

Continuing Education for Contractors

**Code Essentials**  
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SUMMARY OF CONSTRUCTION LAW AND CLAIMS

BY

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## 1. INTRODUCTION

Construction law comes from two sources: 1) the enactments of the legislature known as statutes; and 2) the common law which are the pronouncements of the Utah Supreme Court and Court of Appeals in cases brought before those courts. The former law changes each year with the meeting of the legislature. The latter body of law develops slowly over many years, and shows variations in the law based upon facts specific to each case. The law governing contractors is complex and varied, and overlaps with many other areas of the law, such as contracts, agency, business law, employment law, insurance and surety law, property law, and personal injury law. This brief summary of construction law and construction claims is intended as an general overview, and as an introductory guide to the basics of construction law. Given the brief treatment of the subject matter and the limitations inherent in this forum, this discussion of the law is of necessity somewhat overly simplistic, and should not be considered a substitute for engaging competent construction legal counsel. This is particularly so if one finds oneself in a developing construction dispute. The purpose of this paper is to set forth a foundational basis for contractors to navigate through what is truly a veritable minefield of legal issues in the day-to-day operations of a construction company. Because most of the actions taken by contractors in the ordinary course of a contractor's life are fraught with legal consequences, this paper will provide guidance and direction to the average builder so that he or she will at least know how judges and juries view certain actions, and to provide a vocabulary to the contractor for understanding and characterizing certain critical legal transactions and events.

## 2. THE NATURE AND FORMATION OF CONTRACTS

Whether he or she knows it or not, the average contractor lives in a world of contracts. Contracts and agreements form the basis of the construction industry — that is why they are referred to a “contractors.” Change orders, proposals, lien waivers, releases, addenda, bonds, warranties, certifications, and like agreements are all contracts, and each are treated as such under the law. Contracts express the expectations and obligations of the parties, and the law’s objective is to find the intentions of the parties when interpreting and enforcing a contract. Understanding the purpose, meaning and nature of contracts is essential to the life of a successful contractor.

a. The elements of a contract and contract formation. In order to form a contract, three elements must be present: 1) offer; 2) acceptance; and 3) consideration. An offer is a firm proposal made to a third party, which is presented in such a way that it appears to invite acceptance. In the construction industry, this usually takes the form of a bid or a proposal. An offer may be restricted or open-ended, conditional or unconditional. Usually, an offer that invites acceptance can be withdrawn or modified at any time prior to acceptance. If the offer is limited in duration, it will expire by its own terms. If it is open ended, a judge might restrict it to a limited time or circumstances. In large contracting and in public contracting, offers often take the form of bids. Usually, government entities are required by law to take the lowest responsible bidder who supplies a bid bond with his or her bid. When a prime contractor sends a contract form to a subcontractor, that is usually considered an offer. When the subcontractor marks up the form contract, deletes terms, or adds conditions, it is treated in the law as a counter-offer. Offers and counter-offers can be exchanged numerous times between owners and contractors or primes and subs, until there is agreement on every material term of the agreement. Once both parties have a

meeting of minds on all terms, and agreement is struck, which usually means the parties sign the agreement with the changes initialed.

The second element required to form a contract is consideration. Consideration is an esoteric term which refers to the bargained for exchange, or the mutual promises that flow between the parties. No contract can be formed unless the parties each bargain for an exchange of promises. A contract that lacks consideration on the part of one party is not a contract at all, but is just an act of volunteerism. Such an arrangement is called illusory because one party receives nothing for his performance. Such a deal is unenforceable as a contract, because there is no mutuality in the promises and no benefit conferred on one of the parties. Having said the above, judges rarely will get into deciding if the consideration is “fair” or “reasonable.” Under principals of freedom of contract, people are free to contract for whatever they desire. If one can talk an Eskimo into buying ice, the law will not interfere unless one of the parties lacks the age requirement (which is usually sixteen) or mental capacity to contract. For example, frequently when documents are available to be viewed by the public, such as recorded deeds to real property, people not wanting others to know the terms of their deal will cite as consideration the sum of \$10, and this is considered adequate consideration to a judge reviewing the same.

Acceptance occurs the moment the contract is signed, or the offer is acknowledged and agreed upon. Acceptance occurs where there is a clear manifestation of agreement as to the material terms of the arrangement. Once acceptance occurs a contract is formed, and the offer cannot be withdrawn or modified without the consent of the other party. If the acceptor does not strictly accept what is offered, but seeks to modify the offering, a counter-proposal occurs, and no contract is formed, unless or until the original offeror agrees to accept the newly revised terms.

While simple in concept, the stock and trade of judges and lawyers are to determine if and when negotiations consisting of offers and counter-offers end, and the contract begins and is formed. Judges look for a meeting of the minds on the essential terms of the agreement. If it appears that the parties expressed an intention to be bound, the contract will be enforced. Preliminary discussions, and puffing type language such as “I think I can do it for that price,” or “I’ll get my crews on it,” or “I will try get it done,” usually do not contain the type of clarity and specificity to manifest an intent to be bound. Arrangements which lack critical terms such as payment, nature of performance, or time for performance, are often said to be too vague to be enforced as contracts.

b. Oral versus written contracts. You probably know by now that a contract can be either oral or written. There is no requirement that a contract be in writing in order for it to be enforceable. However, having said that, a written contract is certainly more easy to prove if a dispute arises. The terms of an oral agreement, such as the value and payment terms agreed upon, the scope of work, time for performance, and the expectation of the parties in terms of performance, are difficult to prove unless there are witnesses present who can verify the nature of the deal. While many small construction projects are done on a handshake (particularly subcontractor/prime contractor arrangements on residential projects), if one is to avoid disputes, this lawyer always urges at least a simple handwritten agreement showing the price, the scope of work, the payment terms, and the expected time of performance. Terms of a contract can often be discerned by the parties’ conduct. For example, if a contractor pays weekly for many weeks, then stops, a court can imply that weekly payments were a material term of the agreement. When it comes to the breach of a construction contract, the issue of materiality of the breach often

arises. The contractor may have thousands of obligations under the construction contract. If he fails to perform two or three minor items, it may not be a material breach of the contract. By contrast, since an owner's only obligation under a construction contract is to timely pay, failure to pay even a single construction draw is generally considered a breach.

