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CONSTRUCTION LAW *UPDATE*

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We welcome any feedback on this newsletter, either negative or positive, and look forward to serving you in future issues.

REPAIR EFFORTS MAY EXTEND CONTRACTOR'S STATUTE OF LIMITATIONS FOR CLAIMS AGAINST BUILDER

by J. Kevin Bridston

In *Highline Village Associates v. Hersh Companies, Inc.*, No. 98CA1886, 1999 WL 976682 (Colo. App. 1999), **the Colorado Court of Appeals held that a contractor who undertakes to repair a defect may, by doing so, toll (or extend) the applicable statute of limitations during the period in which repairs are performed or attempted.** This recent Colorado Court of Appeals decision potentially has significant implications to contractors and builders.

BACKGROUND

Colorado has a special statute of limitations that applies to architects, contractors, builders, engineers and certain others in construction related professions, C.R.S. § 13-80-102 (the "Contractors' Statute of Limitations"). The Contractors' Statute of Limitations requires that all claims against a builder or contractor relating to construction of improvements be brought within two years after the claimant "discovers or in the exercise of reasonable diligence should have discovered the **physical manifestations of a defect** in the improvement which ultimately causes the injury."

The Contractors' Statute of Limitations further provides that no such action may be brought more than six years after substantial completion of the improvement (unless the claim arises in the fifth or sixth year after substantial completion, in which case the two-year limitation applies from the time the defect manifests itself). In other words, if the defect does not manifest itself or is not discovered for many years, a claim based on the defect may be barred.

The Contractors' Statute of Limitations is significantly less generous to claimants, and more protective of builders and contractors, than are other statutes of limitation, particularly in that it is triggered by the "physical manifestations of a defect in the improvement" rather than actual knowledge and understanding of the injury.

THE ISSUE

Often, when a problem is discovered on a project, a Contractor will make efforts to repair any defects or correct any deficiencies. A typical scenario might be as follows: On January 1, 1998, the owner identifies a structural defect in his newly completed building. Throughout 1998 and into 1999 the contractor makes efforts to repair the problem, but is unable to satisfy the owner. Thereafter, on July 1, 1999, the contractor tells the owner that he has done all that he is going to do in terms of remedial work and ceases further repair efforts. On February 10, 2000, the owner files a lawsuit against the contractor.

If the contractor had not undertaken any repair efforts, the owner's claim would be late and barred by the Contractors' Statute of Limitations, since it was filed more than two years after the "physical manifestations of the defect were discovered. Does it make a difference that the contractor made efforts to satisfy the owner and make repairs?

THE ANSWER, ACCORDING TO THE COURT OF APPEALS

The Contractors' Statute of Limitations does not address the question of whether the period continues to run during the period of attempted repairs. The *Highline Village* case resolves that issue, at least until the Colorado Supreme Court speaks. This decision held that under such circumstances, at least **where the owner can show that he reasonably relied upon an express or implied promise that the attempted**

repairs would remedy the defect, the limitations period of the Contractors' Statute of Limitations will be tolled, or stop running, until the date the contractor abandons its repair efforts. In other words, if repairs are attempted over a six-month period and then abandoned or terminated, the Contractors' Statute of Limitations will be extended an equal period.

Briefly, the *Highline Village* case involved a painting contractor who was hired to repaint an existing structure. The painting was completed in August 1992, but beginning in June 1994 the paint began to peel (the physical manifestation of the defect). The owner apparently notified the contractor of the defect and insisted that the structure be repainted. Repainting was completed by November of 1994, but the peeling began again in March 1995. In the Spring of 1995, the contractor refused to repaint any other surfaces where paint was peeling. The owner commenced a lawsuit in October 1996, or approximately two years and three months after the problem initially manifested itself.

The trial court dismissed the owner's claims based on the Contractors' Statute of Limitations. However, the Court of Appeals reversed and adopted the "Repair Doctrine." "[The] Repair Doctrine requires proof of a promise that the repairs will cure the defect and that plaintiff reasonably relied upon that promise. . . . Such a promise need not be express; it may be one that is reasonably implied from all of the circumstances."

