

MINIMIZING RISK FOR GENERAL CONTRACTORS IN THESE CHALLENGING ECONOMIC TIMES

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The Construction Group at Murtha Cullina is pleased to provide clients and friends with information about topics of interest in the construction law area.

If you have questions about the issues addressed in this newsletter, or any other matters involving construction law issues, please feel free to contact any of our attorneys listed in this Alert.

Being a successful general contractor in this down economy is an extremely challenging task. With competition at an all time high, there are less projects to bid and margins are shrinking and, in some cases, disappearing. Despite fewer opportunities to make money, the contractor's risks and exposure remain the same or are worse. Here are some suggestions to help minimize risk as you weather this storm.

Know who you are doing business with before signing a contract - do your due diligence.

Oftentimes a contractor is reluctant at the beginning of a project to ask the owner for information about its financing or for information necessary to record a mechanic's lien, such as the exact name of the owner or the name of the title owner of record of the project site. Many contractors believe that asking such questions early in a project will hurt the contractor-owner relationship going forward. However, the contractor can explain to the owner that it is careful and prudent in all aspects of its work and because of that approach, asking these questions is important. A contractor should never hesitate to ask for this information as it is critical for evaluating and managing the risk the contractor is taking on by proceeding with the project.

- **Know who your owner is.** It is essential that the contractor know exactly who it is contracting with to build the project. Without knowing the legal name of the owner entity, a contractor cannot evaluate the risk of nonpayment. Armed with the exact name of the owner, the contractor can research the owner's background on the internet, run a Dun & Bradstreet® report, ask

industry contacts about the owner, hire an investigative firm to perform a background search or take other steps to gather as much information as possible to evaluate the risk of entering into a contract with this owner.

- **Know who owns the project land.** A contractor's lien rights attach to the land, provided that the contractor has a written contract with or consent of the owner of the land. If the contractor is performing work under a contract with a tenant, for example, the contractor's lien will attach only to the tenant's leasehold interest in the property, unless the property owner affirmatively consented to the contract between the contractor and tenant. The law in Massachusetts is not clear with regard to what evidences an owner's "consent" to a tenant's construction contract. For a Massachusetts project where a contractor is contracting with a tenant, the best way for the contractor to protect itself is to have the property owner sign a document in which the owner expressly acknowledges its consent to performance of the work by the general contractor for mechanic's lien purposes. If the contractor's agreement is with a person or entity with no legal interest in the property,

In Boston: 617.457.4000
In Hartford: 860.240.6000
In Madison: 203.245.9991
In New Haven: 203.772.7700
In Stamford: 203.653.5400
In Woburn: 781.933.5505

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the contractor will have no mechanic's lien rights. Unfortunately, such a document likely would be ineffective to establish consent in Connecticut. Connecticut courts have found that merely granting permission or acknowledging work being performed is insufficient to establish consent. To establish consent, one must show that the landlord had an "implied contract" to pay, which is often dependent on the terms of the lease.

- **Know your owner's financing.** Under the standard terms of the AIA A201 General Conditions, Article 2.2.1, the general contractor has a right to request evidence of the owner's financing before beginning or continuing to perform work on the project. Knowing the amount of the owner's financing and the terms on which the money is lent are essential to understanding the risk a project presents. If the project is being financed by a lender, a contractor should request a copy of the owner's sources and uses schedule, the commitment letter from the lender and/or the owner's loan agreement.

Make a fair and binding contract with the owner. Do not just sign the general contract that the owner presents. No matter how much you need the job or how much you "trust" the owner or have worked with the owner before, carefully review every contract your company is asked to sign and have your attorney review it as well. General contracts are fraught with provisions that create or increase a contractor's exposure. For example, provisions governing indemnity rights, payment terms, liquidated damages and damages limitations, if not modified through negotiation, can lead to situations that can devastate a company. Even a contract for a project with a small dollar value can result in exposure that far exceeds the value of the contract. The point is to review and negotiate fair contracts with owners and in doing so understand and take into account the risks as you proceed with the project.

It is also extremely important to carefully define the scope of the work for the project in the contract. This is another way the contractor can reduce its exposure to unforeseen costs. The scope of work should be as specific as possible, with express references to drawings and specifications. Further, the contractor should include its qualifications and assumptions in the contract in order to further clarify its responsibilities. Similarly, the contractor must ensure that this same scope of work is passed on to its subcontractors. An inconsistency between the owner-contractor scope of work and the contractor-subcontractor scope of work can expose the contractor to unanticipated costs.

After you have successfully negotiated the contract, make sure it is executed by both parties. Often times the parties work hard to hammer out a contract with one party signing the final version and the other party failing to sign it and instead letting it sit in a desk drawer. Although the party that did execute the contract has strong legal arguments that the contract is enforceable, the safest route is to have an original contract signed by both parties.

