PRACTICAL CONSTRUCTION LAW FOR MARYLAND CONTRACTORS

Last Updated; July 21, 2017

Stephen S. McCloskey
J. Snowden Stanley, Jr.
Semmes, Bowen & Semmes
25 South Charles Street
14th Floor
Baltimore, Maryland 21201
(410) 576-4842
jstanley@semmes.com
smccloskey@semmes.com
www.semmes.com

PRACTICAL CONSTRUCTION CONTRACT LAW
FOR MARYLAND CONTRACTORS

TABLE OF CONTENTS

PRACTICAL CONSTRUCTION CONTRACT LAW FOR MARYLAND CONTRACTORS

I. INTRODUCTION.

The purpose of this document is to offer Maryland contractors and subcontractors a practical outline of some of the legal principles applicable to their daily business activities in an effort to help them anticipate problems and to be better equipped to resolve potential disputes with a minimum of difficulty and expense.

A limited outline such as this cannot provide legal advice and does not contain the "solution" to particular legal problems. Rather, it is intended to provide a conceptual framework against which to analyze some of the contractual issues which may arise in the day-to-day operations of Maryland construction companies. The hope is that this summary may better equip those companies to identify, analyze and assure the solution of legal issues as they arise rather than being forced to await the development of a full-blown crisis.

Since this outline is directed at an audience of Maryland business persons, it focuses entirely on Maryland legal principles. While Maryland law on the issues mentioned here may be the same or similar to that of other states, anyone dealing with issues concerning a project in another state must take special care to assure that they understand the rules which apply in that other jurisdiction.

II. INTERPRETATION AND ENFORCEMENT OF CONTRACTS BY MARYLAND COURTS AND ARBITRATION PANELS.

A. How courts will interpret contract language and what it means to you.

For many years, Maryland courts have interpreted and applied the language of contracts brought before them in accordance with the "objective theory" of contract interpretation. It is essential to remember that all contract clauses in these documents including those that are "standard" will be enforced as written regardless of whether one or both parties intended or believed that the terms meant something else.[1]

[1] Maryland courts have long recognized the objective standard for interpreting contracts, as discussed in Nat'l Union Fire Ins. Co. v. Bramble, Inc., 388 Md. 195, 208 (2005) (stating that when the language of a contract is clear and unambiguous, the language as it means to a reasonable person in the position of the parties overrides what the actual parties thought or intended the language to mean). See Griggs v. Evans, 205 Md. App. 64, 75 (2012) (stating that Maryland follows the objective standard of contract interpretation, such that a court shall give effect to the plain meaning of unambiguous language, leaving "no need for further construction by the court").

This means that when a dispute over the meaning of a document goes before a court or arbitration panel,[2] the court or panel can be expected to interpret the disputed language in accordance with its view of what the words meant to reasonable, contracting parties at the time of the agreement, rather than what the parties actually thought or intended the document to mean.[3] Indeed, it is only when a court or properly guided arbitration panel becomes convinced that a particular clause or term is "ambiguous" and cannot be understood from the language of the contract document (or in extreme situations such as fraud), that it may properly consider matters outside the contract such as testimony by the parties as to what they intended to agree to, custom and usage in the industry, or conduct of one or both of the parties to the contract.[4] Contracts with public agencies will be interpreted in accordance with these same principles.[5]

It should also be pointed out that these rules of the "objective theory" of interpretation apply to the wide range of contract documents, including bids, estimates, quotations, subcontracts, extra work orders, etc.

In practical terms, if a court or arbitration panel does not agree that particular contract language means what the parties intended and thought it meant, then the document may be interpreted in a completely different way than either party expected.

Consequently, considerable care needs to be taken in the drafting and review of all contract language to make sure that it clearly and unmistakably says what was intended. Using language that "everybody understands" simply "because we have always done it that way," can produce startling and unfortunate results if such documents are put into the hands of a court or arbitration panel.[6]

B. Standard Form Contracts - Helpful and Dangerous!

On both public and private jobs, the construction industry routinely uses standard form contracts. Frequently, parties execute form contracts because they have seen them before, or perhaps they believe them to be subject to negotiation and scrutiny after signing. In so doing, they may fail to adequately understand the full significance of this decision. They also may have

[2] Although arbitration panels may not be required to follow Maryland common law in the same sense as a court is obligated to do, they will often be encouraged to do so by lawyers for one or both parties. Indeed, this practice may be especially likely if one or more lawyers are members of the panel.

[3] Wells v. Chevy Chase Bank, F.S.B., 377 Md. 197, 224-25 n.12 (2003).

[4] Long Green Valley Ass'n v. Bellevale Farms, Inc., 205 Md. App. 636, 655 n.10 (2012) (providing that ambiguities in contract language be resolved by the trier of fact); Sullins v. Allstate Ins. Co., 340 Md. 503 (1995) (defining ambiguous as when a word is susceptible to more than one meaning to a reasonably prudent individual).

[5] Arthur E. Selnick Assoc., Inc. v. Howard Cnty., 206 Md. App. 667, 682 (2012).

[6] Heritage Oldsmobile Imports v. Volkswagen of America, Inc., 264 F. Supp. 2d 282, 289 (D. Md. 2003) ("Custom and practice, however, may only be used to interpret the terms of an ambiguous or deficient contract—not to contradict the terms of the contract or create an obligation absent from the contract.") (citing Applestein v. Royal Realty Corp., 181 Md. 171, 174 (1942) ("The true test is that there must be in the contract something doubtful that can be explained by usage or custom. If the contract is plain, evidence cannot be received to contradict it.")).

cause to regret not giving the documents more careful scrutiny because they will be required to comply with the contract terms irrespective of whether they have read them.[7]

For private projects, the most widely used documents may be the forms published by the American Institutes of Architects (AIA). The most recent version includes the 2017 editions of the AIA A-101 (Owner Contractor Agreement), AIA A-201 (General Conditions for Construction), and AIA A-401 (Subcontract).[8] Even when these forms are used, parties frequently amend the AIA terms by supplemental documents that often have the effect of substantially changing the standard forms. Consequently, for each project, all documents should be reviewed with care and should be fully understood before they are executed.

Public owners often have their own "standard" contracts. For example, the State of Maryland, while not using a single contract for all of its various procurement activities, does have a number of contract clauses that are required by law to be included in construction contracts issued by the State.[9]

Many owners and contractors have developed their own preprinted form agreements that they may wish to use on all their projects. Thus, it is critical that the parties understand all of the requirements and risks contained in such documents as they apply to each project. Obviously, the entity that issues its own "form" contract intends to protect its own interests. Other parties may also be able to use such forms as a starting point for changes for their contracts if adequately tailored for specific projects.

In sum, perhaps the most important point in the foregoing discussion is that standard form contracts are practically essential and commonly employed, yet potentially dangerous if not reviewed carefully and modified as necessary to make them suitable for each individual project.

C. Implied contracts - much better if your agreement is in writing.

It may be necessary for parties on construction projects to perform some work without a written or oral agreement. Such a step is often risky and should be avoided if at all possible.

Nonetheless, there are circumstances where parties do proceed without a written agreement on the belief that all parties understand what work is expected to be done and what the payment will be for the labor or materials supplied for a project. If the acts of the parties clearly

[7] Holzman v. Fiola Blum, 125 Md. App. 602, 630 (1999) (sellers of real property owed their real estate broker a commission on a sale since it was provided by the contract terms notwithstanding the fact that the sellers signed the contract without reading it).

[8] See *A-Series: Owner Contractor Agreements*, THE AMERICAN INSTITUTE OF ARCHITECTS, http://www.aiacontracts.org (last visited July 10, 2017). AIA contracts have been updated as of October 2017 *Id.*

[9] See MD. CODE ANN., STATE FIN. & PROC. § 13-218 (West 2017); John L. Mattingly Const. Co. v. Hartford Underwriters Ins. Co., 415 Md. 313 (2010) (describing subrogation waivers, for example, as standard clauses in construction contracts); Dep't of Gen. Servs. v. Harmans Assocs. Ltd. P'ship, 98 Md. App. 535, 551 (1993) (stating that when procurement regulations are adopted pursuant to statutory authority they require that a contract contain a particular clause and the contract must be read as though it contained that clause, whether or not the clause was actually written in the contract).

establish that there was an agreement or understanding of the essential terms, a court can determine that an implied contract existed between the parties which is enforceable.[10]

There are two kinds of implied contracts, "implied-in-fact" and "implied-in-law." An implied-in-fact contract is one where the facts and circumstances reflect a mutual agreement of the parties to be bound to each other. A contract that is "implied-in-law," sometimes referred to as a "quasi" or "constructive" contract, is imposed by a court to prevent injustice or unfairness even if there was no agreement as to material terms. Where a court finds that a contract was "implied-in-law," it may make an award on the basis of *quantum meruit*, which is defined in the construction context as the reasonable value of the labor and materials provided to the other party.[11]

Parties should not perform construction work with the hope that an implied-in-fact or implied-in-law contract will be found by a court to have existed after long and expensive litigation. Prudence dictates that all parties should make certain that agreements for construction are reduced to writing and that the terms of those writings are fully understood.[12]

III. PRE-CONTRACT DISCUSSIONS, ESTIMATES, QUOTATIONS AND BIDS - PITFALLS AND BENEFITS

In an age of ever-increasing competition for a limited number of projects, pre-contract discussions, as well as proposals, estimates, or bids for particular projects may be an ever more important part of the task of selling the services of your company to potential clients.

For that reason, there may be substantial marketing pressure to present your company's capabilities and services in an extremely favorable light in order to get the business needed to keep the company's profits at an acceptable level.

While aggressive advertising and salesmanship has been and remains acceptable, there are circumstances in which, if a dispute arises later, such statements can be considered representations upon which a client had a right to rely. This can give rise to potentially significant liability on the part of the contractor or subcontractor making such statements.

---

[10] See Baltimore City Bd. of School Comm'rs v. Koba Inst., Inc., 194 Md. App. 400, 412-13 (2010); Mass Transit Admin. v. Granite Constr. Co., 57 Md. App. 766, 774 (1984); Cf. LLC v. DS Federal, Inc., 224 Md. App. 164 (2015) (holding that courts will not enforce contracts to make decisions on a future date, or in other words, "agreements to agree.").