One exception to the rule that verbal contracts are enforceable is the Statute of Frauds. That statute appearing at Utah Code Ann. § 25-5-1 *et seq.* is premised on the theory that some agreements are so important and sacred in the law that they must be in writing. These agreements involve any agreement affecting real property, agreements taking more than one year to perform, agreements that involve value of over \$100,000, agreements of suretyship and guaranty agreements, and real estate agency agreements.

c. Implied contracts and quasi contracts. Most contracts are express, meaning the terms are clearly stated either orally or in writing. However, occasionally, a contract can be implied from the circumstances of the transaction, although no firm agreement was ever struck. A good example of this occurs often with change order work. Sometimes an owner will express his desire for certain extra work to be performed as an extra to the contract. The contractor will perform the work with the expectation on the part of both parties that the contractor will be paid for the value of his or her work. Under such circumstances, there is no contract at all, but under principles of *quantum meruit* or unjust enrichment, a court will not permit a party to receive the benefit of the work without compensating the contractor for the value of such work. Construction lawyers typically collect hundreds of thousands of dollars in compensation for builders for the value of work upon which there is no express agreement. Of course, all of the problems of proof are eliminated if the contractor will simply take out his change order form and have the owner or

prime contractor sign the same, approving in writing all such extras. This simple and life saving act on the part of the contractor of getting change orders signed will save him or her more grief from disputes than any other act of self-preservation that he or she can take. Usually it is a contract requirement that change orders be in writing, and when they are not, it is just one more difficult hurdle to collection.

### 3. COMMON CONSTRUCTION CONTRACT CLAUSES

There are literally scores of clauses that are included in construction contracts. Here reference will be made to certain critical clauses found in construction contracts.

a. Incorporation by references. These clauses are indispensable clauses to construction contracts. Usually construction contracts consists of a wide variety of documents, such as plans, specifications, bonds, safety rules, addenda, materials specifications, portions of the prime contract, general conditions, special conditions, schedules of value, and like documents. All of these documents can be integrated into a single construction contract by means of an “incorporation by reference” clause. By the use of such clauses, contractors and owners make clear the hundreds of parallel obligations of the contractors and those who work under them. By fusing or incorporating all of the separate and distinct documents needed to guide the contractor, the owner or prime contractor is able to generate a single integrated agreement.

b. Scope of work. “Scope of work” clauses define the performance expectations of the parties. Scope of work disputes represent a very large percentage of all construction disputes for which counsel and courts are engaged. For this reason, setting forth with exactitude the precise nature and extent of the work being offered is the single most important lesson (next to disciplined bidding) a contractor will ever learn. It is in the scope of work clause that the

contractor limits or excludes what he or she intends to perform, and identifies exactly what work is to be considered as part of his bid. Contractors should be careful to properly express the limits of their work by eliminating or qualifying such risks as weather conditions, heat and cover requirements, who is providing supplies, equipment that will be provided, working conditions which must be present, and like variables. A thoroughly researched and carefully defined scope of work will eliminate most of all disputes that occur in construction.

c. Flow down. “Flow clauses” or “pass through” clauses serve to bind the parties underneath the prime contractor to assume the same obligations the prime contractor has assumed to the owner. These clauses ensure that the subcontractor’s duties parallel those of the prime contractor to the owner. When a subcontractor assumes portions of the prime contractor’s obligations with the owner, it protects the prime contractor from incurring an obligation he thought would be performed by the subcontractor. Before agreeing to assume agreements appearing in another parties’ contract, it may be important to get a copy of the prime contract to determine what those obligations that are being assumed consist of.

d. Pay when paid. These clauses are common and expected, in that they state that the prime contractor will pay a sub or supplier within a certain number of days (usually ten) after the prime is paid by the owner. If the owner never pays, the courts will usually set a reasonable time in which the prime must pay the subcontractor from the owner. By contrast, “pay *if* paid” clauses are contingent payment clauses. These clauses say that the prime contractor will pay only if and when it is paid by the owner. These clauses shift to the subcontractor the risk of never being paid if the owner goes broke or defaults to the prime contractor. This lawyer strongly recommends that such clauses be stricken from the subcontractor agreement, or converted to a “pay when

paid” clause, unless the owner is reputable, or is a large public owner for whom there is not concern of payment. Contingent payment clauses shift to the subcontractor the risk of ascertaining the financial viability of the owner — in many instances, an impossible task. A new statute states that if a prime contractor requires a “pay if paid” clause, he is obligated to provide to the subcontractor certain financial information about the owner.<sup>1</sup>

e. No damage for delay. “No damage for delay” clauses are enforceable in Utah. Such clauses state that the subcontractor or prime contractor will not be entitled to any damages if the owner, prime contractor, or other parties working at the site, delay the work or cause injury or loss to the subcontractor from such delays. Again, if a serious delay is foreseeable, a contractor would be wise to strike such a clause from the contract. “No damage for delay” clauses are clauses in which the contractor waives his right to be compensated if he is delayed in the performance of his work.

f. Indemnity and insurance. Indemnity and insurance clauses are common and require the contractor to reimburse or provide a defense to the indemnified party for any loss or injury that occurs on the project. A recent Utah statute<sup>2</sup> now provides that no party can require indemnity from another party for more than that parties’ degree or percentage of fault. Essentially, the statute states that every entity or person is allocated or apportioned legal responsibility for loss or injury to the extent and percentage of his or her own fault. A clause that requires one contractor to indemnify for another contractor’s negligence is illegal.

Insurance clauses must be examined closely to ensure that the required insurance is being

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<sup>1</sup> Utah Code Ann. § 13-8-4.

