CHAPTER 2

CONTRACT TERMS AND PRESERVING RIGHTS

On default, the legal contract terms that seemed to be academic now dictate the rights to money. However, contract terms will not prevent all problems or make sure that you are held harmless. This is an unrealistic job description for any attorney or risk manager. If you do business with the wrong people, you will have problems. If you supply the wrong project, you will have problems. In most cases, business people put their contract documents in the file and never look at them again. If there are no problems, there is no need. If there are minor problems, business people usually discuss and resolve these issues in order to preserve relationships and keep moving forward. Contract terms usually do not matter. Does this mean contract terms are unimportant?

Contract terms are about leverage, cost and risk. If you end up in an unavoidable and irresolvable problem, your leverage, cost and risk determine whether you have profit or loss. In times of insolvency, mechanic's lien or other security rights may be the only avenue to be able to collect. Creditors must be sure contract terms do not waive those rights. Creditors also want to make sure that debtors are amply motivated to resolve the problem, raise the priority of the debt and encourage a quicker resolution. Contract terms can hold down costs in resolving the dispute, while making sure a debtor faces a cost penalty for avoiding resolution. You want to avoid risk and limit problems where possible. Contract terms will not avoid all problems for you, but you can lower the risk of a complete loss and lower the costs of problems. It is all about leverage, cost and risk.

This chapter will discuss:

1. Supplier Credit Applications and Proposals
2. Contractor Proposals and Contracts
3. Guaranties and Joint Check Agreements
4. Doing Business with Disadvantaged Business Enterprises
5. Reviewing and Revising Contracts Received
6. Contract Administration
7. Lien and Bond Claim Waivers

You should also review the chapter on Uniform Commercial Code Sale of Goods if your transaction involves buying or selling materials. The UCC adds many terms to an agreement to buy or sell materials. The chapter on Changes, Delays and Other Claims will discuss contract terms, contract administration and other legal issues peculiar to change orders, scheduling, delays and other claims.

Some of the following discussion applies only to suppliers; some applies only to subcontractors, while other parts are applicable to all contractors. In any event, all suppliers and contractors have something to learn in a discussion of construction contracting. We do not intend to be taking "one side or the other." The terms "seller" and "customer" or "buyer" are sometimes used instead of "general contractor," "subcontractor" or "supplier" to help avoid confusion or offense.

CONTRACTOR AND SUPPLIER CONTRACT FORMS

Contract terms are a credit management issue for contractors and suppliers (creditors) upon default. They will determine whether or not you collect all of your money. That is why powerful customers are so insistent on using their forms. Some customers very consciously set up a network of contract terms and corporate protection that allow them to unabashedly refuse payment if they get in trouble. With a marginal customer or project you want to be just as insistent on using your form or on modifying the customer's form to add important protection.

There are going to be a certain number of jobs in which you will have an opportunity to supply the contract, waiver, change order or other form. Surprisingly, many contractors and suppliers do not have their own forms for this purpose. *When you have the opportunity to supply the form for a transaction, use a custom form that protects your interest*.

These forms can be produced at a low cost and can return your investment many times over. It will only hurt for a little while. You must only spend a few hours and a few hundred dollars with a good lawyer to review your current forms and develop better forms for your use. Once you have gone through this process and make the right forms available to your staff, they will not take any longer to use than your current forms. This is working smarter, not working harder. Examples of such forms are included in the Appendices.

Supplier Credit Applications and Proposals

The Credit Application shown in the Appendices can be used to qualify customers. Some customers will complete this application, as would a borrower from a bank. Even if a customer will not complete this form, it will remind you about the various pieces of information that you should collect. Fill the form out as you gather information from various sources.

The Credit Application shown in the Appendices contains information that will be very important in the event of a default. If you know where a customer works or banks, for example, you may be able to file garnishments after obtaining a judgment. It is much easier to get this type of information from your customer while you are still friends.

This form also includes important legal terms in the "Terms and Conditions" section, some of which are discussed below.

Service Charges and Attorney's Fees

Most credit managers already know about attorney's fee provisions. This may be the most important contract term in the event of default, however, and is an excellent example of the concept of leverage. Legal costs are one of the reasons you try to avoid and settle disputes. If the dispute will cost you more in legal fees than your debtor, you have bad leverage. The buyer is already holding your money for the materials. The dispute is more of a problem for you than it is for your debtor. You must reverse that leverage and make sure the debtor will pay a penalty for the dispute and, therefore, is motivated to resolve the dispute.

If an attorney is necessary to collect your account, this will eat up all of your profit. You want a chance to get this profit back. The usual rule in the U.S. is that no attorney's fees can be recovered unless the defendant has agreed *in writing* to pay attorney's fees.[1] A judge is absolutely powerless to award you legal fees unless you have a contract with the debtor in which the debtor has agreed to pay your legal fees in the event of a dispute. On the other hand, do not make the mistake of thinking that a contractual legal fee provision will guarantee that you will get legal fees.[2] Legal fees and interest are almost always discretionary for the judge.[3] If the case is a "good faith dispute" that the judge thinks is a difficult decision, there is a good chance the judge will award judgment, but without legal fees.[4] Similarly, judges will often refuse to award prejudgment interest,[5] although prejudgment interest is mandatory under some state laws.[6] However, creditors are usually always entitled to interest from the date of judgment.

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[1] *Dewberry & Davis, Inc. v. C3NS, Inc.*, 284 Va. 485, 495, 732 S.E.2d 239 (2012), *citing Ulloa v. QSP, Inc.*, 271 Va. 72, 81, 624 S.E.2d 43, 49 (2006) to say that under the so-called "American rule," a prevailing party generally cannot recover attorneys' fees from the losing party. This rule, however, does not prevent parties to a contract from adopting provisions that shift the responsibility of attorneys' fees to the losing party in disputes involving the contract.

[2] *Dewberry & Davis, Inc. v. C3NS, Inc.*, 284 Va. 485, 495,732 S.E.2d 239 (2012) [A prevailing party who seeks to recover attorneys' fees pursuant to a contractual provision has the burden to present a *prima facie* case that the requested fees are reasonable and necessary, *citing Chawla v. BurgerBusters, Inc*., 255 Va. 616, 623, 499 S.E.2d 829, 833 (1998); *see also Seyfarth, Shaw, Fairweather & Geraldson v. Lake Fairfax Seven Ltd. P'ship*, 253 Va. 93, 96, 480 S.E.2d 471, 473 (1997)].

[3] *Myers v. Kayhoe*, 391 Md. 188, 207, 892 A.2d 520, 532 (2006), holding that when there are contract provisions requiring the award of attorneys' fees to the prevailing party, the amount of the fees to be awarded is "within the sound discretion of the trial court."

[4] *But see Dewberry & Davis, Inc. v. C3NS, Inc.*, 284 Va. 485, 496, 732 S.E.2d 239 (2012) [A trial court may, when determining the reasonableness of the fees and expenses claimed by a prevailing party, deduct from the award any fees and expenses associated with claims and defenses the court views to be frivolous, spurious, or unnecessary. However, "[c]ourts will not rewrite contracts; parties to a contract will be held to the terms upon which they agreed." The trial court should not have reduced the attorney fee award to one dollar ($1) because it had been a good faith dispute. The trial court should only determine whether the fees were reasonable, necessary and appropriate].

[5] *Continental Ins. Co. v. City of Virginia Beach*, 908 F. Supp. 341, 349 (E.D. Va. 1995) [The Court is hesitant to award any party prejudgment interest in a case such as this, where the problems arose over the interpretation of a contract, prejudgment interest is high, and both parties acted in good faith]; *Maksymchuk v. Frank*, 987 F.2d 1072, 1077 (4th Cir. Md. 1993) (The award of prejudgment interest is within the discretion of the district court); *McDevitt & Street Co. v. Marriott Corp*., 754 F. Supp. 513, 515 (E.D. Va. 1991) [District courts must weigh the equities in a particular case to determine whether an award of prejudgment interest is appropriate].

[6] *Turner Constr. Co. v. First Indem. of Am. Ins. Co*., 829 F. Supp. 752, 762 (E.D. Pa. 1993) [the Pennsylvania Supreme Court directs that in all cases of contract, interest is allowable at the legal rate from the time payment is withheld after it has become the duty of the debtor

A high service charge such as 1% or 2% per month is a way to partially collect your own high internal administrative cost for dealing with default. Your credit manager and sales staff will lose time and money dealing with default. Service charges will help recoup these administrative costs. This is also an important penalty to a debtor for making you wait. You may rarely actually charge or collect service charges, but it helps move the debtor along and get your payments in. In some states, it is important to say that this higher rate will apply both "before and after judgment." Otherwise some states will apply a lower "judgment rate of interest" after judgment.

Many frustrated sellers have waited a year for payment, gone through frustrating litigation, heard the court rule that the seller "wins" and collected $10,000, only to be handed a legal bill for $12,000. If your contract does not have a provision for attorney's fees, there is no way that the legal process can make you whole. You will always be faced with a partial payout. Many "smart" customers in default will propose a settlement for less than you are owed. They will tell you how you will have to sue, and then wait many months and pay attorney's fees. If you have service charge and attorney's fee clauses, you can tell the customer how they will pay more by employing this tactic.

You have to make sure that the customer pays a penalty for making you wait a long time for payment. If you have no attorney's fee or service charge clauses, the most the debtor will ever have to pay is principal (and perhaps legal interest). The debtor has less incentive to pay you sooner and is more likely to make you wait, make you act as the debtor's bank and make you incur legal fees. If the debtor will pay a penalty comprising your legal fees on top of his legal fees, the debtor is more likely to decide that paying you sooner is the best business decision. This "leverage" helps get you resolutions of disputes on accounts. An attorney's fee clause, in other words, makes it less likely your attorney will have a job.

We also recommend identifying a specific percentage for attorney's fees, rather than stating that the debtor will pay "reasonable" attorney's fees. The word "reasonable" can lead to arguments about what is reasonable. In some states, the creditor must actually bring in an expert witness to help the court determine what is "reasonable."[7] This means the creditor must hire a second lawyer to be a witness on the attorney fee issue. This adds considerably to the cost of collection. If the debtor has agreed to pay 33% of the debt as attorney's fees, it is more likely the court will award this amount without the need for an expert witness and even if actual attorney's fees were lower. It is normally still in the court's discretion, however, to award a lower amount of legal fees.[8]

The following clause accomplishes all of these objectives:

> Customer agrees that any amount not paid within 30 days of invoice date will carry interest at the rate of 1½% per month, both before and after judgment, and further agrees to pay all costs incurred in collection, including attorney's fees in the amount of 1/3 of the total balance due if this account is placed with an attorney for collection, whether suit is filed or not.

Notice, however, that this clause entitles you to legal fees only in the event of a payment dispute. You could not get legal fees in the event of another type of dispute. For example, the customer or some third party could sue you for defective material or personal injury. To cover this, you would also need to add a clause stating:

> Customer further agrees to pay all costs incurred by Seller, including reasonable attorney's fees, in the event of any other dispute arising out of or related to this agreement.

Trust Fund Agreement

Trust Fund Statutes and Trust Fund Agreements are discussed in detail in another chapter of this book.[9] However, they are an important and underutilized opportunity for credit agreements and other contracts.

Suppose a bankrupt debtor is the trustee on his niece's college tuition trust fund. The bankruptcy debtor's creditors cannot attach this college trust fund, because it is not the bankruptcy debtor's money. The money belongs

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to make the payment. Allowance of interest does not depend upon discretion but is a legal right; *citing Palmgreen v. Palmer's Garage, Inc*., 383 Pa. 105, 108, 117 A.2d 721, 722 (1955)]; D.C. Code §15-108.

[7] *Mullins v. Richlands Nat'l Bank*, 241 Va. 447, 403 S.E.2d 334 (1991), *but see Monmouth Meadows Homeowners Ass'n v. Hamilton*, 416 Md. 325, 338, 7 A.3d 1 (2010), ftn. 12.

[8] *Monmouth Meadows Homeowners Ass'n v. Hamilton*, 416 Md. 325, 333, 7 A.3d 1 (2010); *but see Dewberry & Davis, Inc. v. C3NS, Inc*., 284 Va. 485, 496, 732 S.E.2d 239 (2012) [Courts will not rewrite contracts; parties to a contract will be held to the terms upon which they agreed].

[9] *See* chapter, Trust Fund Laws and Agreements.

to the niece. The trustee has only "legal" title. The niece is the "beneficiary" of the trust and has "equitable" title to the money.

Some states have trust fund "statutes" or laws to protect subcontractors and suppliers in the construction industry, including Maryland, New York and New Jersey. When a general contractor receives payment from the construction project owner, the general contractor holds funds in trust for the benefit of the subcontractors and suppliers. Subcontractors then hold funds in trust for their suppliers and sub-subcontractors.

Even in states without trust fund laws, it is possible to create a trust fund relationship by agreement. This works just like a bank trust fund (or the college tuition trust fund for the niece) and would apply in any non-construction industry. It is possible to add clear trust language to a joint check agreement, credit agreement, proposal or to any contract with just a few sentences.

> Customer agrees that all funds owed to Customer from anyone or received by Customer, to the extent those funds result from the labor or materials supplied by Seller, shall be held in trust for the benefit of Seller (Trust Funds). Customer agrees it has no interest in Trust Funds held by anyone, to segregate and to make no use of, except to promptly account for and transmit to Seller all such Trust Funds no later than on demand.

We believe that this language creates a trust fund relationship that should work just like the trust fund laws. Your debtor agrees that all funds received are held in trust, to the extent funds result from your labor or materials. If your debtor files bankruptcy, these funds will not be property of the bankrupt estate. You will not need to share with the general unsecured creditors and should be able to keep these funds as the trust beneficiary.

This language should also be relatively easy to "sell" to a customer on a credit agreement or proposal. The customer certainly intends to pay you promptly on receipt of funds. That is all this language says. It does not create any additional burden or cost on the customer. The issue is whether you would have to "share" this receivable with your customer's other creditors in the unlikely event of insolvency. This language allows you to identify your customer's receivable as produced or created by the labor and materials you supplied and claim ownership of that receivable.

Since your debtor is never the owner of trust funds, it is also impossible for the debtor to grant a security interest in trust funds. The trustee could not give away or sell trust property, since a trustee does not have title. The beneficiary of the trust could claim ownership of the trust property, even in the hands of third parties. By the same token, a trustee cannot grant an effective security interest in trust property. The trustee has no good title to sell, give away or grant a security interest in trust property.

Accordingly, trust fund laws or agreements are one way that a vendor can gain priority over a customer's bank that has a blanket security interest on receivables. This also makes sense. You are essentially saying to a customer that you will not give them the value of your labor and materials if some other lender will have priority over the receivable that is generated by the value you provide. You can refuse to supply labor or materials unless you will have absolute first priority to the value you provided. This absolute first priority is a trust fund agreement.

In the event of bankruptcy, the trust funds held for the benefit of subcontractors and suppliers do not become a part of the bankruptcy estate. While the creditor may need to get appropriate bankruptcy orders, the creditor may be entitled to payment directly from an owner or general contractor. A trust fund claimant may even be able to obtain payment from the bankruptcy estate, by bankruptcy court order, since trust funds are not property of the bankruptcy estate and always belong to the beneficiary.

Trust fund laws or agreements can also be very helpful in "preference" litigation.[10] If a creditor received payments less than 90 days before a bankruptcy, the creditor may have to give the money back as a "preference." If a trust fund law or agreement applied, however, the payment cannot be a preference. The debtor was giving you your own money. It was never the debtor's property and was not a payment from the debtor.

Trust fund agreements may be more effective in contracts, proposals, joint check agreements or other agreements created for a particular project for a particular owner. There is no downside, however, to putting a blanket trust agreement in your credit agreement to cover all sales to this customer.

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[10] *See* chapter, Bankruptcy Primer for Creditors; section, Preferences; subsection, The Trustee's Burden of Proof.

Limitation of Liability

A buyer can agree that remedies will be limited for any breach of contract by a seller. One example would be an exclusion of express or implied warranties, discussed below.

Where sophisticated business professionals enter into an arms-length transaction, a court will enforce the terms of the agreement between them, unless it is unreasonable or unjust.[11] When an agreement is plain and unambiguous in its terms, it has full effect.[12] Construction industry buyers and sellers are sophisticated business people. If they waive warranties or limit liability in contract documents, they will be held to those terms. These terms could even be inserted during the "Battle of the Forms" in a response or confirmation without the actual knowledge of the buyer.[13]

A buyer can be bound to limits of liability and exclusions of warranties in a credit agreement for any sales of goods after the credit agreement is signed. A buyer can also be bound to these same limits of liability and exclusions of warranty if they are stated in each proposal for each individual sale of goods.[14]

The sample Credit Application and Supplier Proposal shown in the Appendices state:

> Seller agrees to replace or, at Seller's option, repair any defective goods within a reasonable time. Customer's remedies for any delay or any defect in the materials are subject to and limited by any limitations contained in the manufacturer's terms and conditions to Seller. Further, Customer's sole and exclusive remedy and Seller's limit of liability for any and all loss or damage resulting for breach of warranty, from defective or non-conforming goods or any other cause shall be for the purchase price paid for the particular delivery and materials with respect to which loss or damage is claimed, plus any transportation charges actually paid by the Customer. THE FOREGOING WARRANTY IS IN LIEU OF ALL OTHER WARRANTIES, WHETHER WRITTEN, ORAL, EXPRESS OR IMPLIED, INCLUDING THE WARRANTY OF TITLE, AGAINST LIENS, INFRINGEMENT, THE WARRANTY OF MERCHANTABILITY AND THE WARRANTY OF FITNESS FOR A PARTICULAR PURPOSE. IN NO EVENT SHALL SELLER OR ANY OF THEIR PARENTS OR AFFILIATES, OR ANY OF ITS/THEIR RESPECTIVE DIRECTORS, OFFICERS, EMPLOYEES OR REPRESENTATIVES, BE LIABLE HEREUNDER OR IN CONNECTION HEREWITH FOR ANY SPECIAL, RELIANCE, CONSEQUENTIAL, DELAY, EXEMPLARY, PUNITIVE, INCIDENTAL, LIQUIDATED, OR INDIRECT DAMAGES, INCLUDING WITHOUT LIMITATION, FOR LOSS OF PROFITS, INCOME, USE, OR TIME, WHETHER IN CONTRACT, TORT, OR OTHERWISE.
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> Customer shall make a careful inspection at the time of delivery. Customer's failure to give written notice specifying any claim within ten (10) days of delivery shall constitute an unqualified acceptance of the labor and material as shown on delivery tickets and a waiver of all claims of shortages, damage or defect or any other claim. Seller will not be liable for any damage, warranty or remedy and back charges will not be accepted without prior notification, an opportunity to view and repair, replace or otherwise cure, and approval by Seller. No returned product will be accepted without prior approval. A restocking charge of 25% will apply on products approved for refund. Seller may stop the manufacture or supply of any labor or materials when it, in its sole discretion, determines that Customer is in breach of this Agreement or any other contract with Seller, or Seller has insecurity with respect to funding or creditworthiness, until payment is made and any dispute or insecurity has been resolved.

These provisions evidence a clear intent to create a comprehensive set of remedies. First, the limitations in any manufacturer's warranty are passed on to a buyer. This creates a "conduit relationship" for a distributor that did not manufacturer the goods. The eventual buyer and end user is limited to the manufacturer's warranties and remedies. The "middleman" distributor cannot be responsible for more than the manufacturer.

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[11] *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 92 S.Ct. 1907, 32 L.Ed.2d 513 (1972).

[12] *McLean House v. Maichak*, 231 Va. 347, 349, 344 S.E.2d 889, 890 (1986); *Gordonsville Energy v. Virginia Elec. & Power Co.*, 257 Va. 344, 354, 512 S.E.2d 811, 817 (1999) [reiterating that "when contract terms are clear and unambiguous, the words used by the parties must be given their plain and ordinary meaning"].

[13] *See* chapter, The Uniform Commercial Code Sale of Goods; section, Formation and Modification of Contract; subsection, Battle of the Forms.

[14] UCC Section 2-207; *See e.g., Foley Co. v. Phoenix Engineering & Supply Co.*, 819 F.2d 60 (4th Cir. 1987) and *Moore Electrical Contractor, Inc. v. Westinghouse Electrical Supply Co.*, 221 Va. 745, 273 S.E.2d 553 (1981).

These provisions also limit a buyer's remedies to return of the goods and repayment of the price or to repair and replacement of non-conforming goods.[15] This could eliminate the potential for any claim or counterclaim against a seller for allegedly defective material, if the buyer has not paid the purchase price. A buyer would have at most a defense to a seller's claim for the unpaid purchase price. If the seller repairs or replaces any defective goods within a reasonable time, the buyer would owe the full purchase price.[16]

It is probably important to be clear in a contract that these remedies are "sole and exclusive." Remedies for breach of contract or breach of warranty are generally cumulative. Saying a buyer has one remedy does not necessarily mean that all other remedies are excluded.[17]

A buyer can also waive incidental, consequential, special, punitive or delay damages. Consequential damages are discussed in greater detail in another chapter of this book.[18] However, it is possible to waive the right to consequential damages in a contract, just as it is possible to waive other remedies. It also is possible to waive damages for delay in a "no damage for delay" clause. This is discussed in greater detail in another chapter of this book.[19] In short, however, suppliers do want the above Limitation of Liability provision in their credit applications and proposals.

Exclusion of Warranties

Express and implied warranties under the Uniform Commercial Code are discussed in detail in another chapter of this book.[20] Express and implied warranties are cumulative. In other words, a buyer would have the choice of suing under an express written warranty or an implied warranty or both. Even if an express warranty is offered, the seller must carefully exclude any implied warranty.