[11] Alts. Unlimited, Inc. v. New Balt. City Bd. of Sch. Comm'r*s*, 155 Md. App. 415 (2004) ("'Quantum meruit'" is Latin for "as much as he deserved." As a measure of recovery, it means the reasonable value of the work performed or the services rendered by a plaintiff for a defendant."); see also Evergreen Amusement v. Milstead, 206 Md. 610 (1995).

[12] See, e.g., Skanska USA Bldg., Inc. v. Smith Mgmt. Const., Inc., 184 Md. App. 659, 672–73 (2009) (citing 41 U.S.C. § 605(a) ("All claims by a contractor relating to a contract must be in writing and must be submitted to the appropriate contracting officer for a decision.")); Enter. Sys. Inc., MSBCA 2010, 5 MSBCA ¶426 (1997) (using sovereign immunity to bar claim based upon an alleged oral modification of a state contract); Dep't of Pub. Safety v. ARA Health Servs., Inc., 107 Md. App. 445, aff'd, 344 Md. 85 (1996) (barring recovery for work on contract formed by "modification by conduct" of earlier written contract).

A. Estimates and Quotations: You send and receive them all the time, when can they get you in trouble?

In many situations, contractors send or receive quotations and estimates for particular work to be done if a contract is awarded to them. Some of these quotations and estimates are clearly presented and received as part of informal discussions based upon preliminary information and assumptions. When exchanged between responsible businessmen and women, such estimates and quotations serve as a constructive part of the process of planning and estimating the cost and time necessary to complete a project.

At some point, however, the process may change from an exchange of preliminary estimates based upon assumptions, to one in which the recipient of the quotations or estimates is relying on them to make commitments of its own to another party. If a court or arbitration panel should later determine that it was reasonable for the recipient to rely on the estimate and to make a bid or other commitments of its own based upon that estimate, then the individual providing the estimate may be held responsible for any failure to perform in accordance with it.[13]

1. What if the quotations are oral?

The fact that the quotations or estimates may not be in writing does not alter the applicable rule but may make the proof more difficult on both sides. What this means is that an oral statement such as "I think we could probably build out this phase of the project in about 16 months for approximately $2.4 million," might be considered as one on which a developer could not legitimately rely as a basis for committing to a bank loan.[14] By contrast, a statement to a general contractor that "I'll be able to have humidifiers installed in all those units in two weeks for $135,000" might be deemed enforceable against the mechanical subcontractor who made it.

2. Who can rely on your estimates?

Maryland courts have enforced estimates and quotations for construction projects in situations in which they believed that it was commercially reasonable for the recipient to rely on them and the recipient made some commitment of his own in reliance upon them.[15]

3. How can you protect yourself from disputes over your quotations and estimates?

---

[13] See Pavel Enters., Inc. v. A.S. Johnson Co., 342 Md. 143, 167 (1996) ("[i]n a construction bidding case, where the general contractor seeks to bind the subcontractor to the sub-bid offered, the general must first prove that the subcontractor's sub-bid constituted an offer to perform a job at a given price."); Md. Supreme Corp. v. Blake, 279 Md. 531 (1977); Allen M. Campbell Contractors v. Va. Metal Indus., 708 F.2d 930 (4th Cir. 1983).

[14] E.g., Sass v. Andrew, 152 Md. App. 406 (2003) (finding no binding contract where subcontractor agreed to frame plaintiff's addition for "roughly" $3,000).

[15] See Goldstein v. Miles, 159 Md. App. 403, 434-35 (2004); Ward Dev. Co., v. Ingrao, 63 Md. App. 645 (1985) (finding that homeowners reasonably relied on erroneous estimates of sewer and water connection charges in contracts for sale).

While informal discussions at preliminary planning stages may cause no problems, all personnel need to be aware that quotations or estimates presented later in project development or in bid preparation stages may well impose contractual liability on your company.

Consequently, personnel should be adequately prepared and a record should be kept of any estimates made or received so that the parties will understand the commitments made and hopefully avoid disputes over compliance with them.

B. Bids and Proposals

One definition of a "bid" is "a statement of price, terms of sale, and description of the supplies, services, construction, or construction-related services offered by a bidder in response to an invitation for bids under procurement by competitive sealed bidding or comparable small procurement procedures."[16] Stated another way, a "bid" is an offer to perform specified work or supply specified materials at a particular time under terms and conditions spelled out or referred to in the bid.[17] If accepted by an award, such offers result in the creation of a contract requiring the bidder to provide the promised services under the specified terms and conditions.

In a private project, an owner may invite a number of contractors to submit a price for the project. The final terms and conditions are then negotiated between the owner and the successful offeror. A private owner is not required to enter into a contract based upon the responses to a request for a price. Once the offer is received, there will often be negotiation among the offerors with a formal offer of contract made by the owner to the successful party. The owner's invitation for a bid does not constitute an offer that may be accepted by submitting the lowest price. Additionally, under the Maryland Door-to-Door Sales Act, a homeowner engaging in a contract for home improvements may cancel the contract by sending notice to the contractor by midnight of the fifth business day following the sale.[18] This time period is extended to midnight of the 7th business day if the buyer is 65 years or older.[19]

For projects with public owners, and especially the State, the situation will often be much different. The requirement for competitive bidding is usually mandated by statute, which requires the public entity to enter into a contract with the lowest responsive and responsible bidder. The bidders must meet all of the requirements of the invitation to bid. If they do and their price is the lowest, then they are entitled to the award of the contract.[20] The process is open

[16] MD. CODE REGS. 21.01.02.01 B(9) (2017).
[17] Citiroof Corp. v. Tech Contracting Co., 159 Md. App. 578 (2004) (requiring that a bid constitute an offer to perform a job at a given price).
[18] MD. CODE ANN. COM. LAW § 14-302.1(1) (West 2017).
[19] Id.
[20] Ferrero Const. Co. v. Dennis Rourke Corp., 311 Md. 560, 578 (1988) (citing Rofra, Inc. v. Board of Ed., Prince George's Cnty., 28 Md. App. 538 (1975) ("Even though the charter of a municipality expressly requires that a contract shall be awarded to the lowest responsible bidder, a contract is not formed until the lowest bid is in fact accepted.")).

to all qualified bidders who wish to participate, as opposed to a private owner soliciting prices from contractors of his own choosing.

The goal of competitive bidding is to prevent public officials from exercising favoritism and to achieve the best possible price for the benefit of the public. Generally, the terms and conditions of the contract are contained in the invitation to bid and are not negotiable. This again is intended to promote fairness in the competition since contractors are setting their price based upon identical terms and conditions.

In the event the bid process on a public project does not follow statutory requirements, or the alleged low bidder does not in fact follow the requirements of the invitation to bid, a protest procedure is established either within the body of the invitation to bid itself or by statute or regulation.[21] The protest procedure allows other bidders to challenge the legality of the alleged low bid and ensures that the legal requirements are adhered to by public officials and the other bidders. Notwithstanding the laws and regulations, the invitation to bid is not considered a legal offer, which may be accepted by submitting the lowest bid.[22] In virtually all cases, the statutes allow the public authority to reject the entire pool of bids at its discretion.[23] This reservation is particularly important when the bids come in significantly higher than the public authority's cost estimates.

1. When can you correct an error in your bid?

In order to give public or private owners the opportunity to review and evaluate all bids, ascertain which was the lowest responsive bid from a responsible bidder, and decide whether to proceed to award a contract, competitive bids by general contractors are often required to be "firm" and not subject to change for a certain period after opening.[24] Consequently, in submitting bids to owners, general contractors must often rely on bids or quotations from subcontractors and suppliers. As mentioned above, the courts of Maryland have for a number of years permitted general contractors to enforce such a subcontractor bid, even if oral, as long as it can be shown to have been made under circumstances which gave the general contractor reason to rely on it in presenting its bid and if the contractor was awarded the contract for which the bid was submitted.[25]

---

[21] See MD. CODE REGS. 21.10.02.01–11 (2017).

[22] See Rofra, 28 Md. App. at 539. ("We do not agree that an invitation to bid is an offer and a conforming bid an acceptance.")

[23] See MD.CODE ANN. STATE FIN. & PROC. § 13-206(b) (West 2017); MD. CODE REGS. 21.06.02.02(C)(1) (2017) (allowing public entities broad discretion to reject bids when it is "in the State's best interest"); see also Brawner Builders, Inc. v. State Highway Admin., MSBCA 2770–71 (2012) (stating that the State Highway Administration's broad statutory discretion justified rejecting a low bid which it found unbalanced).

[24] Jay Dee/Mole Joint Venture v. Mayor and City Council of Balt., 725 F.Supp.2d 513 (D. Md, 2010) ("Award of a competitively bid contract normally is made by . . . communication of the acceptance by an authorized person to the low bidder during the 'firm bid' period." (citations omitted)).

[25] Id.; Rofra, 28 Md. App. at 540; Citiroof, 159 Md. App. at 581. Cf. Pavel Enters., Inc., 342 Md. at 143 (holding that subcontractor's low bid did not form binding contract under detrimental reliance theory).

No matter how careful bidding procedures are, many contractors will make errors during the bidding process. Some are insignificant or can be corrected by agreement of the parties. Others, however, are of great significance in terms of time and cost, and cannot be so easily corrected. If correction of those errors is not possible, the potential result may be a lawsuit to enforce the price and other terms of the bid by the party to whom it was submitted, or a claim for the breach of the contract that was created when the bid was submitted.[26] The claim for breach of contract would be in an amount necessary to permit the owner or contractor to procure the labor or materials which were the subject of the bid from other sources.[27]

a. What if a Mistake is Noticed Prior to Award?

A general contractor's bid containing arithmetic or other errors might be subject to correction or withdrawal after opening, but prior to award, if it was not submitted as "firm" or irrevocable. This is because any offer to contract may be withdrawn or amended prior to acceptance. For example, if a roofing company incorrectly submits a bid to do the roofing of a mansion for $1,750.00, it may withdraw the bid or correct the error to reflect the intended bid of $11,750.00 prior to acceptance.