The Court of Appeals noted that "such an approach makes good sense and is consistent with public policy. So long as the . . . contractor is undertaking repairs to remedy the defect (irrespective of any disclaimers of liability for that defect) and those repairs appear to accomplish their purpose, requiring the . . . owner to institute suit against the . . . contractor while those repairs are being made would be inconsistent with the policy that favors voluntary settlement of disputes. Indeed, a rejection of the doctrine might well lead to wholly unnecessary litigation."

The Court of Appeals held that if an owner "can establish that, after there was a manifestation of a defect under the statute, [the contractor] undertook to repair that defect; that, in doing so, [the contractor] either expressly or impliedly promised or represented that such repairs would remedy such defect; and that [the owner] reasonably relied upon such promise or representation and, as a result, did not institute legal action against [the contractor], the limitations period of the contractors' statute will be tolled until the date that [the contractor] abandoned its repair efforts."

Practical Tips

• Repairing real or perceived defects should always be the first and best means of avoiding claims of defective work. Where, however, a contractor intends to do no further remedial work and wants the two-year Statute of Limitations to begin running, the contractor should avoid actions that might be perceived as ongoing repairs or promises of repairs, or promises that the repairs will remedy the defect. The contractor must make sure that the evidence is clear at that time, preferably in the form of a letter or some other written communication to the owner, that no further repairs will be attempted.

• Owners, on the other hand, should not rely on the absence of such written communication to protect themselves. Where provable assurances of repair are not forthcoming from the contractor, or where it appears that the contractor may have abandoned the repair process, owners should assume that the statute of limitations period is running and take appropriate action to protect themselves.

Pay-When/If-Paid Clauses, Who Pays When the Owner Doesn't?

by David S. Prince

Background: The Pay When Paid Situation

A construction project is completed. The general contractor is owed $500,000 for its own work and work of its subcontractors. The owner declares bankruptcy. A deed of trust securing the owner's construction loan is senior to the mechanic's liens rendering them virtually worthless. Who suffers the loss of unpaid pay requests from the subcontractors, the general contractor or the subcontractors? The answer may surprise you.

Under most typical construction contracts, the situation identified puts the general contractor in the position of the owner's *de facto* guarantor; the general contractor is required to pay all of its subcontractors, even though the payments come out of the general contractor's own pocket. The theory is that the general contractor has contracted with the subcontractors to have the work performed and promised to pay for it. In this context, the subcontract obligations are independent of the general contractor's contract with the owner. Consequently, the general contractor is obligated to pay the subcontractors for their work, regardless of whether the general contractor, in turn, ever gets paid by the owner.

In recent years, however, a growing number of contractors have tried to avoid being the party ultimately responsible to pay for work that benefits the owner. Many general contractors have tried to transfer the risk of non-payment by the owner to their subcontractors through a "pay-if-paid" clause. A pay-if-paid clause simply provides that the general contractor only has to pay the subcontractors if the owner has paid the general contractor.

In legalese, payment by the owner is a condition precedent to the general contractor's obligation of payment to the subcontractor. However, a significant question has existed as to whether these controversial clauses are enforceable, with some states enforcing them and a handful of states refusing to enforce them. This uncertainty has limited the widespread use of these clauses.

Colorado Law of Pay When Paid

In Colorado, the pay-if-paid clauses became particularly popular after 1997 when a Colorado Court of Appeals issued the first *Printz* decision enforcing a pay-if-paid clause. The court relieved the general contractor of the obligation to pay the subcontractors out of his own pocket after the owner went belly-up. Based on the first *Printz* decision, we started seeing subcontracts with clauses along the following lines:

> The contractor shall pay the subcontractor, provided that the contractor has received payment from the owner.

This language was dictated by the specific holding of the first *Printz* decision which decided that this language made payment by the owner to the general contractor a condition precedent to the general contractor's duty to pay its subcontractor.

As you have already guessed, there is a reason I refer to the **first** *Printz* decision. This year, the Colorado Supreme Court considered the first *Printz* decision and reversed it in *Main Electric, Ltd. v. Printz Services Corp.,* 980 P.2d 522 (Colo. 1999).

In the second *Printz* decision, the Colorado Supreme Court held that the "provided" language at issue was a pay *when*-paid clause rather than a pay-*if*-paid clause. **A pay-when-paid clause only governs *when* the general contractor is to pay its subcontractors, not *whether* payment will be made.** Under such a clause, the general contractor may delay payment to the subcontractor if the owner has failed to make payment. However, the general contractor may only delay payment for a *reasonable time*, not indefinitely. Consequently, a pay-when-paid clause may buy the general contractor a few weeks or months, but the general contractor ultimately will still have to pay the subcontractor.