The UCC permits disclaimers of express warranty.[21] If a seller has excluded all express warranties, it does not matter what any salespeople may have said in any meetings. The buyer has agreed in advance not to rely on any oral statement.[22]

An exclusion of warranty should be "conspicuous." This is why you often see such language in large print, all caps, in a contract or written warranty. This would make the exclusions conspicuous as a matter of law.[23]

> Seller agrees to replace or, at Seller's option, repair any defective goods within a reasonable time. Customer's remedies for any delay or any defect in the materials are subject to and limited by any limitations contained in the manufacturer's terms and conditions to Seller. Further, Customer's sole and exclusive remedy and Seller's limit of liability for any and all loss or damage resulting for breach of warranty, from defective or non-conforming goods or any other cause shall be for the purchase price paid for the particular delivery and materials with respect to which loss or damage is claimed, plus any transportation charges actually paid by the Customer. THE FOREGOING WARRANTY IS IN LIEU OF ALL OTHER WARRANTIES, WHETHER WRITTEN, ORAL, EXPRESS OR IMPLIED, INCLUDING THE WARRANTY OF TITLE, AGAINST LIENS, INFRINGEMENT, THE WARRANTY OF MERCHANTABILITY AND THE WARRANTY OF FITNESS FOR A PARTICULAR PURPOSE. IN NO EVENT SHALL SELLER OR ANY OF THEIR PARENTS OR AFFILIATES, OR ANY OF ITS/THEIR RESPECTIVE DIRECTORS, OFFICERS, EMPLOYEES OR REPRESENTATIVES, BE LIABLE HEREUNDER OR IN CONNECTION HEREWITH FOR ANY SPECIAL, RELIANCE, CONSEQUENTIAL, DELAY, EXEMPLARY, PUNITIVE, INCIDENTAL,

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[15] UCC Section 2-719(1)(a).

[16] *Marr Enterprises, Inc. v. Lewis Refrigeration Co.*, 556 F.2d 951, 955 (9th Cir. 1977).

[17] UCC Section 2-719(1)(b).

[18] *See* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsection, Waiver of Consequential Damages.

[19] *See* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsection, No Damage for Delay.

[20] *See* chapter, The Uniform Commercial Code Sale of Goods; section, Contract Interpretation; subsection, Warranties.

[21] UCC Section 2-316(1) states, "Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other..." *See also Buettner v. R.W. Martin & Sons, Inc.*, 47 F.3d 116 (4th Cir. 1994) [Express warranty disclaimer between a seller and a buyer was valid and enforceable, even against a third party].

[22] *King Industries, Inc. v. Worlco Data Systems, Inc.*, 736 F. Supp 114, 118 (E.D.Va. 1989) *citing Hill v. BASF Wyandotte Corp.*, 696 F.2d 287, 291 (4th Cir. 1982) [the parol evidence rule precludes the admission of oral statements which contradict the terms of a written disclaimer].

[23] *Armco, Inc. v. New Horizon Dev. Co.*, 229 Va. 561, 567, 331 S.E.2d 456, 460 (1985).

LIQUIDATED, OR INDIRECT DAMAGES, INCLUDING WITHOUT LIMITATION, FOR LOSS OF PROFITS, INCOME, USE, OR TIME, WHETHER IN CONTRACT, TORT, OR OTHERWISE.

The smaller wording at the beginning of this paragraph describes the limited warranty provided. The "conspicuous" language in large print, all caps, waives express and implied warranties.

In a construction context, a materials supplier will normally supply goods to a subcontractor, who then supplies the goods to a general contractor, who then supplies the goods to a real estate owner. The general contractor and owner are "third parties" to the supply contract between the supplier and subcontractor. The general contractor and owner do not have "privity of contract" with the supplier.

Third parties, with no privity of contract, cannot normally make a claim for breach of contract. The third party owner or general contractor *has no contract* with the supplier. The Uniform Commercial Code has an exception to the normal privity of contract rule stating that "[l]ack of privity ... shall be no defense in any action brought against the ... seller of goods to recover damages from breach of warranty ..."[24] If you buy a malfunctioning dishwasher from a department store, you can sue the manufacturer under the UCC, even though you have no privity of contract with the manufacturer.

However, recovery for breach of warranty for a third party not in privity is limited to the warranty that exists between the contracting parties.[25] If the original contract of sale excluded or modified warranties or remedies for breach, such provisions are equally operative against beneficiaries of warranties under this section.[26] In other words, if a material supplier had excluded express and implied warranties in its contract with the subcontractor, these warranties are also excluded to the general contractor or owner. The end user of a product can enjoy no more contractual rights than are enjoyed by the original purchaser."[27]

Material sellers should consider adding language to their credit agreements and proposals that exclude warranties and limit the buyer's remedies and the seller's liability for damages.

Notice of Breach to Seller

The Uniform Commercial Code Section 2-607(3) states that when a buyer has accepted goods, the buyer must notify the seller within a reasonable time after the buyer discovers or should have discovered any breach—or be barred from any remedy.[28] This generally means that a buyer has to notify a seller fairly promptly after delivery if there are any defects in the material. Otherwise, the buyer will lose the right to claim breach of contract or breach of warranty.[29]

This code section is helpful to a seller, especially where a buyer waits to complain of problems until after the seller files suit to collect the purchase price. However, the UCC probably does not require written notice or a complete statement of defect[30] and a buyer may claim that notice of defects was given verbally to employees of the seller. It is also not clear how long a buyer can wait to complain.[31]

These uncertainties can be eliminated in a contract term requiring written notice and an opportunity for the seller to cure within a defined period of time.

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[24] UCC Section 2-318.

[25] *See* chapter, The Uniform Commercial Code Sale of Goods; section, Remedies for Breach of Contract; subsection, Third Party Claims.

[26] UCC Section 2-318, Official Comment 1.

[27] *Buettner v. R.W. Martin & Sons, Inc.*, 47 F.3d 116, 119 (4th Cir. 1994).

[28] UCC Section 2-607(3).

[29] *Begley v. Jeep Corp*., 491 F. Supp. 63 (W.D. Va. 1980) [Whether plaintiffs gave defendants reasonable notice of breach of warranty is ordinarily a question of fact reserved for the jury; however, if the evidence is clear, the court can rule as a matter of law that a party failed to give proper notice. Plaintiffs violated the letter and spirit of by waiting over two years to give defendants notice and sanction of dismissal should operate against them]; *Hebron v. American Isuzu Motors, Inc*., 60 F.3d 1095 (4th Cir. 1995) [a two-year delay in giving notice under subsection (3) was unreasonable as a matter of law where no explanation for the delay was provided and actual prejudice was sustained].

[30] *Cancun Adventure Tours, Inc. v. Underwater Designer Co*., 862 F.2d 1044 (4th Cir. 1988) [The provision does not require that notification include a clear statement of all objections. A buyer simply is required to notify the seller that the transaction is troublesome and should be watched]; *See also Virginia Transformer Corp. v. P.D. George Co.*, 932 F. Supp. 156 (W.D. Va. 1996).

[31] *Begley v. Jeep Corp*., 491 F. Supp. 63 (W.D. Va. 1980) [Plaintiffs violated the letter and spirit of the law by waiting over two years to give defendants notice and sanction of dismissal should operate against them]; *Hebron v. American Isuzu Motors, Inc*., 60 F.3d 1095 (4th Cir. 1995) [a two-year delay in giving notice under subsection (3) was unreasonable as a matter of law where no explanation for the delay was provided and actual prejudice was sustained].

> Buyer shall make a careful inspection at the time of delivery. Buyer's failure to give written notice specifying any claim within ten (10) days of delivery shall constitute an unqualified acceptance of the labor and material delivered and a waiver of all claims. Seller will not be liable for any damage, warranty or remedy and back charges will not be accepted without prior notification, an opportunity to view and repair, replace or otherwise cure, and approval by Seller. No returned product will be accepted without prior approval. A restocking charge of 25% will apply on products approved for refund.

The Right to Stop Work

Monitoring marginal projects is very important. If a problem is developing, you want to stop sending money out the door at the earliest possible stage. A seller must be concerned, however, with being declared in default for refusing to supply materials. Open account suppliers who have not agreed to supply any particular quantity of materials can generally stop shipment at any time. This is explained in greater detail in the Uniform Commercial Code chapter.[32]

If you have a contract with a defined scope of work or material quantities, however, you have an obligation to supply that scope of work in the scheduled time. Even if a customer is late in paying you, you may need to continue to send money out the door. It is very difficult to tell when a customer has breached the contract so completely that you have no further obligation.[33] The customer may be in breach for paying you late, but you also may be in breach for failing to supply in a timely manner.

Even suppliers with a defined scope of material quantities in a contract may be able to demand an "adequate assurance of due performance" from a buyer when the material supplier has reasonable grounds for "insecurity."[34] If a seller, for example, has reasonable grounds to believe that the buyer will be unable to make payment, that seller could demand an assurance that the buyer is capable of paying, before goods are delivered. The right to demand an "adequate assurance of due performance" comes from the Uniform Commercial Code.[35]

Suppliers prefer an express contract term allowing the supplier to stop supplying materials until disputes are resolved if a payment is not received *for any reason*. It is also important that this situation results in a time extension on the contract.

The contract term on the Credit Application and Supplier Proposal shown in the Appendices state:

> Seller shall have no obligation to begin or continue performance until adequate credit and funding information is provided, at any time on request of Seller. Seller may stop the manufacture or supply of any labor or materials when it, in its sole discretion, determines that Buyer is in breach of this Agreement or any other contract with Seller, or Seller has insecurity with respect to funding or creditworthiness, until payment is made and any dispute or insecurity has been resolved.
>
> In no event shall Seller be liable for any damage due to delay of any type, nor consequential, special or punitive damages.

This allows the seller to stop deliveries when it, in its sole discretion, determines that the customer's creditworthiness or funding is in question or that the customer is in breach. This term also states "seller shall not be responsible for damages due to delay of any type." This is known as a "no damage for delay" clause and is generally enforceable.[36] This clause, coupled with the right to stop work for non-payment, should protect sellers who desire to stop performance because of payment problems. This puts the pressure on the customer to resolve disputes with you and make payment.

Authorization to Run Credit Checks and Verify Funding

For small, closely held companies, it is always the best practice to obtain authorization to run both corporate and *individual* credit checks and to contact various references, including lenders.

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[32] *See* chapter on Uniform Commercial Code; section, Termination or Modification of Ongoing Supply Contracts.

[33] *See* chapter, Default and Termination; sections, The Right to Stop Work for Non-Payment, The Law and The Realities.

[34] UCC Section 2-609(1).

[35] *See* chapter, The Uniform Commercial Code Sale of Goods; section, Contract Performance and Breach; subsection, Right to Adequate Assurance of Performance.

[36] *See* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsection, No Damage for Delay.

> I/We authorize Seller from time to time to obtain Business and Consumer Credit Reports on Customer or any principals listed above or to obtain credit and funding information from any other persons or entities.

The Supplier Proposal includes an authorization to run credit reports on all of the individual officers, shareholders or partners listed in the application. Under the federal Fair Credit Reporting Act, it is still questionable whether the one officer signing the application can give you permission to run credit checks on the other non-signing officers.[37] Separate signatures are still preferable for this reason.

You have independent business reasons to ask each individual officer or partner to sign the Credit Application. If one officer signs a credit agreement and later leaves the business, the remaining partners may claim that the original signer was not authorized. If you are shipping materials on a long-term basis to a company, it is important to make sure that all partners, officers or owners are aware of the terms of credit. Therefore, your company asks that all officers sign the credit agreement. This ensures that you will be able to enforce your credit terms. It also means you have the right to run a personal credit report on all owners of the company that have signed the Credit Application, allowing you to accurately evaluate and predict the future credit relationship with the company.

The Personal Guaranty shown in the Appendices also contains an authorization to run personal credit reports. With this form, you have the right to run a personal credit report anytime you are getting a personal guaranty.

A construction seller should strive for a contract term allowing it to monitor the health of the project and adequate funding as often as necessary. It is also helpful to have the right to consult the architect, lender and any other persons who may have knowledge concerning the health of the project, funding, scheduling, expected changes and other matters. The terms above accomplish these objectives, including the right to verify adequate funds to complete the project before the project begins and at various later stages of the project. This is especially important when large change orders are requested or when it is apparent that the project schedule will be much longer than planned. At a minimum, the seller should be allowed to verify funding for change orders in excess of a certain dollar amount. The seller should have the contractual right to refuse to perform any further work if adequate funds cannot be established. A similar term actually appears in the standard AIA Document A201-2017 (General Conditions of the Contract for Construction).[38]

Forum Selection Clause

Your customer can agree to allow you to sue the customer in the court (forum) near your office.[39] The customer can even agree to file suit on your home turf, even if the customer initiates the litigation. This holds down your costs of litigation and increases the debtor's cost. This "leverage" helps the seller get a quicker resolution of accounts.

If you do not have this "Forum Selection" agreement, you will need to travel to the customer's home to litigate. The collection process will be more convenient for your customer, its lawyers and witnesses, while your litigation costs increase. You want a forum selection clause to help ensure that you will litigate any dispute on your home turf, hold down your costs and increase your customer's cost of litigation.

Similarly, you want the debtor to agree to submit to the "jurisdiction" in your forum state. This is a similar concept, but means that the debtor will not argue that your home court lacks jurisdiction or that constitutional due process prohibits your court from hearing the case.

Remember that it is different to say, "This agreement will be decided under the laws of Virginia." This is a "choice of law" provision. It does mean that the court must interpret your contract under Virginia law, but it does not guarantee that it will be a Virginia court making the decision. In other words, you may end up with a case in New York, where the New York court is required to figure out Virginia law to decide the case.

You want to make sure your credit agreements and other contracts state that the *forum* for litigation is your home county and state; that the debtor agrees to submit to *jurisdiction* there; and that the court will decide the case under the *law* of your home state. The following provision in the appendices accomplishes all of this:

> Customer expressly agrees to submit to personal jurisdiction in Virginia and agrees that the forum for any litigation pursuant to this Agreement or any other contract between Seller and Customer, whether

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[37] *See* chapter, Credit Management; section, Creditworthiness; subsection, Fair Credit Reporting Act (FCRA) and Equal Credit Opportunity Act (ECOA).

[38] *See* section below, Reviewing and Revising Contracts Received; subsection, Monitoring and Verifying Funds for the Project.

[39] *United States Smoke & Fire Curtain, LLC v. Bradley Lomas Electrolok, Ltd*, 612 Fed. Appx. 671, 672-673 (4th Cir. Va. 2015) [dispute-resolution provisions, such as forum-selection clauses, are enforceable beyond the expiration of the contract].

> Seller or Customer brings suit, shall be the County of Fairfax, Virginia. This Agreement shall be governed by and construed in accordance with the laws of Virginia.

Preservation of Security Rights

The following language concerning waivers should help avoid an accidental waiver of lien or bond rights and avoid bankruptcy preference claims:

> All mechanic's lien, payment bond or similar waivers or restrictive endorsements on checks shall be effective only to the total dollar amount of payments actually received without any bankruptcy filing for ninety (90) days thereafter. Customer agrees that Seller retains its mechanic's lien, payment bond or other legal rights for unpaid deliveries, regardless of what other waiver documents may imply otherwise. Customer further understands that Seller has a policy of enforcing mechanic's lien and payment bonds rights on all projects in the event of payment default and intends that all payments are in exchange for those rights.

Otherwise, some later contracts and progress payment waivers will waive *all* lien or bond rights, even for future deliveries or even though the seller has not been paid in full. This provision may not be enforceable against any owner or bank that is not a party to the credit agreement or contract. It is preferable to get this language in project specific supply contracts and even more important to get this language in all progress payment waivers signed. There is more information on this problem in the section below titled Waiver Forms.[40]

The last sentence may help establish a contemporaneous exchange defense to a future preference claim,[41] it may be necessary for the creditor to prove that the creditor was aware of mechanic's lien and payment bond rights, that the creditor would have enforced those rights if the payment was not received and that both the creditor and the debtor intended that the payment be in exchange for those mechanic's lien and payment bond rights.[42] Providing a waiver on payment may actually benefit a creditor for this reason. Again it is preferable to have the later waiver recite that the creditor is aware of its mechanic's lien and payment bond rights, intended to promptly enforce those rights in the absence of payment and is expressly waving those rights in exchange for payment. There is more information on this problem in the section below titled Waiver Forms.[43] The following sentence allows the seller to decide how to apply payments received:

> Seller has the right to determine, in its sole discretion, how to apply payments, and which invoices to pay with all payments received on this account, despite any advice to the contrary.

This may also help preserve mechanic's lien and bond rights if a debtor wants to argue that payments sent were intended for a job on which you are claiming mechanic's lien or bond rights. However, if you have reason to know for which project or invoices the payment was intended, you may be bound to apply the payment to those invoices. This provision may also not be enforceable against any owner or bank that is not a party to the contract.

Continuing Agreement

The third paragraph of "Terms and Conditions" of the Credit Application states that this credit agreement remains in force until the debtor has sent you "written notice closing this account mailed U.S. Mail Certified Return Receipt Requested." This makes it harder for a debtor to claim an old credit agreement is no longer in force or that it was applicable for only one project. For the same reason, it is better not to include "job information" on the credit agreement. Instead, use the separate Project Information Sheet shown in the Appendices. It is, of course, still a good practice to update all of your credit agreements on a periodic basis to get up-to-date information about the customer, its officers and stockholders.

It is also important to have any credit agreement state that you can "raise credit limits or change other terms at any time." On the one hand, this makes it clear that you have not promised to lend money. You can stop lending at any

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[40] *See* section below, Contract Administration; subsection, Waiver Forms.

[41] *See* chapter, Bankruptcy Primer for Creditors; section, Preferences; subsection Contemporaneous Exchange for New Value.

[42] *United Rentals, Inc. v. Angell*, 592 F.3d 525 (4th Cir. N.C. 2010).

[43] *See* section below, Contract Administration; subsection, Waiver Forms.

time. On the other hand, this also keeps a debtor (and especially a guarantor) from saying that the agreement is not enforceable because you lent more money than the stated credit limit.

Changes in Borrower Entity

You may have a long-term open account relationship with a small, closely held corporation. This small corporation may have signed your standard credit application many years ago. Ten years later, you sue on your credit agreement, only to find out that the "customer" on the credit application closed its business years ago. You are now dealing with the same people on the telephone everyday, but do not know you are dealing with a different corporation. Your "new customer" may claim that your credit agreement is not applicable to this new corporation and that you are not entitled to 2% service charges, attorney's fees or other credit agreement terms.

You are even more likely to have this problem with personal guaranties. The guarantor may claim that their guaranty applied only to sales for the earlier corporation. You may even find out that the person who gave you a guaranty is no longer involved in the corporation. You want to put the responsibility on the corporation or guarantors to inform you of such changes.

This is accomplished in the Credit Application and Personal Guaranty forms with the following:

> Customer further agrees to pay all amounts due under this Agreement until Seller has received written notice closing this account, mailed U.S. Mail Certified Return Receipt Requested. In the event other entities or individuals order or use the labor or materials pursuant to this Agreement, it is agreed that both the Customer and such other legal entities or individuals shall be obligated for all amounts due under this Agreement.

The Credit Application shown in the Appendices states that it remains in effect no matter what changes occur in the corporate entity, unless and until you receive notice in writing closing the account. Likewise, the Personal Guaranty shown in the Appendices states that it remains in effect until the guarantor provides you written notice.

Internal Office Approval and Changes in Terms

The Internal Office Approval Form shown in the Appendices can be used to record the procedure used to collect information and approve the account. There should be a clear record in the file that all references and other information have been confirmed. This form should *not* be sent to your customer but can be attached to the Credit Application once the applicant has signed it.

A specific credit limit should be established and an automatic internal system should be in place to alert the credit department when the debtor is approaching this credit limit. It is better *not* to have the limit appear on the credit agreement signed by the debtor. Debtors and guarantors sometimes argue that their liability should be limited to the credit limit established in the agreement. This limit should remain an internal number that can be later modified internally. Credit Agreements should state that credit limits and other terms can be changed by the creditor at any time, without notice.

In the case of individual debtors or guarantors, internal credit department records should show that the financial assets of an individual (all assets titled in the individual's name alone) have been evaluated and found to be insufficient before a spousal signature is required.[44]

> This is not an agreement by Seller to lend money; it is an agreement by Customer for the benefit of Seller if Seller determines to extend credit. Seller may change credit limits or other credit terms at any time, in its sole discretion. No modifications may be made otherwise to this Agreement, except in a writing signed by Seller.

Project Information Sheet

It is probably better *not* to have project information on the Credit Agreement. Otherwise, a debtor or guarantor may later argue that the agreement was applicable only to that project. In addition, it is the best practice to have a new project information sheet for *every* project to which you will supply substantial labor and materials. Each project should be analyzed before you expend large sums of money for labor and materials, to determine whether you will be

[44] *See* chapter, Credit Management; section, Creditworthiness; subsection, Fair Credit Reporting Act (FCRA) and Equal Credit Opportunity Act (ECOA).

a secured creditor or an unsecured creditor. It is also very important to have information on the project in the event of a default, to speed up collection and lower your costs.[45]

A sample Project Information Sheet is attached in the Appendices. The identity of the project, the owner and general contractor should be collected and recorded at the start of any major project to which you will supply labor and materials. The other project information is needed at the first sign of trouble. All of this information and the documents described should be sent to your attorney in order to enforce your collection rights.

Supplier Proposal

The Supplier Proposal shown in the Appendices contains many of the same provisions described in the Credit Application. Any supplier should refer to that section when reviewing their Supplier Proposal to add provisions for Service Charges and Attorney's Fees, Trust Fund Agreement, Limitation of Liability, Exclusion of Warranties, Notice of Breach to Seller, the Right to Stop Work, Authorization to Run Credit Checks and Verify Funding, Forum Selection Clause and Preservation of Security Rights. In addition, material supplier proposals have the following special considerations.

