THE PRACTICAL LAWYER

VOLUME 21 APRIL 15, 1975 NUMBER 3

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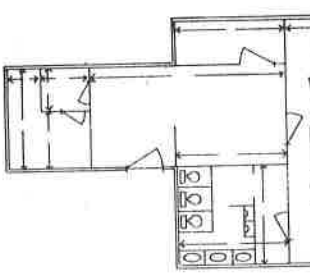

When the Subcontractor Fails To Perform — the Notice Problem

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When a general contractor enters into an agreement with an owner or a public entity for a construction project, his expected profit is built into the price bid. While the vicissitudes of construction work create myriad factors that can erode the contractor's profit margin, or, in an extreme case, threaten the very existence of the company, this discussion deals with only one problem area —that between the contractor and his subcontractors.

But it is not only the contractor who must be concerned with subcontractor problems. Where a private owner, a public entity, or a public benefit corporation has required the contractor to execute either a payment bond or a performance and payment bond, the surety may be the defendant in a suit by a purportedly aggrieved subcontractor. Since the defenses available to a defendant contractor may be interposed by a surety when recovery is sought under the bond, the actions taken by a contractor on the job, and the defenses that arise thereby, are of material importance to the surety. They are significant also in the not uncommon situation where the surety must complete the project for a defaulting or financially pressed contractor.

In addition, to the extent that a general contractor has secured some form of financing from a bank, the profitability of the job to him can be of critical concern to the lending institution. Thus, if, without adhering to the special provisions controlling substituted performance, the general contractor completes or corrects the work of a breaching subcontractor or pays another firm to complete or correct, the prospect of double

payment for the same work can prove disastrous to the general contractor and those standing behind him.

The dangerous consequences of this situation increase with the magnitude of the project, the number of subcontractors, and the volume of deficient performance by subcontractors. Moreover, the problem is likely to be exacerbated in these times of increasing construction costs, which, all too frequently, push underfinanced subcontractors into the position of inability or refusal to perform.

THE CONTRACTOR'S RIGHT TO COMPLETE

Since the concern of the surety and the bank is essentially derivative, the failure of performance by the subcontractor has its initial impact upon the general contractor and, depending upon the scope and character of the work sublet, difficulties with a subcontractor can have considerable disruptive effects on a job, particularly when he is performing work that must be completed before the remainder of the project activities. This possibility being obvious, general contractors protect themselves with a clause in the subcontract agreement providing that if the subcontractor fails to prosecute the work or perform properly any contractual obligation, the general contractor may correct any deficiency and backcharge the subcontractor's account.

Since a breaching subcontractor is liable for all the damages flowing from his breach, the contractor would seem to be protected. However, whether out of a sense of fair play or merely because the standard AIA contract form so states, typical subcontract clauses provide that the contractor must give three days written notice to the subcontractor before the contractor may remedy the deficiencies. See Trapasso, *The Lawyer's Use of AIA Construction Contracts* 19 THE PRACTICAL LAWYER, May 1973, p. 37.

The standard clause, as it appears in American Institute of Architects (AIA) Document A-401, reads as follows:

¶"11.10. The Subcontractor agrees that if he should neglect to prosecute the Work diligently and properly or fail to perform any provisions of this Subcontract, the Contractor, after three days written notice to the Subcontractor, may, without prejudice to any other remedy he may have, make good such deficiencies and may deduct the cost thereof from the payments then or thereafter due the Subcontractor, provided, however, that if such action is based upon faulty workmanship or materials and equipment, the Architect shall first have determined that the workmanship or materials and equipment are not in accordance with the Contract Documents."

When Contractor May Act

Variations of this language are often used, and a comprehensive example of situations in which the contractor is empowered to act include the following:

- Refusal or neglect of the subcontractor to supply a sufficient number of skilled workmen—in construction parlance, failure to man the job;
- Refusal or neglect by the subcontractor to use materials of the proper quality;
- Acts or omissions of the subcontractor that cause interference with the contractor or other subcontractors or result in work stoppage;
- Failure, in any respect, by the subcontractor to prosecute the work with promptness;
- Adjudication that the subcontractor is a bankrupt;
- A general assignment by the subcontractor for the benefit of his creditors;
- Appointment of a receiver for the subcontractor or his assets;
- Insolvency of the subcontractor, or when he becomes a debtor in reorganization, composition, or arrangement proceedings; and
- Failure of the subcontractor to perform any of the covenants of the subcontract.

