

# CONSTRUCTION CLAIMS MANAGEMENT

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## A. PROTECTIVE MEASURES

The legal measures available to protect your interests and rights will vary depending on the facts and on your status as owner/architect/engineer/contractor/subcontractor/supplier. It is important to consider the procedures available to you to protect your position. Some specific procedures are established by statute and others are governed by the common law. Many procedures are strictly construed so that, in order to protect your legal right, you must carefully comply with the various timing and notice requirements.

### 1. Perfecting lien rights and claims

There is a difference between perfecting lien rights and perfecting claims. For example, a subcontractor may have claims for breach of contract, unjust enrichment, etc. which may be perfected by filing a lawsuit against the general contractor (and perhaps the owner). Time limitations for these claims are established under applicable statutes of limitation which, in Colorado, may range from one to six years after the claim "accrued." Time limitations for filing a mechanics' lien, however, are relatively short. Failure to give proper notice, record a Lien Statement and initiate a lawsuit to foreclose the lien within the time limits established by statute will forever bar the contractor's/subcontractor's rights to a lien on the property.

#### a. Perfecting Mechanics' Lien Rights

Mechanics' lien rights are created by statute and, in order to maintain and enforce them the procedures set out in the statutes must be carefully followed. Richter Plumbing and Heating v. Rademacher, 729 P.2d 1009 (Colo. Ct. App. 1986); Trustees of Mortgage Trust of America v. District Court, 621 P.2d 310 (Colo. 1980). The mechanics' lien statutes are intended to protect persons who provide a benefit to the owner's property. Colorado, like other states, has statutes which define who is entitled to a lien, what property is subject to a lien and prescribe the means to perfect and foreclose on a lien.

\*Who is entitled to claim a mechanics' lien?

The Colorado statute protects a broad category of claimants who have supplied labor, materials, services or other things of value at the request of the owner or the owner's agent. C.R.S. ' 38-22-101. This includes materialsmen, Beco Equipment Co. v. Box, 608 P.2d 850 (Colo. Ct. App. 1980), subcontractors, Kobayashi v. Meehleis Steel Co., 472 P.2d 724 (Colo. Ct. App. 1970), architects and engineers, Bankers Trust Co. v. El Paso Pre-Cast Co., 560 P.2d 457 (Colo. 1977).

Although the list of persons entitled to claim a lien is quite broad, the following categories of persons

are not protected by the lien statute: temporary personnel agency that furnished laborers to subcontractor, Skillstaff of Colorado, Inc. v. Center Real Estate Corp., 1998 WL 251479 (Colo. Ct. App. May 14, 1998), people with an ownership interest, Damrell v. Creagar, 599 P.2d 262 (Colo. Ct. App. 1979), persons who provided materials or services at the request of someone other than the owner or the owner's agent, C & W Electric, Inc. v. Casa Dorado Corp., 523 P.2d 137 (Colo. Ct. 1974), attorneys who provided legal services to the developer, Rich v. First Interstate, 807 P.2d 1199 (Colo. Ct. App. 1990).

\*Is a person who pays to remediate hazardous conditions entitled to a mechanics' lien?

The Kansas Supreme Court held that removal of hazardous waste from real property was not an "improvement of real property" so that the Kansas Mechanics' Lien Statute did not protect a subcontractor who removed materials from the owner's property. Haz-Mat Response, Inc. v. Certified Waste Services Limited, 1996 W.L. 47305 (Kansas Feb. 2, 1996). However, the Kansas Mechanics' Lien Statute is distinguishable from Colorado's. First, Colorado's statute provides that the labor or materials must be used in "construction, alteration, improvement, addition to, or repair, either in whole or in part, of any building. . . . or any other structure or improvement upon land. . . ." In contrast, Kansas requires the labor or materials to be "used or consumed for the improvement of real property. . . ." K.S.A. ' 60-1101.

The Kansas Court reasoned that removal of the hazardous waste was not done as a part of an overall plan to improve the property and would not necessarily enhance the value of the real property. This was because the subcontractor merely removed the hazardous waste, which continued to accumulate in the ordinary course of business.

The Haz-Mat case identifies a Kansas case which held that bringing in and grading dirt was considered a lienable activity in Kansas, Southwestern Electrical Co. v. Hughes, 30 P.2d 114 (Kansas 1934), and a case recognizing that activities to clear land was lienable under Alabama law, which has a Mechanics' Lien statute similar to Colorado's. See Mazel v. Bain, 133 So.2d 44 (Ala. 1961) (the Alabama statute grants a lien to "every . . . person . . . who shall do or perform any work, or labor upon . . . any building or improvement on land.").