Battle of the Forms

Let's think about the way modern commerce works. Material suppliers mail or fax proposals. Contractors send back purchase orders. Both proposals and purchase orders often have detailed "fine print." The fine print terms on the proposal often conflict with the fine print terms on the purchase order. What provisions are in the final contract? This "Battle of the Forms" will determine the contract terms between a buyer and seller of construction materials, discussed in the Uniform Commercial Code Sale of Goods chapter of this book.[46]

It is important to join the "battle of the forms" within the meaning of the UCC. The best advice is to expressly limit acceptance of all proposals, purchase orders or confirmations you send out. Proposals sent out by material suppliers should state that "any acceptance of this proposal is limited to the terms of this proposal." This would make it more difficult for the return "acceptance" to change the terms of the agreement.[47] The sample Supplier Proposal in the Appendices states:

> Acceptance is limited to terms of this Proposal. Seller objects to any different or additional terms contained in any purchase order, offer or confirmation sent or to be sent by Buyer, which are expressly rejected. The price proposed will be held firm only if acknowledgment is received by Seller or Buyer calls for delivery within 30 days of this Proposal, either of which shall be an acceptance of all terms herein. This Proposal is conditional on Buyer's agreement to all terms and Seller is otherwise unwilling to proceed with this transaction. This is the final expression of this agreement and here will be no waiver or modification of any of these terms unless in writing signed by both parties. If Seller does expressly make any further agreement regarding these goods, all terms of this Proposal shall be incorporated into and shall become a part.

Deadline for Acceptance

Any supplier should have a deadline for acceptance, since costs can increase, availability can decrease and schedules can be filled. Any proposal will be "open" for acceptance for a reasonable period of time. You do not want to get into arguments later about your right to change prices or scheduling. Make sure all proposals have a specific deadline for acceptance, especially those with special pricing.

The deadline paragraph included in the sample Supplier Proposal also requires the customer to send a signed copy of the proposal to your office for acceptance. This helps assure you will receive an enforceable contract and prevents buyers from "riding both sides of the fence." Customers will sometimes hold proposals, claim you are bound if your proposal becomes favorable, but also claim you never had a deal if they find a better price. You can prevent this by combining a deadline on acceptance with a required manner of acceptance.

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[45] *See* chapter, Credit Management; section, Collectability; subsection, Qualifying the Project. *See also* chapter, Default and Termination; section, Buyer in Default; subsection, Collecting Information on Default.

[46] *See* chapter, The Uniform Commercial Code Sale of Goods; section, Formation and Modification of Contract; subsection, Battle of the Forms.

[47] UCC Section 2-207(2)(a).

You should also remember to *withdraw* proposals that contain special pricing or scheduling, if they have not already expired. You may send out special low-priced proposals because your orders are low and have excess output. If you start to become busy, however, you must remember to go back and "withdraw" proposals that are no longer favorable to you. Any offer that you make can normally be withdrawn at any time *before* the customer accepts it. For information about the sale of goods under the Uniform Commercial Code, you should refer to that chapter.[48]

Delivery Schedule

In a sale of goods covered by the UCC, all goods must be delivered in a single lot (group) unless otherwise agreed.[49] If a supplier needs more time to make deliveries, the supplier must say so in the contract.

If there is no definite delivery schedule in the contract, the goods must be delivered within a "reasonable time."[50] The most common "counterclaim" or "back charge" dispute with a supplier is that the materials were delivered late and delayed the job. If the contract defines a particular delivery schedule, then the supplier can be liable for damages if the materials are delivered late. If there is no definite delivery schedule, however, then the supplier cannot be liable for damage as long as the materials are delivered in a reasonable time. In other words, if a supplier has not agreed to deliver goods on twenty-four hours verbal notice, there is no breach of contract if a supplier is unable to do so.

If the goods are shipped in multiple lots, a material supplier is entitled to payment on each delivery.[51] On the other hand, the contract could say that no payment is due until all deliveries are complete.

Storage

Suppliers will want an agreement calling for a reasonable storage fee if the customer does not promptly call for delivery. The payment terms in the sample Supplier Proposal also state that the full price is due when the seller is *ready for delivery* of the described materials. This is especially important for specially manufactured materials. Otherwise, there is no cost to a customer who orders materials but never requests delivery.

Limitation of Liability and Exclusion of Warranties

Material sellers should add language *both* to their credit agreements and proposals that exclude warranties and limit the buyer's remedies and the seller's liability for damages. A buyer can also waive incidental, consequential, special, punitive or delay damages. These provisions are discussed in greater detail in the section above on Credit Applications and in another chapter of this book;[52] they should be included on each proposal as well.

Order Acknowledgment

Many material suppliers will receive orders from buyers by telephone or mail. Suppliers should verify these orders with some type of written order acknowledgment. The seller wants to be certain that the correct materials are manufactured or shipped. Telephone orders leave room for later arguments on specifications.

The same form Supplier Proposal should be used as an Order Acknowledgement, if the process starts with an order from the buyer. Material suppliers should take every opportunity to get agreement on their protective terms and conditions. You may also need to countermand some of the terms in a buyer's written order. This is the "battle of the forms," discussed below. In a sale of goods covered by the UCC, the last writing sent between a buyer and seller may control some terms and conditions; this topic is furthered discussed in the chapter on the Uniform Commercial Code.

Delivery Ticket

Signed delivery tickets are important to serve as evidence that materials were in fact delivered and received in the correct quantities. They can evidence proper allocation for mechanic's lien or bond claim purposes. Delivery tickets

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[48] *See* chapter, The Uniform Commercial Code Sale of Goods; section, Formulation and Modification of Contract; subsection, Firm Offers.

[49] *See* chapter, The Uniform Commercial Code Sale of Goods; section, Contract Interpretation; subsection, Contract Terms Added by the UCC; sub-subsection, Delivery.

[50] UCC Section 2-309(1); *USEMCO, Inc. v. Marbro Co., Inc.,* 60 Md.App. 351, 483 A.2d 88 (1984) *See* chapter, The Uniform Commercial Code Sale of Goods; section, Contract Interpretation; subsection, Contract Terms Added by the UCC; sub-subsection, Time for Performance.

[51] UCC Section 2-307.

[52] *See* chapter, The Uniform Commercial Code Sale of Goods; section, Contract Interpretation; subsection, Warranties; sub-subsection, Exclusion of Warranties. *See also* section, Remedies for Breach of Contract; subsection, Limitation of Liability.

should also include an acknowledgment that the buyer has made a careful inspection of the goods and that they are acceptable.

Delivery tickets are also one last opportunity to get a signature on some of the other terms and conditions, including service charges, attorney's fees, limitation of liability and exclusion of warranties. Depending on who signed the delivery ticket, however, there may be arguments about whether the signature was authorized and whether the terms and conditions are enforceable.

It is preferable to get agreement on terms and conditions in a credit agreement or proposal *before* shipment. This will make it clearer that these terms and conditions were a part of the agreement for this shipment. A delivery ticket is signed after shipment. The supplier has already fully performed the agreement. A court may conclude that there must have been some prior agreement, which did not include these terms and conditions. Otherwise, the supplier would not have shipped.

Rental Ticket for Equipment

Equipment lessors have many of the same concerns as labor and material suppliers. They just rent their equipment for short periods of time rather than selling them permanently. The Rental Ticket shown in the Appendices can be used to make an order and later to acknowledge receipt of that order, fulfilling the same roles as the Proposal and the delivery ticket.

The Rental Ticket includes a confirmation of the type of equipment supplied, the length of time it was used, moving charges and the total amount due. Rental Tickets are also a last opportunity to reach agreement on important terms and conditions. The second page of the sample Rental Ticket contains many of the terms discussed in the Credit Application and Supplier Proposal sections discussed above.

Contractor Proposals and Contracts

A sample Proposal for Labor and Materials can also be found in the Appendices. A labor and material proposal or contract form, however, should also contain other clauses. If the customer signs the proposal and sends it back, this will be the entire contract for the project. There are going to be a certain number of jobs in which you will have an opportunity to supply the contract form. Contractors should have their own forms for this purpose. *When you have the opportunity to supply the form for a transaction, use a custom form that protects your interest*.

Contractor proposals and contracts should contain many of the important terms discussed above regarding Credit Applications and Supplier Proposals. Any contractor should refer to those sections when reviewing their Proposals to add provisions for Service Charges and Attorney's Fees, Trust Fund Agreement, Limitation of Liability, Exclusion of Warranties, Notice of Breach to Seller, the Right to Stop Work, Authorization to Run Credit Checks and Verify Funding, Forum Selection Clause and Preservation of Security Rights. In addition contractor proposals have the following special considerations.

Governmental Requirements

Many states, counties and cities have regulatory or licensing requirements for the contracts used by construction contractors, including Virginia,[53] Maryland[54] and the District of Columbia.[55] You must make sure that the forms you use will comply with the requirements of all states, counties, cities and towns in which you are supplying labor and materials. Contractors doing residential and home improvement work often have special requirements, in addition to the requirements for all contractors. Those regulatory requirements are beyond the scope of this outline. Residential contractors should contact state and county agencies, this law firm or another lawyer to make sure their contract forms comply with the regulations in their state.

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[53] *See* http://www.dpor.virginia.gov/uploadedFiles/MainSite/Content/Boards/Contractors/A501-27REGS.pdf (Virginia Board of Contractors Regulations).

[54] *See* http://mgaleg.maryland.gov/webmga/frmStatutesText.aspx?article=gbr§ion=8-101&ext=html&session=2016RS&tab=subject5 (Annotated Code of Maryland, Business Regulations, Title 8).

[55] *See* http://www.contractors-license.org/dc/DistofColumbia.html and http://dcra.dc.gov/node/545242.

Draw Schedule

The general rule is that payment is due for labor and materials supplied upon completion of work. This may work fine for smaller projects that can be finished in a day or two. If you will need progress payments to finance a job, however, you must specify them in your contract. Otherwise, no progress payments are assumed.

This may be the most important provision in a proposal or contract. If the customer signs your proposal and sends it back, this will be your entire contract for the project. You want to make sure that your proposal has all the contract terms you need. You do not want to end up financing a project for months because you forgot a draw schedule. It is enough to say that you will "be paid at the end of each month for all work in place."

Often a customer intends that you will eventually sign the customer's long contract form. Often however, the subcontract is never sent or never signed. A seller is usually satisfied with this result, as long as the proposal has a few basic terms, especially a draw schedule.

Deadline for Acceptance

Any seller of labor or materials should have a deadline for acceptance, since costs can increase, availability can decrease and schedules can be filled. Any proposal will be "open" for acceptance for a reasonable period of time. You do not want to get into arguments later about your right to change prices or scheduling. Make sure all proposals have a specific deadline for acceptance, especially those with special pricing.

The deadline paragraph included in the sample forms provided also requires the customer to send a signed copy of the proposal to your office for acceptance. This helps assure you will receive an enforceable contract and prevents buyers from "riding both sides of the fence." Customers will sometimes hold proposals, claim you are bound if your proposal becomes favorable, but also claim you never had a deal if they find a better price. You can prevent this by combining a deadline on acceptance with a required manner of acceptance. The Uniform Commercial Code and the "Battle of the Forms" applies in a materials only contract and does not apply in a labor *and* material contract. A customer is less likely to be bound to the terms of a labor *and* material contract unless they sign it.

You should also remember to *withdraw* proposals that contain special pricing or scheduling, if they have not already expired. You may send out special low-priced proposals because your orders are low and have excess output. If you start to become busy, however, you must remember to go back and "withdraw" proposals that are no longer favorable to you. Any offer that you make can normally be withdrawn at any time *before* the customer accepts it.

Bid packages on particular projects can require that bids be left open for a prescribed period of time. You may be bound to keep these bids open when you submit a proposal.

Incorporation of Proposal

The first paragraph of the Proposal Form states that "This proposal shall be incorporated into and shall become a part of any further or additional agreement made for the job described." If the customer signs your proposal form, this may help you enforce some of your own contract provisions, even if your customer eventually requires you to sign their contract form.

Suppliers and contractors often submit proposals but later receive a detailed contract form from the customer. Consider adding wording in that contract form that the supplier or contractor's "proposal is incorporated herein by reference." Then the customer will have its detailed contract clauses for protection, but you will at least have a few protective clauses from your proposal form. This is described in greater detail below in the section on Reviewing and Revising Contracts Received.

Service Charges and Attorney's Fees

Contractors have the same concerns with service charge and attorney's fee provisions as material suppliers and should review that discussion above.[56] Your buyer has leverage on you from holding your purchase price for your labor and material. You must reverse that leverage and make sure the debtor will pay a penalty for holding your money and, therefore, is motivated to resolve the dispute.

The usual rule in the U.S. is that no attorney's fees can be recovered unless the defendant has agreed *in writing* to pay attorney's fees. Contractors would normally want a unilateral attorney's fees clause if possible:

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[56] *See* subsection above, Supplier Credit Applications and Proposals; sub-subsection, Service Charges and Attorney's Fees.

> Customer agrees that any amount not paid within 30 days of invoice date will carry interest at the rate of 1½% per month, both before and after judgment, and further agrees to pay all costs incurred in collection, including attorney's fees in the amount of 1/3 of the total balance due if this account is placed with an attorney for collection, whether suit is filed or not.

Notice, however, that this clause entitles you to legal fees only in the event of a payment dispute. You could not get legal fees in the event of another type of dispute. For example, the customer or some third party could sue you for defective material or personal injury. To cover this, you would also need to add an indemnity clause discussed in the following subsection or simply add a clause stating:

> Customer further agrees pay all costs incurred by Seller, including reasonable attorney's fees, in the event of any other dispute arising out of or related to this agreement.

Contractors want an attorney's fee provision, since they are the most likely to be a plaintiff in litigation. If a seller breaches its contract, the customer can usually withhold money. They can make themselves whole without resorting to litigation. If a customer breaches, however, the seller must litigate to change the "status quo." The seller cannot make itself whole without recovering the cost of litigation. Contractors should also readily agree to add a bilateral provision (goes both ways) anywhere in the contract:

> In any action or proceeding involving a dispute arising out of this agreement, the prevailing party shall be entitled to receive from the other party reasonable attorney's fees to be determined by a court or arbitrator.

Indemnity Clause

This clause primarily concerns personal injury or damage to property from accidents on projects to which a seller is supplying labor and materials, but can also be expanded to include contractual damages. The buyer agrees to "indemnify and hold harmless the seller" in the event someone is injured on the job site, even if the injury is partially caused by the seller.

> Buyer shall indemnify and hold harmless the Seller and their agents and employees from and against all claims, damages, losses and expenses, including attorney's fees, incurred in enforcement of this agreement by Seller, or arising out of this agreement or the described supply of labor or materials if any such claim is attributable to bodily injury, sickness, disease or death or injury to or destruction of tangible property, including the loss of use resulting therefrom, only to the extent caused in whole or in part by any negligent act or omission of Buyer, any subcontractor, employee, agent, or anyone else directly or indirectly employed by any of them or by any third person, regardless of whether or not it has been also been caused in part by a party indemnified hereunder.

Some state codes do limit the enforceability of clauses that require indemnification if the damage is caused by the sole negligence of the indemnified party.[57] Many construction contract forms do exactly this and are unenforceable for this reason. You should make sure that your contract documents require indemnity "*only to the extent* caused in whole or in part by any negligent act or omission of Buyer."

Notice that the indemnity clause above also allows attorney's fees "incurred in enforcement of this agreement by Seller, or arising out of this agreement" allowing recovery of costs in the event of a payment or other contract dispute.

Trust Fund Agreement

Trust fund statutes and trust fund agreements are discussed in detail in another chapter of this book.[58] Subcontractors have the same concerns with trust fund statutes and trust fund agreements as material suppliers and should also review that discussion above.[59] Trust fund agreements are an important and underutilized opportunity for subcontractors.

Some states have trust fund "statutes" or laws to protect subcontractors and suppliers in the construction industry, including Maryland, New York and New Jersey. When a general contractor receives payment from the construction

[57] Va. Code Anno. §11-4.1 (Michie 1950); Maryland Courts and Judicial Proceedings Section 5-401.

[58] *See* chapter, Trust Fund Laws and Agreements.

[59] *See* subsection above, Supplier Credit Applications and Proposals; sub-subsection, Trust Fund Agreement.

project owner, the general contractor holds funds in trust for the benefit of the subcontractors and suppliers. Subcontractors then hold funds in trust for their suppliers and sub-subcontractors.

Even in states without trust fund laws, it is possible to create a trust fund relationship by agreement. It is possible to add clear trust language to a joint check agreement, proposal, or to any contract with just a few sentences.

> Customer agrees that all funds owed to Customer from anyone or received by Customer, to the extent those funds result from the labor or materials supplied by Seller, shall be held in trust for the benefit of Seller (Trust Funds). Customer agrees it has no interest in Trust Funds held by anyone, to segregate and to make no use of, except to promptly account for and transmit to Seller all Trust Funds no later than on demand.

We believe that this language creates a trust fund relationship that should work just like the trust fund laws. This language should also be relatively easy to "sell" to a customer in a contract. The customer certainly intends to pay you promptly on receipt of funds. That is all this language says. It does not create any additional burden or cost on the customer. This language allows you to identify your customer's receivable as produced or created by the labor and materials you supplied and claim ownership of that receivable.

Limitation of Liability

A buyer can agree that remedies will be limited for any breach of contract by a contractor. Contractors should consider adding language to their agreements that limit the buyer's remedies and the seller's liability for damages.

Where sophisticated business professionals enter into an arm's length transaction, a court will enforce the terms of the agreement between, unless it would be unreasonable or unjust.[60] When an agreement is plain and unambiguous in its terms, it has full effect.[61] Construction industry buyers and sellers are sophisticated business people. If they waive warranties or limit liability in contract documents, they will be held to those terms.

A buyer can be bound to limits of liability and exclusions of warranties in a proposal or contract.[62]

> Seller agrees to replace or, at Seller's option, repair any defective goods within a reasonable time. Customer's remedies for any delay or any defect in the materials are subject to and limited by any limitations contained in the manufacturer's terms and conditions to Seller. Further, Customer's sole and exclusive remedy and Seller's limit of liability for any and all loss or damage resulting for breach of warranty, from defective or non-conforming goods or any other cause shall be for the purchase price paid for the particular delivery and materials with respect to which loss or damage is claimed, plus any transportation charges actually paid by the Customer. THE FOREGOING WARRANTY IS IN LIEU OF ALL OTHER WARRANTIES, WHETHER WRITTEN, ORAL, EXPRESS OR IMPLIED, INCLUDING THE WARRANTY OF TITLE, AGAINST LIENS, INFRINGEMENT, THE WARRANTY OF MERCHANTABILITY AND THE WARRANTY OF FITNESS FOR A PARTICULAR PURPOSE. IN NO EVENT SHALL SELLER OR ANY OF THEIR PARENTS OR AFFILIATES, OR ANY OF ITS/THEIR RESPECTIVE DIRECTORS, OFFICERS, EMPLOYEES OR REPRESENTATIVES, BE LIABLE HEREUNDER OR IN CONNECTION HEREWITH FOR ANY SPECIAL, RELIANCE, CONSEQUENTIAL, DELAY, EXEMPLARY, PUNITIVE, INCIDENTAL, LIQUIDATED, OR INDIRECT DAMAGES, INCLUDING WITHOUT LIMITATION, FOR LOSS OF PROFITS, INCOME, USE, OR TIME, WHETHER IN CONTRACT, TORT, OR OTHERWISE.
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> Buyer shall make a careful inspection of all labor and material at the time of delivery. Buyer's failure to give written notice specifying any claim within ten (10) days of delivery shall constitute an unqualified acceptance of the labor and material delivered and a waiver of all claims. Seller will not be liable for any damage, warranty or remedy and back charges will not be accepted without prior notification, an opportunity to view and repair, replace or otherwise cure, and approval by Seller.

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[60] *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 92 S.Ct. 1907, 32 L.Ed.2d 513 (1972).

[61] *McLean House v. Maichak*, 231 Va. 347, 349, 344 S.E.2d 889, 890 (1986); *Gordonsville Energy v. Virginia Elec. & Power Co.*, 257 Va. 344, 354, 512 S.E.2d 811, 817 (1999) [reiterating that "when contract terms are clear and unambiguous, the words used by the parties must be given their plain and ordinary meaning"].

[62] UCC Section 2-207; *See e.g., Foley Co. v. Phoenix Engineering & Supply Co.*, 819 F.2d 60 (4th Cir. 1987) and *Moore Electrical Contractor, Inc. v. Westinghouse Electrical Supply Co.*, 221 Va. 745, 273 S.E.2d 553 (1981).

These provisions evidence a clear intent to create a comprehensive set of remedies. First, the Limitations in any manufacturer's warranty are passed on to a buyer. This creates a "conduit relationship" for a contractor that did not manufacture materials. The eventual buyer and end user is limited to the manufacturer's warranties and remedies.

These provisions also limit the buyer's remedies to repair and replacement of non-conforming work. This could eliminate the potential for any claim or counterclaim against a seller for allegedly defective work, if the buyer has not paid the purchase price. A buyer would have at most a defense to a seller's claim for the unpaid purchase price. If the seller repairs or replaces any defective work within a reasonable time, the buyer would owe the full purchase price.[63] It is probably important to be clear in a contract that these remedies are "sole and exclusive."

A buyer can also waive incidental, consequential, special, punitive or delay damages. Consequential damages are discussed in greater detail in another chapter of this book.[64] However, it is possible to waive the right to consequential damages in a contract, just as it is possible to waive other remedies. It is also possible to waive damages for delay in a "no damage for delay" clause. This is discussed in greater detail in another chapter of this book.[65] In short, however, contractors do want the above Limitation of Liability provision in their proposals and contracts.