However, in the more likely event that a general contractor's bid was submitted as firm or that a subcontractor's quotation was relied upon by a general contractor in its quote to an owner and a mistake was noticed after opening but prior to award, the courts have been very hesitant to allow the correction of such bids to relieve bidders of the consequences of their mistakes. One concern has been that correction of such bids would not only slow down and greatly increase the costs of construction projects, but would also allow a bidder to take unfair advantage of the process by amending its bid after it has had an opportunity to review the bids of its competitors under the pretense of correcting its mistaken bid. However, some courts have authorized relief to bidders to correct obvious cases of unfairness when clear proof has been presented of an innocent mistake of fact by a bidder, particularly when the court concludes that the owner receiving the bid should have been aware of the mistake. Moreover, under circumstances in which the bidder's mistake was obvious and not of a material nature, the invitation for bid and contract documents may allow an owner to correct minor errors and award a contract on the basis of the corrected bid.

b. What if a Mistake is Not Detected Until After Award?

The reasons courts are reluctant to allow correction of bids after opening but prior to award, apply even more strongly to efforts to alter a bid after the bidder has received the award and a contract has been created. This hesitation is especially strong with regard to construction contracts for government agencies where the owner claims to represent the interests of the citizens of a city, state, or the entire country.

---

[26] See Citiroof, 159 Md. App. at 578 (general contractor sued for breach of contract when the roofing subcontractor submitted the lowest bid, the general contractor relied on it, but the subcontractor withdrew the bid upon learning it was much too low as a result of a miscalculation).

[27] See id. (mandating that the subcontractor reimburse the general contractor $20,276 in damages, which was the difference between the subcontractor's original bid price and the actual cost of the roofing work).

Consequently, bid errors discovered after award are frequently not going to be correctable, and a bidder will be forced to choose between compliance with its bid and a claim for breach of contract damages from the owner for the cost of re-procuring the labor and materials from another company (often at prices higher than its bid).[28]

There are circumstances, however, under which courts and Boards of Contract Appeals have allowed modification, correction, or rescission of bids even in situations in which the mistake is entirely that of the bidder. Maryland's highest court has ruled that, in order to obtain rescission, a bidder must provide clear and convincing proof of the following facts:

> (1) the mistake must be of such grave consequences that to enforce the contract as made or offered would be unconscionable; (2) the mistake must relate to a material feature of the contract; (3) the mistake must not have come about because of the violation of a positive legal duty or from culpable negligence; (4) the other party must be put in status quo to the extent that he suffers no serious prejudice except the loss of his bargain.[29]

Nonetheless, these decisions must be understood as applicable only in limited cases in which a contractor or subcontractor can offer convincing proof of entitlement to relief from its commitments. In addition, the Maryland Board of Contract Appeals has held that "minor irregularities" can often be corrected, but if the bid was submitted to a state agency, the procurement officer has the discretion of whether to permit the bidder to correct it or require him to waive the deficiency if it is in the state's best interest to do so.[30]

c. Can bid mistakes be corrected after commencement of construction?

A contractor or subcontractor claiming to have discovered a mistake in its bid, only after it began construction, will likely face great difficulty in obtaining relief from a Maryland court. Such a contractor would certainly seem to face difficulty in overcoming arguments that it had not only failed to exercise reasonable care in bidding and preparing to do the work, but also had really discovered its "mistake" only after it began work and found it to be more difficult and costly than expected.

---

[28] See MD. CODE REGS. 21.05.02.12 (2017); Md. Port Adm. v. John W. Brawner Contracting Co., 303 Md. 44, 50 (1985).

[29] Steele v. Goettee, 313 Md. 11, 27 (1988) (citing Baltimore v. DeLuca-Davis Constr. Co., 210 Md. 518, 527 (1955)).

[30] Mediterranean Constr. Co. v. Dept. of Natural Res., Inc. MSBCA 2583 (2007); see also Bd. of Ed. of Carroll Cnty. v. Allender, 206 Md. 466 (1955) ("In judging whether or not the omission or irregularity in a bid is so substantial as to invalidated it, the court must be careful not to thwart the purpose of competitive bidding by declaring the lowest bid invalid on account of variations that are not material." (citing George A. Fuller Co. v. Elderkin, 160 Md. 660, 665 (1931))

2. How do you protect yourself and your clients from future misunderstandings and disputes arising from your bids and proposals?

Since estimates, quotations, and bids can give rise to contractual liability on the part of the company submitting them, they must be prepared accurately and with the same care as other contract documents.

It is also extremely important that careful records be kept so that compliance with the promises contained in the contract can be verified.

IV. CONTRACT DOCUMENTS

A. What are the "contract documents"?

The "contract documents" are all those documents which comprise a particular contract. Depending upon the agreement of the parties, they may consist of one or two simple documents plus some plans, or they may include a large volume of plans, specifications, addenda, general conditions, supplementary general conditions, change orders, proposals, letters, and so on.

Because construction agreements are made in many ways, it is not possible to apply one description to all cases. Nonetheless, any documents that convey obligations on a project will likely be considered part of the contract. In each case they must be reviewed and followed with great care.

B. Key Contract Issues to Be Considered Before You Sign.

While each part of a contract is important, the following are some of the provisions and issues in construction contracts that have been the cause of disputes on numerous occasions. Perhaps the most important message regarding all these claims is that contractors should read them, understand them, and believe them.[31]

1. Incorporation by Reference

Virtually all construction contracts, whether prime contracts or subcontracts, contain clauses incorporating by reference other documents as if they were set forth in full. Such clauses incorporate into one construction contract the provisions of other documents such as separate agreements, plans, specifications, technical manuals, and general and special conditions. An example of an "incorporation by reference" clause is found in the American Institutes of Architects (AIA) Section A-101, General Conditions of the Contract for Construction (2017 edition) which states in Article 1:

> The Contract Documents consist of this Agreement, Conditions of the Contract (General, Supplementary, and other Conditions), Drawings, Specifications, Addenda issued prior to execution of this Agreement, other documents listed in this Agreement, and Modifications issued after execution of this Agreement, all of which form the Contract, and are as fully a part of the Contract as if attached to this Agreement or repeated herein. The Contract represents the entire and integrated agreement between the parties

[31] Under Armour, Inc. v. Ziger/Snead, LLP, 232 Md.App. 548 (2017) (Courts "seek to determine the parties' intentions by construing the contract as a whole, 'giving to every clause and phrase, so as not to omit an important part of the agreement.'") (quoting Owins-Illinois v. Cook, 386 Md. 468, 497 (2005).

> hereto and supersedes prior negotiations, representations, or agreements, either written or oral. An enumeration of the Contract Documents, other than Modification, appears in Article 9.

The effect of this language is to make all of the other written documents referred to wholly binding on the parties insofar as they relate to the specific work to be performed by the party, whether or not they have been read or examined. [32]

Incorporation by reference clauses may also reference various industry standards such as ASTM, ANSI, MILSPEC, SMNCA, and the like. Documents or standards specifically incorporated by reference in a construction contract will be considered and applied exactly as if they were physically attached and incorporated into the contract.[33]

Clauses which incorporate by reference all of the documents that are part of and incorporated into the prime contract are almost always found in subcontracts. In addition, subcontracts normally contain "flow-down" language, which has the legal effect of making the contractor and subcontractor obligated to each other in the same manner that the contractor and the owner are bound to one another. For example, the AIA A-401 Subcontract (2017 edition) states the following in Article 2:

> The Contractor and Subcontractor shall be mutually bound by the terms of this Agreement and, to the extent that the provisions of AIA Document A201-2017 apply to this Agreement pursuant to Section 1.3 and provisions of the Prime Contract apply to the Work of the Subcontractor, the Contractor shall assume toward the Subcontractor all obligations and responsibilities that the Owner, under such documents, assumes toward the Contractor, and the Subcontractor shall assume toward the Contractor all obligations and responsibilities that the Contractor, under such documents, assumes toward the Owner and the Architect. The Contractor shall have the benefit of all rights, remedies, and redress against the Subcontractor that the Owner, under such documents, has against the Contractor, and the Subcontractor shall have the benefit of all rights, remedies and redress against the Contractor that the Contractor, under such documents, has against the Owner, insofar

[32] But see Schneider Electric Buildings Critical Systems, Inc. v. Western Surety Company, 231 Md.App. 27, (2016), cert. granted 452 Md. 2 (2017), (holding that "incorporation of one contract into another contract involving different parties does not automatically transform the incorporated document into an agreement between the parties to the second contract unless there is an indication of a contrary intention to do so." (internal quotations and citatations omitted)).

[33] See Hartford Acc. & Indem. Co. v. Scarlett Harbor Assocs. Ltd. P'ship, 109 Md. App. 217 (1996) ("When an earlier document is incorporated by reference into a subsequent contract, it simply means that the earlier document is made a part of the second document, as if the earlier document were fully set forth therein." (citations omitted)); see also Am. Elec. Contracting Corp. v. United States, 217 Ct. Cl. 338, 349 (1978) (provisions incorporated by reference have the same force and effect as if written into the contract).

> as applicable to this Subcontract. Where a provision of such documents is inconsistent with a provision of this Agreement, this Agreement shall govern.

Consequently, it is essential that all parties understand that the labor, materials, standards, and requirements of any document incorporated by reference into a contract are part of the scope of work required by that contract. This applies whether or not the incorporated documents have been seen or read.

2. Scope of Work

Virtually all construction contracts contain clauses defining the scope of work required to be performed by a contractor or subcontractor. Particular care must be taken to make certain the scope as written is what each of the parties intended.

Except where there are multiple prime contractors, the scope of work clause in a prime contract will generally require the prime contractor to perform all requirements to complete the project. However, problems may occur when the prime contractor, in assigning the various trade work to particular subcontractors, fails to assign all of the contractually required work, resulting in gaps and unassigned responsibilities.[34] Particular care must be taken in the development of each subcontract to fully detail the subcontractor's responsibilities and obligations to perform particular work with clear scope language which should include any intended exclusions.

3. Payment

Since no construction companies will remain in business long without proper payment for their work, this contractual provision may be the most important, but these contract clauses are often the subject of disputes over the amount and timing of payment.

a. Payment clauses.