<sup>2</sup> Utah Code Ann. § 13-8-1.

provided. For example, some insurance clauses require the contractor to provide builder's risk insurance, when such insurance is usually and customarily purchased by the owner. Failure to provide the nature and extent of the insurance specified is considered a breach of contract nearly every time.

g. Arbitration. Arbitration and mediation clauses are common in construction contracts. Usually, construction lawyers prefer such clauses as an acceptable and wise alternative to litigation. The reason for this preference is that such forums are usually cheaper and quicker than traditional litigation. In addition, since arbitrators are frequently chosen from a pool of seasoned construction lawyers who know how projects come together, the results are often more predictable, balanced, and equity-based, than traditional court-based litigation. Supply houses are normally better in court, since supplier disputes usually resolve around nothing more than non-payment. Any contractor should carefully consider whether an attorney fee provision should be included as part of their contracts. If an attorney fee provision to the prevailing party is included, such fees will be recoverable, and can dramatically affect the outcome of a case one way or the other.

h. Liquidated damages. These contract clauses are inserted into contracts where the owner's damages are difficult to access if the project is not completed by the specified date. For example, it would be difficult for an owner to quantify his damages if a contractor did not complete a public library on time. In such circumstances, the owner and contractor agree to quantify or "liquidate" their damages in advance of the start of construction so there is complete agreement on what it will cost the owner — what the "injury" will be — for such a delay. Provided the liquidated damages are not grossly inflated and bear a reasonable relationship to

what the owner would actually incur as a result of the delay, such clauses are freely enforceable in Utah. Since an owner can get all foreseeable damages that result from the breach of a construction contract, *actual* delay damages for a delayed completion may be more onerous to the contractor than agreed-upon *liquidated* damages. For example, if a contractor finishes an apartment complex late, he may be liable for lost rents on the entire project. Such damages could be hundreds of thousands of dollars. For this reason it may be prudent for the contractor to contract for a liquidated damage amount that is slight, such as \$100 per day. An owner cannot get both liquidated and actual damages.

#### 4. AMBIGUOUS CONTRACTS AND THE PAROL EVIDENCE RULE

Going all the way back to ancient England where our law comes from, judges got tired of reading what was otherwise a clear and unambiguous written contract, but hearing that a verbal contract modification was the “real deal” between the parties. For example, if a promissory note stated that the debt was due to be paid by a date certain, judges were miffed at hearing that the creditor actually orally agreed to a different later date. As a result, the parol evidence rule came into play. That rule holds that if a contract is clear, unambiguous, and integrated, a court is bound to look only at the four corners of the agreement, and will not permit any outside evidence of any verbal arrangement which tends to modify or contradict the written agreement. A contract is unambiguous and integrated if it appears on its face to be the complete agreement, and the parties intentions are fully and accurately expressed in the agreement. If the parties intent is manifest by the writing, the judge will not permit any evidence of any contradictory terms. This is an important issue for construction contracts, since many contractors never read their agreements, and later protest some onerous terms which they say they did not know were part of their

performance requirement. Under the law, all such protests will be in vain. Stated more specifically, if a contractor submits a proposal to a prime contractor and the prime contractor later provides a subcontract that has additional terms or different terms than those which the subcontractor intended, the sub will be precluded from introducing into court what he intended by his proposal.

## 5. RULES GOVERNING THE INTERPRETATION OF CONTRACTS

There are certain judicial rules which govern the interpretation of contracts. Generally, due to the favored status contracts have in the law, a judge will not rewrite or rescind the terms of a contract, or make a better deal for a contractor than he made for himself. The main rules can be summarized by six simple principals. Most of these only have application if the meaning of the contract or the parties' intentions cannot be readily discerned from the four corners of the agreement: 1) words are to be given their common and ordinary meanings, and all of the clauses of the contract are to be harmonized as a whole; 2) all of the circumstance may be taken into consideration when a judge is trying to determine the intentions of the parties. (If, however, as noted above regarding the parol evidence rule, once the contract is found to be clear and unambiguous, no evidence of the terms outside of the contract itself will be permitted.); 3) specific terms of a contract have precedence over general terms, and handwritten terms take precedence over printed boilerplate terms; 4) the contract is usually construed against the drafter if its terms are ambiguous; 5) if the major intent of the contract conflicts with another minor purpose of the contract, the interpretation which gives meaning to the major purpose or the transaction will be given greater effect than the one which renders the purpose of the contract obsolete; 6) The writing shall be given the meaning that is reasonable in light of the entire

agreement. If an interpretation does damage to the reasonableness of the parties' larger intentions, such an interpretation will be ignored or limited.

## 6. BID MISTAKES AND PROMISSORY ESTOPPEL

The heart and soul of any viable construction contractor is the quality of his estimating. If he estimates correctly, he should be a successful contractor. Most public and private contracting involve formal bid openings, where the builder's estimated cost of the work is set forth in his bid. Bids are an offer, which form a contract when accepted by the owner. As noted previously, all public contracts in Utah must be given to the lowest responsible bidder.<sup>3</sup> The term "responsible" usually refers to financial qualifications and work history capacity. Ordinarily, a contractor is considered "responsible" if a bid bond accompanies his bid. If the contractor later refuses to honor his bid, the penal sum of the bid bond (usually ten percent of his bid) is forfeited by the surety to the owner. Most contractors go broke as a result of mistakes made in the bid or estimating process. Ordinarily, a bid can be withdrawn any time prior to acceptance or the formal opening of the bid. In public contracting, a bid that does not exactly comport with the bid invitation will be considered "non-responsive" and will be eliminated from consideration. Minor irregularities usually do not disqualify bidders.

Bid mistakes are frequently the subject of construction disputes. If the contractor makes a mistake in her bid, it may be difficult to get out of the bid, depending on the nature of the mistake. If the bid mistake is palpable and obvious to anyone receiving the bid, Utah cases hold that there may be some relief for the bidder. Such cases are concerned with whether or not the prime

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<sup>3</sup> Utah Code Ann § 63-56-502 *et seq.*

contractor or owner relied to their detriment on the mistaken bid. Under principals of promissory estoppel, if the prime contractor used and relied upon the mistaken bid in her bid to the owner, the subcontractor may not be able to extract herself from her low bid, even though there is no formal contract. Judges are also concerned with the reasonableness of the reliance on the part of the prime contractor. For example, if the prime contractor or owner can see that there is a considerable variance in the mistaken bid from the other ten bids he or she received, a court might say that the reliance on the mistaken bid was not reasonable or justified. The greater the variance in the mistaken bid from the other bids, the greater the likelihood that the contractor or owner will not be able to enforce the bid. On the other hand, the closer the bid to the other bids or to estimates for similar work, the more likely that the subcontractor will be “estopped” from repudiating her promised price in the bid. Of course, it is always wise for the prime contractor to call the sub to verify that the out-of-balance bid is correct and accurate.