Exclusion of Warranties

Express and implied warranties under the Uniform Commercial Code are discussed in detail in another chapter of this book.[66] Subcontractors have the same concerns with express and implied warranties as material suppliers and should also review that discussion above.[67] Express and implied warranties are cumulative. In other words, a buyer would have the choice of suing under an express written warranty or an implied warranty or both. Even if an express warranty is offered, the seller must carefully exclude any implied warranty.

It is possible to disclaim any express warranty.[68] If a seller has excluded all express warranties, it does not matter what any salespeople may have said in any meetings. The buyer has agreed in advance not to rely on any oral statement.[69]

An exclusion of warranty should be "conspicuous." This is why you often see such language in large print, all caps, in a contract or written warranty. This would make the exclusions conspicuous as a matter of law.[70]

> Seller agrees to replace or, at Seller's option, repair any defective goods within a reasonable time. Customer's remedies for any delay or any defect in the materials are subject to and limited by any limitations contained in the manufacturer's terms and conditions to Seller. Further, Customer's sole and exclusive remedy and Seller's limit of liability for any and all loss or damage resulting for breach of warranty, from defective or non-conforming goods or any other cause shall be for the purchase price paid for the particular delivery and materials with respect to which loss or damage is claimed, plus any transportation charges actually paid by the Customer. THE FOREGOING WARRANTY IS IN LIEU OF ALL OTHER WARRANTIES, WHETHER WRITTEN, ORAL, EXPRESS OR IMPLIED, INCLUDING THE WARRANTY OF TITLE, AGAINST LIENS, INFRINGEMENT, THE WARRANTY OF MERCHANTABILITY AND THE WARRANTY OF FITNESS FOR A PARTICULAR PURPOSE. IN NO EVENT SHALL SELLER OR ANY OF THEIR PARENTS OR AFFILIATES, OR ANY OF ITS/THEIR RESPECTIVE DIRECTORS, OFFICERS, EMPLOYEES OR REPRESENTATIVES, BE LIABLE HEREUNDER OR IN CONNECTION HEREWITH FOR ANY SPECIAL, RELIANCE, CONSEQUENTIAL, DELAY, EXEMPLARY, PUNITIVE, INCIDENTAL, LIQUIDATED, OR INDIRECT DAMAGES, INCLUDING WITHOUT LIMITATION, FOR LOSS OF PROFITS, INCOME, USE, OR TIME, WHETHER IN CONTRACT, TORT, OR OTHERWISE.

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[63] *Marr Enterprises, Inc. v. Lewis Refrigeration Co.*, 556 F.2d 951, 955 (9th Cir. 1977).

[64] *See* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsection, Waiver of Consequential Damages.

[65] *See* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsection, No Damage for Delay.

[66] *See* chapter, The Uniform Commercial Code Sale of Goods; section, Contract Interpretation; subsection, Warranties.

[67] *See* subsection above, Supplier Credit Applications and Proposals; sub-subsection, Exclusion of Warranties.

[68] *Buettner v. R.W. Martin & Sons, Inc.*, 47 F.3d 116 (4th Cir. 1994) [Express warranty disclaimer between a seller and a buyer was valid and enforceable, even against a third party].

[69] *King Industries, Inc. v. Worlco Data Systems, Inc.*, 736 F. Supp 114, 118 (E.D.Va. 1989) *citing Hill v. BASF Wyandotte Corp.*, 696 F.2d 287, 291 (4th Cir. 1982) ["the parol evidence rule precludes the admission of oral statements which contradict the terms of a written disclaimer"].

[70] *Armco, Inc. v. New Horizon Dev. Co.*, 229 Va. 561, 567, 331 S.E.2d 456, 460 (1985).

The smaller wording at the beginning of this paragraph describes the limited warranty discussed above. The "conspicuous" language in large print, all caps, excludes express and implied warranties.

Notice of Breach to Seller

Any contractor wants "notice and an opportunity to cure" any problems in its work. This generally means that a buyer has to notify a seller fairly promptly if there are any defects, allow the seller to see the problem and have an opportunity to repair. Otherwise, the buyer will lose the right to claim breach of contract or breach of warranty. This is accomplished as follows:

> Buyer shall make a careful inspection of all labor and material at the time of delivery. Buyer's failure to give written notice specifying any claim within ten (10) days of delivery shall constitute an unqualified acceptance of the labor and material delivered and a waiver of all claims. Seller will not be liable for any damage, warranty or remedy and back charges will not be accepted without prior notification, an opportunity to view and repair, replace or otherwise cure, and approval by Seller.

The Right to Stop Work

Monitoring marginal projects is very important. If a problem is developing, you must turn off the money spigot at the earliest possible stage. If you have a contract with a defined scope of work, however, you have an obligation to supply that scope of work in the scheduled time. Even if a customer is late in paying you, you may need to continue to send money out the door. It is very difficult to tell when a customer has breached the contract so completely that you have no further obligation.[71] The customer may be in breach for paying you late, but you may also be in breach for failing to supply in a timely manner.

This problem can be largely avoided with a contract term allowing you to stop supplying labor and materials until disputes are resolved if a payment is not received for any reason. It is important that this situation also result in a time extension on the contract. Your contract can also contain a provision that "seller will not, in any event, be responsible for any damage due to delay." This puts the pressure on the customer to resolve disputes with you and make payment.

The contract term similar in the Proposal in the Appendices states:

> Seller may stop the manufacture or supply of any labor or materials when payments to Seller pursuant to this agreement stop, until payment is made and any dispute or insecurity has been resolved.

The Proposal also states, "In no event shall Seller be liable for any damage due to delay of any type, nor consequential, special or punitive damages." This includes what is known as a "no damage for delay" clause and is generally enforceable.[72] This clause, coupled with the right to stop work, should protect sellers who desire to stop performance because of payment or funding problems.

Authorization to Run Credit Checks and Verify Funding

For small, closely held companies, it is always the best practice to obtain authorization to run both corporate and *individual* credit checks and to contact various references, including lenders. The Proposal includes an authorization to run credit reports on all of the individual officers, shareholders or partners that sign the Proposal.

> I/We authorize Seller from time to time to obtain Business and Consumer Credit Reports on Buyer or any principals of Buyer or to obtain credit and funding information from any other source. Seller shall have no obligation to begin or continue performance until adequate credit and funding information is provided, at any time on request of Seller.

Under the federal Fair Credit Reporting Act, it is still questionable whether the one officer signing the contract can give you permission to run credit checks on the other non-signing officers.[73] Separate signatures are still preferable for this reason, if possible.

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[71] *See* chapter, Default and Termination; sections, The Right to Stop Work for Non-Payment, The Law and The Realities.

[72] *See* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsection, No Damage for Delay.

[73] *See* chapter, Credit Management; section, Creditworthiness; subsection, Fair Credit Reporting Act (FCRA) and Equal Credit Opportunity Act (ECOA).

A contractor should strive for a contract term allowing it to monitor the health of the project and adequate funding as often as necessary. It also is helpful to have the right to consult the architect, lender and any other persons who may have knowledge concerning the health of the project, funding, scheduling, expected changes and other matters. The term above accomplishes these objectives, including the right to verify adequate funds to complete the project before the project begins and at various later stages of the project. This is especially important when you have a cost plus time and materials contract, when large change orders are requested or when it is apparent that the project schedule will be much longer than planned. At a minimum, the seller should be allowed to verify funding for change orders in excess of a certain dollar amount. In the case of a cost plus time and materials contract, the seller should be able to verify funding once the original budget has been surpassed.

The seller should have the contractual right to refuse to perform any further work if adequate funds cannot be established. A similar term actually appears in AIA Document A201-2017 (General Conditions of the Contract for Construction), which reads:

> **2.2.1** Prior to commencement of the Work and upon written request by the Contractor, the Owner shall furnish to the Contractor reasonable evidence that the Owner has made financial arrangements to fulfill the Owner's obligations under the Contract. The Contractor shall have no obligation to commence the Work until the Owner provides such evidence. If commencement of the Work is delayed under this Section 2.2.1, the Contract Time shall be extended appropriately.
>
> **2.2.2** Following commencement of the Work and upon written request by the Contractor, the Owner shall furnish to the Contractor reasonable evidence that the Owner has made financial arrangements to fulfill the Owner's obligations under the contractor only if (1) the Owner fails to make payments to the Contractor as the Contract Documents require; (2) the Contractor identifies in writing a reasonable concern regarding the Owner's ability to make payment when due; or (3) a change in the Work materially changes the Contract Sum. If the Owner fails to provide such evidence, as required, within fourteen days of the Contractor's request, the Contractor may immediately stop the Work and, in that event, shall notify the Owner that the Work has stopped. However, if the request is made because a change in the Work materially changes the Contract Sum under (3) above, the Contractor may immediately stop only that portion of the Work affected by the change until reasonable evidence is provided. If the Work is stopped under this Section 2.2.2, the Contract Time shall be extended appropriately and the Contract Sum shall be increased by the amount of the Contractor's reasonable costs of shutdown, delay and start-up, plus interest as provided in the Contract Documents.
>
> **2.2.3** After the Owner furnishes evidence of financial arrangements under this Section 2.2, the Owner shall not materially vary such financial arrangements without prior notice to the Contractor.

Forum Selection Clause

Your customer can agree to allow you to sue the customer in the court (forum) near your office.[74] The customer can even agree to file suit on your home turf, even if the customer initiates the litigation. This holds down your costs of litigation and increases the debtor's cost. This "leverage" helps the seller get a quicker resolution of accounts.

If you do not have this "Forum Selection" agreement, you will need to travel to the customer's home to litigate. The collection process will be more convenient for your customer, its lawyers and witnesses, while your litigation costs increase. You want a forum selection clause to help ensure that you will litigate any dispute on your home turf, hold down your costs and increase your customer's cost of litigation.

Similarly, you want the debtor to agree to submit to the "jurisdiction" in your forum state. This is a similar concept, but means that the debtor will not argue that your home court lacks jurisdiction or that constitutional due process prohibits your court from hearing the case.

Remember that it is different to say, "This agreement will be decided under the laws of Virginia." This is a "choice of law" provision. It does mean that the court must interpret your contract under Virginia law, but it does not guarantee that it will be a Virginia court making the decision. In other words, you may end up with a case in New York, where the New York court is required to figure out Virginia law to decide the case.

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[74] *United States Smoke & Fire Curtain, LLC v. Bradley Lomas Electrolok, Ltd*, 612 Fed. Appx. 671, 672-673 (4th Cir. Va. 2015) [dispute-resolution provisions, such as forum-selection clauses, are enforceable beyond the expiration of the contract].

You want to make sure your contracts state that the *forum* for litigation is your home county and state; that the debtor agrees to submit to *jurisdiction* there; and that the court will decide the case under the *law* of your home state. The following provision in the Proposal accomplishes all of this:

> Customer expressly agrees to submit to personal jurisdiction in Virginia and agrees that the forum for any litigation pursuant to this Agreement or any other contract between Seller and Customer, whether Seller or Customer brings suit, shall be the County of Fairfax, Virginia. This Agreement shall be governed by and construed in accordance with the laws of Virginia.

Preservation of Security Rights

The following language concerning waivers should help avoid an accidental waiver of lien or bond rights:

> All mechanic's lien, payment bond or similar waivers or restrictive endorsements on checks shall be effective only to the total dollar amount of payments actually received without any bankruptcy filing for ninety (90) days thereafter. Customer agrees that Seller retains its mechanic's lien, payment bond or other legal rights for unpaid deliveries, regardless of what other waiver documents may imply otherwise.

Otherwise, some later contracts and progress payment waivers will waive *all* lien or bond rights, even for labor and material supplied later or even though the seller has not been paid in full. This provision may not be enforceable against any owner or bank that is not a party to the contract. There is more information on this problem in the section below titled "Waiver Forms."[75]

Substitution of Materials

The Proposal form provided allows the seller to substitute materials or terminate the contract if specified materials are unavailable.

Personal Guaranty

The bottom of the Proposal provides a place for the buyer to personally guarantee performance. Some buyers will not be willing to do this, and sellers may not be in a position to require it. It can be helpful, however, to have this possibility readily available on your form.

Guaranties

A great deal of business is conducted by "shell" corporations. The "ABC" corporation named in your contract may look substantial, but careful analysis will reveal that it has no assets. It may be important to look carefully at this situation. A construction or development corporation may have no asset other than the property being developed. This property is mortgaged in excess of value once the construction process begins. You can be sure that the construction lender has protected itself by requiring guaranties. You may need to do the same, especially if your mechanic's lien would have low priority.[76]

If the owner is a shell corporation *and* the contract waives mechanic's lien rights, then the owner can close the corporation and walk away from the project at the first sign of trouble. There will be absolutely nothing you can do to collect. The bank that loaned the owner $10,000 to buy a truck made the borrower sign personally; why shouldn't a contractor that is lending $40,000 worth of labor and materials also require a personal signature? You are a lender too.

With many small corporations you can and should require personal guaranties from the principals involved. If a small businessperson has a corporation with no real assets and refuses to personally sign a contract, perhaps you should just plain refuse to supply. This customer is asking you to go into your pocket for materials and payroll for several months but is not willing to take any risk in order to make sure you get paid. You may be able to tell this customer that you believe in him/her personally and that you are entering into the transaction based on personal trust. You are only asking this customer to put in writing what you have been told over and over again: that he/she will

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[75] *See* section below, Contract Administration; subsection, Waiver Forms.

[76] *See* chapters, Mechanic's Lien Rights and General Principles and Mechanic's Liens in Virginia, Maryland, Pennsylvania and the District of Columbia; sections, Priority.

make sure that you are paid. Remember that you may need to obtain the signature of spouses in order to make the guaranty enforceable against all of the guarantor's assets.[77]

A guaranty from another corporation may also be sufficient. There are often a number of related corporations operating together. The corporation with the money may not be the corporation with which you have your contract.

A Guaranty Form appears in the Appendices. This form contains many of the terms and conditions contained in the Credit Application, discussed above, including provisions for attorney's fees, a forum selection clause, changes in borrower entity and preservation of security rights. The importance of all of these terms is discussed above. This Guaranty form also contains explicit permission for the lender to run credit reports on the guarantors in order to ensure compliance with the federal Fair Credit Reporting Act and a waiver of rights under the Equal Credit Opportunity Act.[78]

Joint Check Agreements

A common credit management device is the joint check agreement. This requires the consent of more than one player on the construction project. The creditor supplier needs the consent of not only of the debtor customer, but also the customer's buyer (normally the general contractor). An owner or general contractor needs the consent of the debtor customer, but may also want agreements or waivers from the creditor supplier.

The next important thing to understand about joint check agreements is that they vary tremendously in how they are worded. There is no such thing as a "standard" joint check agreement. You do not know what rights it gives you until you see it. Some joint check agreements actually remove more rights than they give, by including a waiver of mechanic's lien and bond rights.

The most commonly used joint check agreements are not actually "security," and this difference can be very important in the event of bankruptcy.

Joint Check Agreements for Seller-Creditors

Seller-creditors would certainly prefer a guaranty from the owner or general contractor. Here, the general contractor guarantees that the supplier will be paid no matter what problems are with the subcontractor. This option should be remembered, although the word "guaranty" usually sends shivers up and down spines.

Another option is to request that materials be sold on the owner's or general contractor's account. This avoids the risk of liens or bond claims on this project, and the general contractor may avoid a mark-up on the materials.

If these options are rejected, a joint check agreement may be an opportunity. Joint check agreements do vary tremendously in how they are worded, so the seller would certainly prefer to draft the joint check agreement if possible. If someone else drafts the agreement, it is important to make sure the seller is not giving up rights such as a waiver of mechanic's lien and bond rights.

The most important thing for a seller to remember about a "standard" joint check agreement is that IT ONLY HELPS IF A CHECK IS EVER WRITTEN. For example, you may supply materials to a construction subcontractor and you may have a joint check agreement with the general contractor. However, the general contractor may later assert back charges against the sub or claim that the subcontractor never completed its contract. If the general contractor is not obligated to pay the sub, the general contractor is also not obligated to write a check and the joint check agreement will do no good. A joint check agreement is a terrific opportunity to establish the trust fund provision discussed above. Remember: the trust fund provision does not place any additional burden or risk on the general contractor or the customer. The general contractor or owner has no obligation to write a check if they owe no debt to the customer and there is no greater risk of having to pay for the same materials twice. It just puts the supplier in a better position vis-à-vis the other creditors of the customer, including the customer's secured lender. Both the supplier and the general contractor would be in a much stronger position, especially if the subcontractor files bankruptcy.[79] General contractors on bonded projects do not want the risk of liability to a supplier on a payment bond, when the general has already paid the subcontractor in full. This is also discussed in greater detail in the

[77] *See* subsection above, Signatures and Facsimiles. *See also* chapter, Credit Management; section, Creditworthiness; subsection, Fair Credit Reporting Act (FCRA) and Equal Credit Opportunity Act (ECOA). *See also* chapter, Enforcement of Judgment; section, Forms of Ownership.

[78] *See* chapter, Credit Management; section, Creditworthiness; subsection, Fair Credit Reporting Act (FCRA) and Equal Credit Opportunity Act (ECOA).

[79] *M&T Elec. Contrs., Inc. v. Capital Lighting & Supply, Inc. (In re M&T Elec. Contrs., Inc.)*, 267 B.R. 434, 480 (Bankr. D.D.C. 2001) [The use of a joint check agreement alone does not establish the creation of a trust].

chapter on Trust Fund Agreements.[80] The sample form shown in the Appendices includes a guaranty of the account and a trust fund provision.

Suppliers may also succeed in slightly rewording the "standard" joint check agreement to include an outright assignment of funds or a security interest in the accounts receivable to be due to the buyer. This is security, which would make you a secured creditor in the event of bankruptcy. Without this security, your buyer's accounts receivable go into the general bankruptcy fund to pay all general unsecured creditors. With the security interest, you may have first claim to this one fund.[81] The second sample form includes a guaranty of the account and a security interest provision.

With an assignment of funds, you are already the owner of the fund, not your customer. These mechanisms are not in the sample joint check agreement, although a sample Assignment is also available in the Appendices. It is probably better for you to use the assignment of funds, the security interest or the trust fund provision, but not more than one of these mechanisms in one document. If the intent is ambiguous or contradictory in the document, there is greater risk you will get no remedy at all. The trust fund agreement is probably preferable. If someone objects to any one of these provisions, it can be stricken out of the form and you will still have another important protection included in the form. For example, a creditor also wants a joint check agreement that requires checks be sent directly to the supplier and provides a power of attorney to endorse checks on behalf of the customer. This solves the problem of the debtor that disappears, refuses to endorse a joint check or refuses to give it to the creditor. The debtor can also agree that the owner or general contractor can rely on the creditor's statements of the total current indebtedness to the creditor. In other words, the debtor may tell the owner or general contractor to issue a check in a lower amount or instruct the owner of general contractor not to issue any check, especially if there is a dispute with the supplier. In this provision, the debtor has agreed that the owner or general contractor can rely on the amount due to the seller in statement of account from the seller. This provision essentially lets the money flow and makes the debtor take up any dispute with the supplier later. The sample forms in the Appendices include all of these provisions.

Joint Check Agreements for Owners and General Contractors

An owner or general contractor may want or be willing to agree to joint check agreements to attract better suppliers or better pricing. These arrangements may also allow the use of cheaper subcontractors that cannot otherwise get supplier credit. Any time that marginal subcontractors are used, however, the general contractor must take on the greater administrative burden of policing the subcontractors. To protect against mechanic's liens and payment bond claims, the general contractor must be aware of all suppliers and make sure that they are paid. The subcontract should require a complete list of suppliers on the project and prohibit the use of unauthorized suppliers. This allows an owner or general contractor to make sure they have lien waivers from all suppliers on the project at each progress payment. A general contractor should also require the debtor to come to the general contractor's office to endorse the joint check and then the general contractor should deliver that check to the creditor. This eliminates any risk of forgery on the check and makes sure the check is actually delivered.

A trust fund agreement in subcontracts and joint check agreements, discussed above, is as beneficial to a general contractor as it is to a creditor supplier. This does not add any additional burden or risk on the general contractor and provides important protection to both the general contractor and the supplier if the subcontractor files bankruptcy.

A general contractor does also have an opportunity to get added protection by getting a supplier to waive various rights. Most importantly many general contractors get unwary suppliers to waive mechanic's lien and bond rights in exchange for the joint check agreement before supplying. A supplier can also agree to a "Pay if Paid" provision, eliminating any obligation in the general contractor if payment is never received from the owner. A general contractor may also say that the agreement does not create any contractual rights in the creditor and is made "solely as a convenience." All of these provisions are shown in the third sample form.

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[80] *See* chapter, Trust Fund Laws and Agreements; section, Trust Fund Agreements; subsection, Protective Provisions for Owners and General Contractors.

[81] *See* chapter, UCC Security Agreements; section, Types of Security Property; subsection, Accounts Receivable.

ELECTRONIC TRANSACTIONS, COPIES AND FACSIMILES

Signatures and Facsimiles

Needless to say, you must have a signature on an agreement to make sure it is effective and enforceable. If your staff does not make sure that credit agreements and contracts have been signed and received back, you probably do not have any of the protections discussed above. Adding "Terms and Conditions" on invoices does not normally make them enforceable.

It is always best to get signed *originals*. If an original is unavailable for some legitimate reason, however, a copy is usually equally enforceable. For the same reasons, a facsimile will probably be as enforceable as originals or a good copy. With copies and facsimiles, however, make sure it is clear that the customer has agreed to all terms and conditions. Debtors will often copy or telecopy only the signature page of a contract or credit agreement. This can raise questions later about an attorney's fee clause or forum selection clause that is on a different page. Make sure that the signature page states that the customer "agrees to all terms and conditions on the reverse side of this contract." It is even better to have a signature on the "Terms and Conditions" page. The best way to avoid an argument, of course, is to eventually get the original back.