Is Pay-When-Paid Dead?

For those general contractors who believe that pay-if-paid clauses should be enforceable, don't despair, the news from the Colorado Supreme Court provides support. The court held that the standard rules of law governing contract conditions apply to payment provision in construction contracts. That is judge-talk for saying that the court would be willing to enforce a properly drafted pay-if-paid clause. The trick will be in determining what the Colorado Supreme Court will consider a "true" pay-if-paid clause and what language it will shrug off as stating only a pay-when-paid clause. The drafting is not as easy as it may sound because the deck is stacked heavily in favor of paying subcontractors as a matter of judicial policy bias. Courts in other states have gone to surprising extremes to call payment provisions anything but a true pay-if-paid clause that creates payment by the owner as a condition to payment by the contractor to its subcontractors. Some courts have even ruled that clauses that expressly called themselves a "condition" did not really mean that, and were held to be mere pay-when-paid clauses.

Practical Considerations in Drafting an Enforceable Pay-When-Paid Clause

For both subcontractors and general contractors, here are four questions that should be considered when determining whether a given contract clause will be interpreted to be an enforceable pay-if-paid clause in Colorado:

1. Does the clause expressly and unequivocally state that the parties intend for payment by the owner to the general contractor for the work to be a "condition precedent" to the general contractor's obligation to make payment to the subcontractor for the same work?

2. Does the clause expressly state that the subcontractor understands and intends that it is accepting the risk that the owner will not make payment?

3. Does the clause *affirmatively* state that the subcontractor will not receive payment *unless* the owner makes payment to the general contractor?

4. Does the clause state that the subcontractor is affirmatively forfeiting (or waiving) its right to seek payment from the general contractor in the event that the owner fails to make payment?

Theoretically, the whole determination of the meaning of the clause rises or falls on whether the answer to the first question is an unqualified "yes." A "yes" should equate to a pay-if-paid clause that leaves the subcontractor taking the risk of non-payment by the owner. Nonetheless, each of the remaining three questions may leave some room for argument and negotiation between the general contractor and the subcontractor until we have a decision from the Colorado Supreme Court actually enforcing a specific pay-if-paid clause.

No-Damages-for-Delay Clauses – They Still Work

by Daniel R. Frost

Conventional wisdom is that enforcement of no-damages-for-delay clauses is becoming harder and harder, if not completely impossible. As a result, those clauses receive less and less attention in the negotiating and administration process. In fact, at times, they are simply ignored, whether in or out of the contract. The reasoning is that those clauses are strictly construed by the courts or that they are subject to a host of exceptions (including interference, waiver, fundamental breach or a delay not contemplated by the parties). Others may reason that the legislature in many states, including Colorado, has decreed that no-damages-for-delay clauses are void against public policy and unenforceable in state contracts.

Nevertheless, ignoring no-damages-for-delay clauses can still have serious consequences, whether in or out of any contract, despite what some commentators may say about their enforceability. A review of recent cases reveals persons who ignore those clauses still do so at their own peril.

Here's an example from a recent Colorado arbitration. A general contractor entered into a contract with its landscape subcontractor. The general contractor's standard form of subcontract, which contained boilerplate provisions shifting most of the commonly-encountered construction risks to the subcontractor, was used. This no-damage-for-delay clause was included:

"Subcontractor agrees that the allowance of additional time for compensation of the subcontract work precludes, satisfies and bars all other claims by subcontractor on account of any such delay."

This subcontract was used for an RTD project in Colorado. The subcontractor encountered delays it believed were caused by the general contractor and demanded damages in an arbitration. The subcontractor argued that C.R.S. § 24-91-103.5 was incorporated into the subcontract (under the terms of three general flow-down provisions in the subcontract) and barred enforcement of the no-damage-for-delay provision. At the time of the arbitration, there was no law on this issue in Colorado. The arbitrators found the no-damage-for-delay clause to be enforceable despite the flow-down provisions and ultimately ruled against the subcontractor on the delay issues because of the no-damage-for-delay provision.

Thus, a no-damage-for-delay clause, which probably does not receive much attention at the time a construction contract is negotiated or signed, may ultimately have very significant consequences.

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