millions of dollars from thousands of victims. The surge of money to finance that rebuilding led to what Grant Hedgepeth, head of the Attorney General's consumer protection division, describes as "a deluge of home repair fraud complaints." There were many problems, according to the Mississippi Center for Justice, a nonprofit public interest law firm. Some contractors took advantage of inexperienced or desperate homeowners by demanding large up-front payments or making deals with other onerous terms. Others collected money from homeowners but did little or no work, or failed to complete the promised work satisfactorily. In some cases, contractors hired subcontractors but failed to pay them, and some of those subcontractors then filed liens against homeowners' properties. HomeOwners, especially those with low or moderate incomes, faced what Hedgepeth called "the realities of the construction business" in the wake of a disaster: "When a whole town is decimated, there are not enough construction workers to build it back and people are desperate."

E-discovery

Electronic discovery to any process in which electronic data is sought, located, secured, and searched with the intent of using it as evidence in a civil or criminal legal case. E-discovery can be carried out offline on a particular computer or it can be done in a network. Court-ordered or government sanctioned hacking for the purpose of obtaining critical evidence is also a type of e-discovery. The nature of digital data makes it extremely well-suited to investigation. For one thing, digital data can be electronically searched with ease, whereas paper documents must be scrutinized manually. Furthermore, digital data is difficult or impossible to completely destroy, particularly if it gets into a network. This is because the data appears on multiple hard drives and because digital files, even if deleted, can be undeleted. In fact, the only reliable way to destroy a computer file is to physically destroy every hard drive where the file has been stored.

In the process of electronic discovery, data of all types can serve as evidence. This can include text, images, calendar files, databases, spreadsheets, audio files, animation, Web sites and computer programs. Even malware such as viruses, Trojans and spyware can be secured and investigated. Email can be an especially valuable source of evidence in civil or criminal litigation, because people are often less careful in these exchanges than in hard copy correspondence such as written memos and postal letters.

Examples of the types of data included in e-discovery are e-mail, instant messaging chats, documents (such as Microsoft Office documents files), accounting databases, CAD/CAM files, Web sites, and any other electronically-stored information which could be relevant evidence in a law suit. Also included in e-discovery is "raw data" which Forensic Investigators can review for hidden evidence. The original file format is known as the "native" format.

Litigators may review material from e-discovery in one of several formats: printed paper, "native file," or as TIFF images.

Native format is increasingly the preferred choice for document review and involves the review of documents in their original file formats. This can require installation of the native applications, such as Microsoft Word in order to open a Microsoft Word document. Because there are hundreds of possible electronic file types, installing every application type could be a real challenge for reviewers. TIFFing involves the conversion of native files into an image format that does not require use of the native applications. If the native file contains multiple pages, then an electronic discovery vendor can convert each page into TIFF images (for example 10 images for a 10 page Microsoft Word document) for use in a discovery review database. More frequently, review applications now utilize special viewers, called embedded native viewers, that avoid the need to install native applications and also avoid having to convert native files into TIFF images, which can require significant storage space for large data sets. Documents that are produced are often numbered using Bates numbering. Individuals working in the field of electronic discovery commonly refer to the field as Litigation Support.

Electronic Message Archiving

Quite often, discovery evidence is either delayed or never produced, many times because of the inaccessibility of the data. ***Backup*** tapes can not be found, or are erased and reused. This kind of situation reached its apex during the *Zubulake v. UBS Warburg LLC l*awsuit. Throughout the case, the plaintiff claimed that the evidence needed to prove the case existed in emails stored on UBS' own computer systems.

Because the emails requested were either never found or destroyed, the court found that it was more likely that they existed than not. The court found that while the corporation's counsel directed that all potential discovery evidence, including emails, be preserved, the staff that the directive applied to did not follow through. This resulted in significant sanctions against UBS.

In 2006, the U.S. Supreme Court's amendments to the Federal Rules of Civil Procedure created a category for electronic records that, for the first time, explicitly named emails and instant message chats as likely records to be archived and produced when relevant. The rapid adoption of instant messaging as a business communications medium during the period 2005-2007 has made IM as ubiquitous in the workplace as email and created the need for companies to address archiving and retrieval of IM chats to the same extent they do for email.

With electronic message archiving in place for both email and IM it becomes a fairly simple task to retrieve any email or IM chat that might be used in e-discovery. Some archiving systems apply a unique code to each archived message or chat to establish authenticity. The systems prevent alterations to original messages, messages cannot be deleted, and the messages cannot be accessed by unauthorized persons.

Also important to complying with discovery of electronic records is the requirement that records be produced in a timely manner. The changes to the Federal Rules of Civil Procedure were the culmination of a period of debate and review that started in March 2000 when then Vice President Al Gore's fundraising activities were being probed by the United States Department of Justice. After White House counsel Beth Norton reported that it would take up to six months to search through 625 storage tapes, efforts began to mandate timelier discovery of electronic records.

Modern message archival systems allow legal and technology professionals to store and retrieve electronic messages efficiently and in a timely manner.

Claims against Design Professionals

The right to recover damages from a professional in a tort or contract action is based on the rendition of services by a person who claims to have special expertise, or who engages in a profession, trade, or business that requires special care, skill, knowledge, or experience. An engineer certainly qualifies as one who is a professional: that is, one who purports to be versed in the planning, design, construction, or management of machines, roads, buildings, or bridges; or one who possesses scientific knowledge in branches of this profession that deal in electrical, civil, mechanical, chemical, aeronautical/astronautical, or related disciplines. Each of these engineering endeavors qualifies as an activity for which a legal liability and negligence standard will apply.