Most states have adopted some form of the Uniform Electronic Transactions Act.[82] These laws give legally binding effect to transactions conducted entirely by electronic means and provide legal recognition for electronic records and signatures. However, these laws usually apply only where parties have agreed to conduct transactions electronically.[83] The recipient must be capable of retention of the electronic record at the time of receipt. If a law requires a signature or record to be notarized, acknowledged, verified, or made under oath, the requirement is satisfied if the electronic signature of the person authorized to perform those acts is attached with the electronic signature or record, together with all other information required.[84]

It is not necessary to have any contract, agreement or guaranty notarized in order to make it enforceable against the party that signed it. It is possible, however, that a debtor will claim that he or she never signed the document and that any signature is a forgery. A notary will help defeat this argument. Notarized signatures may also be necessary in order to have documents recorded in the land records or court clerk's office.

If your contract is with an individual, you do not need a personal guaranty to sue them personally. If your customer is married, however, your ability to collect under the contract is severely impaired if you do not get the spouse to sign.

If you are building a house on property owned by a husband and wife and only the husband has signed the contract, then you may not be able to file a mechanic's lien on the project. If you sell goods to the husband, you end up suing him for your money and get a judgment against him, this judgment will not be enforceable against any property owned by the couple together as tenants by the entirety.[85] The personal residence is the major asset of most people. Mr. and Mrs. Customer usually own it as tenants by the entirety. Bank accounts and other assets can also be owned as tenants by the entirety. You cannot touch any of these assets if you only have a judgment against Mr. Customer.

If you contract with a corporation and you get a personal guaranty signature, the same problem exists. The husband may be the only officer and only stockholder in the corporation and may not think that his wife should sign for a company matter. If you sue on the personal guaranty, however, you will end up with a judgment only against the husband. You will not be able to touch any assets he jointly owns together with his wife as tenants by the entirety.

You should be aware that federal Equal Credit Opportunity Act will not allow you to *automatically* require a spouse's signature on credit agreements and personal guaranties. Creditors should always qualify an individual debtor or guarantor on their own independent assets. Spousal signatures should be required only after determining that the individual spouse has insufficient assets to qualify for the debt.[86]

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[82] Va. Code Anno. §59.1-485 (Michie 1950); Maryland Commercial Law Code Section 21-106; 73 P.S. §2260.101; 73 P.S. §2260; DC Code Section 28-4906.

[83] *See e.g.*, Va. Code Anno. §59.1-486 (Michie 1950).

[84] *See e.g.*, Va. Code Anno. §59.1-489 (Michie 1950).

[85] *See* chapter, Enforcement of Judgment; section, Forms of Ownership.

[86] *See* chapter, Credit Management; section, Creditworthiness; subsection, Fair Credit Reporting Act (FCRA) and Equal Credit Opportunity Act (ECOA).

Uniform Electronic Transactions Act (UETA)

The Uniform Electronic Transactions Act (UETA) was originally drafted by the National Conference of Commissioners of Uniform State Law (Uniform Law Commissioners) in 1999. Like the Uniform Commercial Code (UCC), the UETA is a "model code" that is not the law in any state until each state legislature adopts it as part of their state code. Each legislature is free to modify the model code. However, the UETA has been adopted in its entirety by most states and the federal government.[87]

Also like the UCC, one objective of the UETA was to promote interstate commerce by creating one set of commercial rules that would be almost identical in all fifty states. This gives consumers and business people confidence buying and selling goods across the country.

Historically, all records were in hard copy, created with ink and paper. The only copies were the originals. This changed with carbon copies and copying machines. Technological advances in the last few decades have resulted in the creation and storage of documents in electronic form. Business people needed to know whether an electronic copy was an enforceable "writing." The UETA addresses the enforceability of electronic documents and facilitates the electronic storage or retention of documents.

Enforceability of Electronic Signatures

The UETA does NOT dictate that electronic documents are enforceable. It establishes, to the greatest extent possible, that an electronic signature is equivalent to a manual signature.[88] The purpose is to overcome unwarranted biases against electronic methods of signing and authenticating records. If another law requires a contract to be in writing or requires a signature to make a writing enforceable, an electronic record or signature will satisfy that law. A record or signature may not be excluded from evidence solely because it is in an electronic form.[89]

Hard copy original documents are not always enforceable. Manual signatures can be forged. Agents signing hard copy documents may lack authority. A contract may lack "consideration" or may otherwise be legally unenforceable. You can have these same issues with electronic documents. The purpose of the UETA is that we will NOT have these issues MORE with electronic documents than original hard copy documents.

A contract, credit agreement, guaranty, or joint check agreement containing an electronic signature is legally enforceable, provided the parties have consented to using electronic means of doing business and the document satisfies all other applicable legal requirements outside the UETA. To enforce documents, you may need to prove that the buyer consented to the use of an electronic transaction, that the electronic signature was "the act" of the buyer and that you have an accurate copy of what was agreed to.

An electronic signature may be accomplished by a wide variety of acts, as long there is an intention to sign and the signature is attributable to the signatory. It is advisable to use a more involved system for electronic signatures, to make it clearer who signed and that they intended a signature and legal enforceability. Many internet websites have only a "checkbox" that refers to adjoining verbiage with contract terms. This is perfectly "enforceable," until the customer claims that they did not intend to enter into an agreement or did not intend to agree to these terms.

The objective is to make intentions clear. Under the UETA, the parties must "agree to conduct transactions by electronic means."[90] There is no set procedure for determining whether the parties agreed. It is determined from the context and circumstances surrounding the transaction. It is preferable for this reason to have a customer separately agree early in the process that they wish to enter into an electronic transaction.

The UETA states that "an electronic record or electronic signature is attributable to a person if it is the act of the person." The act of the person may be shown in any manner, including the security procedure applied to determine

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[87] The full text of the final Model Act may be accessed online at: http://www.uniformlaws.org/shared/docs/electronic%20transactions/ueta_final_99.pdf.

[88] *See* the 'Prefatory Note' of the Model Act at http://www.uniformlaws.org/shared/docs/electronic%20transactions/ueta_final_99.pdf at page 1.

[89] *See* D.C. Code § 28-4906; Md. COMMERCIAL LAW Code Ann. § 21-106; 73 P.S. § 2260.303; Va. Code Ann. § 59.1-485. *Also see*, http://www.uniformlaws.org/shared/docs/electronic%20transactions/ueta_final_99.pdf at Section 7, p. 26.

[90] *See* D.C. Code § 28-4904(b); Md. COMMERCIAL LAW Code Ann. § 21-104(b)(1); 73 P.S. § 2260.301(b); S.C. Code Ann. § 26-6-50(B); Va. Code Ann. § 59.1-483(b). *Also see*, http://www.uniformlaws.org/shared/docs/electronic%20transactions/ueta_final_99.pdf at Section 5(b), p. 21.

the person providing the signature. The effect of an electronic record or electronic signature is determined from the context and surrounding circumstances at the time of its creation, execution, or adoption.[91]

It is generally advisable to use an involved electronic procedure that requires the buyer to separately ask for an electronic transaction and to identify the person signing. Rather than requiring a customer to only check a box, it is advisable to require the customer to identify themselves by filling in their name and additional contact and identifying information. Passwords and security codes chosen by the customer are helpful for the same reasons. Docu-sign and similar products have a customer create their own signature to identify themselves. A unique signature created by the customer with a computer mouse may be a good option. You should retain any transmittals sent to you for electronic documents to help identify the source. It is also advisable to require the customer fill in their signature repeatedly, evidencing their understanding of each page.

It is also important to have an incorruptible electronic storage system that retains data exactly as your customer saw it and executed it, so that you have a single authoritative copy that is unique, identifiable and unalterable. This will give a court confidence that the customer agreed to an electronic transaction and the terms of that agreement.

Types of Electronic Documents Enforceable

There is limited court case law in any state on the UETA. The official comments to the UETA discuss agreements to buy and sell goods, but not agreements to lend money. However, there is no reason to think a credit agreement, guarantee, promissory note, and joint check agreement would not be covered by the UETA.

Because the official comments to the UETA do discuss agreements to buy and sell goods, purchase orders or other sales contracts are almost certainly covered by the UETA and electronic signatures are enforceable. Most state UETA statutes apply to their Uniform Commercial Code Article 2 on the Sale of Goods. A purchase order containing an electronic signature is legally enforceable. A credit agreement containing an electronic signature is legally enforceable. A guarantee containing an electronic signature is legally enforceable.

The UETA seems to provide for the enforceability of "transferable records," which can include promissory notes, but there is limited case law interpreting this section. Case law in some states has decided that a promissory note, defined on the face of the note as a transferable record, and generated and signed electronically would be enforceable.[92] A note generated electronically, in accordance with the UETA requirements, and containing an electronic signature is legally enforceable as a transferable record. Most state UETA statutes do not apply to their Uniform Commercial Code Article 3 on Negotiable Instruments. However, the UETA does recognize "Transferable Records" which, when executed in accordance with the law's requirements, function very similarly to paper notes under the Commercial Code.

Uniform Commercial Code Security Agreements and Financing Statements on the other hand are most certainly excluded by the UETA and electronic signatures may not be enforceable.

Most state UETA statutes do not apply to their Uniform Commercial Code Article 9 on Secured Transactions. A security agreement containing an electronic signature is likely not legally enforceable and a financing statement without an original signature is probably not recordable.

Retention of Electronic Documents

The UETA states that a law requiring a record to be retained is satisfied by retaining an electronic record of the information that accurately reflects the information in the record after it was first generated in its final form as an electronic record or otherwise; and remains accessible for later reference.[93] Any legal requirement to maintain a record is satisfied by the retention of an electronic record that accurately reflects the information set forth in the record at the time it was first generated in its final form and remains accessible for later reference.[94] Satisfying these requirements satisfies any law requiring retention of a record for evidentiary, audit, or similar purposes.

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[91] *See* D.C. Code § 28-4908(b); Md. COMMERCIAL LAW Code Ann. § 21-108(b); 73 P.S. § 2260.305(b); S.C. Code Ann. § 26-6-90; Va. Code Ann. § 59.1-487(b). *Also see*, http://www.uniformlaws.org/shared/docs/electronic%20transactions/ueta_final_99.pdf at Section 9(b), p. 31.

[92] *Rivera v. Wells Fargo Bank, N.A.*, 189 So. 3d 323 (Fla. Dist. Ct. App. 4th Dist. 2016).

[93] *See* D.C. Code § 28-4911; Md. COMMERCIAL LAW Code Ann. § 21-111; 73 P.S. § 2260.308; S.C. Code Ann. § 26-6-120; Va. Code Ann. § 59.1-490. *Also see,* http://www.uniformlaws.org/shared/docs/electronic%20transactions/ueta_final_99.pdf at Section 12, p. 38.

[94] *See* D.C. Code § 28-4911(a); Md. COMMERCIAL LAW Code Ann. § 21-111(a); 73 P.S. § 2260.308(a); S.C. Code Ann. § 26-6-120(A); Va. Code Ann. § 59.1-490(a). *Also see*, http://www.uniformlaws.org/shared/docs/electronic%20transactions/ueta_final_99.pdf at Section 12(a), p. 38.

It is also an important objective to make sure records are clear. Each page that was viewed and signed by the insured should be stored, so that it can later be viewed in the same manner and sequence as was viewed by the customer.[95] Each document should be stored in a manner that shows how it was generated in its final form and showing that the electronic record is in the same form as the original, void of alteration.

The UETA allows outsourcing of document storage stating, "A person may satisfy [requirements] by using the services of another person if the requirements . . . are satisfied otherwise."[96] Outsourced servicers could be employed not only to retain the documents, but to operate and service the website portal document reviewing and signing.

The issue of how long you should retain documents is, in large part, an issue of best business practices and is a legal question only to a limited extent. The length of time you need to retain documents depends on the type of document. Documents must be retained in accordance with various state and federal document retention laws. To some extent this varies according to your type and the size of your business. The U.S. Internal Revenue Service can claim taxes due for 3 years from the tax due date, 6 years from the tax due date if substantial errors are discovered.[97] The Statute of Limitations for various state taxing authority will vary from state to state. State and federal statutes require retention of personnel, employment and other human resource documents. These types of records should be retained for as long as an employee is employed and six (6) years after the employee leaves. However, this is an example of a record your company may NOT want to keep beyond the statutory requirements.

The length of time you need to retain documents also depends on the state in which you do business. The Statute of Limitations period for legal action by you, your customer, your employees, any taxing authority or other government regulators will vary from state to state and for federal agencies. The Statute of Limitations in Virginia to enforce a default on a written contract is 5 years. However, in Louisiana it is ten (10) years. You certainly want to retain documents for as long as you are at risk of legal action. This is all beyond the scope of this outline.

REVIEWING AND REVISING CONTRACTS RECEIVED

The guidepost in determining the legal responsibilities is the contract itself. The contract constitutes the law that governs the parties' relationship.[98] Where sophisticated businessmen enter into an arms-length transaction, a court will enforce the terms of the agreement, unless it would be unreasonable or unjust.[99] When an agreement is plain and unambiguous in its terms, it has full effect.[100]

Legal clients often want to tell their lawyer a story and then ask, "What is the answer?" The "answer" usually is that "We need to read your contract to know." Construction industry buyers and sellers are sophisticated business professionals. They will be held to the terms in their contract documents. The construction industry generally works with sophisticated and detailed contract form documents that determine the result of most problems and disputes on a construction project. Construction industry buyers and sellers essentially decide for themselves what "the law" will be for their transaction through these contract documents.

When customers do insist on using their own contract form, you or someone in your risk management or credit management department must be able to read them and negotiate modifications that will limit your exposure and add important protections. This can often be a daunting task, but it can directly impact your costs and easily make the difference in collecting your accounts. There are a limited number of provisions that will truly impact your cost and risk, which are very repetitive and easy to find in contract forms. You may be more willing to accept the form of an established customer with whom you have a track record. If your risk analysis has left you nervous because

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[95] *Traynum v. Scavens*, 416 S.C. 197, 786 S.E.2d 115 (2016).

[96] *See* D.C. Code § 28-4911(c); Md. COMMERCIAL LAW Code Ann. § 21-111(c); 73 P.S. § 2260.308(c); S.C. Code Ann. § 26-6-120(c); Va. Code Ann. § 59.1-490(c). *Also see*, http://www.uniformlaws.org/shared/docs/electronic%20transactions/ueta_final_99.pdf at Section 12(c), p. 38.

[97] *See* 26 USCS § 6501(a) and (e). *See* the I.R.S. website for information on statute of limitations with respect to audits at: https://www.irs.gov/businesses/small-businesses-self-employed/irs-audits.

[98] *McDevitt & Street Co. v. Marriott Corp.,* 713 F. Supp 906, 914 (E.D. Va 1989), aff'd in part and rev'd in part 911 F.2d 723 (4th Cir. 1990), on remand 754 F. Supp 513 (E.D. Va. 1991, *citing Chantilly Construction Corp. v. John Driggs Co.,* 45 B.R. 297, 306 (Bankr.E.D.Va.1985); *Bob Grissett Golf Shoppes, Inc. v. Confidence Golf Co.,* 44 B.R. 156, 159 (Bankr.E.D.Va.1984); *Russell County v. Carroll,* 194 Va. 699, 703, 74 S.E.2d 685, 687-88 (1953).

[99] *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1, 92 S.Ct. 1907, 32 L.Ed.2d 513 (1972).

[100] *McLean House v. Maichak*, 231 Va. 347, 349, 344 S.E.2d 889, 890 (1986); *Gordonsville Energy v. Virginia Elec. & Power Co.*, 257 Va. 344, 354, 512 S.E.2d 811, 817 (1999) [reiterating that "when contract terms are clear and unambiguous, the words used by the parties must be given their plain and ordinary meaning"].

the customer is new or undercapitalized, you must take the time to make sure you have preserved a few important legal rights.

If an owner or general contractor has given you a contract form to sign, you may not be in a position to demand substantial changes. It is often not worthwhile to review, discuss or attempt to negotiate a contract agreement in great detail. First, owners or general contractors are not normally willing to change many terms. Second, there are many terms that are unlikely to ever cause a practical problem. Third, it can be very expensive in terms of legal fees and good will. Accordingly, in making proposed revisions you are looking for items that are likely to cause you practical problems, with a potential for large cost to you, and which an owner or general contractor is more likely to agree to modify. You are looking for the "greatest hits."

Some of the following discussion only applies to subcontractors, while some is applicable to all contractors. The terms "seller" and "customer" or "buyer" are sometimes used instead of "general contractor" or "subcontractor" to avoid offense or confusion. In revising contracts, general contractors and subcontractors will want to add many of the same provisions described in the sample Credit Application, Proposal for Labor and Materials, and Supplier Proposal, found in the Appendices. Any contractor should refer to these above sections when reviewing contracts received from other parties.

Incorporating Proposal

When a customer insists on using its own long form, many contractors can still succeed in attaching their proposal as an exhibit to the contract. It is logical to attach your proposal to describe your bid, to describe the specifications of the work and to quietly include a few critical contract terms. Add one sentence in the contract form stating that the proposal is "incorporated herein by reference and made a part of this contract."

This can be done with the sample Proposal for Labor and Materials and Supplier Proposal. You can also do this with a proposal drafted on a computer. Some of the contract terms on your proposal will now conflict with the terms in your customer's contract. In the event of problems, you would much rather have terms in conflict, with some of the terms for your benefit, rather than having all the terms favor the customer.

Waiver of Lien or Bond Rights

Lien and bond waivers are discussed in detail in the section below titled Waiver Forms.[101]

In connection with contract review, however, it is important to know that many construction contracts state that the seller may not lien the project. This means what it says in most states. If you sign a contract with a waiver, the courts may strike your lien. If the customer is insolvent, this probably means you just worked for nothing.

Some states have created special laws making some waivers in contracts "void as a matter of public policy." Lien rights cannot be contractually waived in Maryland, for example, unless the waiver is a separate document signed after the contract.[102] In Virginia, a subcontractor, lower-tier subcontractor, or material supplier may not waive or diminish lien or bond rights in a contract in advance of furnishing any labor, services, or materials.[103] Waivers are also limited in Pennsylvania.[104] If you are not in a state with special legislation, however, the general rule will apply that any legal right can be waived in a contract as long as it is a clear waiver.

The importance of lien rights depends on the financial strength of your customer. If the customer is never going to run out of money, your lien rights do not matter. If your customer is a small, closely held corporation or an individual, your lien rights are absolutely critical.

Lien rights are normally considered "hallowed ground" in the construction industry. Owners and general contractors will normally agree to modify or delete lien waivers in a contract. General contractors do not have lien rights unless the owner owes them money. In other words, it is a part of any lien proceeding for a general contractor to prove that they are owed money and that the owner breached the contract. The lien only provides security for that money if the owner is insolvent. The owner has nothing to worry about as long as it is not in breach of contract.

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[101] *See* section below, Contract Administration; subsection, Waiver Forms.

[102] Maryland Real Property Code Section 9-113(c).

[103] Va. Code Anno. §43-3 (Michie 1950); Va. Code Anno. §2.2-4341 (C) (Michie 1950); Va. Code Anno. §11-4.1:1 (Michie 1950).

[104] 49 P.S. §1401(a) & (b)(2).

In a “defense of payment” mechanic’s lien state, a subcontractor cannot enforce a lien unless the owner owes the general contractor money.[105] In other words, an owner and the property are only liable to pay a subcontractor what is owed to the general contractor anyway. Owners are in a radically different position in a state with no defense of payment, however.[106]

Complete waivers of lien rights are sometimes included in progress payment waivers, even for work supplied in the future. Progress payment waivers are discussed in more detail later in this chapter.[107] However, it is important to notice whether a progress waiver form is attached to the contract as an exhibit and you are agreeing to sign this waiver form in exchange for each progress payment. You may be agreeing in advance to permanently waive lien rights in exchange for your first progress payment. If a progress waiver form is attached to the contract as an exhibit, you must review and modify that waiver now as a part of your contract review.

Contractors can consider adding the following language concerning waivers to help avoid an accidental waiver of lien or bond rights:

> All mechanic’s lien, payment bond or similar waivers or restrictive endorsements on checks shall be effective only to the total dollar amount of payments actually received without any bankruptcy filing for ninety (90) days thereafter. Customer agrees that Seller retains its mechanic’s lien, payment bond or other legal rights for unpaid deliveries, regardless of what other documents may imply otherwise.

Otherwise, some later contracts and progress payment waivers will waive *all* lien or bond rights, even though the seller has not been paid in full. This provision may not be enforceable against any owner or bank that is not a party to the contract. There is more information on this problem in the section below titled Waiver Forms.

Subordination of Mechanic’s Lien Rights

Subordination of mechanic’s lien rights to the rights of the construction lender can be as deadly as a complete waiver in states such as Virginia with a high mechanic’s lien priority. This subordination gambit may include assurances that you are not waiving your rights at all but “merely” subordinating them. While this statement is technically true, from a practical point of view you might as well not have lien rights at all. If a project goes belly up, it is normally over-encumbered by the construction loan. Upon foreclosure, the lender will receive less than what it is owed. In this case, all subordinate or “junior” liens are wiped out forever. If the project does not go belly up, you are probably not going to need your lien rights anyway. Subordination of mechanic’s lien rights is not as big an issue in states, such as Maryland and Pennsylvania, where your mechanic’s lien is already inferior to the construction lender.

Notice and Opportunity to Cure

This may be the single most important clause in the contract for a contractor or supplier.[108] Watch out for clauses that state simply:

> If seller breaches any provision of this contract, then buyer may declare this contract in default and terminate this contract on written notice to seller.

