

Be Careful What Documents You Sign - Unintended Consequences

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Contractors and subcontracts should carefully review, question and understand every document that they sign on a construction project. This basic tenant must be followed from signing the contract to the final document executed to close out a project. Courts assume that contractors and subcontractors are sophisticated business persons and will be deemed to have read, understood and agreed to be bound to the terms of every document they execute. This concept was the main focus of a recent court decision, where a subcontractor's bond claim was dismissed based upon documents it executed at the onset of the project.

In this recent case, a subcontractor executed an initial subcontract to perform certain exterior masonry work on a public improvement project. When the general contractor advised the subcontractor that the public agency would not approve the subcontract value, the subcontractor and general contractor executed a second subcontract, for the same scope of work, at a lesser dollar amount. The general contractor then advised the subcontractor that the public agency would not approve the subcontract value of the second subcontract. The general contractor and subcontractor then proceeded to cross out the dollar value on the subcontract and inserted a lower dollar value on the subcontract and initialed the changed subcontract value. After executing the third subcontract, the subcontractor executed at least three separate documents that were presented directly to the public agency for subcontractor approval that represented to the public owner that the dollar value of the subcontract was a fourth and even lower dollar value. One of the documents executed by the subcontractor contained a certification that "[w]ilfull or fraudulent falsifications of any data or information submitted herewith may result in the termination of the contract between the City and the bidder or contractor and in disapproval of future contracts for the period of up to five years. Further, such falsification may result in civil and/or criminal prosecution." Based upon the three documents executed by the subcontractor for the fourth and lowest subcontract value, the public owner approved the subcontractor to perform work on the project.

Work commenced and, before the subcontract work was completed, the subcontractor was removed based upon the public owner's termination of the general contractor. The subcontractor filed a bond claim against the general contractor's surety and a Mechanic's Lien with the public owner. When the bond claim was not negotiated and settled, the subcontractor commenced a litigation against the general contractor, the general contractor's surety, and the public owner. The general contractor did not appear in the action, so a default judgment was taken.

At trial, the subcontractor claimed that the initial and highest subcontract value was the subcontract and that the subsequent subcontracts and documents it executed were merely documents that the general contractor made it sign and that the general contractor

and subcontractor always intended the highest subcontract value to be controlling. The surety argued that the subcontractor should not be permitted to pursue its bond claim based upon the highest subcontract value because the subcontractor was aware that the public owner would not approve the subcontract at that highest amount and the subcontractor and general contractor substituted the initial subcontract with the second subcontract, which, in turn, was substituted by the third subcontract. The surety also argued that the subcontractor should be bound by the lowest subcontract value as represented by it to the public owner in the documents the subcontractor executed during the subcontractor approval process.

In light of the arguments made by the subcontractor and the surety, the first and main issue that the court addressed was “what was the subcontract price.” The court held that the lowest subcontract value in the documents executed by the subcontractor and presented to the owner for subcontract approval was the value of the subcontract. The court reasoned that the documents presented to the public owner were open public representations and the public owner’s approval was predicated upon the subcontractor’s representations. Therefore, the subcontractor was estopped from claiming the subcontract price was anything above the lowest price represented. The subcontractor’s bond claim was ultimately dismissed because it was nearly paid in full based upon the lowest subcontract price represented to the public owner and the surety presented convincing evidence that the surety had incurred substantial costs to remediate the subcontractor’s non-compliant work.

Commentary

This court decision highlights the harsh realities that a subcontractor and/or contractor face when they execute documents that they do not read, understand and question. Whether the subcontractor and the general contractor in this case always understood that the first and highest subcontract was the subcontract value, the subcontractor was ultimately bound by the subsequent documents that it executed and presented to the public owner.

Contractors and subcontractors need to be mindful that the documents they execute today can have unexpected and unintended negative consequences at the end of a project. While not every document needs to be reviewed by counsel, important documents, like contracts and any documents in which a contractor/subcontractor is being asked to reserve/waive claims should always be reviewed by counsel to minimize the unexpected and unintended negative results.

Feel free to contact me to discuss construction contracts and implications of documents executed in the regular course of a construction project.