## 7. IMPLIED AND EXPRESS WARRANTIES AND COVENANTS OF CONSTRUCTION CONTRACTS

Regardless of what the parties expressly state in their agreements, the law will simply impute certain terms into construction contracts. Such implied terms are usually based upon some overwhelming public policy concern that the courts or legislatures believe should be part of what is provided to construction consumers. This means that even though certain provisions are not expressly stated in the agreement, the law reads into the agreement terms which, while not stated or apparent, are treated as though they were expressly stated.

- a. Implied warranty of workman-like construction. Nearly every state imputes to

construction contracts an implied warranty of workmanlike construction.<sup>4</sup> Contractors frequently believe that their work is automatically warranted for a period of one year. This is not the case. However, it is correct to say that contractors who perform work on a home or commercial building impliedly warrant that the work will be done in a workman-like manner. The warranty is generally characterized as the contractor impliedly representing that its work is within industry standards, free from defects, and in conformance with the contract documents. This warranty typically applies to both residential and commercial construction, and its application may trump any written warranty provided by the contractor. It may be possible for a contractor to expressly exculpate himself from the requirements of this warranty if he clearly gets the owner to waive the warranty in writing, but usually a judge will want to enforce the obligation that a contractor build according to industry practices and standards. Claims for breach of this implied covenant may be able to be brought any time up to the expiration of the statute of limitations, which is six years<sup>5</sup> for a written contract, and four years<sup>6</sup> for a verbal agreement.

b. The “Sperin Doctrine.” At the turn of the 20<sup>th</sup> Century, there occurred a significant development in construction law with the advent of the Sperin Doctrine. The Sperin Doctrine refers to the 1918 case of *Sperin v. U.S.*<sup>7</sup> In that case, George B. Sperin contracted with the

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<sup>4</sup> *Lewis v. Anchorage Asphalt Paving Co.*, 535 P.2d 1188, 1196 (Alaska 1975); *Management Committee, etc. v. Greystone Pines, Inc.*, 652 P.2d 896 (Utah 1982).

<sup>5</sup> See, Utah Code Ann. §78-12-23. The difficulty is that the statute of limitations does not begin to run until the construction defect is, or should have been, discovered. So, if a latent defect is not discovered for three years, the statute of limitations of six years may not begin to run until six years after the defect is discovered. However, in all events, the statute of repose bars claims involving improvements to real property after nine years, regardless of the date of discovery. Utah Code Ann. § 78-12-21.5.

<sup>6</sup> Utah Code Ann. §78-12-25.

<sup>7</sup> 248 U.S. 132, 39 S.Ct. 59, 63 L. Ed. 166 (“Sperin”).

U.S. government to build a dry dock at a Brooklyn, New York navy yard in accordance with plans and specifications provided by the government. During work on the project, Sperin relocated a sewer line exactly as the specifications and plans for the project showed. The sewer line later failed causing a flood that damaged much of the work in place. The government insisted that Sperin repair the flooded dry dock at his cost, but Sperin refused. After the government terminated Sperin, he lost at the trial court level and appealed to the Court of Claims, which affirmed the trial court. The United States Supreme Court reversed the Court of Claims and the trial court.

The ruling in the Sperin case made two major innovations to construction law: 1) the Court held that the government impliedly warranted<sup>8</sup> the suitability and accuracy of the plans and specifications that it supplied to the contractor for the project; and 2) the implied warranty could not be overcome by boilerplate contractual risk-shifting clauses that required the contractor to check the plans and inspect the site prior to starting work. An investigation into the broken sewer line revealed that there was a hidden site condition which had not appeared on the original plans, which caused the sewer line to erupt. Because the designers of the sewer line had not known of the hidden condition, they did not convey the information to the contractor through the plans or specifications. The court held that the government impliedly warranted the accuracy and suitability of the plans for the project. The court went on to hold that if the contractor is forced to build a project according to a set of plans, the contractor will not be responsible for the consequence of defects in those plans.

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<sup>8</sup> A warranty is defined as a representation or promise that a proposition of fact is true. Thus, an implied warranty related to design is one where the owner impliedly represents that the plans and specifications are workable, buildable, suitable of implementation, and fit for their intended purpose. The plans can be relied upon by the contractor such that, when followed, a complete and safe project will result.

The importance to the development of construction law of this holding cannot be overstated. Even when an owner hires a professional, such as an architect or engineer, to prepare plans, the ruling is that the owner impliedly warrants the suitability of those plans, such that the contractor is entitled to a change order for such unforeseeable issues as defects or omissions in the plans, accidental damage to work in place, or costs associated with making the project workable in light of the defective plans. This is so even where there is a contract clause which requires the contractor to field-measure or visit the site to confirm conditions.<sup>9</sup> In practical terms, the Sperin Doctrine requires many government and private owners to disclose — or pay for — latent or hidden site conditions which vary from those revealed in the plans, and which are not otherwise readily ascertainable.

One major exception to the Sperin Doctrine that has been carved out over the years is the patent ambiguity defense. Just as the name implies, if there is a patent or obvious ambiguity in the plans and specifications, typically the contractor will have a duty to inquire, or a duty to bring to the attention of the owner, an obvious omission or error within the plans or specifications. The responsibility of a contractor to discover obvious or “patent” ambiguities in the language of a contract on which it is bidding is implied in any government contract. The patent ambiguity defense is in place in order to ensure fairness in the bidding process both for the government and the bidders. If the doctrine was not in place, a bidder recognizing an ambiguity in contract specifications could exploit the ambiguity in their favor, thereby winning the contract with the lowest bid and ensuring themselves a large change order once the ambiguity is clarified by the

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<sup>9</sup> One exception to the Sperin Doctrine is where a performance specification is agreed to in the contract, as opposed to a design specification. The implied warranty does not apply to performance specifications because with the latter specification, the owner does not dictate the materials or methods of construction. Unlike a design specification, with the use of a performance specification, the contractor is representing that it can achieve a certain level of

government.