From the standpoint of anyone involved in the construction industry, one of the most important provisions in the contract for the job is the payment clause. Such clauses often provide that payment will be made at certain intervals as the required labor and materials are provided to the project. While the procedures set out by payment clauses may work well, it should be remembered that in the event of a dispute, they will be interpreted in accordance with the "objective theory of contract interpretation" described above.

A progress payment provision in a contract is intended to ensure that partial payments are made for work as the project progresses. Generally, such payments are at monthly intervals. The system of such periodic payments has arisen because, without a progress payment provision, an owner or general contractor would be entitled to retain one hundred percent of the contract funds

[34] See P.G. Constr. Co., MSBCA 1642, 4 MSBCA ¶ 312 (1992) (finding that the State was not responsible for general contractor's inadequate review of subcontractor's bids where work was missed).

until final completion of the work. This would impose the significant financial burden of carrying the entire cost of labor and materials sometimes for weeks or months.

Such clauses often condition receipt of progress payments upon the submission of specified documents verifying the completion of portions of work in a manner satisfactory to an owner or his architect (or an inspector for a lending institution) at particular intervals.

An example of a progress payment clause is found in Article 5 of AIA A-101, the Standard Form of Agreement Between Owner and Contractor, which is then supplemented by Article 9 of A-201, the General Conditions of the Contract for Construction (2017 edition). These provisions spell out in detail the amount and the frequency of progress payments and the documentation that must be submitted by a contractor to establish entitlement to those payments.

While an effective payment clause need not be as long and detailed as those found in these AIA documents, the issue of payment is obviously crucial to the successful completion of any construction project. Consequently, anyone contemplating entering into a construction contract must closely examine and thoroughly understand all aspects of the payment clause of the documents he is being asked to sign.

Two common versions of payment clauses that have generated litigation between general contractors and their subcontractors are "pay when paid" and "pay if paid" clauses.

b. "Pay when paid" clauses

A "pay when paid" clause does not affect a contractor's contractual obligation to pay a subcontractor, but postpones the time for payment until the happening of a future event or for a reasonable time, if such an event does not occur.[35]

An example of such a clause is:

> "Contractor agrees to pay subcontractor for said work ... as the work progresses, based upon estimates approved by contractor and architect ... and payment by owner to contractor. ... Final payment shall be made within 30 days after the completion of the work included in this subcontract, written acceptance of the same by the architect and owner, . . . and full payment therefore by the owner."

Maryland courts have held that such clauses do not impose on a subcontractor the risk of an owner's insolvency or of a dispute over work in which the subcontractor was not involved.

[35] Gilbane Bldg. Co. v. Brisk Waterproofing Co., 86 Md. App. 21, 25 (1991); see also Young Electrical Contractors, Inc. v. Dustin Construction, Inc. 231 Md.App. 353, 368, (2016), cert. granted, 452 Md. 523 (2017) (explaining that there are no magic words for creating a pay when paid clause, and that "an incentive scheme to encourage prompt payments to a subcontractor when the Owner has paid" the general contractor indicates such a clause).

Rather, they merely postpone the subcontractor's right to payment for a "reasonable period" after completion of the project.[36]

c. "Pay if paid" clauses

Unlike a "pay when paid" clause, a "pay if paid" clause provides that a general contractor's payment to a subcontractor is conditional upon the general contractor being paid.[37]

An example of such a clause is:

> "Monthly and final payments will be made to the trade contractor within five (5) days after receipt of payment by the construction manager from the owner. The retained percentage will be forwarded as soon as received by the construction manager from the owner. It is specifically understood and agreed that the payment to the trade contractor is dependent, as a condition precedent, upon the construction manager receiving contract payments, including retainer from the owner."

Because of the "condition precedent" language, the Maryland Court of Special Appeals has ruled that such a clause transfers the risk of the owner's insolvency to a subcontractor, so that a contractor is not obligated to make payments to a subcontractor unless and until payment is received from the owner.[38] Maryland courts have also noted, however, that conditions precedent can be implied in the absence of specific language, such as in the example cited above.[39]

These "pay when paid" and "pay if paid" clauses may not include a requirement that a subcontractor waive its right to assert a mechanic's lien or to file a payment bond claim because the Legislature has added a provision to the Mechanics' Lien Law making void as against public policy any clause that includes such a waiver.[40]

4. Notice requirements

The purpose of notice provisions in construction contracts is to give another party the opportunity to prepare for the happening of certain events. The effective and timely receipt of notice of an event might reduce or eliminate the costs associated with an event or may give another party the opportunity to act as required under a contract and avoid costly disputes. Many

---

[36] Id. ("Pay when paid" clause required subcontractor to wait a "reasonable period of time" after work satisfactorily completed before being able to recover from general contractor).
[37] Id. at 28.
[38] Id. (concluding that, due to "pay if paid" clause, subcontractor not entitled to recover from general when owner ran out of money); see also Architectural Sys., Inc. v. Gilbane Bldg. Co., 760 F. Supp. 79 (D. Md. 1991).
[39] Richard F. Kline, Inc. v. Shook Excavating & Hauling, Inc., 165 Md. App. 262, 270 (2005); New York Bronze Powder Co., Inc. v. Benjamin Acquisition Corp., 351 Md. 8, 17 (1998).
[40] MD. CODE ANN., REAL PROP. § 9-113(b) (West 2017).

construction contracts contain a myriad of notice provisions that delineate the responsibility, the procedure, and the time requirements for sufficient notice of particular events.

Most construction contracts contain provisions requiring a party to give the other party notice of the occurrence of unexpected events that could cause a party to incur unanticipated costs. These contracts normally contain provisions requiring a party who intends to assert a claim for damages due to unanticipated occurrences to provide written notice within a relatively short period of time after the event or occurrence.[41] Failure to comply with these notice provisions will often cause the loss of rights otherwise provided by the contract or by law.[42]

As with so many of these key contract provisions, it is of utmost importance that a contractor strictly complies with the notice provisions in a construction contract. Failure to do so is one of the most common causes for the loss of rights otherwise provided by a contract. As will be discussed elsewhere in this outline, compliance with the contract procedures for notice is a prerequisite to protecting one's rights under the contract.

Therefore, when preparing to sign the contract, consider those circumstances in which proper notice may prevent or mitigate additional costs of your work. Provide for adequate notice procedures during the life of a contract and make sure that, in the event of a dispute, you can prove they were followed correctly.

5. No damage for delay.

It is often stated that in construction projects (as in other parts of life) “time is money.” In view of their cost, complexity, and duration, the time set for completion of a project and its various phases is almost always a critical part of the contractual undertaking of all of the parties.

Predictably, the failure to meet those time deadlines is a fertile source of disputes. These disputes concern the cause of any delay, the contractor’s responsibility to achieve the required schedules, and the costs to be assessed as a result of missed deadlines.

As a general proposition, an owner will be liable to his contractor if the contractor incurred extra costs due to delay caused by an owner's decision to change the design of a project, the refusal to make decisions in a timely fashion, and so on.

It is not unusual, therefore, for owners, particularly governmental agencies, to include "no damage for delay" clauses in their contracts. These provisions seek to exclude any monetary

[41] But see Manekin Construction, Inc. v. Maryland Dep’t of Gen. Serv., No. 600 2017, WL 2806288, at *11 (Md. Ct. Spec. App. June 28, 2017) (holding that under COMAR 21.07.02.05-1C and D, “the thirty-day limitations period begins when the contractor has notice that the agency *disputes* the contractor’s request.” (emphasis added))

[42] In Cnty. Comm'rs of Caroline Cnty. v. J. Roland Dashiell & Sons, Inc., 358 Md. 83 (2000), the failure of the contractor to make claims within 21 days after occurrence of an unanticipated event as required by AIA A201 resulted in substantial unrecoverable losses. The court held that the contractor’s written notice stating it might file a claim for delay was inadequate. *Id.* at 103-04.

compensation for the costs of owner-caused delays and consequently to entirely shift such risks to the contractors.

The potential for unfair application of a "no damage for delay" clause is obvious and has led to judicial decisions in various states which have refused to uphold them. However, the courts of Maryland and other states have upheld such clauses as written.[43]

6. Liquidated damages.

Liquidated damages are damages in an amount agreed upon by the parties in advance as payable if an event (such as completion of a project) does not occur on a certain date. Although they may be found more frequently in construction contracts issued by governmental agencies, they have also been used for many years in contracts for private projects as well. Since they are frequently enforced to impose significant damages on parties to construction contracts, they require careful review and consideration in advance of contract execution.

While such clauses may be found in various forms, one example is the provision mandated for all state construction contracts in Maryland, absent special circumstances:

> Time is an essential element of the contract and it is important that the work be vigorously prosecuted until completion.
>
> For each day that any work shall remain uncompleted beyond the time(s) specified elsewhere in the contract, the Contractor shall be liable for liquidated damages in the amount(s) provided for in the solicitation, provided, however, that due account shall be taken of any adjustment of specified completion time(s) for completion of work as granted by approved change orders.[44]

In other words, such a provision entitles an owner to collect damages in a liquidated or stated amount, usually calculated on a daily basis, to compensate for the contractor's failure to complete the project on time, without regard to actual damages incurred as a result of the delay.

If the parties agree on a liquidated damages provision, courts generally enforce them.[45] However, Maryland courts have made clear that such provisions may not properly be used to "penalize" one party for failure to comply with its obligations. They may only be enforced if it can be shown that at the time the contract was made: (1) the parties intended the amount stated to be reasonable compensation for breach of the contract, and (2) that at the time the contract was entered into, damages for a breach of contract would have been difficult to ascertain with

---

[43] Compare Beka Indus., Inc. v. Worchester Cnty. Bd. of Educ., 419 Md. 194, 235-36 (2011), with State Highway Admin. v. Greiner Eng'g Science, Inc., 83 Md. App. 621 (1990), cert. den. 321 Md. 163 (1990).

[44] MD. CODE REGS. 21.07.02.08 (2017).