In order for a person who pays to remediate hazardous conditions to prevail under Colorado's Mechanics' Lien Statute, the following legal/factual issues would be important:

1. Have Claimants (i) "supplied" machinery, tools, or equipment, or (ii) are they "mechanics," "materialmen," "contractors," "subcontractors" or "builders" or (iii) are they persons of a class performing labor upon or furnishing directly to the owner or persons furnishing labor, materials to be used in the project? If Claimants fall within any of these three classes, they are entitled to a mechanic's lien if they satisfy the remaining requirements of the Statute.
2. As an alternative to Question 1, are Claimants architects, engineers, draftsmen, or artisans who have furnished designs, plans, plats, maps, specifications, drawings, estimates of cost, surveys, or superintendence or rendered other professional or skilled service?

3. Does the environmental cleanup constitute an "improvement" or "repair" to a "structure or improvement upon land" within the meaning of the statute?

\*What property is subject to a mechanics' lien?

All property upon which services/materials were provided and the property which "may be necessary for the convenient use and occupation of such building, structure, or improvement" is subject to the mechanics' lien. C.R.S. ' 38-22-103(1). However, the lien is imposed upon only property identified in a recorded Lien Statement. First National Bank v. Sam McClure & Son, 431 P.2d 460 (Colo. 1967). Thus, it is important to accurately describe the owner's property in the Lien Statement.

\*What dollar amount should a lien Claimant claim?

The Colorado Statute provides a lien claimant with a lien "for the value of such machinery, tools, or equipment supplied or services rendered or labor done or material furnished." C.R.S. ' 38-22-101 (emphasis supplied.) The Statute does not explain how the "value" should be determined. For example, is field overhead or home officer overhead a component of the "value" of the services or materials provided by a subcontractor? If overhead is not considered a part of the value, a subcontractor who includes overhead in its Lien Statement runs the risk of losing all of its lien rights for overstating the amount of its lien in its Lien Statement. See, C.R.S. ' 38-22-188.

\*How do I perfect my mechanics' lien rights?

In order to perfect a mechanics' lien the claimant must:

1. Serve a Notice of Intent;
2. Record a Lien Statement; and
3. Commence a lawsuit.

Each of these steps is described below.

A Notice of Intent to File a Lien Statement must be served on the owner and the prime contractor at least ten days before a Lien Statement is recorded. C.R.S. ' 38-22-109(3). The standard form "Notice of Intent to File Lien Statement" and "Lien Statement" are available from Bradford Publishing. These forms are self-explanatory, but must be completed carefully and completely.

The next step is to record a Lien Statement with the clerk and recorder of the county where the property is located. The Lien Statement, if the claimant is claiming for labor, without furnishing materials, must be recorded after the last labor was provided but within two months after completion of the project. C.R.S. ' 38-22-109(4). All other claimants must record their Lien Statement within four months after the claimant last performed labor or furnished material. C.R.S. ' 38-22-109(5). A claimant may extend the two-month and four-month periods by recording a Notice Extending Time to File a Lien

Statement ("Notice Extending"). The Notice Extending will extend the period within which to record a Lien Statement to the shorter of four months after completion of the project or six months after the date the Notice Extending was recorded. C.R.S. ' 38-22-109(10). If the project is not completed within one year after the Lien Statement is recorded, the claimant must record an affidavit stating that the improvements on the property have not been completed in order to preserve the lien. C.R.S. ' 38-22-109(8).

Failure to record the Lien Statement within the specified time will result in a loss of all lien rights (but not other rights such as claims for breach of contract). First National Bank v. Sam McClure & Son, 431 P.2d 460 (Colo. 1967).

The date of "completion" is an important issue with regard to the timing of filing a Lien Statement. Generally, there is no bright-line test to determine when a project is completed. Colorado courts have held, however, that a contractor cannot extend the time for filing a Lien Statement by making trivial alterations. Richter Plumbing and Heating v. Rademacher 729 P.2d 1009 (Colo. 1986). There is a presumption of completion three months after cessation of all labor, work, services and furnishing of materials at the site. C.R.S. ' 38-22-109(7).