Nearly every state in the country, including Utah, has adopted the Sperin Doctrine to one degree or another. Much of the litigation related to this issue involves deciding whether the plans themselves are indeed defective. If there is a cardinal change in the work which differs materially from the work which the contractor agreed to perform, a question frequently arises as to whether or not the contractor has the right to pull off of the project rather than perform the work. Since there is no bright-line test, lawyers must look at individual fact patterns to make a decision about this issue. Generally, it is safe to say that if the changes are not cardinal, the contractor should take the safe route of staying on the project to complete it, while making his claim for extras at the same time. Sometimes, though rarely, it might be prudent for the contractor to simply refuse to perform the changed work without a change order. At least one Utah case has approved of this action in certain circumstances.<sup>10</sup> Individual contract clauses will bear heavily on this issue.

c. The implied covenant of good faith and fair dealing. All Utah contracts are imputed with an implied covenant of good faith and fair dealing. Essentially, this implied covenant obligates each party to not do anything which would tend to interfere or hinder the other party from receiving the benefit of the contract. In effect, it prohibits one party from demanding performance, then intentionally interfering with that performance in such a way as to deny the other contract party the benefit of his bargain. Any acts of bad faith or active or intentional bad acts can violate this implied covenant, and will result in a finding that the violating party has breached its contract to the non-violating party. Some courts have held that there is an implied

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performance using its own methods and means.

<sup>10</sup> *Darrell J. Didericksen & Sons v. Magna Water*, 613 P.2ND 1116 (Utah 1980).

duty by the owner to coordinate work, or to provide access to the work. This duty is usually imposed where the owner or prime contractor is imputed with the obligation to coordinate and provide access to the many trades in such a way as to not cause them to interfere with each other, or to cause excessive delays to others working at the site. Where the owner actively interferes with the work of the contractor, at a minimum, such interference should cut off liquidated damages to the contractor. However, most courts say that if the interference is truly active as opposed to passive, the owner is liable for additional costs or injury to the contractor from such active interference.

d. Legality. There is an implied condition of all contracts that the contract does not violate any law or public policy. If a contract is found to be in violation of a law, be it criminal, federal or state, common law, or city or town ordinance, that contract is considered unenforceable. Thus, a contract is unenforceable as it pertains to aspects of a contract that are in violation of applicable building codes or construction statutes, but is enforceable as it pertains to aspects of the contract that are not in violation of such codes and for which labor and materials have already been supplied. Closely related to statutes concerning building specifications are those requiring construction permits. Generally, a contract is unenforceable if the contractor fails to obtain a permit, unless it is found that: 1) the contract itself is lawful and could have been performed legally, even if, in fact, it was not; 2) the failure to obtain the permit(s) was unintentional, i.e., the contract was performed in good faith; and 3) the failure to obtain a permit does not endanger the public.

e. Licensing. In the same family of statutes concerning building specifications and permits are statutes requiring a contractor that is actively engaged in the performance of a construction

contract to be licensed. In Utah, the licensing statute states that the contractor who fails to obtain a license cannot use the courts to enforce his contract.<sup>11</sup> Due to the harsh and sometimes inequitable results of this law, Utah courts have made some exceptions to this rule, where it can be shown that the person with whom the unlicensed contractor worked, was himself licensed, or was not within the classification of persons to be protected by the licensing statute.<sup>12</sup> Generally, the rule in Utah is that an unlicensed contractor may recover where the absence of a license is a good faith mistake, the contractor has fully performed the contract, and the opposing party is not in the class of persons to be protected by the statute.<sup>13</sup> The courts closely scrutinize each case. Hence, where there is any doubt, it is always wise to have a license, or check the license of those working under you.

f. The superior knowledge doctrine. This doctrine holds that by virtue of their licensing, contractors have such vastly superior knowledge to the construction process than the average consumer layman that they should be held to a higher standard of performance as a result of that superior knowledge. In the recent case of *Smith v. Fransen*, 94 P.3d 919 (Utah 2004), the court held that contractors are imputed with “specialized knowledge” and the skill, expertise and training to build a structure so that it will be fit for its intended use. In particular, certainly contractors have a duty to be aware of sub-soil conditions such that there will be no subsidence of the structure they are building if the soils collapse. A contractor can be held to have breached their duty of care to third parties or to persons with whom they are in privity of contract if they

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<sup>11</sup> Utah Code Ann. § 58-55-604.

<sup>12</sup> *Fillmore Products, Inc v. Western States Paving, Inc.*, 561 P.2d 687, 690 (Utah 1977).

<sup>13</sup> *Loader v. Scott Const. Corp.*, 681 P.2d 1227 (Utah 1984).

build a home or structure on soils that subside. It may be that contractors will be found to be liable for any other acts which violate a standard of practice in the industry and which cause injury or loss to the owner of the residential or commercial project. Thus, roofs that leak, stucco that causes wet rot, concrete that contains structural cracks, and landscape that dies due to no fault of the owner may all be the source of an action based upon the superior knowledge doctrine.

g. Express warranties. In addition to implied warranties, the contractor, of course, must also be careful of the express warranties contained within his construction contract. For example, the AIA - Form A201(1997) contains the following three warranties: 1) the materials and equipment furnished under the contract will be of good quality and new unless otherwise provided for in the contract; 2) the work will be free of defects not inherent in the quality required or permitted; and 3) the work will conform to the contract (the plans and specifications) requirements. Most of the breaches of construction contract disputes relate to the issue of whether the contractor has failed to comply with the express terms of the contractor by not building in conformance with the plans and specifications.

h. The UCC and contracts for the sale of goods. If one is supplying construction goods (as opposed to services) the transaction is governed by the Uniform Commercial Code (UCC). The UCC is limited to transactions involving the sale of goods. The UCC imputes to the contract for the sale of goods any express representation contained in the literature or statements of the seller of goods, including the representation of fitness for a particular purpose. With this warranty, the supplier warrants that the goods are fit for the intended or specified uses. For example, if a salesmen states that paint will work in certain conditions, the contractor is entitled to rely on those representations in the purchase and use of the paint. The UCC also contains a

warranty that the goods are merchantable — meaning the goods are of new and good quality, and can be used for their intended purposes. In short, any express warranties made by a builder or supplier about the quality of its work or goods may be enforceable by the courts against such contractor or supplier.