[45] Barrie Sch. v. Patch, 401 Md. 497, 507–12 (2007) (explaining the well settled law of liquidated damage provisions).

accuracy.[46] In addition, liquidated damages that are grossly excessive and out of proportion to any damages that might have reasonably been expected to result from the breach of contract will not be enforced.[47]

It is important to remember that, when assessing the enforceability of a liquidated damages clause in a construction contract, a Maryland court will focus on the position of the parties at the time the contract was entered into to determine whether the amount of damages appears reasonable, and actual damages would be difficult to determine with certainty. Having chosen to sign a contract containing liquidated damages clause, a party cannot later seek to recover actual damages in addition to those liquidated damages if it later appears that they were somehow inadequate.

Further, the conduct of a party to a contract may preclude recovery of liquidated damages from another party due to delayed contract completion if that party, for example, had caused the delay.[48]

These liquidated damages provisions may be bargained away in negotiations, but they should be viewed with utmost seriousness and with the assumption that they will be enforced by a court or arbitration panel if the project is delayed.

7. Indemnity provisions.

Most construction contracts contain clauses to indemnify the owner, the architect, and others from damages resulting from personal injury, property damage, and liens or defaults arising out of the performance of the indemnifying party. "Indemnify" means that one party agrees to hold another party harmless against loss or damages which occur from certain events. In practical terms, this often means that a person providing the indemnification must pay litigation costs and damages awarded against the person to be indemnified regardless of whether the indemnifying party was negligent and even when the other party was itself negligent.

For many years, owners and general contractors attempted to utilize their economic leverage to force subcontractors or others to agree to broaden indemnity clauses even to the point of protecting an owner or general contractor against their own negligence. The abuses and obvious unfairness of such provisions gradually led to restrictions on them. For example, the Maryland legislature enacted a law which makes null and void any agreement in a construction

[46] Bd.of Educ. of Talbot Cnty. v. Heister, 392 Md. 140, 157-58 (2006) (quoting Anne Arundel Cnty. v. Norair Eng'g Corp., 275 Md. 480, 492–93 (1975)).

[47] Cuesport Prop., LLC v. Critical Dev., LLC, 209 Md. App. 607 (2013) (enforcing per diem clause as a liquidated damages provision because the clause met the two-part test, despite using the word "penalty" the clause was actually not a penalty, and the parties clearly intended the clause to serve as liquidated damages, with the parties' intent being the controlling factor); Willard Packaging Co. v. Javier, 169 Md. App. 109, 123-24 (2006).

[48] Glassman Constr. Co. v. Md. City Plaza, Inc., 371 F. Supp. 1154, 1160–62 (D. Md. 1974), aff'd., 530 F.2d 968 (4th Cir. 1975).

contract that indemnifies another against liability for damages due to personal injuries or property damage caused by the sole negligence of the indemnifying party.[49]

While there are limits to the permissible scope of indemnity clauses, it should be assumed that they also will be enforced as written and may shift significant risks to unsuspecting parties. Consequently, all contracting parties should be careful in considering the broad scope of indemnity clauses, particularly as some obligations may extend beyond standard insurance coverage.

Any indemnity clause in a contract must be carefully reviewed before execution, as it will likely be enforced by the courts if it does not violate Section 5-401. It should also be understood that liability under such clauses may not be covered by certain insurance policies.

8. Arbitration and other alternative dispute resolution techniques.

For many years, the construction industry has been a leading innovator and proponent of arbitration as an alternative to the time-consuming and expensive process of a trial before a judge or jury. That leading role is continuing with the development of methods such as mediation, "mini–trials," partnering, and so on. All of these methods are gaining increasing attention outside the construction industry and by statute, and judicial decisions in many states, including Maryland, have enforced agreements to resolve disputes by arbitration or other means.

Consequently, the best time to decide whether disputes between parties to a contract will be decided by arbitration or by going to court is before the contract is signed.

C. Plans and Specifications.

The plans and specifications are obviously among the most important of the contract documents.

The clarity, completeness, and coordination of these documents often play a large part in determining the success of a project.

Although the contractors and subcontractors have the responsibility of complying with the plans and specifications, there are situations in which the plan documents might be deficient in some manner.

1. Owner's warranty of sufficiency of plans and specifications

[49] MD. CODE ANN, CTS. & JUD. PROC. § 5-401 (West 2017); See Mass Transit Admin. v. CSX Transp., Inc., 349 Md. 299, 307-08 (1998) (citing Heat & Power Corp. v. Air Prods. & Chems., Inc., 320 Md. 584 (1990) (applying statute in action by contractor's employee against property owner)).

Maryland law and the law of the majority of states and the federal government, provide that the owner impliedly warrants the adequacy and sufficiency of plans and specifications provided to the contractors. In other words, a contractor is free from liability if it constructs a building in accordance with the plans and specifications supplied by the owner, but the result is unsatisfactory due to some defect in those documents. A contractor may also recover for the costs of any delays, extra work, or disruption arising from errors in the plans and specifications provided by the owner. This warranty has been applied even in the face of general disclaimers of such liability in the contract documents.[50] Maryland courts have upheld this doctrine and imposed upon owners the costs of defects in the plans by their architects or engineers.[51]

Specifically in government contracts, if an architect for a government project provides inadequate plans, the general contractor may not be allowed to recover for purely economic losses absent privity, an actual injury or risk of injury.[52] In complex public construction projects, "parties have sufficient opportunity to protect themselves (and anticipate their liability) in negotiating these contracts."[53] Therefore, design professionals in government contracting projects may be protected from tort liability if the general contractor has not negotiated it within the contract and absent an actual injury or risk of injury.[54] The court explained that this does not necessarily extend to private construction projects.[55]

While this rule is of great assistance to any contractor who can prove that they followed the contract documents issued to him by the owner, such disputes have often caused extensive litigation or arbitration, and it is far preferable for all parties concerned to have any errors or defects resolved and clarified as early as possible in the project.

2. What if plans are discovered to be deficient or incomplete?

a. During the bid or proposal process?

If a contractor, while preparing his bid for a project, discovers an ambiguity, a conflict, or an error in the bid documents, the contractor may have a duty to seek clarification from the owner or its architect or engineer. This obligation is probably particularly strong if the bid documents spell out a procedure for obtaining clarification. However, even if a method is not set forth in the bid documents, the argument may be made that a contractor has such an obligation because, as an "expert" in his field, he should not be entitled to unfairly take advantage of mistakes that could have been corrected in a timely fashion to save money and time for all parties.[56]

---

[50] Id.
[51] Gladwynne Constr. Co. v. Mayor & City Council of Baltimore, 147 Md. App. 149, 175 (2002) (citing Dewey Jordan, Inc. v. Maryland-Nat'l Capital Park. & Planning Comm'n., 258 Md. 490, 497–99 (1970)).

[52] Balfour Beatty Infrastructure, Inc. v. Rummel Klepper & Kahl, LLP, 451 Md. 600, 630 (2017).
[53] Id. at 626.
[54] Id. at 630
[55] Id. at 627.
[56] Appeal of Dominion Contractors, Inc., 1 MSBCA (MICPEL) § 69 at 13–15, 31–33 (Feb. 9, 1984).

Having notified the owner of his concern and received clarification from the owner or his architect, the contractor may then submit his bid based on the clarification. However, if the contractor fails to do this and proceeds on the basis of documents that he knows require clarification, he risks being held responsible by a court or arbitration panel for the costs of later correcting or performing the work in a proper fashion.[57]

b. During construction?

When such defects or ambiguities in the contract documents are discovered during construction, a prudent contractor or subcontractor will promptly notify the owner of the concerns in order to give the owner or his designer an opportunity to evaluate the problems and decide whether a change or clarification of the documents is required.

c. After construction?

When defects are identified after completion of construction, an owner may have a cause of action against the contractor for breach of warranty as well as breach of contract. A warranty is generally a promise that work will meet certain standards and can be either express or implied. Express warranties arise from written or oral promises as well as from a contractor's representations about the quality of the work or the materials. Implied warranties are imposed by law and are based upon the facts and circumstances of each case. The existence of an express warranty does not, by implication, nullify an implied warranty. Both express and implied warranties may exist simultaneously.

In addition, Maryland provides certain implied warranties by statute. The Maryland Real Property Article states that for improvements to private dwellings, the contractor warrants that the improvement is: "(1) Free from faulty materials; (2) Constructed according to sound engineering standards; (3) Constructed in a workmanlike manner; and (4) Fit for habitation."[58] This Article also contains a warranty that an improvement is fit for its particular purpose if the owner makes known to the contractor/vendor the purposes for the improvement and relies upon the contractor/vendor's skill and judgment.[59] However, these warranties do not apply to conditions or defects that can be discovered through inspection by a "reasonably diligent purchaser."[60]

The Maryland Real Property Article also provides warranties that apply to construction of new homes. Section 10-604(a) details warranties required to be given by home builders: a one-year warranty that the home is free from any defects in materials and workmanship; a two-year warranty covering defects in electrical, plumbing, heating, cooling, and ventilation systems; and a five-year warranty covering structural defects. Subsection (c) describes the remedies available

[57] Appeal of Hanks Contracting, Inc., 1 MSBCA (MICPEL) § 110 (Aug. 20, 1985).
[58] MD. CODE ANN., REAL PROP. § 10-203(a) (West 2017).
[59] Id. at § 10-203(c).
[60] Id. at § 10-203(b).

to the owner upon breach by the builder, and includes rescission and a refund of any money paid to the builder for the new home.

V. CHANGES OR DELAYS TO THE PROJECT

Contract changes, unanticipated conditions at the project site, and delays have been the subjects of a myriad of decisions of state and federal courts and administrative agencies, many of which are governed by the language of particular contract documents. A thorough discussion of these decisions is well beyond the scope of the outline, which is intended to provide only a summary of general concepts applicable to these issues.

A. What if the owner changes his mind and wants you to do more or less work?

It seems safe to say that there has probably never been a project of any size that proceeded unchanged and on-time to completion.

Changes to construction projects seem inevitable, whether due to an owner's decision to add a different window unit in a single family dwelling or a developer's decision to change one type of roof construction to another on every building in a complex.

Construction claims arise with some frequency when a contractor believes that the owner or his design team has changed the scope of the contractor's work, requiring the expenditure of extra time or money to complete the required tasks. Disputes over such issues often develop on a construction project, especially as circumstances occur that had not been entirely foreseen. Therefore, no matter how common they may be, changes to construction contracts may not be unilaterally imposed by an owner or contractor without a contractual provision granting such a right.