The final steps in preserving a lien are to commence a lawsuit to foreclose on the mechanics' lien and record notice of the action (the notice is called a "Notice of Lis Pendens"). These steps must be taken within the later of six months after the last work is performed or materials furnished or completion of the project. C.R.S. ' 38-22-110; Meurer, Serafini & Meurer, Inc., v. Skiland Corp., 551 P.2d 1089 (Colo. Ct. App. 1976). The six-month period is tolled if the owner files bankruptcy. In re Cantrup, 38 Bankr. 148 (Bankr. D. Colo. 1984).

\*What defenses are available to the owner?

The owner can limit its liability for mechanics' liens by recording the contract in the real property records (or a memorandum summarizing the terms of the contract). C.R.S. ' 38-22-101(2). The price of the recorded contract sets the maximum value of all liens that can be asserted. Independent Trust v. Stan Miller, Inc., 796 P.2d 483 (Colo. 1990); Heating & Plumbing Engineers v. H.J. Wilson, 698 P.2d 1364 (Colo. Ct. App. 1984).

An owner/landlord can protect against mechanics' liens arising from improvements obtained at a tenant's request by giving written notice that its interest in the property shall not be subject to any lien on all persons performing labor or furnishing materials or by posting written notice in a conspicuous fashion on the property. C.R.S. ' 38-22-105. The notice must be personally served or posted within five days after the owner/landlord receives notice of the intended improvement. Id. The notice is effective even if it is posted before the owner receives notice. J.M. Hall & Co. v. Southwest Properties, 747 P.2d 688 (Colo. Ct. App. 1987).

If a lien claimant files a Lien Statement claiming an amount greater than is due without a reasonable possibility that the amount claimed is actually due and with the knowledge that the amount is overstated, the lien claimant forfeits all lien rights. C.R.S. ' 38-22-128. In addition, the lien claimant who intentionally overstates the amount to which it is reasonably due will be required to pay all costs

and attorneys' fees related to any court proceedings. Id.

In 1997, the Colorado legislature enacted a new "Spurious Liens and Documents" Act. The Act allows an owner of real property to petition the state district court for an order to show cause why a document that contains material misstatements or false claims or is otherwise "patently invalid" should not be declared invalid. C.R.S. ' 38-35-204. To date, there are no reported cases indicating if or how this new statute dovetails with the Mechanics' Lien Statute. Under the Spurious Liens and Documents Act, the Court must conduct a "show cause" hearing within twenty days of service of the show cause order. Thus, if an owner is faced with a Lien Statement under the old Mechanics' Lien Statute which it believes contains material misstatements, false claims or is patently invalid, the owner might succeed in obtaining a prompt determination that the Lien Statement should be declared invalid under this new statute. If successful, the owner would be entitled to attorneys' fees and costs. Id. Conversely, the owner is required to pay the lien claimants costs and attorneys' fees if the Court determines that the Lien Statement was not a "spurious document." Id.

Owners should obtain broad lien waivers to use as a defense against mechanics' liens. Courts will generally enforce waivers signed by subcontractors, vendors, etc., which purport to release any rights to assert a lien on a project.

Owners may also use joint checks, payable to the contractor and the subcontractor, vendor, etc.,. However, there is a risk, in Colorado, that by making joint checks payable to the contractor and subcontractor/vendor, a court will find that the owner has ratified the contract between the contractor and subcontractor/vendor and will be personally liable for a breach of that contract. See *Buttermore v. Firestone Tire and Rubber Co.*, 721 P.2d 701 (Colo. Ct. App. 1986).

#### b. Perfecting rights on Public Projects

Mechanics' liens are not available on public works projects in Colorado. Instead, contractors/subcontractors on Colorado public works projects are protected by the use of mandatory bonds (on projects over \$50,000) and verified statements which permit the contractor/subcontractor to file with the contracting body who awarded the contract a verified statement of the amount due and unpaid. C. R.S. ' 38-26-107. Upon the filing of the verified statement, the contracting body is required to withhold sufficient funds to insure the payment of the claim for a period of ninety days after the date fixed for final settlement. If a lawsuit and notice of lis pendens are filed within this ninety-day period, the contracting body must continue to hold the funds pending resolution of the parties' disputes through litigation.

\*Can the general contractor bond around a verified statement?

By filing a verified statement, a subcontractor can impose severe pressure on the general contractor to settle a dispute because the owner must withhold payment to the general unless the subcontractor voluntarily releases the verified statement or loses at trial. Unlike the specific provisions which allow a bond-around for mechanics' liens, C.R.S. ' 38-22-131, there is no similar provision in the public works statute. Although some Colorado trial courts (in unreported decisions) have allowed contractors to bond around verified statements, others have refused.

