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Plumb LAW

Beat It! You're Off the Project!

It's painful, it's incurable, and it's expensive—a default termination has all the symptoms of a fatal illness. You might loathe the subject of this article, but one day, it may mean the difference between a real business killer and the financial equivalent of a post-nasal drip.

First, absolutely never treat the threat of any default termination too lightly. A termination for default, or "T/D", can cause enormous financial losses and reputational injury which a contractor may not survive. Furthermore, the law does not have a way to fully reimburse a contractor when a termination was wrong.

Second, do not confuse a "termination for convenience", or "T/C", with a T/D. In a T/C, the Owner cancels a contract without claiming the contractor is at fault. The parties then negotiate close-out costs due the contractor, such as the value of completed work, demobilization and cancellation charges for ordered material. The Owner can only issue a T/C, however, if there is a T/C contract clause. Without one, the Owner is in breach of contract.

Many contractors have learned to cope with threatened terminations through "on-the-job" training. For a less expensive approach, keep the following items in mind:

1. Keep cool: Never lose your temper or try to "get" the Owner. For example, do not walk off the job, do not take things which you do not own, and do not make threats. Good architects fully understand the value of a project's smooth completion, so, try and accommodate any reasonable requests.

2. Respond in writing: Letters should always be sent in response to any accusations about poor contractor performance, including delay, and they should be written carefully because they can be used in court. T/D contract clauses generally contain time limits for responses, so be sure to follow them. Fault should not be admitted in writing, but if you are at fault, fix it. Never write more than necessary because the real facts may later prove your writings to be mistaken.

3. Demand a writing: Most contracts require a written "default status" letter and an architect's written recommendation before a T/D is issued. Get them and address each specified reason. If the Owner refuses to release them, send a letter saying so.

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The Termination Burdens

A contractor who claims that a termination was "wrongful" must prove it, including the damages it has suffered. But, terminations also place unusually heavy responsibilities or "burdens of proof" on contractors in the following two particular areas, and they should be very sensitive to them when documents and letters are sent to the Owner.

Termination for Default: Construction contracts typically provide for an architect's written recommendation in support of a termination, and historically, the courts gave them a lot of legal weight. But, a termination used to be automatically wrongful when the Owner obtained a defective one or did not obtain one at all. The New Jersey rule is changing, and its precise future is not clear. A properly written recommendation will not have as much legal weight, but a defective or omitted one will not automatically produce a wrongful termination.

Termination for Convenience: The law places a tough burden on contractors who think that an Owner's attempt to terminate a contract for convenience is a breach by the Owner of their contract. In a 2004 New Jersey decision called *Capital Safety, Inc. v. State of New Jersey*, the court wrote that the State did not breach the parties' contract when it terminated a contractor for convenience because the State was trying to avoid a potential delay claim by the contractor. While the court agreed that an Owner cannot act in "bad faith", this just means the Owner must not actually intend to cause harm to the contractor. Moreover, the court knew that the contractor was being forced to absorb ongoing delay damages because of the State's woefully inept project administration. Nonetheless, to "serve the financial interests of the State by avoiding exposure to a claim for additional delay damages" was not an "intent" to cause contractor harm, or a contract breach. That's favoritism--pure and simple.

Construction Liens

The New Jersey Supreme Court has cleaned up some unanswered questions under the Construction Lien Law involving the lien amount and the "lien fund". The "lien fund" is like an imaginary pot of money representing the maximum amount which a project owner must pay to satisfy any construction liens. Ordinarily, the lien fund is limited to the amount which a GC has earned but has not yet been paid.

First, the court imposed a new obligation on suppliers which functions like a reverse "trust fund" in public works construction. When a GC owes money to a supplier on several projects, and the supplier receives a partial payment from the GC which was not allocated to a particular project, then the supplier has a duty to inquire about the source of funds and to give a credit to whichever project owner the supplier believes to have paid them. Since construction liens must be reduced by the value of received payments, this reduces the amount of any supplier lien.

Second, the court decided that if a GC abandons construction, but the Owner had fully paid the GC for all its performed work, and if there were no unpaid retainage, then there is ordinarily no "lien fund". This is because the Owner would have paid everything to the GC which the GC had earned.

Finally, the Supreme Court also agreed that there are exceptions to these rules. Thus, an Owner might be liable to pay even more money in cases where there were negligent or knowing advance payments to the GC, payments to a GC in violation of the general contract, or collusive payments involving the Owner and GC .

We liked the Supreme Court's sharp analysis, but we must confess some bias: the opinion partly relied on a book which we co-authored shortly after the Construction Lien Law was first enacted. (*Craft v. Stevenson Lumber*).

Get Off the Project!

4. Use the contract's tools: Contract procedures governing claims, extra work, time extensions and the like must be followed. This will prevent the accidental waiver of a contractor's rights and it should encourage the owner/architect to commit to a written position.

5. Preserve "the record": Before the actual termination, take date-stamped pictures of everything in order to show its true condition at termination. Remove all documents from the site and preserve them safely. Duplicates can then be made before originals are given to the Owner. Save relevant samples for testing.