Under this clause, the contractor can wake up one morning, without any notice, and discover that its contract has been terminated. It is very important to modify this term so that the seller is not in “default” until the seller has received notice of the breach and has failed to correct the breach within a reasonable period of time. The previous clause should be changed to read:

> If seller breaches any provision of this contract *and seller does not begin to diligently cure such default, within ten (10) days after receiving written notice specifying the default*, then buyer may declare this contract in default and terminate this contract on written notice to seller.

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[105] *See* chapter, Mechanic’s Lien Rights and General Principles; section, Defense of Payment: Owner’s Responsibility for Payment to Subcontractors. *See also* chapters on Mechanic’s Liens in Virginia and the District of Columbia; sections on Defense of Payment: Owner’s Responsibility for Payment to Subcontractors.

[106] *See* chapters, Mechanic’s Liens in Maryland and Pennsylvania; sections on Defense of Payment: Owner’s Responsibility for Payment to Subcontractors.

[107] *See* section below, Contract Administration; subsection, Waiver Forms.

[108] *See* chapter, Default and Termination; section, Seller in Default.

This clause is the most advantageous to a contractor. Note that the contractor does not have to completely cure the default within 10 days, only diligently begin to cure. Some defaults cannot be cured in 10 days. Also note that the contractor must actually receive notice of the breach. There is often a question whether or when notice was actually received. It is also important that the clause requires the notice to be written and to specify the breach. Verbal notice of breach should not be effective to terminate the contract. Owners or general contractors will sometimes send vague written notices declaring a contractor to "be in breach." A contractor cannot effectively cure a breach, however, if they do not know the specific complaint.

Contracts sometimes have one provision discussing the owner or general contractor's right to *terminate* the contract on default and other provisions allowing *supplementation* of the contractor's forces or allowing a cure of the breach and a back charge of the costs. Make sure each of these provisions contains the same requirement for notice and an opportunity to cure before you are liable for costs.

A contractor can consider adding a requirement that the buyer has to provide notice fairly promptly if there are any defects, to allow the seller to see the problem and to have an opportunity to repair. Otherwise, the buyer will lose the right to claim breach of contract or breach of warranty. This is accomplished as follows:

> Buyer shall make a careful inspection of all labor and material at the time of delivery. Buyer's failure to give written notice specifying any claim within ten (10) days of delivery shall constitute an unqualified acceptance of the labor and material delivered and a waiver of all claims. Seller will not be liable for any damage, warranty or remedy and back charges will not be accepted without prior notification, an opportunity to view and repair, replace or otherwise cure, and approval by Seller.

Attorney's Fees and Interest

Most customer contract forms do not allow the seller to recover attorney's fees. Even worse, attorney's fees are often recoverable by the customer but not the seller (unilateral provision). This is a difficult situation for the customer to justify. What is good for the goose is good for the gander. If a customer must have an attorney's fee provision to protect itself from the horrible things a seller can do, then a seller also needs an attorney's fee provision to protect itself.

Contractors should review the discussion above regarding attorney's fees provisions in their own contract forms.[109] The usual rule in the U.S. is that no attorney's fees can be recovered unless the defendant has agreed *in writing* to pay attorney's fees.

Contractors want an attorney's fee provision, since they are the most likely to be a plaintiff in litigation. If a seller breaches its contract, the customer can usually withhold money. They can make themselves whole without resorting to litigation. If a customer breaches, however, the seller must litigate to change the "status quo." The seller cannot make itself whole without recovering the cost of litigation. Your buyer has leverage on you from holding your purchase price for your labor and material. You must make sure the debtor will pay a penalty for holding your money and, therefore, is motivated to resolve the dispute.

Attorney's fees provisions should always be "bilateral." Either both parties get them or neither gets them. Sellers will usually prefer to have an attorney's fee provision, since they are the most likely to be a plaintiff in litigation. It is normally best to change a few words in the contract to make a unilateral attorney's fees clause bilateral (going both ways). Where the contract says

> if (sub)*contractor* breaches this contract, then it will be liable for attorney's fees

change this to say:

> if *either party* breaches this contract, then it will be liable for attorney's fees.

You could also add a bilateral provision anywhere in the contract:

> In any action or proceeding involving a dispute arising out of this agreement, the prevailing party shall be entitled to receive from the other party reasonable attorney's fees to be determined by a court or arbitrator.

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[109] *See* section above Contractor and Supplier Contract Forms; subsections, Contractor Proposals and Contracts, Service Charges and Attorney's Fees.

You may even want to add your own unilateral provision:

> In the event that General Contractor (or owner) breaches this contract or in the event arbitration, litigation or other dispute resolution is instituted by either party, then (Sub)Contractor shall be entitled to recover its costs and attorney's fees.

Unilateral attorney's fees provisions are often in the Indemnity Provisions in the subcontract. These indemnities are primarily for insurance or personal injury purposes, but sometimes add unilateral liability for attorney's fees for contractual disputes.

Indemnity Provisions

Contracts normally state something to the effect that:

> (Sub)Contractor agrees to defend, indemnify and hold harmless General Contractor (or Owner) and their agents and employees, against any claim, cost, expense or liability (including attorney's fees) attributable to bodily injury, sickness, disease or death, or damage, loss or destruction of property caused by, arising out of, resulting from or occurring in connection with the performance of the Work by (Sub)Contractor or their agents or employees, whether or not caused in part by the active or passive negligence or other fault of a party indemnified hereunder.

This is an indemnity clause protecting the owner or general contractor in the event of an accident causing injury or property destruction. It is not normally worthwhile to try to draft the perfect insurance provisions or the perfect indemnification provisions. This would be very time consuming and expensive, and the owner or general contractor is unlikely to agree to changes. If possible, a contractor would like to state that "this duty shall not arise to the extent that the injury or damage is caused by the negligence of others" or at least "the *gross* or *sole* negligence of others." Consider adding a statement that any indemnity "shall apply only to the extent of insurance coverage."

From a practical point of view, it is most important to send a copy of this contract to your insurance agent and ask for confirmation that your insurance will cover the risk described in these parts of the contract. Insurance providers should be expert risk managers and should be able to help you understand and insure against these risks.

Watch for indemnity provisions that include *contractual* liability by stating that the contractor indemnifies against damage:

> ... attributable to *breach of this subcontract*, bodily injury, sickness, disease or death, or damage, loss or destruction of property caused by, arising out of or resulting from occurring in connection with the performance of the Work by (Sub)Contractor.

This is essentially a unilateral attorney's fee provision as discussed above. The subcontractor would want to at least add a bilateral attorney's fee provision discussed above.

Some state codes, such as Virginia and Maryland, do limit the enforceability of clauses that require indemnification if the damage is caused by the sole negligence of the indemnified party.[110] The indemnification clause above does exactly that and would be entirely unenforceable for this reason in Virginia. To be enforceable in Virginia, the clause would have to require indemnity "*only to the extent* caused in whole or in part by any negligent act or omission of Buyer." Maryland courts, however, would not find the entire provision unenforceable. If the provision allowed recovery for concurrent or sole negligence, Maryland courts would require indemnity from damage caused by concurrent negligence.[111]

Accordingly, if you are reviewing such an indemnity clause in Virginia, you would not want to change a thing. The clause would be unenforceable, as if it was not even in the contract, even if you did partially cause the disputed damage.[112]

[110] Va. Code Anno. §11-4.1 (Michie 1950); Maryland Courts and Judicial Proceedings Section 5-401.

[111] *Bethlehem Steel Corp. v. G.C. Zarnas & Co*., 304 Md. 183, 194-95, 498 A.2d 605, 610-11 (1985).

[112] *Uniwest Constr., Inc. v. Amtech Elevator Servs*., 280 Va. 428, 441-41, 699 S.E.2d 223, 230 (2010).

Contract Schedule

Most contracts provide that a seller will be in default if it is unable to keep to a delivery schedule.[113] Many contracts also provide, however, that the buyer can modify the contract schedule from time to time. This may put a seller in an unavoidable default. The seller will be in default, for example, if the buyer cuts production time in half or doubles the length of a project. A seller may not have the manpower to complete production in less time and may not have a claim for overtime or other costs. Project schedule extensions can also be troublesome if the seller has already committed to other projects.

You may know that you need a certain amount of time to mobilize on a project, to order materials, or to take measurements before you can begin work. If so, make sure your contract says so. Contractors also generally prefer a definite starting date in their contract, rather than a need to mobilize immediately on a "notice to proceed." Then if the start of the project is delayed, you may have a claim for overtime or disruption of your schedule on other projects.

It is a good policy to attach an actual projected contract schedule as an exhibit to the contract. Eliminate any terms allowing the buyer to change this schedule without the seller's consent. Remember that a defined schedule will cut both ways. If the actual projected contract schedule is attached as an exhibit, then you will probably need to keep up with this schedule. If possible, allow for some flexibility in your own scheduling.[114]

> These dates reflect the (Sub)Contractor's best estimates and assume normal job, site and weather conditions, the availability of materials, the prompt cooperation of the General Contractor (or owner), and free access to all work areas. The (Sub)Contractor is not responsible for delays caused by conditions beyond its control.

Force Majeure

Most contracts state that a contractor is not responsible for delays from causes beyond the contractor's control. In fact, some state contractor's regulations require such an explicit "force majeure" clause in contracts.[115]

Many contractors make the mistake of thinking they are never responsible for delays out of their control, but this is not true. You have to make sure it is in your contract.

Most construction contracts will state that "Time is of the Essence." This means what it says in a construction contract. In the absence of an "excusable delay" or "*force majeure*" term in the contract, a time is of the essence clause can leave a contractor liable for damages in the event of delay, even if the contractor did not cause the delay.[116] If your contract has a definite completion date and does not have a "force majeure" term, you can be liable for delay, even if caused by the owner or other third parties.

It may be enough to add the simple statement that "contractor is not responsible for delays from causes beyond the contractor's control." Of course, it is even better to add a more developed "force majeure" term stating:

> If the Contractor is delayed at any time in the commencement or progress of the Work by an act or neglect of the Owner or Architect, or of an employee of either, or of a separate contractor employed by the Owner, or by changes ordered in the Work, or by labor disputes, fire, unusual delay in deliveries, unavoidable casualties or other causes beyond the Contractor's control, then the Contract Time shall be extended by Change Order for a reasonable time.

Limitation of Liability

Contractors would certainly like to add limitations of liability provisions to any contract and should review that discussion above for clauses to add to a contract.[117] Contractors should consider adding language that limits the buyer's remedies and the seller's liability for damages.

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[113] *See* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsections, Contract Duration and Schedule and Time of the Essence.

[114] *See* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsection, *Force Majeure* and Excusable Delays.

[115] *See e.g., Virginia Board of Contractors Regulations,* 18 VAC 50-22-260 (B)(9)(d).

[116] *Sands v. Quigg,* 111 Va. 476, 69 S.E. 440 (1910).

[117] *See* section above, Contractor and Supplier Contract Forms; subsection, Supplier Credit Applications and Proposals; sub-subsection, Limitation of Liability. *See also* subsection, Contractor Proposals and Contracts.

> Seller agrees to replace or, at Seller's option, repair any defective goods within a reasonable time. Customer's remedies for any delay or any defect in the materials are subject to and limited by any limitations contained in the manufacturer's terms and conditions to Seller. Further, Customer's sole and exclusive remedy and Seller's limit of liability for any and all loss or damage resulting for breach of warranty, from defective or non-conforming goods or any other cause shall be for the purchase price paid for the particular delivery and materials with respect to which loss or damage is claimed, plus any transportation charges actually paid by the Customer. THE FOREGOING WARRANTY IS IN LIEU OF ALL OTHER WARRANTIES, WHETHER WRITTEN, ORAL, EXPRESS OR IMPLIED, INCLUDING THE WARRANTY OF TITLE, AGAINST LIENS, INFRINGEMENT, THE WARRANTY OF MERCHANTABILITY AND THE WARRANTY OF FITNESS FOR A PARTICULAR PURPOSE. IN NO EVENT SHALL SELLER OR ANY OF THEIR PARENTS OR AFFILIATES, OR ANY OF ITS/THEIR RESPECTIVE DIRECTORS, OFFICERS, EMPLOYEES OR REPRESENTATIVES, BE LIABLE HEREUNDER OR IN CONNECTION HEREWITH FOR ANY SPECIAL, RELIANCE, CONSEQUENTIAL, DELAY, EXEMPLARY, PUNITIVE, INCIDENTAL, LIQUIDATED, OR INDIRECT DAMAGES, INCLUDING WITHOUT LIMITATION, FOR LOSS OF PROFITS, INCOME, USE, OR TIME, WHETHER IN CONTRACT, TORT, OR OTHERWISE.

When reviewing contract forms received, it is equally important to notice the limitations of liability that a customer has placed in a contract. The contract may waive your right to delay damages or consequential, incidental, special or punitive damages. Waivers of consequential damages and "no damage for delay" clauses are discussed in greater detail in another chapter of this book.[118] The issue is your ability to get full (or any) compensation if an owner or general contractor causes you to incur additional costs.

No damage for delay clauses are generally enforceable.[119] Such clauses often limit the consequences of delay to a time extension and then only if the contractor provides timely written notice of the delay. Damages resulting from delay will not be allowed in any event. You could incur large field office and home office overhead costs, for example, if a project is delayed for months because of design defects. If you have agreed to a "no damage for delay" clause, you simply may have to absorb these costs. You would prefer to strike out such a "no damage for delay" clause if possible, or modify it to allow damages caused by the owner, caused by gross negligence or some other standard.

A waiver of consequential damages is somewhat broader and may include a waiver of delay damages. Consequential damages are also difficult to define. To avoid confusion, contracts sometimes identify or define direct damages that are recoverable and consequential damages that are not recoverable. You should review these definitions to determine whether any waived damages are likely to occur and cost you substantial money. Again, you would prefer to strike out such a waiver of consequential damages clause if possible, modify some of the types of damages defined as consequential or modify it to allow damages caused by the owner, caused by gross negligence or some other standard.

Warranties

Contractors would certainly like to add exclusion of warranties to any contract and should review that discussion above for clauses to add to a contract.[120] Contractors should consider adding language to their agreements that limit the seller's liability for express and implied warranties. A contractor can be subject to implied warranties under the

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[118] *See* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsections, No Damage for Delay and Waiver of Consequential Damages.

[119] *McDevitt & Street Co. v. Marriott Corp.,* 713 F. Supp 906, 921 (E.D. Va 1989), aff'd in part and rev'd in part 911 F.2d 723 (4th Cir. 1990), on remand 754 F. Supp 513 (E.D. Va. 1991).

[120] *See* section above, Contractor and Supplier Contract Forms; subsection, Contractor Proposals and Contracts; sub-subsection, Exclusion of Warranties.

contract[121] and the Uniform Commercial Code.[122] Homebuilders are often bound to implied warranties in residential construction by statute.[123] Contractors should consider adding a waiver of express and implied warranties.

An exclusion of warranty should be "conspicuous." This is why you often see such language in large print, all caps, in a contract or written warranty. This would make the exclusions conspicuous as a matter of law.[124]

> Seller agrees to replace or, at Seller's option, repair any defective goods within a reasonable time. Customer's remedies for any delay or any defect in the materials are subject to and limited by any limitations contained in the manufacturer's terms and conditions to Seller. Further, Customer's sole and exclusive remedy and Seller's limit of liability for any and all loss or damage resulting for breach of warranty, from defective or non-conforming goods or any other cause shall be for the purchase price paid for the particular delivery and materials with respect to which loss or damage is claimed, plus any transportation charges actually paid by the Customer. THE FOREGOING WARRANTY IS IN LIEU OF ALL OTHER WARRANTIES, WHETHER WRITTEN, ORAL, EXPRESS OR IMPLIED, INCLUDING THE WARRANTY OF TITLE, AGAINST LIENS, INFRINGEMENT, THE WARRANTY OF MERCHANTABILITY AND THE WARRANTY OF FITNESS FOR A PARTICULAR PURPOSE. IN NO EVENT SHALL SELLER OR ANY OF THEIR PARENTS OR AFFILIATES, OR ANY OF ITS/THEIR RESPECTIVE DIRECTORS, OFFICERS, EMPLOYEES OR REPRESENTATIVES, BE LIABLE HEREUNDER OR IN CONNECTION HEREWITH FOR ANY SPECIAL, RELIANCE, CONSEQUENTIAL, DELAY, EXEMPLARY, PUNITIVE, INCIDENTAL, LIQUIDATED, OR INDIRECT DAMAGES, INCLUDING WITHOUT LIMITATION, FOR LOSS OF PROFITS, INCOME, USE, OR TIME, WHETHER IN CONTRACT, TORT, OR OTHERWISE.

The smaller wording at the beginning of this paragraph describes the limited warranty discussed above. The "conspicuous" language in large print, all caps, excludes express and implied warranties.

Contractors are almost always expected to provide some warranty that the work will comply with the contract documents and to agree to replace or repair work for some period of time after project completion. Warranties sometimes go further than this, however, and it is important to review the warranty definition to make sure it is limited to an agreement to replace or repair work that does not comply with the contract documents and is the result of labor or material provided by the contractor.[125] It is also important to understand the difference between the length of the express warranty and the statute of limitations for breach of contract. Your obligation to return to the project to correct work may last much longer than you think.

The American Institute of Architects (AIA) Document A201-2017 (General Conditions of the Contract for Construction) states:

> **3.5 WARRANTY**
>
> **3.5.1** The Contractor warrants to the Owner and Architect that materials and equipment furnished under the Contract will be of good quality and new unless the Contract Documents require or permit otherwise. The Contractor further warrants that the Work will conform to the requirements of the Contract Documents and will be free from defects, except for those inherent in the quality of the Work the Contract Documents require or permit. Work, materials, or equipment not conforming to these requirements may be considered defective. The Contractor's warranty excludes remedy for damage or defect caused by abuse, alterations to the Work not executed by the Contractor, improper or insufficient maintenance, improper operation, or normal wear and tear and normal usage. If required by the Architect, the Contractor shall furnish satisfactory evidence as to the kind and quality of materials and equipment.

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[121] *Milton Co. v. Council of Unit Owners of Bentley Place Condominium*, 121 Md. App. 100, 708 A.2d 1047, affirmed 354 Md. 264, 729 A.2d 981 (1999) [condominium association allowed recovery for common area defects on grounds of contractor's breach of implied warranty that the work would be completed in a workmanlike manner]; *Groff v. Pete Kingsley Building Inc.*, 372 Pa. Super 377, 543 A.2d 128 (1988).

[122] *See* chapter, Uniform Commercial Code Sale of Goods; section, Warranties.

[123] Va. Code Anno. §55-70.1 (Michie 1950); Maryland Real Property Code Section 10-204(b).

[124] *Armco, Inc. v. New Horizon Dev. Co.*, 229 Va. 561, 567, 331 S.E.2d 456, 460 (1985).

[125] *Bridgestone/Firestone, Inc. v. Prince William Square Associates*, 250 Va. 402; 463 S.E.2d 661 (1995).

Notice that there is no limitation to the length of time that this obligation continues. AIA Document A201-2017 (General Conditions of the Contract for Construction) and many other contract forms do contain a one-year duty to correct defective work, often referred to as a "call back" period.

> **12.2.2 AFTER SUBSTANTIAL COMPLETION**
>
> **12.2.2.1** In addition to the Contractor's obligations under Section 3.5, if, within one year after the date of Substantial Completion of the Work or designated portion thereof or after the date for commencement of warranties established under Section 9.9.1, or by terms of an applicable special warranty required by the Contract Documents, any of the Work is found to be not in accordance with the requirements of the Contract Documents, the Contractor shall correct it promptly after receipt of notice from the Owner to do so unless the Owner has previously given the Contractor a written acceptance of such condition. The Owner shall give such notice promptly after discovery of the condition. During the one-year period for correction of Work, if the Owner fails to notify the Contractor and give the Contractor an opportunity to make the correction, the Owner waives the rights to require correction by the Contractor and to make a claim for breach of warranty. If the Contractor fails to correct nonconforming Work within a reasonable time during that period after receipt of notice from the Owner or Architect, the Owner may correct it in accordance with Section 2.54.
>
> **12.2.5** Nothing contained in this Section 12.2 shall be construed to establish a period of limitation with respect to other obligations the Contractor might have under the Contract Documents. Establishment of the one-year period for correction of Work as described in Section 12.2.2 relates only to the specific obligation of the Contractor to correct the Work, and has no relationship to the time within which the obligation to comply with the Contract Documents may be sought to be enforced, nor to the time within which proceedings may be commenced to establish the Contractor's liability with respect to the Contractor's obligations other than specifically to correct the Work.

The "statute of limitations" is the period of time that a claimant can wait before filing suit to enforce a contract or warranty. The statue of limitations varies from state to state, but litigants usually have a long time to enforce a written contract. The statute of limitations for breach of a written contract in Virginia, for example, is five years. Contractors must assume that they have five years of exposure, no matter what the contract says about the length of the warranty period.[126]

It is difficult to identify the difference in the standard between these provisions. It may be that one-year warranty is a "no fault" provision. In other words, an owner does not need to prove *why* work failed. The contractor has agreed to repair or replace any work for one year, regardless of the reason for the defect, so long as it was not due to abuse or neglect by the owner.[127] The owner does not need to prove the cause of the defect during the one-year period.[128] It does seem clear that an owner would have to prove there was a breach of contract to enforce that contract beyond the warranty period.[129]

If a contractor wants to make sure that there is no exposure after the expiration of an express warranty, it is important to state in the contract that the warranty is the "sole and exclusive remedy."[130]

Trust Fund Agreement

Trust fund statutes and trust fund agreements are discussed in detail in another chapter of this book; they are an important and underutilized opportunity for all contractors.[131] Subcontractors would certainly like to add a Trust Fund Agreement to any subcontract and should review that discussion above.[132]

It is possible to add clear trust language to a joint check agreement or to subcontract with just a few sentences.