## 8. CONSTRUCTION DEFECTS AND THE ECONOMIC LOSS DOCTRINE

There is a phenomenon sweeping the country which largely originated in California and looms large in Arizona, Nevada, and the Northwest. It has particularly affected the insurance premiums of home builders. For example, in California the plaintiff bar will write letters to all of the homeowners' associations or condo associations asking them if they have any broken sidewalks, leaky plumbing, dead landscape, sprinklers that do not work, or bad stucco. When the lawyer gets a case, he will sue in tort for negligence and misrepresentation all of the subcontractors, prime contractors, architects, engineers, sureties, and developers of a project. Keep in mind that the homeowners' associations have no privity of contract with any of these parties. It is for that reason they are sued in tort as opposed to contract — because there is no contract. Because these suits have so many parties and are very expensive, insurers sometimes settle just to keep down the expenses.

Utah considered what to do with these kinds of cases in *American Towers v. CCI Mechanical*, 930 P.2d 1182 (Utah 1996). In that case the homeowners filed suit against every person who contributed anything to the construction of the American Towers Condominiums. The homeowners sued in tort for their purely economic losses — that is, the fact that the condos were not worth as much as they should have been worth because of the alleged construction defects. The Utah Supreme Court held in *American Towers* that since the expectations of the

parties to a construction project are best expressed in the parties' agreement, Utah Courts would not permit construction contractors to be sued in tort for negligence, unless there is property damage (such a collapse, fire, or flood) to the owner. Thus, where there are purely economic losses (as opposed to actual property damages) which result from sloppy workmanship in construction, the project owners can sue only for breach of contract and not for negligence. The down side to owners is that if the project is sold to a third party, or the prime contractor is defunct, the owner may be out of luck because he cannot file suit against any party with whom he lacks privity. This is also important for insurers, because they will not defend a lawsuit that does not include an action for negligence. An example of the application of the economic loss doctrine is that if a roof leaks, the insurers will not pay for the replacement of the roof, but if the water leaks destroy a wood floor, the insurer will pay for the replacement of the floor.

## 9. CONSTRUCTION SCHEDULING

The Critical Path Method ("CPM") is a scheduling method used by many contractors to organize, schedule and coordinate the various aspects of any given project. CPM's purpose is to enable the contractor to complete the job in the most efficient way possible. Today, CPM scheduling techniques are widely accepted and commonly used in the construction industry. CPM also has the great advantage of graphically illustrating timing and progress issues which were previously difficult to grasp in a complex construction project.

A good way to understand CPM scheduling and how it works is to follow the steps taken in preparing a CPM schedule. First, one determines all the tasks which comprise the project. Then the tasks are evaluated to determine which tasks must

precede others. This information is plotted on a diagram together with the duration of each task. Attention is given to the commencement of each task at the earliest possible date, with care to avoid task overlaps or conflicts. At this point, the contractor can determine precisely the project's critical path. The critical path is the string of activities which depend upon each other and which will take the most time to complete. Many other activities may not be included on the critical path. These side activities, while they may be a prerequisite for a critical path activity, enjoy a greater leeway in the planning and execution of the project.

Contract provisions on scheduling and coordination of work are often neglected by contractors, architects, owners and lawyers not only during contract negotiations, but also during performance. They are also frequently disregarded during claim negotiations and adjudications even though they may go to the essence of a claim or defense. Many reasons can be cited for this neglect. To some extent the neglect stems from the mistaken belief on the part of some owners and managers that today proper scheduling and coordination of the work are simply matters of instinct or are derived from following the progress of the work. The neglect is also due to the failure of some to recognize the importance and benefits of scheduling provisions and the promises and obligations they express or impose. For the contractor this might be traced to past experience on projects where scheduling provisions were considered meaningless or ignored and not enforced by anyone. But if an owner or manager has ever had a claim arise in which scheduling and coordination provisions were used against them, they will probably not neglect those requirements again. Unfortunately, this awareness of

the importance of scheduling provisions often comes too late, after valuable time and money have been lost.

Scheduling provisions are among the least standardized clauses found in construction contracts today. The awareness and benefits of network planning techniques has increased over the years. In 1965 the Associated General Contractors ("AGC"), in their manual entitled *CPM In Construction*, stressed that CPM "is rapidly becoming a standard scheduling procedure in the construction industry."<sup>14</sup> Today, CPM is one of the standard scheduling procedures in the construction industry. For the owner, CPM can guide scheduling and sequencing of the work and provide a better tool for appraising job progress. For the contractor, CPM means better planning and coordination, more labor productivity, and the maintenance of higher profit levels.

The AGC, in commenting on the benefits of CPM, has observed: "CPM is a contractor's scheduling technique utilized to better plan and organize the flow of work and materials. If CPM can properly perform this function, then savings should result . . . CPM should save time and money."<sup>15</sup> Such techniques, however, must be willingly and carefully implemented. The AGC has cautioned:

Contractors must show a willingness to use CPM (or at least to try it) in order to make the system work effectively. Without this, the system starts off with two strikes against it. If CPM is introduced carelessly, reluctantly, or with unconcern on the part of the contractors as to the functional value of such a system, then it undoubtedly will become an added burden to the job, which hinders rather than helps.<sup>16</sup>

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<sup>14</sup> Associated General Contractors, *CPM in Construction*, 7 (1965).

<sup>15</sup> Associated General Contractors, *CPM in Construction*, 7 (1965).

<sup>16</sup> *Id*

In addition to aiding planning and execution of work, CPM can also be used by managers to protect their companies in prosecuting or defending claims for delays, disruptions, acceleration or suspension of work, and to forecast possible problems before they occur. But if the manager uses the required network planning techniques improperly, they may be used or abused by others to the manager's detriment.