In order to deal with this reality, many public and private construction contracts include change order clauses that spell out the situations in which a change in the scope of work may be imposed and a method for determining compensation for any extra costs or time resulting from such a change. An example is contained in Article 12 of the AIA Document A-201 (2017 edition) which reads, in part:

> 12.1.1. If a portion of the Work is covered contrary to the Architect's request or to requirements specifically expressed in the Contract Documents, it must, if required in writing by the Architect, be uncovered for the Architect's examination and be replaced at the Contractor's expense without change in the Contract Time.
> 12.1.2. If a portion of the Work has been covered which the Architect has not specifically requested to examine prior to its being covered, the Architect may request to see such Work and it shall be uncovered by the Contractor. If such Work is in accordance with the Contract Documents, the Contractor shall, be

> entitled to an equitable adjustment to the Contract Sum and Contract Time as may be appropriate. If such Work is not in accordance with the Contract Documents, the costs of uncovering the Work, and the cost of correction, shall be at the Contractor's expense.

Another, somewhat simpler version is found in the Associated General Contractors of America, Standard Form 3, which provides at Section 18:

> The Owner may make changes in the drawings and specifications or scheduling of the Contract within the general scope at any time by a written order. If such changes add to or deduct from the Contractor's cost of the work, the Contract shall be adjusted accordingly. All such work shall be executed under the conditions of the original Contract except that any claim for extension of time thereby shall be adjusted at the time of ordering such change.

Whether employing this language or other terms, the basic elements of a "change" clause are that they allow an owner or authorized representative to order changes to the work without the consent of the contractor, by a written order, within the scope of the work, and provide that the contractor shall be compensated if the change affects the contractor's cost or schedule.

If a contract in which you are engaged has such a clause, and the owner has ordered what you believe to be a change to the work, various steps should be taken in an effort to avoid disputes later.

While various contracts may have different provisions which should be followed precisely, in general you should:

1.) Attempt to reach a specific agreement that the owner's direction is a change to the work agreed upon in your contract.

2.) Make sure the owner has your best estimate of the impact of his directions in terms of time and money.

3.) Urge the owner to put the directions to you in writing. Indeed, you may be entitled to insist on it if your contract calls for such a step. If the owner will not comply and confirm the directions, notify him that you consider it a change to the work, and provide your best estimate of the time and cost impact of the change in one or more letters or faxes to the owner.

4.) Keep careful records of your performance of the changed work, all of your costs associated with it, and the time required to perform the work.

5.) Keep the owner advised of your progress.

6.) Present your detailed claim for additional compensation caused by the change at an early date.

While these procedures may not eliminate a dispute over changes to the work, they should permit you to identify them early and may help you to resolve them amicably.

If your contract has a no change clause, then an owner has no power to unilaterally order changes to your work, and such alterations can only be done by agreement. In such a case, the discussions and writing recommended above may be even more important as a means of assuring appropriate compensation for your extra work since otherwise you may be considered to have agreed to perform additional work for no extra compensation.

B. What if you discover different conditions than anticipated as you proceed to work on the project?

Unforeseen site conditions that affect the performance of work on the project may provide the basis for a claim for a change order, for delay, or even for suspension of work on a project. Although such claims most often occur on projects involving excavation or underground work, they may also arise because of unforeseen conditions in the renovation of existing buildings or because of the unexpected unavailability of necessary materials.

1. Without a specific contract provision, performance is not excused because it is more difficult or expensive.

Absent a specific contractual provision, an unexpected condition that makes contractual performance more difficult or expensive provides no excuse for failure to perform the agreed services at the agreed price.

A contractor is considered by the courts to have assumed the risk of such unforeseen contingencies unless he can prove that this rule should not be applied due to the fraud or negligent misrepresentation of the other party to the contract, or due to the fact that both parties entered into the contract as a result of a mutual mistake of fact. However, there have been relatively few cases where contractors have been successful in making such arguments to overcome the general rule.

2. "Differing Site" clauses.

Since there have been relatively few judicial decisions that have allowed contractors to overcome the application of the general rule with regard to the contractor's responsibility to perform despite the occurrence of unanticipated conditions, and out of a concern that the cost of construction projects would be unnecessarily high if contractors were forced to add contingency amounts to their bids to cover these items, many construction contracts include a "differing site conditions clause."

This clause recognizes the possibility of a claim by the contractor for the costs incurred as a result of certain unanticipated conditions, addresses the question of who bears those costs after the owner, and sets forth a procedure for asserting a claim for such costs and for resolving disputes concerning those costs. A rather detailed example of such a clause may be found in the 2017 edition of the AIA A-201, General Conditions of the Contract Between Owner and Contractor, which reads, in part:

> 3.7.4 Claims for Concealed or Unknown Conditions
>
> If the Contractor encounters conditions at the site that are (1) subsurface or otherwise concealed physical conditions that differ materially from those indicated in the Contract Documents or (2) unknown physical conditions of an unusual nature, that differ materially from those ordinarily found to exist and generally recognized as inherent in construction activities of the character provided for in the Contract Documents, the Contractor shall promptly provide notice to the Owner and the Architect before conditions are disturbed and in no event later than 14 days after first observance of the conditions. . . .

Other versions exist and may be equally effective in describing the type of unanticipated conditions covered, the allocation of the risk of extra cost, and the procedure to be followed in pursuing claims for those costs.

3. Site investigation clauses

In light of the fact that contractors were taking advantage of the differing site conditions clauses to seek compensation for conditions that should have been anticipated by a competent and careful contractor prior to submission of a bid, owners began to insist on inclusion of a "site investigation" clause, which typically requires that a contractor certify that he has visited a project site and familiarized himself with the site conditions prior to submitting a bid.

Such clauses may operate to defeat a claim for recovery of costs imposed by unanticipated or changed conditions if the actual conditions should have been observed by a reasonable investigation. Consequently, investigations of a project site before submission of a bid are extremely important safeguards for a contractor.

4. What should you do if you discover unanticipated conditions on the site?

If your contract contains one or more clauses applicable to the discovery of unanticipated conditions at the site, you must promptly comply with all requirements of those provisions if you are to preserve the opportunity to recover compensation for extra time and money spent to deal with the conditions.

Whether or not such a clause exists, prompt and full notice to the owner—together with a complete record of the costs associated in dealing with the unexpected conditions—is essential.

C. How should you deal with delays to the performance of the contract?

Another fact of life familiar to any contractor is that many projects will be delayed in completion for one or more of a wide variety of potential reasons.

1. Excusable v. Inexcusable, Compensable v. Non-Compensable, Concurrent Delays

As would probably be expected, inexcusable delays are those caused by the contractor for reasons such as defective work that must be removed and replaced, failure to coordinate the work of subcontractors, failure to properly staff the project, late material or equipment deliveries caused by failure to submit timely orders, and so forth. Depending upon the terms of the applicable contract, such delays may generate claims for compensatory or liquidated damages by an owner.

Excusable delays are all delays not caused by a contractor. Some excusable delays are compensable, and depending upon the facts of a case and the terms of the applicable contract, documents may give rise to a claim for time extensions and the recovery of costs generated by the delay. These delays are often those for which the owner bears responsibility, such as delayed access to a project site, late approval of shop drawings on material, or sample submittals by the contractor.

Some excusable delays such as floods or “acts of God” may be non-compensable because neither side bears responsibility for the delay. In such an event, time extensions may be the only remedy available to a contractor.

There are some situations in which both parties contributed to the delay of a project, and it is not possible to clearly establish the time and expense attributable to either party. In the event of such concurrent delays, a contractor may not be granted an extension of time or additional compensation. However, in such situations, the owner may not recover liquidated or compensatory damages from the contractor for the same reason.

2. What should be done if your project is delayed?

As is always the case, in the event of a delay to the project, you should re-examine and carefully follow all of the provisions of the contract documents regarding delays.

If a contractor wishes to recover extra costs incurred and defend against an owner's claim for liquidated damages, it is essential to provide prompt notice to the owner, accurate and thorough records as to the causes of the delay, efforts to minimize its effects on the project, and efforts to minimize all costs in money and time caused by the delay.

VI. WHAT IF YOU GET INTO A DISPUTE DURING CONSTRUCTION OR AFTER COMPLETION OF THE PROJECT?

Since it deals with so many variables, some of which are beyond anyone's control and must operate in rigid timeframes and financial constraints, the construction industry generates a great amount of litigation and other dispute resolution techniques each year. Those procedures cost millions of dollars in fees and expenses and lost productivity.

The purpose of this section is to offer some suggestions about how to deal with the inevitable disputes on a construction project, hopefully in a manner that might limit those losses to some extent.

A. How to recognize and resolve disputes before they get out of control.

A major reason construction project disputes blow up into expensive lawsuits or arbitrations is the failure of the parties to pay sufficient attention to identifying and promptly resolving problems during the course of a job. Ignoring issues or leaving them to the end of the project often results in the issues being considered in an atmosphere of anger and frustration, with each side convinced that it is being mistreated by the other. That emotional reaction often results in disputes being turned over to lawyers who may not have the incentive or ability to resolve the disputes quickly.

If, on the other hand, the businessmen and women involved in a project identify problems, promptly investigate them, and attempt to resolve them in a manner that is reasonable and consistent with their contractual agreements, the opportunity to resolve disputes without resort to the legal process can be greatly increased.

B. What if you do not get paid?

1. Should you continue to work?

If an owner or contractor fails to make payments in accordance with its contract, or materially breaches its contract in other respects, the contractor or subcontractor might, in some circumstances, have the right to stop work until the breach of contract is cured.[61]

However, a work stoppage should usually be considered only when the record is clear that the owner or contractor has failed to live up to its contractual obligations while the aggrieved contractor or subcontractor has complied with all of its obligations. Walking off a job is a step that should be considered drastic because it carries the very serious risk that, if the owner or contractor is later proven not to have materially breached its contract or if the contractor or subcontractor who abandons the job is found to be at fault, all costs of completing the work will be assessed against the departed party (usually at a far higher price than that which it was originally contracted). Even if a court concludes that the breach was material, the non-breaching party still may have had to allow the breaching party an opportunity to cure the breach. Therefore, it may be far more desirable to finish the required work and file a lawsuit or a claim in arbitration for the unpaid balance.