The more frequently encountered circumstances as they occur on the job are as follows:

- Subcontractor has insufficient labor at work and contractor supplies his own men or the employees of another company;
- Subcontractor has insufficient or improper equipment on the job and contractor supplies his own equipment or rents equipment for the account of the subcontractor;
- Subcontractor has insufficient or unskilled technical employees and contractor allocates his own technical staff;
- Subcontractor fails to complete a particular item and contractor completes or engages another company to complete; and
- Subcontractor completes, but his work is deficient and contractor remedies the defect with his own men or engages another company.

Duty To Give Notice

Even though the contractor may not be using an AIA form of subcontract or a common derivative thereof, counsel to any subcontractor will request that a notice provision be inserted. Thus, before being declared to be in breach of the contract, a subcontractor can expect an opportunity to cure

the breach, or, if the alleged breach is questionable, a chance to convince the contractor that no breach has occurred.

The real problem is not a subcontractor who clearly fails to live up to his contract. If a subcontractor should have a 20-man crew on the job, but has only two men, work progress will be so retarded that the contractor will demand an appropriate increase in the work force. If there is no response, the contractor will take steps to man the job with his own personnel or from another source. This need being so apparent, the contractor may be expected to inform the subcontractor that labor is being supplied for the subcontractor's account and that he will be backcharged accordingly.

But what of the situation that is not so blatant? What if, instead of a 20-man crew, the subcontractor has only 16 men? Then, while progress will suffer, the slower pace and the resulting contract breach may not be so egregious as to bring pressure from the owner's job representative. Under these circumstances, the contractor's entreaties to the subcontractor may be less strident. He may, somewhat more casually, ask his job superintendent to direct the subcontractor to add four men. If the request is ignored, the contractor may eventually assign a few of his men to "fill in." He could at the same time neglect to send the subcontractor a written notice of his intention to supply labor for the subcontractor's account. Does the contractor forfeit the right to backcharge the subcontractor for labor where no written notice was given? The answer often will be "no."

Excused Failure To Give Written Notice

There are two categories of excuse the contractor can have for his failure to serve written notice to the breaching subcontractor, which, for simplicity, can be styled factual or legal.

Factual Excuses

The factual excuses, while very real to the contractor, will not serve as a basis for relief. Essentially, they relate to job conditions. As a practical matter, it is impossible for a contractor to give written notice to a subcontractor of every breach, because the realities of the industry simply do not allow for it. A contractor would have to be possessed of a prescience far beyond that which any member of his staff could have. Indeed, he would have to employ one man just to write letters to cover every day-to-day situation arising on the job, coupled with constant legal advice.

All but the largest national contractors are not in a position to detail all job happenings—and even the industry giants confine

their day-to-day notice-giving to the most major projects. Hence, limited or faulty communications, legal naivete of job personnel, uneven pressures from the owner, pyramiding of problems, and the sheer number of subcontractors all contribute to an inability to perceive the importance of the breach at the time. These, however, are not excuses that the contractor may successfully use.

Legal Excuses

The excuse of non-performance is a hornbook concept for which there is much scholarly authority and considerable case law. Professor Williston lists seven excuses for failure to perform that would allow an action, notwithstanding non-performance of the condition. S. WILLISTON, CONTRACTS §676 (Baker, Voorhis, Mt. Kisco, N. Y., 3d ed. W. Jaeger, 1959). However, when couched in general terms, principles that excuse non-performance have little application to the realities of a construction project.

Practically, legal excuses for failure to give written notice to the subcontractor arise from events transpiring on the job, showing in essence that, notwithstanding the failure of the general contractor to give a three-day written notice:

- The subcontractor had sufficient alternate notice or actual knowledge;
- Giving notice would have been to no avail; or
- The contractor's failure to give notice was caused by the subcontractor.

Any or all of these circumstances can be construed as a waiver by the subcontractor of the notice requirement. In addition, there are other forms of conduct from which a court will infer a waiver of the notice condition. To a significant extent, the various excuses are intertwined, but they may be more forcefully presented in litigation by specific application to the fact patterns at issue.