## 10. CONSTRUCTION CLAIMS

Although there are numerous types of construction claims, these materials will focus on the major areas of construction claims. Construction claims are those claims which arise during the course of a construction project.

a. Changed-site condition claims. The most common type of construction claims are changed-site condition claims. These are claims that arise whenever construction site conditions differ or vary from those set forth in the contract or the plans and specifications. If they are wise, owners will provide as much information to contractors as possible (in the form of plans, soil reports, and specifications) so as to take out or limit the contingencies in the contractor's bids. The more uncertainty associated with a bid, the more the contractor is likely to qualify her bid, or put contingency elements in her estimate. When plans, specifications, or sub-soil conditions vary from what the contractor actually encounters at the site, usually the contractor is entitled to a change order for such extras or variances. For example, if electrical sockets are omitted from the plans and have to be included, since they were not in the contractor's bid, she is entitled to a change order for the omitted item. If an excavator bids a project based on a soils report showing clay, but later encounters cobble or caliche, she may be entitled to a change order because the

conditions are not as represented in the soils report or the plans. In short, any misrepresentation or omission from the plans, invitation for bids, specifications, or soils report, can result in the contractor's right to a changed-site condition claim or a change order, provided she follows the procedures set forth in the contract, including the notice and change order provisions, to make such claims.

b. Delay claims. When delays occur on a project, either the owner, the prime contractor, or the subcontractor, are usually going to lose money. This is because the contractor's bid includes only so much labor, equipment and overhead. If the project becomes protracted, labor, equipment, and overhead costs, are almost always going to escalate beyond what was contemplated by the bids. Delay claims focus on the "as bid" costs, versus the "as built" costs. Comparing what a contractor bid for a project, versus what he actually spends to construct a project, is one way of proving or pricing a delay claim, particularly if it can be shown that there is another explanation for the increased costs (such as a blown bid, or inefficiencies in performing the work). Lawyers like to employ some basis or framework to establish how the contractor bid the project, in contrast to how the delay caused his or her work to be inefficient or hindered. Without competent evidence such as daily job logs, correspondence, time extension requests, diary entries, minutes of meetings, bar chart schedules, and like documentation, it is difficult to prove or price a delay claim. Lawyers often use a formula, such as the "Eichley Formula" for determining the value of a contractor's extended overhead incurred on a delayed project. In short, without documentation, delay claims are almost never recoverable.

c. Acceleration claims. Acceleration claims occur when a contractor is forced, for example, to perform 80% of his contract in 20% of the time he allocated or contracted to perform

such work. Such accelerations result in the contractor incurring increased labor costs due to increased crew sizes, overtime labor costs, or when he incurs inefficiencies by working in a congested or obstructive work environment. Accelerations of projects often cause disruptions to the contractor's other work, and may result in the loss of money or cause congestion in his schedules or work forces on other projects he had scheduled at the same time. Acceleration claims, like delay claims, must be proved by detailed daily bar charts and graphs, daily job logs or like documentation.

d. Impact claims. "Impact claims" refers to down stream impacts a delay causes that injure the contractor on a project. For example, if a masonry contractor bids his work for summer conditions but a delay pushes him into winter conditions where he has to pay for, for example, "heat and cover," lack of a work force, or inefficiencies in placing block, such additional costs are known as impact claims. If an excavation contractor bids to put his export soils at a location that later becomes unavailable due to a delay, or if he is required to perform work out of normal sequence, or to compact soil during a rainy season, all of these are impact costs, because they result in costs above what the bid contemplated. Price escalations can be impact claims, if a project goes longer than what a contractor can hold his prices for from his suppliers.

## 11. SURETY BONDS

All private and public projects in Utah over \$50,000, other than residential construction, are required to be bonded.<sup>17</sup> This usually consists of obtaining from a commercial insurance company payment and performance bonds for 100% of the amount of the contract. Payment bonds guaranty that all suppliers and subcontractors used by a contractor for a project will be paid

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<sup>17</sup> Utah Code Ann. § 14-2-1 *et seq.*

in full on the project. Performance bonds guaranty the faithful performance of the project in accordance with the contract documents. Surety bonds are similar to insurance against insolvency. But there are important difference between insurance and suretyship. Insurance involves the actuarial spreading of risks between many persons. In suretyship, the contractor is underwritten with a view to the owner never making a claim against the surety. It is a historical anomaly that bonds are given by insurance companies rather than banks, as contracts of suretyship are more of an extension of credit than an insurance agreement. The surety relationship is tripartite. That is, the party known as the surety or bondsman contracts with the owner, referred to as the obligee, to guaranty the debts and contract obligations of the contractor, referred to as the principal. In return for the surety standing good for the debts of the contractor, the contractor pledges all of his assets, both corporate and personal, to the surety by way of an agreement of indemnity.

Since sureties wish never to have a bond loss, they under write on three critical principals: 1) character; 2) capacity; and 3) capital. Character refers to the moral character of the contractor, his reputation for truthfulness and veracity, his criminal record, or the absence of one, and like moral attributes. Capacity refers to his years of experience, his spotless history in building projects like the one for which he is seeking a bond, the quality and quantity of his equipment, and like qualifications to build. Lastly, capital refers to the amount of liquid and non-liquid assets the builder can devote to a project if the money dries up. Bonding companies refer to this as the contractor's "net quick." If a contractor is able to obtain a surety bond from a reputable surety, it is an invitation for him to build virtually any project in Utah. Thus, obtaining bonds and maintaining one's positive relationship with one's bonding company is one of the most

important undertakings a contractor can perform. Any blemish on a contractor, such as defaulting on or abandoning a project can destroy that relationship.

The law governing payments bonds is closely related to the law governing mechanics' liens. Thus, the details of payment bond claims will be treated in the next section related to liens.

## 12. MECHANICS' LIENS

When a contractor makes an improvement to real property, the concept is that the improvement becomes a fixture to that property. Those improvements entitle the contractor to a portion of the ownership of that property as security for the cost of the improvements.

Mechanics' liens are governed by statute.<sup>18</sup> If an owner or contractor fails to pay a supplier or other contractor for materials or labor incorporated into a project, that supplier or contractor has

a lien right against such property to secure the indebtedness. This is so even if the owner has already paid a contractor who "goes south" with the money. Thus, owners or prime contractors are often required to pay twice: once to the contractor who failed to pay his suppliers or subcontractors, and once again to the supplier or subcontractor who is not paid but claims a lien.

Since liens are creatures of statute, a lien will only be given effect if the contractor strictly complies with the statutory requirements governing such liens. Recent changes to the lien laws put some "teeth" in the lien laws such that filing a lien that is overstated, abusive, or wrongful, can result in severe penalties to the contractor.<sup>19</sup> This section will review the pertinent areas of the mechanic's lien statute.