The entire range of professional liability issues turns on the concept of duty. That is, one who undertakes to render professional services for another (usually a layman who is not versed in the professional service-provider's specialty) has a legal duty to exercise care in performing those services, and to meet a reasonable and accepted professional standard in performing the services. The negligent breach of either of these duties gives rise to a cause of action sounding in tort. For instance, a doctor may perform an acceptable surgical operation, but the doctor is negligent if he or she removes the patient's healthy left lung instead of the cancerous right lung. An accountant may perform accurate calculations on a client's income tax return, but if the accountant neglects to complete the calculations in time to have the tax return properly mailed to the Internal Revenue Service, then the accountant has breached a professional duty. And finally, an engineer may design a building that is structurally sound, but if the design does not also incorporate sufficient measures to ensure the safety of the building's occupants, then the engineer must answer for this breach of professional responsibility. Generally speaking, a person providing professional services is charged with a duty to exercise the degree of skill, care, and diligence that is commonly exercised by other members of the profession under similar circumstances.

The practice of engineering is commonly regulated by statute. The term "engineering" may be statutorily defined to include any service or creative work, the adequate performance of which requires education, training, and experience in the application of special knowledge of the mathematical, physical, and engineering sciences to such services or creative work as consultation, investigation, evaluation, planning, and design of engineering works and systems. Engineering encompasses the inspection of construction for the purpose of determining in general if the construction is proceeding in compliance with the drawings and

specifications related thereto. Engineering embraces services or work in the public or private domain, and in connection with utilities, structures, buildings, machines, equipment, processes, work systems, projects, and industrial or consumer products or equipment of a mechanical, electrical, hydraulic, pneumatic, or thermal nature.

Because only licensed professionals may legally practice engineering, the threshold question in many lawsuits for professional malpractice, or for breach of a professional services contract, is whether the acts in question would constitute the practice of engineering within the meaning of the pertinent statutes. If the defendant was engaged in the practice of engineering without a license, the defendant's unlicensed status may affect the plaintiff's ability to enforce a professional services contract, or to prosecute a professional liability lawsuit against the defendant. Because certain engineering services, such as construction management and construction inspection, often defy easy definition, activities that might appear to be professional in nature may be excluded by law or by definition in the professional services statutes, and an individual may therefore be allowed to engage in them without qualifying as a design or other engineering professional. Conversely, the mere fact that an engineering professional provides a service does not necessarily make that service "professional" by definition; and therefore the nonperformance or negligent performance of the service might not give the injured party the same rights and remedies he or she would have after the negligent performance of a professional service.

When an engineer is employed to work on a project, the engineer's professional duties are usually defined in a written contract for professional services. It might seem that the only cause of action for breach of professional duties would be a lawsuit sounding in contract. However, a tort action can be founded on proof that the engineer was hired to perform certain professional duties, that as a result of that contractual relationship the engineer owed a duty to properly render those services for the plaintiff's benefit, and that the engineer was negligent in the performance of these services.
When an engineer is employed in connection with a construction project, the project *Owner* may contract directly with the engineer, or the project *Owner* may contract with an architect who then employs the engineer as a subcontractor. If the project *Owner* has a direct contractual relationship with the architect, but not with the engineer, then the lack of privity between the architect's client and the engineer may raise an impediment to the client's prosecution of a tort or contract action against the engineer. Under traditional contract law, the client cannot sue for breach of contract unless there is privity of contract with the engineer, or unless the client is an intended third-party beneficiary of the engineer's agreement with the architect. Under traditional tort law, the courts will not recognize a tort action for economic damages or other injuries in the absence of privity of contract between the plaintiff and the defendant.

In an increasing number of jurisdictions, however, the courts refuse to accept the absence of privity of contract as a defense to an action for economic injuries arising from an engineer's negligent conduct, unless the plaintiff is beyond the foreseeable scope of harm that may result from negligent performance of the engineer's professional activities. In a construction project, the project Owner is clearly within the foreseeable scope of harm that may result from the engineer's negligence, so the Owner may recover economic damages from the engineer..

Some legal authorities characterize this particular breach of contract action as one that is derived from negligent conduct; that is, it may be prosecuted in tort, even though it arises in contract as a breach of an implied or express promise that the engineer will act with due care and with the skill demanded from an engineering professional. The cause of action derives from the privity of contract that is shared by the agreeing parties. Privity of contract is that connection or relationship that exists between two or more contracting parties, such that there exists between the plaintiff and the defendant a direct and associated chain of dependence for the agreed-on performance of their respective contractual obligations. While in past years privity was essential to the maintenance of an action on any contract, this theory has now been expanded by many courts to include the rights of third parties (either beneficiaries to the contract, or the general public) to sue for damages or injuries based on the performance, or lack of it, between the contracting parties.

A professional engineer may be held to owe a duty to a third party if the engineer makes representations of fact that are to be relied on by the third party. Professionals, including professional engineers, must maintain the highest standards in the performance of their obligations to those members of the general public who depend on professional skill, services, and expertise, whenever they contract to provide such services. Whether the plaintiff's cause of action is prosecuted in tort or contract, the engineer has a responsibility to the client to exercise reasonable care and skill in the performance of his or her professional duties. The central issue is therefore likely to be the same both in tort and in contract litigation: whether this degree of skill or care was met or exceeded by the engineering professional.

If an engineer expressly or impliedly contracts to accomplish (or to avoid) a particular result, the engineer may be held liable for breach of contract even if there is no negligence in the engineer's performance of his or her professional services. The engineer is liable for breach of a promise that the project will be designed and constructed to be fit for a particular use or a particular purpose.