### c. Claims by Owner

Owners may have claims for delay, corrective work, wrongful termination, torts and based on other legal theories. Damages available to the owner will vary by claim, depending upon the legal theory. For example, generally an owner who is damaged by a contractor's breach of contract is entitled to recover "compensatory damages," sufficient to place it in the position it would have occupied had the breach not occurred. Taylor v. Colorado State Bank, 440 P.2d 772 (Colo. 1968); Smith v. Hoyer, 697 P.2d 761 (Colo. Ct. App. 1984). This may be measured in a variety of ways. Although the basic philosophy for calculation of damages on a tort claim is similar to contract, i.e., to make the plaintiff whole, damages in tort are more flexible and may include punitive damages.

#### \*Breach of Warranty:

The law may impose a number of implied warranties in a construction contract. For instance, homeowners generally are entitled to a warranty of fitness and habitability, which assures the homeowner that the home was built in a workmanlike manner and is suitable for habitation. Cosmopolitan Homes, Inc. v. Weller, 663 P.2d 1041 (Colo. 1983). In broad terms, the implied warranty protects the purchaser from improper construction, design or preparation. Id. Colorado courts have found against contractors even though they built a home in a workmanlike manner, where outside forces such as expanding soils have caused a home to become uninhabitable. Glisan v. Smolenske, 387 P.2d 260 (Colo. 1963). This implied warranty only extends to the first purchaser of the home. (Subsequent purchasers may have tort claims such as a claim for negligence.)

#### \*Negligence

Owners will prevail on a claim for negligence if they can establish defects in the builder's workmanship, supervision, or design arising from the builder's failure to exercise reasonable care in the conduct of its duties to foreseeable users of the property. Cosmopolitan Homes, 663 P.2d at 1045. Unlike breach of warranty claims, subsequent purchasers may pursue negligence claims. A negligence claim requires a subsequent purchaser prove that the defect is a "latent defect," i.e., one manifesting itself after the purchase which is not discoverable through reasonable inspection. Id. Thus, buyers are not expected to discover structural defects which are latent at the time of purchase.

Colorado's two-year statute of limitations applies to such negligence claims. See C.R.S. ' 13-80-104. The statute requires that any claims against architects, contractors, builders, builder vendors, engineers or inspectors must be brought within two years after the claim "arises," but, in any case, not more than six years after substantial completion. A claim arises when the plaintiff discovers, or with the exercise of reasonable diligence, should have discovered the physical manifestation of a defect. Id.

### d. Claims by Contractor/Subcontractors

Contractors and subcontractors, like owners, may assert a variety of claims, including claims for change in scope, acceleration, delay, disruption, nonpayment, termination and claims based on tort or equitable theories. In order to preserve their claims, contractors and subcontractors should be careful

to comply with all notice requirements under their contract and should accumulate supporting documentation and other evidence as the project proceeds.

Although the subcontractor is given the statutory protection of a mechanics' lien, the subcontractor usually cannot prevail in a direct claim for breach of contract against the owner. Even though the owner did not sign a contract in favor of the subcontractor, subcontractors sometimes, however, have succeeded on claims against owners on the following theories:

**\*Unjust Enrichment:**

The law protects persons who provide something of value to another where it would be unjust for the other to retain the benefit without paying for its reasonable value. Thus, subcontractors who have provided value to the owner have prevailed on claims against the owner for unjust enrichment. Frank M. Hall & Co. v. Southwest Properties Venture, 747 P.2d 688 (Colo. Ct. App. 1987) (landlord held liable to contractor on claim for unjust enrichment even though landlord posted notice of nonliability under C.R.S. ' 38-22-105(2)). However, in most cases the courts have found that it would be inequitable for the owner to be held liable under a claim for unjust enrichment if the owner has paid once to the general contractor or for other equitable reasons. DCB Construction Co., Inc. v. Central City Development Co., 965 P.2d 115 (Colo. 1998) (requiring showing that the owner was engaged in some form of improper, deceitful or misleading conduct in order to hold owner liable).

**\*Ratification of Account:**

As discussed above, in Buttermore v. Firestone Tire and Rubber Co., 721 P.2d 701 (Colo. Ct. App. 1986), the court held that the owner was personally liable for the amounts due the subcontractor by the general contractor because the owner made checks payable jointly to the contractor and subcontractor, thus ratifying the account between the contractor and subcontractor.