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[126] *All Seasons Water Users Association v. Northern Improvement Co.*, 399 N.W.2d 278, 285 (N.D. 1987).

[127] *All Seasons Water Users Association v. Northern Improvement Co.*, 399 N.W.2d 278, 285(N.D. 1987).

[128] *Nelson v. Marchand*, 691 N.E.2d 1264, 1279 (Ind.Ct.App. 1998).

[129] *All Seasons Water Users Association v. Northern Improvement Co.*, 399 N.W.2d 278 (N.D. 1987).

[130] *Bender Miller Co. v. Thomwood Farms, Inc.*, 211 Va. 585, 179 S.E.2d 636 (1971); *Magar v. Lifetime, Inc.*, 187 Pa, Super. 143, 144 A.2d 747 (1958); *Mead Corp. v. ABB Power Generation, Inc.*, 319 F.3d 790 (6th Cir. 2003).

[131] *See* chapter, Trust Fund Laws and Agreements.

[132] *See* section above, Contractor and Supplier Contract Forms; subsection, Supplier Credit Applications and Proposals; sub-subsection, Trust Fund Agreement.

> General Contractor agrees that all funds received from the Owner, to the extent those funds result from the labor or materials supplied by Subcontractor, shall be held in trust for the benefit of Subcontractor (Trust Funds). General Contractor agrees it has no interest in Trust Funds held by anyone, to segregate and to make no use of, except to promptly account for and transmit to Subcontractor all such Trust Funds no later than on demand.

A general contractor could include a similar provision stating that the owner will hold in trust all funds received from the construction lender. As discussed in the chapter on Trust Fund Agreements, a general contractor will also want a Trust Fund provision in its subcontracts to protect against costs of completion or bond claims in subcontractor bankruptcies.[133]

The Right to Stop Work

Contractor should consider adding the right to stop work in the event of nonpayment or dispute. If you have a contract with a defined scope of work, you have an obligation to supply that scope of work in the scheduled time. Even if a customer is late in paying you, you may need to continue to send money out the door. It is very difficult to tell when a customer has breached the contract so completely that you have no further obligation.[134] The customer may be in breach for paying you late, but you may also be in breach for failing to supply in a timely manner.

This problem can be largely avoided with a contract term allowing you to stop supplying labor and materials until disputes are resolved if a payment is not received *for any reason*. It is also important that this situation results in a time extension on the contract. This puts the pressure on the customer to resolve disputes with you and make payment.

> In the event that the General Contractor (or Owner) fails for any reason to make a Scheduled Payment when due, the (Sub)Contractor shall have the right to suspend performance and the time to complete the contract shall be extended for the period of such suspension. If the General Contractor (or Owner) shall default in this or any other obligation in this contract after having received written notice, then (Sub) Contractor may give the General Contractor (or Owner) ten (10) days written notice of their intent to terminate this contract. If the General Contractor (or Owner) shall not take immediate remedial action within the 10-day period, the (Sub)Contractor may terminate this contract.

An even stronger contract term states:

> Seller shall have no obligation to begin or continue performance until adequate credit and funding information is provided, at any time on request of Seller. Seller may stop the manufacture or supply of any labor or materials when it, in its sole discretion, determines that Buyer is in breach of this Agreement or any other contract with Seller, or Seller has insecurity with respect to funding or creditworthiness, until payment is made and any dispute or insecurity has been resolved.

This allows the seller to stop work when it, *in its sole discretion*, determines that the customer's creditworthiness or funding are in question or that the customer is in breach.

This provision could also state, "In no event shall Seller be liable for any damage due to delay of any type, nor consequential, special or punitive damages." This includes what is known as a "no damage for delay" clause and is generally enforceable.[135] This clause, coupled with the right to stop work, should protect sellers who desire to stop performance because of payment or funding problems.

Monitoring and Verifying Funds for the Project

Change orders, delays and cost overruns are often the cause of a project's failure. An inexperienced owner or architect and a bad set of plans can cause terrific overruns. Contractors often view this as their very objective, but this is often shortsighted. If the project fails or there is not enough money to finish, a contractor may not collect for

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[133] *See* chapter, Trust Fund Laws and Agreements; section, Trust Fund Agreements; subsection, Protective Provisions for Owners and General Contractors.

[134] *See* chapter, Default and Termination; sections, The Right to Stop Work for Non-Payment, The Law and The Realities.

[135] *See* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsection, No Damage for Delay.

change order work performed. This is particularly a problem for subcontractors with a "pay if paid" clause in their contract.[136]

An owner may begin ordering changes because of a bad set of plans or because he wants to build the Taj Mahal, but has the lender agreed to fund these changes? The owner may even keep the lender in the dark because the owner does not want the lender to know there are problems.[137] Toward the end of the project, there is another $300,000 worth of work to do, $200,000 in retention held and no money left on the construction loan. The owner then begins defaulting on payments to the contractors and to the lender.

Delays and accelerations present the same problem. These are in effect change orders. Is there enough money to pay for the acceleration or to compensate for delays? A contractor should continually monitor the financial health of the project as much as possible. This is especially important with a cost plus contract or when large change orders are requested.

The most important term would include the right to verify adequate funds to complete the project before the project begins and at various later stages of the project. At a minimum, the contractor should have the right to verify funding for change orders in excess of a certain dollar amount. In the case of a cost plus time and materials contract, the seller should be able to verify funding once the original budget is surpassed.

A contractor should strive for a contract term allowing it to monitor the health of the project and adequate funding as often as necessary. This is especially important when you have a cost plus time and materials contract, when large change orders are requested or when it is apparent that the project schedule will be much longer than planned. At a minimum, the seller should be allowed to verify funding for change orders in excess of a certain dollar amount. In the case of a cost plus time and materials contract, the seller should be able to verify funding once the original budget has been surpassed. The seller should have the contractual right to refuse to perform any further work if adequate funds cannot be established. A similar term actually appears in AIA Document A201-2017 (General Conditions of the Contract for Construction), which reads:

> **2.2.1** Prior to commencement of the Work and upon written request by the Contractor, the Owner shall furnish to the Contractor reasonable evidence that the Owner has made financial arrangements to fulfill the Owner's obligations under the Contract. The Contractor shall have no obligation to commence the Work until the Owner provides such evidence. If commencement of the Work is delayed under this Section 2.2.1, the Contract Time shall be extended appropriately.
>
> **2.2.2** Following commencement of the Work and upon written request by the Contractor, the Owner shall furnish to the Contractor reasonable evidence that the Owner has made financial arrangements to fulfill the Owner's obligations under the contractor only if (1) the Owner fails to make payments to the Contractor as the Contract Documents require; (2) the Contractor identifies in writing a reasonable concern regarding the Owner's ability to make payment when due; or (3) a change in the Work materially changes the Contract Sum. If the Owner fails to provide such evidence, as required, within fourteen days of the Contractor's request, the Contractor may immediately stop the Work and, in that event, shall notify the Owner that the Work has stopped. However, if the request is made because a change in the Work materially changes the Contract Sum under (3) above, the Contractor may immediately stop only that portion of the Work affected by the change until reasonable evidence is provided. If the Work is stopped under this Section 2.2.2, the Contract Time shall be extended appropriately and the Contract Sum shall be increased by the amount of the Contractor's reasonable costs of shutdown, delay and start-up, plus interest as provided in the Contract Documents.
>
> **2.2.3** After the Owner furnishes evidence of financial arrangements under this Section 2.2, the Owner shall not materially vary such financial arrangements without prior notice to the Contractor.

It is also helpful to have the right to consult the architect, lender and any other persons who may have knowledge concerning the health of the project, funding, scheduling, expected changes and other matters. You also may consider

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[136] *Moore Bros. Co. v. Brown & Root, Inc*., 207 F.3d 717 (4th Cir. 2000).

[137] *Moore Bros. Co. v. Brown & Root, Inc*., 207 F.3d 717 (4th Cir. 2000).

the right to run credit checks on the general contractor or owner.[138] If you are doing business with a small, closely held company or an individual, it is always the best practice to obtain authorization to run both corporate and *individual* credit checks and to contact various references, including lenders. The following term accomplishes these objectives.

> I/We authorize Seller from time to time to obtain Business and Consumer Credit Reports on Buyer or any principals of Buyer or to obtain credit and funding information from any other source. Seller shall have no obligation to begin or continue performance until adequate credit and funding information is provided, at any time on request of Seller. Seller may stop the manufacture or supply of any labor or materials when it, in its sole discretion, determines that Buyer is in breach of this Agreement or any other contract with Seller, or Seller has insecurity with respect to funding or creditworthiness, until payment is made and any dispute or insecurity has been resolved.

Under the federal Fair Credit Reporting Act, it is still questionable whether the one officer signing the contract can give you permission to run credit checks on the other non-signing officers.[139] Separate signatures are still preferable for this reason, if possible.

The Personal Guaranty shown in the Appendices also contains an authorization to run personal credit reports. With this form, you have the right to run a personal credit report anytime you are getting a personal guaranty.

Reduction in Retention

Many contractors assume that retention will be reduced late in a project. While this may be a "standard in the industry," you have no right to a reduction in retention unless your contract says so. You may want to add language that your "retention will be reduced to five percent at substantial completion" or that "subcontractors retention will be reduced in the same manner and at the same time that the owner reduces the general contractor's retention." If you have a strong bargaining position, you may be able to state simply that your retention will be paid "upon completion" of your work. However, subcontractors must compare retention reduction provisions in a contract with the "pay when paid" provisions.

Subcontracts

Many contracts also state "no part of the work in this contract will be subcontracted, delegated or assigned without written permission." Owners and general contractors have a legitimate right to know with whom they are dealing in order to control the quality of work. Therefore, if you know that you will use subcontractors, you must strike this wording or add a list of the subcontractors you know you will use.

Bonds

Watch out for preprinted contract forms stating that you will provide performance or payment bonds on the project. If this was not in your bid, you want to strike this requirement.

Conduit or Pass Through Provisions

Many construction subcontracts state that the provisions of the general contract will bind the subcontractor or supplier.[140] Such contracts sometimes state that the subcontractor or supplier shall be bound to the general contractor to the same extent that the general contractor is bound to the owner. Such provisions have become very common in the marketplace, and you may have to accept them. It is important to recognize, however, that a subcontractor should either strike such clauses out or obtain a copy of the general contract.

Most general contractors are willing to provide copies of their general contract, although they may wish to "black out" the financial terms or may only make the general contract available for review at their office. Otherwise, a subcontractor has a very compelling argument that you cannot bind yourself to something you have never seen. A subcontractor should be very nervous about this. A subcontractor cannot comply with the general contract provisions

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[138] *See* chapter, Credit Management; section, Creditworthiness; subsection, Fair Credit Reporting Act (FCRA) and Equal Credit Opportunity Act (ECOA).

[139] *See* chapter, Credit Management; section, Creditworthiness; subsection, Fair Credit Reporting Act (FCRA) and Equal Credit Opportunity Act (ECOA).

[140] For a discussion of the effect of Conduit Provisions on subcontractor change orders, delays and other claims, *see* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsection, Conduit or Pass Through Relationship.

if it does not have the general contract. A subcontractor should send a letter requesting a copy of the general contract and pointing out that it will be impossible to comply with general contract requirements if it is not received. This may help later if the general contractor refuses or fails to provide a copy of the general contract and then later seeks to disallow a subcontractor claim for failure to follow the claims procedures in the general contract.

It is, of course, best practice for a subcontractor to review the general contract to determine the risk in agreeing to be bound. Even if a subcontractor will not have time to review the entire general contract, it will still be important to have it on hand in the event of future changes in work, claims or disputes. A subcontractor will have a harder time getting a copy once there is a dispute with the general contractor. If the general contractor only agrees to make the document "available for review at their office," send someone to review it. Although the general contract is certain to be a lengthy legal document, there are only a few provisions that are critical for a subcontractor to understand and copy.

A subcontractor will want to pay special attention to time deadlines in the general contract for making claims for extra time or change orders to the owner. The general contract may have specific restrictions on when you can make such a claim or how you must make such a claim. A subcontractor should also look at the dispute resolution clauses. You may be bound to arbitration or bound to let the architect decide on your claim before you file suit.

Payment Terms and Pay When Paid Clauses

It is helpful to have the contract state that prompt payment is "the essence of" the contract and that significant damage will result to the seller if payment is withheld. This helps you withhold labor and materials and establish damages if payment is not received. Refer also to the section above on the Right to Stop Work.[141]

There are projects and customers so marginal that you may wish to make payment the determining factor as to whether or not you do the work at all. You may wish to have the customer place the total amount due under the contract in the hands of an independent third party before work begins. You may want to get an agreement that you will be paid directly by the lender or that joint checks will be issued by the owner or lender. It is obviously difficult to get this kind of agreement very often, but these sorts of arrangements can allow you to do work and make a profit on projects that you otherwise should just plain turn down.

Subcontractors should watch carefully for "pay when paid" and "pay if paid" clauses in all subcontracts. If the subcontract states clearly that payment by the owner is a "condition precedent," then the general contractor is not obligated to pay unless and until the general contractor has been paid ("pay *if* paid"). This essentially shifts the credit risk. Subcontractors would obviously prefer to eliminate this term from the contract if possible. In any event, however, it is important to recognize this situation in analyzing risks. A subcontractor now must analyze the creditworthiness of the owner and the quality of that project. If the end user of the product becomes insolvent, or if this project fails, the general contractor will have no obligation to pay subcontractors.

If a condition precedent pay when paid clause is in your contract, you will want the same term in lower tier subcontracts. If the credit risk has been shifted to you, you want to keep passing it down the line. In modern construction contracts, the cost of a payment problem usually ends up with the contractor down the line who was handed the hot potato and failed to throw it to the next contractor.

If a pay when paid clause says only that your customer will pay you "within five days after receiving payment," this may not be a condition precedent. This is often referred to as a "pay *when* paid" term. Courts have held that such a "pay when paid" term simply defines the time for payment and does not eliminate the need to pay eventually. This type of pay when paid clause is not as big a concern as the condition precedent pay if paid clause. You may have an opportunity to strike just a few words on your customer's form to delete words like "condition precedent" and change a "pay if paid" clause to a "pay when paid" time of payment term. Your customer's representative may not recognize the significance of this change.

Some states do have laws that limit the effectiveness of "pay if paid" condition precedent clauses.[142]

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[141] *See* section above, Contractor and Supplier Contract Forms; subsection, Contractor Proposals and Contracts; sub-subsection, The Right to Stop Work.

[142] In Maryland, for example, "pay if paid" clauses are generally enforceable, but do not constitute a defense to a mechanic's lien, Little Miller Act or private payment bond. *Gilbane Bldg. Co. v. Brisk Waterproofing Co. Inc.*, 86 Md. App. 21, 585 A.2d 248, 252 (Ct. Spec. App.1991); Maryland Real Property Code Section 9-113(b); Maryland State Finance and Procurement Code Section 17-108(d)(2). In Virginia, amendments to Va. Code Anno. §43-3(C) and §11-4.1:1 (Michie 1950) state that a provision that waives or diminishes the right to assert mechanic's lien or payment bond rights claims or the right to assert claims for demonstrated additional costs in a contract executed prior to providing any labor, services, or materials is null and void. It is sometimes difficult to say what contract terms would be void

Forum Selection Clause

As discussed in greater detail above,[143] your customer can agree to allow you to sue the customer in the court (forum) near your office. This holds down your costs of litigation and increases the debtor's cost. This "leverage" helps the seller get a quicker resolution of accounts. Your first choice is to add such a forum selection clause in your favor in your contract.

> General Contractor (or Owner) expressly agrees to submit to personal jurisdiction in Virginia and agrees that the forum for any litigation pursuant to this Agreement, no matter who brings suit, shall be the County of Fairfax, Virginia. This Agreement shall be governed by and construed in accordance with the laws of Virginia.

Contractors would certainly like to add forum selection provisions to any contract and should review that discussion above. However, it may be difficult to get your customer to agree to such a thing very often.

When reviewing contract forms received, it is equally important to notice the forum selection clause that a customer has placed in a contract to make sure you are not agreeing to an inconvenient and costly venue for disputes.[144] Otherwise, you may need to travel to the customer's home to litigate, which may be far from the project location or your home office. The collection process will be more convenient for your customer, its lawyers and witnesses, while your litigation costs increase.

If you do not have bargaining position to change the forum in the contract received, you would want to strike the inconvenient forum selection clause altogether. At least you now have a more even-handed symmetry. Whoever wins the race to the courthouse to file suit may be able to establish the forum, which is still better than being bound to travel for any dispute.

Dispute Resolution Procedure

Many general contracts and subcontracts also provide procedures to resolve any disputes. A general contractor must review the dispute resolution procedure in its own contract, while a subcontractor must be familiar with the dispute resolution procedure in its subcontract and the general contract. These procedures can affect claims for extra time or money.[145]

You may need to first mediate and then submit disputes to the architect or some third party before you are allowed to demand arbitration or litigate. There may also be a "forum selection" clause in the general contract that binds a subcontractor. General contractors and subcontractors must be aware of these dispute resolution procedures, so that you do not waste time and money using the wrong procedure. Even worse, you can forfeit your right to many claims if you follow the incorrect procedure, particularly in government projects with administrative claims procedures.[146]

You may not want to be bound to arbitration clauses in many cases.[147] Arbitration clauses are a particular problem for all contractors in Maryland mechanic's lien cases, where you have no lien until a court hearing establishes your lien.[148] If the court stays your lien action because of an arbitration provision, your lien rights may be cut off by a bankruptcy or a sale of the property while you are off in arbitration.

Arbitration clauses also can be a particular problem for subcontractors in bond claims. They may be unable to arbitrate with the bonding company, because that bonding company did not agree to an arbitration provision in the bond. This can leave a subcontractor in the position of litigating the same case twice.

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because they diminish lien or bond rights or the right to make claims. A waiver of lien or bond rights in a contract signed prior to work is fairly certainly null and void. However it is debatable whether a "pay when paid" or "pay if paid" clause diminishes the right to make claims and are also void. The same question exists with contract terms requiring written signed change orders or immediate written notice of any delay or other additional costs.

[143] *See* section above, Contractor and Supplier Contract Forms; subsection, Contractor Proposals and Contracts; sub-subsection, Forum Selection Clause.

[144] *United States Smoke & Fire Curtain, LLC v. Bradley Lomas Electrolok, Ltd*, 612 Fed. Appx. 671, 672-673 (4th Cir. Va. 2015) [dispute-resolution provisions, such as forum-selection clauses, are enforceable beyond the expiration of the contract].

[145] *See* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsection, Dispute Resolution Procedures.

[146] *Sabre Construction Corp v. County of Fairfax*, 256 Va. 68, 501 S.E.2d 144 (1998); *W. M. Schlosser Co. v. Fairfax County Redevelopment & Housing Authority*, 975 F.2d 1075 (4th Cir. Va. 1992).

[147] *See* chapter, Dispute Resolution, Arbitration and Litigation for further discussion of administrative claims, mediation, arbitration and litigation.

[148] *See* chapter, Mechanic's Liens in Maryland; section, Petition to Establish Mechanic's Lien; subsection, Arbitration Clauses.

In these cases, a contractor would prefer to state that:

> Any dispute resolution or arbitration clause shall not impact, negate or delay the right to any bond claim or mechanic's lien pursuant to any state statute or third party agreement.

Contractors should particularly guard against dispute resolution provisions that allow the owner or general contractor to choose mediation, arbitration or litigation at their sole option or sole discretion. Otherwise, you can waste much time and money either filing for arbitration or litigation, only to be told that the owner or general contractor opts for the procedure you did not choose. Contractors at a minimum want the procedure to be set one way or the other, by striking out the words "at the owner or general contractor's sole discretion."

Change Orders

Most modern construction contracts state that there will be no payment for changes in the work unless ordered in writing and signed by the buyer. You should be aware that these clauses are enforceable. If your contract has a written change order clause, you will not get paid unless you have a written change order. It does not matter how much work you did, how much it cost or whether it was ordered by the buyer. A general contractor must review the change order provisions in its own contract, while a subcontractor must be familiar with the change order provisions in its subcontract and the general contract. These procedures can affect claims for extra time or money.[149]

Written change orders for extra work and clauses requiring written change orders are actually required by many state licensing statutes or regulations.[150]

Owners, general contractors and other upstream contractors are entitled to know if you think extra charges are involved *before* the work is performed. One person's change order is another's clarification. An owner or general contractor may order work to be performed, thinking they are only providing instructions on details already included in the contract price. Whether or not your contract has a written change order clause, you must make sure your field representatives understand to stop work and request a change order before change work is performed. A sample Change Order appears in the Appendices. If you cannot get a signed change order, you have a "claim." This is all discussed in greater detail below in the section on Contract Administration and in the separate chapter on Changes, Delays and Other Claims.[151]

Notice and Claim Procedures

As discussed in the section below on Contract Administration and in the separate chapter on Changes, Delays and Other Claims,[152] you need to send the owner or general contractor notices of any request or claims for extra time or money. Contracts normally require written notice of such "claims" within a matter of days after events that cause delay or extra costs. It is very important to understand the procedures and make sure that you comply with them. Claims procedures may require "written notice of any claim within 48 hours of the event giving rise to the claim." Courts will enforce this type of clause. If you fail to provide such written notice, you will not have a claim, no matter who caused the problem or how much it cost.

You may not have an opportunity to change the claims procedures in either the general contract or your subcontract. It is most important to have a regular system of periodic "status letters" to preserve your rights to extra time or money. If the claims procedures in the contract create so many hurdles that you will never realistically be able to make a claim, however, you may consider modifying this portion of the contract by revising the deadlines and other requirements for claims.