Record your lien at the beginning of the project. Massachusetts requires the filing of a Notice of Contract as the first step in establishing a mechanic's lien. Although a general contractor's Notice of Contract was often referred to as a "Notice of Conflict" prior to the 1996 amendments to the Mechanic's Lien Statute, the amendments changed the law such that recording a Notice of Contract did not disrupt an owner's project financing and thereby reduced the adversarial nature of the document. Upon execution of its contract with the owner, the general contractor should record its mechanic's lien. By establishing its lien at the beginning of the project, the contractor will have ensured that its lien will have the maximum priority that it is entitled to under the law.

Connecticut does not require the filing of a Notice of Contract to establish lien priority. Rather, in Connecticut, lien priority is determined from the date the contractor first supplies labor or materials to the job, not the date of filing.

Do not skimp on insurance. In addition to carefully negotiating contracts, another key way in which a contractor reduces its exposure is through insurance. In tough economic times, it is tempting to cut back on insurance coverage to save money on premiums. However, it is important for a contractor to maintain sufficient limits and types of coverage to protect itself against potentially devastating claims. Moreover, when negotiating its contract with an owner, the contractor should provide the owner's insurance requirements to the contractor's own insurance advisor to obtain confirmation that its coverage complies with the requirements and that the coverage is adequate. A contractor does not want to wait until a claim arises to discover that its coverage is inadequate. Not having the correct type of insurance or not having enough insurance can result in your company having to pay substantial damages and legal fees that otherwise would have been covered by insurance.

Know the warning signs. Prior to issues with payment arising on a project there are often warning signs. Paying attention to these signs can help you better secure

your rights to payment for work performed and help to guard against performing work for which you will not be paid. One such sign is late payments or payments for less than the full amount of the approved requisition. Also, mechanic's liens being recorded on the project property indicate that problems exist. The failure to formally approve legitimate change orders for time or money, or falsely accusatory communications (emails, letters, etc.) are other indicators that all is not well with the project. In addition, inaccurate job meeting minutes or "CYA" letters are tip-offs that there are potential issues on this project which you need to address. If you notice any of these warning signs, you should consult with your attorney as soon as possible.

The construction industry will continue to be ultra competitive and extremely challenging even after this latest economic crisis passes. Yet, even after this passes, a contractor will always face risk and exposure in this tough and demanding industry. That having been said, a contractor can increase its chances of success and reduce its exposure with careful business practices such as those described above.

ATTORNEY CONTACT INFORMATION

Sara P. Bryant
Phone: 617.457.4048
sbryant@murthalaw.com

Dena M. Castricone
Phone: 203.772.7767
dcastricone@murthalaw.com

Loring A. Cook, III
Phone: 617.457.4014
lcook@murthalaw.com

Sara A. Decatur
Phone: 617.457.4083
sdecatur@murthalaw.com

Michael J. Donnelly
Phone: 860.240.6058
mdonnelly@murthalaw.com

Daniel P. Elliott
Phone: 860.240.6052
delliott@murthalaw.com

Lauren R. Holland
Phone: 617.457.4134
lholland@murthalaw.com

Maury E. Lederman
Phone: 617.457.4133
mlederman@murthalaw.com

Andrew W. Lord
Phone: 860.240.6180
alord@murthalaw.com

James F. Radke
Phone: 617.457.4130
jradke@murthalaw.com

Richard J. Saletta
Phone: 617.457.4016
rsaletta@murthalaw.com

Robert L. Trowbridge
Phone: 860.240.6081
rtrowbridge@murthalaw.com

Andrew G. Wailgum
Phone: 617.457.4006
awailgum@murthalaw.com

Derek T. Werner
Phone: 860.240.6108
dwerner@murthalaw.com

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BOSTON

99 High Street
Boston, MA 02110
Tel: 617.457.4000
Fax: 617.482.3868

MADISON

71 Wall Street
Madison, CT 06443
Tel: 203.245.9991
Fax: 203.245.9997

STAMFORD

177 Broad Street
Stamford, CT 06901
Tel: 203.653.5400
Fax: 203.653.5444

HARTFORD

CityPlace I
185 Asylum Street
Hartford, CT 06103
Tel: 860.240.6000
Fax: 860.240.6150

NEW HAVEN

Whitney Grove Square
Two Whitney Avenue
New Haven, CT 06510
Tel: 203.772.7700
Fax: 203.772.7723

WOBURN

600 Unicorn Park Drive
Woburn, MA 01801
Tel: 781.933.5505
Fax: 781.933.1530