2. Mechanics' Lien Claims

Any person furnishing work or materials or both, for or about the building, pursuant to a contract, may establish a mechanics' lien.[62] This includes architects, engineers, and other designers, at least where they inspect or review work at the site. There is no requirement for contractual privity with the owner or with the general contractor or any specific subcontractor or supplier. The person furnishing the work and materials need not be within a specific tier of contractual relationships with either the general contractor or the owner.

A mechanics' lien may be obtained against the real property and improvements included in a privately owned project if the procedures set forth in the Maryland Mechanics' Lien Statute[63] are strictly followed. The statute specifically includes "the drilling and installation of wells to supply water, the construction or installation of any swimming pool or fencing, the sodding, seeding, or planting in or about the premises of any shrubs, trees, plants, flowers, or nursery products, and the grading, filing, landscaping, and paving of the premises."[64] The statute also grants a lien for the installation of waterlines, sewers, drains, and the streets in a development if the owner of the land or the owner's agent contracts for these services to service all lots in a development.[65] There is, however, no mechanics' lien for work done or materials supplied for or about public buildings.

---

[61] MD. CODE REGS. 21.07.02.05-2(C) (2017) ("If a contractor fails to make payment within the period prescribed in §B, a subcontractor may request a remedy in accordance with COMAR 21.10.08."); John J. Kirlin, Inc. v. Gaco Sys., Inc., 80 Md. App. 506, 511-12 (1989).

[62] A mechanics' lien is a legal right or interest that a creditor (e.g., contractor, subcontractor, supplier) has in property "that secures payment for labor or materials supplied in improving, repairing, or maintaining real or personal property." BLACK'S LAW DICTIONARY 933, 935 (7th ed. 1999).

[63] MD. CODE ANN., REAL PROP. §§ 9-101–114 (West 2017).

[64] Id. at § 9-102(a).

[65] Id. at § 9-102(b).

Claiming a lien requires filing a Petition in court and a hearing before a judge to obtain a "show cause" order, followed by a period for lawyers to conduct discovery regarding any disputed claims, then a full trial of the issues between the parties.[66] If an unpaid contractor or subcontractor receives a judgment at the end of the trial, he can then go back to court and seek an order that the property be sold under the supervision of the court to satisfy debts, hopefully including the debt owed to the contractor or subcontractor.[67]

Construction companies need to understand, however, that their rights to a mechanics' lien on a project may be eliminated if the property has been sold in a normal business transaction to a party with no notice of any dispute over payment for the work.[68] Filing a Petition to commence mechanics' lien procedures may constitute sufficient notice of the possibility of a lien to prevent a subsequent purchaser from cutting off rights of a contractor or subcontractor to a lien on a lot or single-family home. Although this provision was intended to protect innocent home buyers, it can also cause real difficulty for contractors seeking mechanics' liens on residential developments, especially if their work continues while a developer is engaged in the sale of lots to prospective purchasers.

Consequently, subcontractors may have little or no ability to enforce a lien against a homeowner if he or she has paid the general contractor. In its effort to protect innocent homeowners from unscrupulous contractors, the legislature has further limited the benefits of mechanics' liens to contractors and subcontractors. Section 9-104(f)(3) of the Real Property Article states:

> [T]he lien of the subcontractor against a single family dwelling being erected on the land of the owner for his own residence shall not exceed the amount by which the owner is indebted under the contract at the time the notice is given.

Mechanics' lien claims can be a very effective method of forcing payment on privately owned construction projects, particularly if the financing arrangement under which the owner is operating forbids him from allowing any liens to be placed against the property. Yet the procedure is expensive and time consuming, and in some situations offers very limited leverage to a homebuilder.

3. Payment bond claims

Payment bonds are agreements between a principal (contractor) and a surety that the surety will pay certain specified debts of the principal if the principal does not pay them. They may be used on private projects to provide a measure of assurance to the owner that mechanics' liens of unpaid subcontractors or suppliers will not disrupt a project. Contractors of publicly

---

[66] Id. at §§ 9-105–106.
[67] Id. at § 9-109.
[68] "[A] building or the land on which a building is erected may not be subjected to a lien under this subtitle, if prior to the establishment of a lien in accordance with this subtitle, legal title has been granted to a bona fide purchaser for value." Id. at § 9-102(d).

owned projects are required to purchase such payment bonds for the benefit of their subcontractors and suppliers because they cannot claim mechanics' liens against government property.

In order to receive payment from the bond sum, an unpaid subcontractor or supplier must follow the procedures set out in the bond (if the project is privately owned) or a statute (if a government project is involved). If you are a claimant and you do not comply with the provisions of the bond contract, you risk losing your right to recover. The private bond's terms state all of the notice requirements, including to whom the notice must be sent, as well as the content of the notice. Payment bonds will indicate who is covered and who is not covered.

Usually, the bonding company and the contractor must receive notice within 90 days of the date of completion of work by the subcontractor, or the last delivery by the supplier, and its intention to assert a claim against the bond. If payment is still not received, then the subcontractor or supplier must proceed to file suit within a specified time.

Be advised that there are some bond forms that give no direct right of action to an unpaid subcontractor or material supplier. These forms simply indemnify the owner against mechanics' liens. Where this is the case, the supplier or subcontractor must enforce his mechanics' lien rights in order to be paid by the bonding company.

The advantage of payment bonds is that they represent a source of funds from which a subcontractor or supplier may expect to be paid. However, it needs to be understood that collection will only be obtained in some instances after an expensive legal proceeding.

4. Maryland Construction Trust Fund Statute

Recognizing the importance of the orderly and timely flow of construction project funds to their intended recipients, the Maryland Legislature enacted the Construction Trust Law in 1987.[69] The statute was intended to protect subcontractors who receive contract funds and divert them from their intended recipients to pay bills on other projects. The method chosen to protect the intended recipients from such diversion is to impose a trust upon project funds paid for work done or materials furnished by others and to impose personal liability upon those who knowingly use such funds in violation of that trust.[70] However, the statute does not impose personal liability on the managing agent of a contractor because of its mere failure to pay subcontractors in full. There must be a showing of fraud or misappropriation of funds. When funds are earmarked for a particular payee but payment is not made and a subcontractor can track where the money went

[69] Id. at §§ 9-201–204.
[70] Id. at § 9-202.

instead, personal liability may be imposed.[71] The failure to pay subcontractors may not be enough to permit imposition of personal liability.[72]

The statute provides that any money paid under a contract (1) by an owner to a contractor or (2) by a contractor to a subcontractor for work done or materials furnished for a building shall be held in trust for those subcontractors who did work or furnished materials for the purpose of paying those subcontractors. The statute further specifies that any officer, director, or managing agent of a contractor or subcontractor who has direction or control of money held in trust for contractors or suppliers is a trustee for the purpose of paying the money to the subcontractors who are entitled to it.[73]

Between 1987 and 1995, the Construction Trust Statute provided that any officer, director, or employee of a contractor or subcontractor, who "with intent to defraud" used funds held in trust for a subcontractor for any purpose other than to pay those subcontractors, would be personally liable for any damages caused by such a diversion. Further, the statute mentioned that use of funds held in trust for any purpose other than to pay the subcontractors for whom they were held in trust was prima facie evidence of intent to defraud in a civil action.[74]

In 1995, the Maryland Legislature intended facilitate recovery against corporate officials by eliminating the requirement that unpaid subcontractors allege or prove fraudulent intent to divert funds and simply required proof that the funds were "knowingly" retained or used for any purpose other than to pay the subcontractor for whom they were held in trust.[75] Consequently, contractors and subcontractors who receive and disburse contract funds to others should exercise great care in accounting for such funds.

The construction trust law applies to contracts for buildings owned by state or local governments and all property subject to mechanics' lien claims.[76] The statute does not apply to projects owned by the federal government.[77] In addition, it does not apply to contracts for the construction and sale of single family dwellings or home improvement contracts by a contractor licensed under the Maryland Home Improvement Law.[78]

---

[71] See Walter v. Atl. Builders Grp., Inc., 180 Md. App. 347, 366 (2008) (showing a specific flow of money designated for a subcontractor but paid to another party).

[72] Selby v. Williams Constr. Servs., 180 Md. App. 53, 64-65 (2008) (noting the fact that funds received by the general contractor were in response to general invoices and not earmarked for particular subs and the good faith of the general contractor in trying to pay subcontractors by using a line of credit).

[73] MD. CODE ANN., REAL PROP. § 9-201(b) (West 2017).

[74] See Ferguson Trenching Co. v. Kiehne, 329 Md. 169 (1993) (holding that subcontractor failed to prove an intent to defraud and rejected the claim of personal liability); In re Woodall, 177 B.R. 517 (Bankr. D. Md. 1995).

[75] MD. CODE ANN., REAL PROP. § 9-202; see also Phillips Way, Inc. v. Presidential Fin. Corp. of Chesapeake, 137 Md. App. 209 (2001) (holding that subcontractor's accounts receivable lender might be liable under the law if it exercised control over trust funds with knowledge that they were being used to pay debts of its subcontractor-borrower on projects other than those for which the funds were intended).

[76] See Jaguar Techs., Inc. v. Cable-La, Inc., 229 F. Supp. 2d 453 (D. Md. 2002) (subcontractor on utility line construction project had not worked on "buildings," as required for application of Construction Trust Statute).

[77] Allied Bldg. Prods. Corp. v. Fed. Ins. Co., 729 F. Supp. 477, 478 (D. Md. 1990).

[78] MD. CODE ANN., REAL PROP. § 9-204(b) (West 2017).

The imposition of a trust upon contract funds and the designation of any officer, director, or managing agent of a contractor or subcontractor who has control over contract funds as trustee for the payment of them to the subcontractor for whom they are intended, coupled with a provision specifically imposing personal liability on such individuals if they knowingly use those contract funds for any purpose other than to pay the subcontractors for whom they are intended, represents a strong weapon in the hands of unpaid subcontractors or suppliers.