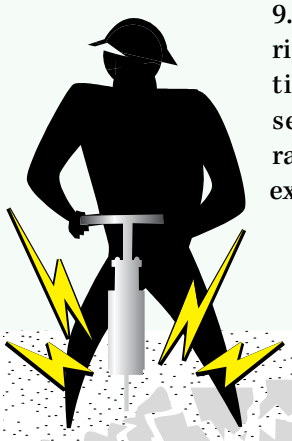
6. Protect your tools and equipment: After termination, the Owner has the right to keep the contractor's things until project completion. So, get them off the project before termination.

7. Keep the surety on your side: The contractor must convince the surety that the contractor did not breach the contract because a surety who believes that a T/D was properly issued must finish the job or pay for its completion. Completion costs are then charged to the contractor and its owners—and they will be high.

8. Keep your sub's on your side: Most sub's will share the pain of a termination, but an angry sub could support the Owner's claims. Formalize the pain-sharing in a contract called a "liquidating agreement".

10. Achieve substantial completion: The law radically reduces an Owner's potential damage claim at substantial completion, so, if it can be reasonably achieved, do so.

11. Keep dealing, even after termination: Projected losses and the threatened cost of litigation have a wonderful way of making unreasonable people change their tune. If a claim can be settled, protect against a "negative experience" contractor rating by converting the T/D into a T/C or the equivalent.



9. File liens: Protect your payment rights by "liening" the job. A poorly timed filing could impede any settlement discussions, but it is rarely wise to allow time limits to expire.

12. If a T/D termination occurs, and the dispute is not settled, move quickly to litigation or arbitration. The contractor should be recognized as the injured party.

Finally, remember an ancient "Klingon" proverb after the judge finds in your favor: revenge is a dish which is best served cold.

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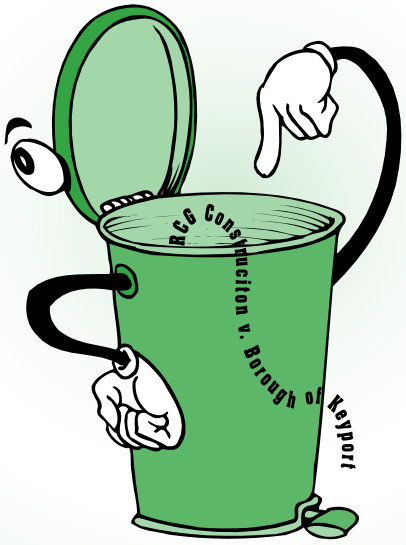
Galloping Gertie II: The State Strikes Back



We weren't the only ones who thought that the court decision called "RCG Construction v. Borough of Keyport" was a terrible piece of legal analysis. That's why we awarded it our "2003 Galloping Gertie Award" for the worst case of the year. In a direct slap at the collective faces of the New Jersey Supreme Court, the Governor has signed an amendment to the New Jersey Public Works Contractor Registration Act which wipes out that blot.

The court had decided that a GC's bid on a public works project need not be rejected by a public body even though one of the four mandatory, listed trade subcontractors was not registered at the time of bidding. Instead, the court wrote "we are confident that interpreting [the law] as requiring subcontractors to register before commencing performance on a public project will not compromise the underlying goals of the Legislature".

The court should have been less "confident". Almost immediately, the Legislature re-wrote the Registration Act to provide that each listed subcontractor in a GC's bid proposal must be registered at the time the GC submits its bid. This is plainly what the law meant from the beginning, and why the court's conclusion was so wrong.

Other Registration Act amendments make the law even more formidable. First, a GC or sub is no longer allowed to bid on or to perform work while an application for registration is pending. Second, each contractor must now submit certificates of registration to the public body from all listed sub's prior to any award. As a bonus, the amendment also eliminated a special interest exception in which projects for pumping stations, treatment plants and similar facilities were excluded from Registration Act coverage.

Public Bidding

Strict constructionists, take heart! Under the Local Public Contracts Law (or "LPCL"), a bidder's failure to identify subcontractors who will be used for four trades is "deemed a fatal defect". Its ramifications can be seen in two decisions by the New Jersey Appellate Division.

In one case, the court decided that it was "legal" for a GC to name a sub in its bid even though the sub had not been asked for a price quote beforehand. The LPCL does not include any explicit words which mandate pre-bid price quotes except when two subs are being used to perform a single trade's work. Thus, no requirement would be imposed.

But, the court also decided that the GC must use the listed sub. This means if there were no pre-bid price quote by the sub, then the GC must either accept the sub's negotiated price or lose the contract. (*Clyde N. Lattimer & Son Construction Co. v. Township of Monroe Utilities Authority*).

In another case, the court decided that the Legislature's use of the "fatal defect" phrase, in particular, meant that subcontractor lists were not just required for building construction but for all types.

Here, a GC omitted a list for a road construction project. To avoid acceptance of a higher bid, the public body argued that no list was needed because the LPCL only refers to the "construction, alteration or repair of any public building". The court wrote that the Legislature wanted the listing requirement to be strictly followed in all local public works construction, primarily because of the law's "fatal defect" language. So, the public body had to accept the higher, properly prepared bid. Interestingly, the LPCL's "public building" language is probably the result of old-fashioned grammar from earlier laws. Using modern grammar, the law would read: "construction, alteration or repair of any public building project." (*Star of the Sea Concrete Corp. v. Lucas Brothers, Inc.).*