- a. Preliminary Notices. Before a contractor or supplier can record a notice of lien, he

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<sup>18</sup> Utah Code Ann. § 38-1-1 to 38-1-39.

<sup>19</sup> See, e.g. § 38-9a-101 *et seq.* and 38-1-25.

must first comply with the preliminary notice<sup>20</sup> requirements of the statute. The preliminary notice requirements are an attempt on the part of the legislature to balance, on the one hand, the needs of prime contractors and owners to know who is providing labor or materials on their projects, with, on the other hand, the rights of suppliers and subcontractors to be secured for payment when they supply such labor or materials. Because owners and prime contractor are not always aware of what downstream entities are supplying materials or labor to a project, the preliminary notice laws protect all parties. With such notices, the owner or prime contractor can insure payment and avoid liens, such as by means of joint checks, receipt of lien waivers, or other methods, to assure that all contributors to the project are being paid. Utah is on the cutting edge of technology by establishing the State Construction Registry (“SCR”). This registry acts like a public bulletin board to the entire state, so that all entities can show the rest of the world, so to speak, that they are contributing something to a given project. Each contractor or supplier who wishes to preserve a lien claim or payment bond claim must go online and register with the SCR. The cost is nominal and the failure to so register on the SCR is fatal to the assertion of a mechanic’s lien claim.<sup>21</sup> The statute requires the city, county or town clerk who issues the building permit for the project to register the project on the SCR at the time the permit is issued. The preliminary notice covers work twenty (20) days back from the date that it is registered.<sup>22</sup> If, for example, a pipe supplier delivers pipe for six months to a project, then registers with the SCR, then delivers pipe for three additional months, he can only claim a lien or make a bond claim for

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<sup>20</sup> These statutes are found at § 38-1-27.

<sup>21</sup> § 38-1-32(c).

<sup>22</sup> § 38-1-32(A).

supplies delivered beginning twenty (20) days before the date he registered.

b. Time requirements. If a preliminary notice is registered on the SCR, a mechanic's lien must be filed within ninety (90) days from the final completion of the original contract.<sup>23</sup> The term "original contract" refers to the prime contract between the owner and the contractor, or, if the subcontractor is contracting directly with the owner, this contract will be considered the original contract.<sup>24</sup> Completion of the project refers to substantial completion, or the time that a certificate of occupancy is issued for the structure being built, or, if no certificate is issued, it is when the structure can be used for its intended purpose.<sup>25</sup> In order to preserve his lien, within 180 days after the notice of lien is recorded in the county recorder's office in the county where the construction project is located, a contractor or supplier must file suit to foreclose and enforce the lien.<sup>26</sup> At the time suit is filed, the attorney who files the suit records a *lis pendens* which notifies all interested parties that a lawsuit affecting the property is pending in court.<sup>27</sup> If the lien is not foreclosed within 180 days, it simply goes away as expired, or is no longer enforceable. If no *lis pendens* is filed, the lien will not provide notice to third parties who may claim an interest in the property by publicly recording an instrument against the property. Liens relate back to the first date work is started on the project (such as when the land is grubbed off).<sup>28</sup> If there is a long suspension of time between when one person's work starts and another person's work is

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<sup>23</sup> § 13-1-7 (1)(a)(i).

<sup>24</sup> *Id* at (ii).

<sup>25</sup> *Id* at (ii)(B).

<sup>26</sup> § 38-1-11.

<sup>27</sup> *Id*

<sup>28</sup> § 38-1-5.

commended, the lien will relate from the date work began the second time. If a construction lender files a trust deed securing a loan before work is commenced, any mechanic's lien is probably junior in time and as of right to the lender, and the lien may be foreclosed or washed out by the trust deed holder. Once suit is commenced, it acts like any other suit involving a construction contract, except that if the contractor prevails, his lien acts as security in that he may have his judgment attached to the owner's land if the debtor can not or will not pay, and the lien is enforced.

c. Payment bond claims. As noted above, since Utah law<sup>29</sup> requires all projects over \$50,000 (other than residential projects) to be bonded, payment bond claims are an important part of Utah construction law. Even if a contractor does not have lien rights, if an owner on a public or private project fails to obtain a payment bond from the contractor building the project, that owner is or may be liable to the supplier or subcontractor for the value of labor or materials provided. This is so even if the owner has fully paid the contractor who failed to pay those below him. As with mechanics' liens, payment bond claimants must comply with the preliminary notice requirements by registering online with the SCR. A payment bond claimant must bring suit on his claim within one year from when he last supplies labor or delivers materials to a project.<sup>30</sup> Surety companies are difficult to get money out of if there is a dispute about what is owed. This is because bonding companies stand in the shoes of the bonded contractor, and may assume the defenses of that contractor. In other words, if a prime contractor believes that he has a defense to the payment of your claim, the surety will likely assert the same defense to payment. Once a

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<sup>29</sup> Utah Code Ann. § 14-1-1 *et seq.*

<sup>30</sup> Utah Code Ann. §14-2-2.

contractor is broke, his surety should not hesitate to pay the payment bond claim if all of the notice requirements have been followed. With both bond claims and mechanic's lien claims, the successful party is ordinarily entitled to interest and attorney fees incurred in pursuing the bond or lien claims.

### 13. CONCLUSION

The best course of action for any contractor is to avoid disputes which will take him away from making money and force him into court. The contractor does this by clearly setting forth his or her expectations, particularly regarding payment, and the limitations of his or her liability. This is just another way of saying that one must have clear agreements and contracts, and must be careful of situations where someone can place the contractor in a position to take advantage of the builder. Some contractors believe that they prefer ambiguous agreements, because they think that they can gain the upper hand with such vague agreements. While that may be so with a naive owner, it will eventually be costly and unproductive, and may damage your reputation. Remember, courts and arbitrators will try to protect the innocent consumer or owner, since contractors are supposed to be more knowledgeable on the subject of their contracts. As a general rule, keeping a construction lawyer on retainer for purposes of proactive claims and dispute avoidance is a good policy. Because construction law is highly specialized, you may not wish to use your divorce lawyer in a construction dispute. If the guidelines and principals of this summary are followed, much of the heartache and expense of construction disputes can be avoided.