Abandonment

If a subcontractor leaves the job site with no intention of returning, he has abandoned his contract. While a general contractor should nevertheless inform the breaching party in writing that the contract is terminated or that his account will be backcharged for all completion or correction work, notice is not essential. Thus, when the subcontractor sues to recover the contract balance, presumably on the ground that his abandonment was either forced or was in some way justified, and he uses no written notice as a defense to the contractor's counterclaims, the contractor may interpose abandonment as an excuse.

The existence of an abandon-

ment, however, is not always clearly defined. What can happen is that a subcontractor may have submitted a bid that was too low, a fact he discovered only once the job has begun. To avoid losses, he may leave the job under color of a dispute, with constant promises to perform if the contractor will change his position on the alleged points of disagreement. In order for the contractor to successfully prove abandonment, he must show by testimony or documentary proof that the subcontractor's promises to perform were transparent self-serving statements.

Useless Notice

Where the contractor can show that the subcontractor was given sufficient oral notice of the breach or the defect in performance and still failed or refused to cure it, then the old maxim that the law compels no man to do a useless act would apply. Stated another way, "If the promisor is not going to keep his promise in any event, it is useless to perform the condition and the promisor becomes liable without such performance." S. WILLISTON, CONTRACTS §699 (Baker, Voorhis, Mt. Kisco, N. Y., 3d ed. W. Jaeger, 1959).

Clearly there may be a factual dispute here. While the quantum of oral notice given that precludes the necessity for written notice will vary from case to case, the real question to be answered is: Did the oral notice give the subcontractor sufficient opportunity to cure his breach? If it did, no amount of letter writing would have persuaded the subcontractor to do what oral notice could not get him to accomplish. Written notice having been shown to be a useless and wasted act, it is thus dispensed with as a condition.

Prevention by Subcontractor

Where non-performance of the notice provision was caused by the party claiming to be disadvantaged, that party may not insist upon the notice. If a subcontractor continuously promises performance until such time as the corrective work must be performed by some other party in his stead, the failure to give notice will be excused.

A typical situation stems from the importance of scheduling on construction projects. Where an excavation subcontractor is required to prepare a level and properly compacted subgrade for a parking lot prior to the paving work by another subcontractor, time of performance is critical, particularly if the paving subcontractor has allocated only so many days for his work. One scenario would be as follows: The paving subcontractor has planned to begin paving the parking lot on May 15, expecting to finish on May 18 and then move on to another job. On April 15, the excavation subcon-

tractor, who has either not yet prepared the grade or has done the job improperly, is directed orally by the general contractor to perform or correct, as the case may be. The subcontractor promises to do so. Days pass and nothing happens. The general contractor, who assumes that the excavator is certainly going to perform, accepts the promises until May 14, when he gives the three-day written notice. Since the paving subcontractor can only work May 15 through May 18, he prepares the subgrade with his own forces. Obviously, the excavator did not receive three days written notice, because work was performed for his account one day after the notice was mailed. However, the fault was his and the notice he seeks will not be required.

Estoppel

A subcontractor may waive his rights to written notice by word or deed, or by accepting the benefits of the actions for which lack of formal notice is claimed. If a subcontractor acquiesces, either by silence or oral acceptance, when labor, material, or equipment is supplied or work is performed in his behalf by the general contractor, he will be considered to have waived the receipt of written notice. Concurrently, he will be estopped to deny the efficacy of the oral notice given him. While the overwhelming majority of cases discuss waiver in terms of an owner waiving written presentation of claims, the principle is also relevant to the contractor-subcontractor relationship.

Conclusion

If a subcontractor breaches his subcontract, forcing the general contractor to expend money to complete or correct the work, the general contractor will, if he can, hold back as additional retainage an amount equal to the sum spent. If the work had progressed so far that the retainage is less than the sums expended, a suit against the subcontractor can be instituted. In either event, the subcontractor may interpose lack of written notice as a defense if the contractor has not sent the required letter.

All this is particularly important to a general contractor and the surety, for if the subcontractor's defense is successful, they will be subject to a double expense—the cost of completion or correction when the subcontractor breached and the payment to the subcontractor of the money withheld on account of the breach.

Nevertheless, to the extent that a general contractor attempts to honor the spirit of the notice clause, he will be protected if he does what logic dictates. Reasonable oral notice or the existence of facts indicating that notice would be useless or absurd will make written notice unnecessary.