If a contract states that you must give written notice *before* or *within two days* of performing any work you consider a change, you may want to change this to say "notice within 10 days of any event giving rise to any claim for extra time or money." This is especially important on projects where your managers will not always be present on site to notice problems. Similarly, a contract may state that you "accept and waive any objection to any back charge notice sent to you if there is no written objection within two days after receipt" or that you will "correct any defective work within 24 hours." You may want to change these to five or 10 days.

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[149] *See* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsection, Change Orders.

[150] *Virginia Board of Contractors Regulations,* 18 VAC 50-22-260 (B)(9)(i).

[151] *See* chapter, Changes, Delays and Other Claims.

[152] *See* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsection, Claims Procedures and Notice Requirements.

Also review the procedure for making a claim. If the contract states that change orders can be ordered "only by a Vice President," you need to delete this or know who the Vice Presidents are and whether they will be on site for this purpose.

Some contracts will limit your remedy to a time extension, if you are delayed in your performance.[153] You will be unable to claim the extra costs incurred as a result of the delay. Delay costs can be considerable, especially if you must keep your personnel on the job throughout the delay or if delays on one project keep you from performing on another. You could incur large liquidated damages on a project, for example, if delay on another project leaves you short of manpower. You would obviously prefer to preserve your right to these costs by striking out language in a contract that limits you to time extensions.

Conduit claims procedures in subcontracts often state that subcontractors will receive extra time or money only if the general contractor receives the same from the owner. This is understandable in the sense that a general contractor would not want to be out of pocket for labor or material if an owner can successfully show that the event was not a change under the general contract. Subcontractors should be careful, however, to preserve rights if the event is caused by a mistake or omission of the general contractor. Some subcontracts will state, "General Contractor will not be liable to subcontractor for delay caused by the owner or other subcontractors." Coordinating the other subcontractors is the essence of the general contractor's mission on the project. If the general contractor fails to get prior work performed that is necessary for performance, a subcontractor does not want to be left without any remedy. In the example above, a subcontractor would want to strike the words "or other subcontractors."

If possible, you want to include a "contractor friendly" claim procedure into your contract:

> UNFORSEEN CONDITIONS. The (Sub)Contractor has competitively estimated the cost and schedule of the Work under the assumption of normal job and site conditions in order to provide the lowest reasonable Price. In the event that, during the course of the Work, the (Sub)Contractor encounters unforeseen job or site conditions not readily ascertained or disclosed by the examination of the Work area at the time this (Sub)Contract is signed, the Price and Schedule of the Work shall be equitably adjusted to reflect the additional time and costs incurred.

CONTRACT ADMINISTRATION

Monitoring for Funding Problems

Change orders and cost overruns are a persistent credit management problem and are often the cause of a project's failure. In a construction context, an inexperienced owner or architect and a bad set of plans can cause terrific overruns. Contractors often view this as their very objective, but this can often be shortsighted. If the project fails and there is not enough money to finish, you may not collect for the change order work you performed.

Many a project has failed because there was insufficient funding for the cost overruns. A construction owner may begin ordering changes because of a bad set of plans or because he wants to build the Taj Mahal, but has the lender agreed to fund these changes? The owner may even keep the lender in the dark because the owner does not want the lender to know there are problems.[154] When you get toward the end of this project, all of a sudden there is another $300,000 worth of work to do, $200,000 in retention held and no money left on the construction loan. The owner then begins defaulting on payments to the contractors and to the lender.

A construction seller should continually monitor the health of the project as much as possible. This is especially important when you have a cost plus time and materials contract or when substantial change orders are requested. Delays and accelerations present the same problem. These are in effect change orders. Is there enough money to pay for the acceleration or to compensate you for your delays?

Once again, it may be necessary to consult the architect, lender and any other persons who may have knowledge concerning the health of the project, funding, scheduling, expected changes and other matters. Check your contract for terms that allow you to request verification of funding and stop work if the owner cannot show the ability to pay. Hopefully your risk manger negotiated these terms in your contract.[155]

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[153] *See* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsection, No Damage for Delay.

[154] *Moore Bros. Co. v. Brown & Root, Inc*., 207 F.3d 717 (4th Cir. 2000).

[155] *See* section above, Reviewing and Revising Contracts Received; subsection, Monitoring and Verifying Funds for the Project.

Change Orders

Needless to say, the most important thing to keep in mind is that you must document your change orders.[156] Most contracts state that all change orders must be in writing. What a contractor views as a clear change order, an owner or general contractor views as simple directions on how to perform work covered by the contract.

The most important function of a written change order is that it requires seller and buyer to slow down and agree on whether this item is covered by the contract and what the compensation will be. One person's change order is another's clarification. Be very wary of the customer who insists that this work must be completed immediately and that there is no time to get a written change order. This customer often knows exactly what he is doing and will later remember the conversation very differently. Have your own change order forms available. The most important thing is to establish in writing that the work being performed is a change in scope or schedule. Establishing an equitable price and time extension is not as difficult.

A sample Change Order is provided in the Appendices. This Change Order form has a "default" mechanism, if no price or time extension can be agreed to at this time. If you are in agreement, the form allows you to establish a fixed sum or a cost plus agreement. If you can't agree on anything else, describe the work being performed carefully and get the form signed. This means that you are going to get paid for the work at a price to be established, considering the reasonable value of the labor and materials. Establishing a price later will not be as difficult as establishing that the work was a change.

Be sure to establish an extension of time for the change, as well. Many contractors remember to get a written change order but forget about the contract time. It doesn't do you any good to get an extra $500 for a change if the additional work means that the contract is completed four days later and you are assessed $1,000 in liquidated damages. The sample Change Order form has a default mechanism stating the contract time will be adjusted "by an equitable amount of time, if no time estimate is available." It also allows the contractor to verify funding for the change.

If it is impossible to get a signed change order and you must begin work immediately, the claims provisions in your contract become important. Normally, you must perform the work "under protest." This does not mean you have to start a big fight, but you must determine what your contract says about preserving your claim for extra time and money. It may be enough to prepare and send your proposed change order within the time required. Written notice is normally required before or soon after you begin the change work, followed by pricing data soon after the work is complete.

Claims Recognition and Preservation

The recognition of claims must start *before* and *during* the construction process.[157] When projects degenerate into litigation, the party with the best records and documentation will have a tremendous advantage. Even long before any litigation has commenced, the party that is best able to illustrate its point of view and prepare for possible litigation will be in a stronger negotiation position and will dissuade others from filing suit.

In order to anticipate problems, claims recognition really starts *before* a project begins by qualifying a project and the people with whom you are working and then negotiating a contract with protective clauses. During the project, it is very important for owners and contractors to keep accurate records, including daily reports summarizing who was on the project and what work was performed. Photographs should be taken of every aspect of the project on a regular basis.

A critical path analysis schedule, detailed estimates and job accounting reports will help you recognize when a project is being delayed or costs are higher than expected. It is very important to keep your antenna up for signs that someone else on the project is hampering your performance or increasing your costs.

When you perceive that a claim may be developing, whether it be work you consider a change, a delay, increased costs due to the owner or another contractor, or a simple nonpayment situation, you want to develop and preserve documents recording the event. Photographs are the single most important tool. It may also be helpful to have independent third party experts visit the site to view the problem. While these steps can be very important as evidence in any eventual litigation, they also will help you immediately put the other party "on notice" of the problem. If you

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[156] For a detailed discussion of change orders, delays and other claims, *see* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsections, Change Orders and Claims Procedures and Notice Requirements.

[157] For a detailed discussion of change orders, delays and other claims, *see* chapter, Changes, Delays and Other Claims; section, Contract Clauses and Theories; subsections, Change Orders and Claims Procedures and Notice Requirements.

can put another party on detailed documented notice that they are causing delays or cost increases, then it is more likely that they will move to rectify the situation. If they don't, your notice has strengthened your case against them for a later date.

To properly preserve claims, it is very important to read your contract, read any general contract incorporated into your contract and make sure that you are following the claims procedures. A court will enforce these contractual procedures. If you fail to follow all steps described in your contract, you will not be able to get the extra money or the extra time that was lost.

Your project manager should have a procedure to send written notice about any events that *may* later give rise to a claim. It is best to have a regular policy of sending weekly or biweekly "status" or "progress" letters. Owners and general contractors generally appreciate a contractor that is organized and keeps them informed about the status of the contractor's work, their anticipated schedule going forward and problems caused by others. This is also an opportunity to describe all problems or events you encounter that may give rise to a claim.

Claims procedures may also require detailed cost information within a certain period of time. If costs are continuing or if you will need more time to document your costs, send a letter reiterating that you are incurring ongoing costs, explaining what you do know about the total costs and stating that a complete claim will be submitted when work is complete and information is available. Claims may have to be submitted to the architect or the general contractor first. It may then be necessary to send a second notice of the claim if the architect fails to respond or gives a negative response. You must follow all of these procedures if they are required by your contract.

Preserving Security Rights

Don't let your security rights expire. This is the number one rule. The best rule of thumb is that all bond and lien claims must be made within 90 days of the last supply of labor or materials. Open account suppliers should take care, however, to review discussions devoted to them below in the mechanic's lien sections of this book. The 50-state summary of mechanic's lien rights chapters in this book and the chapters on Virginia, Maryland, Pennsylvania and the District of Columbia should help.

Tickle Systems

Tickle systems are very important to track aging accounts. Such a system must be linked to the last day labor or materials are supplied and *not* linked to the date of invoice. Most computer programs and accounting procedures run from the last date of invoice. This will not work for companies in the construction or public procurement businesses. These procedures or programs must be modified.

The best practice is to start the rotating tickle system when the major portion of your work ends. It should be the duty of the project or production manager to inform the accounts receivable department when shipment has been made or your construction crew is pulling off the job. This may give you an additional cushion because a punch list may add additional time to your lien rights.

Material suppliers should have a company policy of dating all invoices with the date of delivery, even if the invoice is physically printed another day. Then when a credit manager is looking at an accounts aging summary, they know how much time has passed since the last delivery. Mechanic's lien or bond rights are often lost, because clients are looking at the invoice dates and not the delivery dates.

Labor and material contractors must normally use a different tickle system. They are usually billing monthly and may be on the project doing punch lists long after the job has been billed in full. Someone in the company must have the responsibility to recognize when the project is substantially complete and then track the date to make sure lien or bond rights do not expire. It is often helpful and cheap to buy an accounting system like QuickBooks® to generate an artificial internal "invoice" when you have substantially completed your work. The credit manager can then track this artificial invoice in a conventional aging summary.

All suppliers and contractors must remember that each project or parcel of land will normally run its own mechanic's lien deadline. It is not sufficient to know whether the customer is late on the invoices generally. You must know whether 90 days have passed since your last delivery of labor or material on any particular piece of real estate. For this purpose, aging summaries should show more than just the customer name and the age of that customer's invoices. The summary should show each project as a separate line item. This is discussed in greater detail in the mechanic's lien portions of this book.

Information on the Project

Correct project information is very important to ensure mechanic's lien or bond claim accuracy, to hold your costs down and to cut the time your attorney will need to prepare a lien or bond claim.

The best practice is to collect project and customer information during the qualification stage. It is always easier to collect such information while you are still friends with your customer. When a customer is more than 60 days past due, they are not likely to return phone calls or provide copies of payment bonds. You may already be in a dispute. The sample Project Information Sheet shown in the Appendices will help prompt you on the information to be collected.

You should keep a site plan or building permit for the project within easy reach. These are the best sources of information to hand your attorney to identify the project and begin a title search and other investigations. A site plan can also be very important to solve allocation problems in a lien.

Lien and Bond Waiver Forms

Lien and bond waiver forms required with payment requisitions can be the kiss of death. It is very important to get your money, but do not let cash flow urgency result in long-term losses. Waiver forms vary greatly in their wording and effect. Recognize and revise what you are signing.

Have Your Own Waiver Forms Available

There will be times that you have the opportunity to use your own lien waiver form. Your customer may simply say "Send me a waiver." The sample Supplier and Subcontractor Lien and Bond Waiver form shown in the Appendices protects the interest of the owner or your customer without stripping you of legitimate security rights for unpaid labor or materials.

Bankruptcy Preference Risks[158]

If you received a payment in the 90 days before a customer bankruptcy, you can be confident you will be sued. These preference actions have become common to the point of being expected. Preference actions are not normally filed, however, until almost two years after the bankruptcy filing. By that time, your lien and bond rights have long expired. There is no way to get these lien and bond rights back. You may need to repay the preference money, even though you had security rights at the time you received payment.[159] There are a few essential steps to solving this problem.

First, make all of your lien and bond waivers conditional. You waive your security rights against the owner or bonding company as long as your customer does not file bankruptcy within 90 days after funds clear. Remember that the 90 days starts from the day that the check clears the debtor's bank, not the day you receive the check. Without a conditional waiver, your lien rights may be permanently gone, even if you have to pay the money back. Add the conditional waiver language discussed below to all lien and bond waivers.

Second, whenever a customer files bankruptcy, you must look at all payments received in the prior 100 days. Treat this money the same as your uncollected receivable. Determine whether you have lien or bond rights. You may need to file a lien or make a bond claim on money you have already received. This is discussed in greater detail in the Bankruptcy Primer chapter.

Seeking a resolution of preferences early in a bankruptcy while the client still has lien or bond rights usually is successful. Bankruptcy courts can shorten the time a bankruptcy trustee has to file a preference action and establish your lien or bond rights at the same time the court considers the preference claim against you. Get the bankruptcy debtor, the bonding company, the owner and the general contractor all in the same court at the same time. If you must repay the preference, the lien or bond rights still protect your receivable.

This strategy makes it more likely you can settle a preference case or get it dismissed. Preference actions are easier to resolve when the business people you know are still involved and you have easier access to witnesses and documents to establish preference defenses. The bankruptcy trustee usually brings preference actions long after all of the business people have left the bankruptcy company. You will have difficulty finding witnesses or documents

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[158] *See* chapter, Bankruptcy Primer for Creditors; section, Preferences.

[159] *JWJ Contracting Co. v. Joseph J. Janus, Chapter Seven Trustee* (*In re JWJ Contracting Co.*)*,* 371 F.3d 1079 (9th Cir. 2004); *Morrison v. Champion Credit Corp.* (*In re Barefoot*), 952 F.2d 795,797 (4th Cir. 1991); *Goger v. Cudahy Foods Co.* (*In re Standard Food Services, Inc.*), 723 F.2d 820,821 (11th Cir. 1984).

you need from the owner or general contractor. The trustee has no incentive to settle and is not concerned with legal fees for a number of reasons. You will need to pay a settlement because of nuisance value.

In order to successfully establish a contemporaneous exchange defense to a future preference claim,[160] it may be necessary for the creditor to prove that the creditor was aware of mechanic's lien and payment bond rights, that the creditor would have enforced those rights if the payment was not received and that both the creditor and the debtor intended that the payment be in exchange for those mechanic's lien and payment bond rights.[161] Providing a waiver may actually benefit a creditor for this reason, as evidence of awareness of the rights and the intent to exchange. It is preferable to have the waiver recite that the creditor is aware of its mechanic's lien and payment bond rights, intended to promptly enforce those rights in the absence of payment and is expressly waving those rights in exchange for payment. It would be even better to have the debtor making payment also sign the waiver to acknowledge these facts and also evidence the debtor's intent. It would be best to get this acknowledgment of receipt from any bond principal other than the debtor and the property owner in the case of mechanic's lien rights on private property, although this will present practical business problems.

Waivers for Partial Payment

Contractors are usually requested to sign waivers of lien at the time of each progress payment. Waiver forms presented for signature at that time vary greatly in their wording and effect.

The owner and your customer are entitled to a receipt for payments made and an agreement that you will not lien the project for payments you have received. A waiver form should not do any more than this. Owners or their title insurance companies usually produce the mechanic's lien waiver forms presented to you. They have a strong interest in making sure liens never succeed against the property. You must understand and revise these waivers.

Complete Waiver

A complete waiver of the right to ever lien a project often appears in a partial or progress payment waiver form. Partial waivers can completely waive mechanic's lien or bond rights for unpaid deliveries in the future, even if the initial progress payment is very small and even if valuable labor and materials are supplied later. Contractors often believe that lien rights are waived only to the extent of the payment received, if the waiver form recites a specific payment amount. This is not always true and a contractor should be careful to inspect the waiver form to determine the extent of rights waived.[162] A complete waiver often appears something like this:

> In consideration of the sum of $_________ paid on account of labor and materials supplied through the _____ day of _____________, 20___, and the receipt of which is hereby acknowledged, and other benefits accruing to us, and in favor of each and every party owning the property improved or in order to procure the making of one or more loans on said real estate, as improved, we do hereby waive, quit-claim in favor of each and every party making a loan on said real estate, as improved, and his or its successors and assigns, all right that we, or any of us, <u>may now or hereafter have</u> to a lien upon the land and improvements above described, by virtue of the laws of the state wherein said land is situate, or any amendments of said laws; and we do further warrant that we have not and will not assign our claims for payments, nor our right to perfect a lien against said property, and that we have the right to execute this waiver and release thereof.

In this example, the contractor should strike the underlined words and add the conditional language discussed below.

Waiver for Retention

Even a thinking contractor may inadvertently waive the right to lien for retention. Most contractors will sign the following waiver if put in front of them:

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[160] *See* chapter, Bankruptcy Primer for Creditors; section, Preferences; subsection Contemporaneous Exchange for New Value.

[161] *United Rentals, Inc. v. Angell*, 592 F.3d 525 (4th Cir. N.C. 2010).

[162] *See United Masonry, Inc. v. Riggs Nat'l Bank*, 233 Va. 476, 357 S.E.2d 509 (1987); *cf Southern Management Corp. v. Kevin Willes Construction Co., Inc*., 382 Md. 524, 856 A.2d 626, 631 (2004).

> In consideration of the sum of $______________ the receipt of which is hereby acknowledged, the undersigned does hereby waive, release and quit-claim the right to lien the described real estate for labor and materials supplied through the _____day of _____________, 20__.

This form may look acceptable. The contractor is only waiving the right to lien for labor and materials supplied up until the day the waiver is signed. If retention is still held on the project, however, the contractor has probably just waived the right to lien for that retention at a later time, since the retention is "for labor and materials supplied through today." In this case, the contractor should add the words "except for retention" and use the cover-all conditional language discussed below.

Waiver for Unpaid Goods Delivered

This is similar to the previous problem on retention. A contractor may make multiple shipments or work multiple days on a job site, but now receives only partial payment for some of those materials. The contractor must expressly exclude the release of lien rights for the unpaid items. If the deliveries occurred on different days, be careful with the effective date of the release. Instead of filling in the date on which the release was signed, fill in the date of the last paid delivery.

Waiver for Change Orders or Extra Work

Similarly, a contractor may have claims for change orders or extra work. The formal change order process is often delayed. The contractor may submit requisitions and receive payment on base contract work before change orders are approved. The contractor must expressly exclude the release of lien rights for these unpaid change orders. The contractor must also remember to expressly exclude any other type of claim they have not yet submitted as a change order, such as delay claims.

An owner should insist that the contractor specifically identify all such excluded change orders or claims. The contractor might try to exclude "all unpaid change orders and claims." The owner should insist that the change orders be listed by date, amount, subject, or proposed change order number. Excluded claims should be limited to claims that have been submitted by written notice to the owner and identified by date, amount and subject. This is a good opportunity for an owner (or general contractor) to get a complete list of all change orders or claims and get a waiver for any claims not identified at the time of the progress payment.

Make Lien Waiver Forms Conditional

If you cannot provide your own waiver forms, the safest practice is to review and strike out offensive wording in the waiver. If clients do this a few times, they quickly learn how to deal with most waiver forms. There are only a few recurring problems on these forms. Also add the following statement just above your signature:

> This release will be effective only to the total amount of payments actually received without any bankruptcy filing for 90 days thereafter.

Author's Note: Lien Waiver Forms

I am always happy to review waiver forms with clients. As well, I have developed a rubber stamp with the above statement, which you can put on any lien or bond waiver. Based on my understanding of the law, this stamp should avoid inadvertent waivers. This stamp is available by sending a request to this office. Please keep in mind, however, that this stamp is an innovation of mine and its wording has not been tested in the courts.

Owner and General Contractor Waiver Forms

Needless to say, general contractors have very different interests in waiver forms. They would like to make sure lien and bond and other claims will never be filed on the project. Whether or not a claim is valid and whether or not the general contractor intends to pay all valid claims, a general contractor does not need the added expense and strain on business relationships with owners and sureties. Not all claims are valid. Subcontractors and suppliers are known to make spurious claims. Owners and general contractors have a strong incentive to get complete waivers at every progress payment. This is exactly what a general contractor wants and exactly what a supplier should avoid. The General Contractor Lien and Bond Waiver shown in the Appendices is a complete waiver. A general contractor also

wants a trust fund provision, stating that the recipient will hold all payments in trust for the benefit of their suppliers and subcontractors. This is very similar to the trust provision in a subcontract, discussed in the chapter on Trust Fund Laws and Agreements, subsection Trust Fund Agreements, subsection Protective Provisions for Owners and General Contractors. This provision adds no risk cost to anyone in the payment transaction. It protects the lower tier suppliers and subcontractors, as well as the general contractor, from any bankruptcy of the payment recipient. Otherwise, the owner or general contractor could face mechanic's lien or bond claims from lower tier suppliers and subcontractors, even when the owner or general contractor have paid in full.

An owner or general contractor also wants an indemnity if they face mechanic's lien or bond claims from lower tier suppliers and subcontractors when the owner or general contractor has paid in full. This indemnity should include an attorney's fee provision, especially if there is no subcontract with an attorney's fee provision.