5. Prompt Payment Act.

In the face of complaints from subcontractors and others that contract funds for work properly done were being withheld for a variety of improper reasons, the Maryland Legislature in 1989 enacted a statute, which provides that a contractor or subcontractor who does work or furnishes material under a contract with a private owner is entitled to prompt payment.

That statute provides that if a contract with an owner does not specify dates or times of payment, the owner must pay to the contractor undisputed sums owed within the earlier of 30 days after a grant of an occupancy permit or 30 days after the owner or its agent takes possession.[79] If the contract specifies time for payment, the owner shall pay to the contractor undisputed sums within 7 days from the specified date.[80] The statute provides that a contractor or subcontractor whose funds are being withheld may go to court to seek an order requiring payment of the funds with interest. If the court determines that the funds were withheld in bad faith, it may order the payment of the attorney's fees to the prevailing party.[81]

The statute covers any agreements, express or implied, for doing work or providing materials for a building.[82] Like the Mechanics' Lien Statute, the Prompt Payment Act specifically includes erection, repairs, rebuilding, or improvement of a building; drilling and installation of wells to supply water; construction or installation of a swimming pool or fencing; grading, filing, landscaping, and paving of the premises of a building; installation of water lines, sanitary sewers, storm drains, or streets; and erection, repair, rebuilding, or improvement of a wharf.[83]

However, the coverage of the Prompt Pay Act does not include the provision of nursery products or equipment leases. In addition, deadlines for payment set forth in the statute do not apply to any contracts between a contractor and the state, a county, municipal corporation, board of education or other public authority or instrumentality.[84] In 1999, the legislature passed Section 15-226 of the State Finance and Procurement Article, which amended the State Procurement Code to provide similar protections to subcontractors on State projects.

---

[79] Id. at § 9-302 (b)(1)(i).
[80] Id. at § 9-302 (b)(3).
[81] Id. at § 9-303 (b).
[82] Id. at § 9-301(b)(1).
[83] Id. at § 9-301(b)(2).
[84] Id. at § 9-302(b)(2).

The Prompt Payment Act makes clear that withholding the payment of undisputed amounts of contract funds to obtain negotiating leverage can be a risky strategy. Particularly, in its grant of authority for a court to order injunctions requiring prompt payment and to order that the prevailing party receive its attorney's fees in bring the lawsuit, the Act provides contractors, subcontractors, and suppliers with useful weapons if they are forced to go to court to seek payment of undisputed amounts owed to them. As a result, construction project participants will need to maintain careful records of the dates and amounts of contract funds received and of payments to those who have supplied material for their work in order to be able to respond to clauses under the Prompt Payment Act.

C. Alternatives to litigation

In some instances, litigation in a court or before a Board of Contract Appeals may be the best or the only way to resolve a dispute on a construction project. However, there are various alternatives which should be carefully considered before parties incur the time and expense of litigation.

1. Negotiation

It seems safe to say that, in virtually every case, a promptly negotiated settlement of any dispute is preferable to one achieved after resort to legal process.

In order to accomplish this goal, business people must become involved in the matter and decide that they wish to resolve it as a business matter rather than in the costly, time consuming, and combative fashion characteristic of litigation or arbitration.

Even if a matter cannot be resolved prior to commencing a lawsuit or arbitration proceeding, businessmen and women can often resolve disputes sensibly if they will avoid becoming embroiled in the dispute and will remain determined to treat it as a business problem rather than a legal problem.

2. Arbitration

There are some fundamental differences between arbitration and litigation. First, arbitration is a forum presided over by experts in the field. Litigation, on the other hand, involves the application of substantive and procedural laws by a judge or jury. Second, the procedural framework of arbitration is substantially less rigid than that of litigation. Choosing to arbitrate provides parties with a speedy resolution of disputes, a fact-finder with greater expertise, and savings in costs and attorney's fees. On the other hand, there may be lack of discovery, the inclusion of hearsay evidence, and inconsistent decisions in multiparty disputes.

The Maryland Court of Appeals described arbitration in the following terms:

> Arbitration is the process whereby parties voluntarily agree to substitute a private tribunal for the public tribunal otherwise available to them. The arbitration process provides a speedy, informal, relatively inexpensive, and private procedure for resolving controversies arising out of commercial transactions, as well as a tribunal uniquely qualified to resolve such disputes. The arbitrator is not a public official imposed upon the parties by a superior authority, and he is not required to administer justice for a community which transcends the parties. Rather, he is a part of the system of self-government created by and confined to the parties and designed to serve their specialized needs. The arbitrator is usually chosen because of the parties' confidence in his knowledge of the practices of the industry which enables him to employ considerations in fashioning his judgments which may be foreign to the expertise of the courts. The parties expect that the arbitrator's competence and skill, based on his specialized knowledge and experience, will produce a judgment which is founded not only upon the literal meaning of the words appearing in the contract document itself, but also on their meaning in the context of the practices and customs associated with their use.[85]

As mentioned above, Maryland courts have embraced and now strongly favor arbitration as one of various alternatives to the expensive and time-consuming jury trial system for the resolution of disputes.

An example of a broad arbitration clause is that contained in Article 15, Section 15.4.1 of the AIA General Conditions of the Contract for Construction , A-201 (2017 edition).

> If the parties selected arbitration as the method for binding dispute resolution in the Agreement, any Claim subject to, but not resolved by, mediation shall be resolved by arbitration which, unless the parties mutually agree otherwise, shall be administered by the American Arbitration Association in accordance with its Construction Industry Arbitration Rules in effect on the date of the Agreement. The arbitration shall be conducted in the place where the Project is located, unless another location is mutually agreed upon. A demand for arbitration shall be made in writing, delivered to the other party to the Contract, and filed with the person or entity administering the arbitration. The party filing a notice of demand for arbitration must assert in the demand all Claims then known to that party on which arbitration is permitted to be demanded.

[85] Bel Pre Med-Ctr., Inc. v. Frederick Contractors, Inc., 21 Md. App. 307, 315-16 (1974) (citations omitted).

A system of arbitration favored by many is that sponsored by the American Arbitration Association. This private organization will, for a fee, appoint arbitrators with some degree of knowledge in the subject area of the dispute and set up and administer the process and deadlines by which a dispute will be resolved. Use of the American Arbitration Association system, however, is not a prerequisite to an enforceable arbitration clause as the parties are free to design their own system.

Arbitration clauses are extremely common in all matters of construction contracts, and construction industry professionals should expect to encounter them regularly. They should understand that if a dispute arises that is covered by the terms of the arbitration clause, Maryland courts will require resolution of that dispute by arbitration and will not likely allow the parties to appeal to a court unless they can prove that the agreement to arbitrate was obtained by fraud, duress, and so on.[86] With cooperation from the parties and effort from the arbitrators, the process can be efficient, private, expeditious, and relatively inexpensive, providing a satisfactory alternative to the court system.

3. Mediation

In recent years mediation has become increasingly popular as a means to resolve disputes in the construction industry. It is another alternative dispute resolution that has been adopted by the construction industry. Mediation is, in essence, the voluntary process of resolving disputes through settlement conferences conducted by a neutral party. The neutral advisor, selected and paid by the parties, is retained to assist the business people involved in a dispute to understand and resolve their conflict. The process is flexible, confidential, and can be adopted to meet the needs of a particular project or group of parties.

Because mediation can be structured to keep the business people in control of the process and can avoid the time, expense, and damage to on-going business relationships so often attendant to arbitration, it is becoming an increasingly important device in the resolution of disputes in the construction industry. If done correctly, mediation can cut through the confusion and emotion that envelopes so many disputes and can result in the parties settling their own disputes because, for the first time, they each understand the position of the other side and the weaknesses of their own case.

In recognition of that development, the American Arbitration Association has developed a separate set of Mediation Rules, and the American Institute of Architects has now included a mediation provision in addition to the arbitration clause in its General Conditions of the Contract for Construction.

4. Standing Neutral or Dispute Review Board

[86] Fraternal Order of Police, Montgomery Cnty. Lodge 35 v. Montgomery Cnty., 216 Md. App. 634, 639-42 (2014) (discussing the legislative policy in favor of arbitrating disputes, as evinced in the Maryland Uniform Arbitration Act, which gives courts jurisdiction to enforce arbitration agreements and enter judgment on arbitration awards).

Another flexible approach to resolving payment issues on construction projects, which may become increasingly familiar, is the use of Dispute Review Boards on Standing Neutrals.

A dispute review board or standing neutral is appointed before construction even begins. In the case of a dispute review board, each party appoints one expert and then the experts from both parties appoint an independent expert, known as a standing neutral. The board or standing neutral are provided with the contract and project documents. In addition, they periodically visit the site, meet with the owner and contractor, and encourage resolution of any disputes at the job level.

The purpose of a dispute review board or a standing neutral is to avoid problems before they escalate to the point of litigation. When a dispute cannot be resolved by the parties alone, it is referred to the dispute review board or standing neutral for a hearing. After a hearing, the board or standing neutral gives the parties a written, non-binding recommendation. This process can be most effective if the parties have contract language that makes the recommendation of the board or standing neutral admissible into any subsequent arbitration or legal proceeding.

Dispute review boards traditionally have been used for large construction projects because the cost of setting up these boards is significant. Due to cost constraints, this device may not be a practical approach for smaller projects. Nonetheless, the use of both methods has increased in popularity and it is likely that, in the future, there will be a further increase in the use of dispute review boards, standing neutrals, and other variants.

D. <u>What to do if you cannot avoid litigation</u>

Depending upon decisions made (or not made) at the time of contract execution and other factors, litigation may be the preferred or even the only method of resolving a construction contract dispute.

Although often far more expensive and time-consuming than it should be, litigation can be a relatively effective method of dealing with such disputes, particularly if large sums of money are involved or if the positions of the parties are so far apart that there is little chance of amicable resolution. Because of the depositions and other discovery procedures it employs to obtain some element of certainty, litigation can be a satisfactory dispute resolution system if it is focused on resolving real issues in an efficient manner.

The best way to assure that a litigated matter in which you are involved is handled in this manner is to insist that your lawyers and colleagues handle it in a manner calculated to resolve a dispute rather than to create additional problems.