## **B. WHEN ALL ELSE FAILS**

### **1. Common Non-Compliance Problems**

Most contracts require that any change orders be in writing and signed by the owner and the architect or engineer. In order to insure that a contractor will be compensated for any changes, it is important for the contractor to obtain a signed change order as prescribed by the contract. There are a variety of circumstances in which courts have found a way to justify an award to contractors/subcontractors who have not strictly complied with the notice and change order requirements of the parties' contract.

#### **a. Ratification and Constructive Change Orders**

Courts usually enforce the procedures set out in the parties' contract with regard to approving changes. Sime Construction Co. v. WPPSS, 621 P.2d 1299 (Wash. Ct. App. 1980); Swenson v. Lowe, 486 P.2d 1120 (Wash. Ct. App. 1971). However, courts have protected contractors in many cases where the equities lie in the contractor's favor, and have held that an oral request for additional work

waived the requirement that all change orders be made by a signed writing. Hi-Valley Constructors, Inc. v. Heyser, 428 P.2d 354 (Colo. 1967); Flour Mills of America, Inc. v. American Steel Building Co., 449 P.2d 861 (Okla. 1969).

If a contractor does not obtain the required authorization/signatures, it may still recover under the doctrine of "ratification" or by proving a "constructive change order." Ratification requires that the owner accept the work with the knowledge that the contractor intended to claim extra payment. In order to prove a constructive change order, the contractor must establish that it reasonably relied on misrepresentations made by the owner when it underbid the job. See Coleman Engineering co. v. North American Aviation, Inc., 420 P.2d 713 (Cal. 1967). In another case, a subcontractor was awarded additional payment despite failure to comply with the contract requirements for written modifications or notice where it was shown that the contractor had agreed orally to compensate the subcontractor for extra work. Hahl v. Langfur Construction Corp., 529 P.2d 1369 (Colo. Ct. App. 1974).

## b. Waiver

Provisions such as ' 4.3.5 of AIA Document A-201, require that the contractor give written notice of any claim for an increase in the Contract Sum or Contract Time. Noncompliance with the notice requirements may result in the contractor's loss of a claim for extra costs. However, the owner may waive the notice requirements by conduct. For example, in Hi-Valley Constructors, Inc. v. Heyser, 428 P.2d 354 (Colo. 1967), the Court concluded that, although there was never any written change orders, the owners right to require a written change order was waived where the parties handled the accounts "very loosely" and both knew additional work and materials would cost more money. In Hahl v. Langfur Construction Corp., 529 P.2d 1369 (Colo. Ct. App. 1974), the Colorado Court decided that the contractor waived the provision in the contract requiring that any extra work be approved in writing by stating that the work by the subcontractor was an extra and that the contractor was willing to seek additional compensation from the architect.

In general, the courts are likely to find an owner has waived its contractual right to written notice if it can be proved that it knew it had the right but intentionally abandoned the right. Burman v. Richmond Homes, 821 P.2d 913 (Colo. Ct. App. 1991). Waiver may be inferred by the owner's conduct if the intention to waive its rights is free from ambiguity and if the conduct "clearly manifests an intention not to assert the benefit." Richmond v. Grabowski, 781 P.2d 192 (Colo. Ct. App. 1989).

## **2. Disputing Architect/Engineer**

AIA A-201 provides:

Claims, including those alleging an error or omission by the architect but excluding those arising under Paragraphs 10.3 through 10.5 [claims related to hazardous materials], shall be referred initially to the architect for decision. An initial decision by the architect shall be required as a condition precedent to mediation, arbitration or litigation of all claims between the contractor and owner arising prior to the date final payment is due, unless 30 days have passed after the claim has been referred to the architect with no decision having been rendered by the architect.

' 4.4.1. The contractor/subcontractor may waive the right to contest a determination by the A/E unless timely demand for arbitration is made, G.M. Sollenberger v. AA Construction Co., 481 P.2d 438 (Colo. Ct. App. 1971); AIA A-201, ' ' 4.4.5, 4.4.6. Under some circumstances, a court will allow a contractor/subcontractor to challenge an A/E determination even though timely demand for arbitration was not made, such as when the A/E's decision is contrary to custom or trade usage, A.L. Green & Co. v. Great-West Life Assurance Co., 738 F. Supp. 965 (W.D. W.C. 1990); John W. Johnson, Inc. v. J.A. Jones Construction Co., 369 F. Supp. 484 (E.D. Va. 1973), or where the decision arises from fraud, bad faith or similar misconduct, Morse/Diesel, Inc. v. Trinity Industries, Inc., 67 F.3d 435 (2d Cir. 1995).

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