Construction Law From Contract to Closeout

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Construction Law From Contract to Closeout in Pennsylvania

Key Contract Provisions

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Topic Outline

I. Payment
   A. Terms
   B. Pay If/When Paid: Condition Precedent v. Timing Mechanism
      1. Timing Mechanism
      2. True Condition Precedent
   C. Progress And Final Payments
      1. Substantial Completion
      2. Final Completion
      3. Retainage
II. Scheduling
III. Changes And Modifications
   A. Cardinal Change Doctrine
   B. The Need for Written Modifications
      1. Public Contracts
      2. Private Contracts
   C. Construction Change Directives
IV. Damages Provisions
   A. Liquidated Damages
   B. No-Damages-For-Delay
V. Claims And Disputes
   A. Notice Of Termination Provisions
   B. Notice Of Claims
   C. Arbitration
      1. Enforceability Of Arbitration Provisions
      2. Effect On Sureties
   D. Mediation
VI. Indemnification

Key Contract Provisions

I. Payment

A. Terms

Payment for labor and materials supplied to a construction project is usually the single most important consideration of the parties to a construction contract.[1] The terms of the construction contract itself will govern the timing, frequency and process for submitting and approving payments to the contractor. In general, progress payments are made by the owner to the contractor over the course of the project. These payments can be based upon the passage of time, completion percentages, a schedule of values or any other benchmarks established by the parties in their agreement.

In "lump sum" contracts, the contractor submits a schedule of values prior to beginning work. That schedule will detail the allocated cost (usually the bid cost) of each portion of work to be completed by the contractor. With each payment application, the contractor will estimate the percentage of work completed for each component of work at the time of the submission of the payment application. In a "cost plus" contract, the contractor submits proof of actual costs incurred up to that point in the process of the construction project. In a "unit price" contract, the contractor submits evidence of the number of units completed, each of which typically represents a percentage of the overall contract price.

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[1] American Institute of Architects, also known as "AIA", as well as Engineers Joint Contract Documents Committee, known as "EJCDC," are two entities that issue form construction contract documents used frequently in the construction industry.

Regardless of the nature of the benchmarks, where an engineer, architect or project administrator is involved, the construction contracts will usually require the contractor to submit pay applications to that professional for approval. An example of such an approval provision follows:

> ENGINEER will, within ten days after receipt of each Application for Payment, either indicate in writing a recommendation of payment and present the Application to OWNER, or return the Application to CONTRACTOR indicating in writing ENGINEER's reasons for refusing to commend payment. In the latter case, CONTRACTOR may make the necessary corrections and resubmit the Application. Ten days after presentation of the Application for Payment to OWNER with ENGINEER's recommendation, the amount recommended will . . . become due and when due will be paid by OWNER to CONTRACTOR.[2]

The terms of the approval clause usually provide that the design professional's recommendation for payment is necessary before payment is due from the owner. Thus, throughout the project, in order to obtain progress payments, the contractor must perform work, submit payment applications and receive approval from the design professional.

In addition to progress payments, construction contracts will usually provide for the owner to withhold a certain, agreed-upon percentage of the contract price as retainage. This retainage amount must typically be paid to the contractor within a certain time, as established by the terms of the construction contract, after the project has been completed. Often, the contractor must submit proofs that all subcontractors have been

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[2] EJCDC, Standard General Conditions of the Construction Contract, § 14.4 (Review of Applications for Progress Payment) (1990 National Society of Professional Engineers).

paid, insurance and warranties are in effect, consent of the surety or other evidence, including, at times, affidavits that the project is indeed finished and final payment should be made.

B. Pay If/When Paid: Condition Precedent v. Timing Mechanism

Payments to subcontractors are usually governed by a pay-if-paid or pay-when-paid provision. The question of when payments are due under a construction contract often involves the question of whether that final payment is subject to a condition precedent or is merely a timing mechanism.

Under Pennsylvania law, the parties to a contract may specify conditions precedent to either party's further performance. Lezzer Cash & Carry, Inc. v. Aetna Ins. Co., 537 A.2d 857, 865 (Pa. Super. 1998) (failure to comply with condition precedent by one party to contract means liability of other party discharged). "No liability can arise on a promise subject to a condition precedent until the condition is performed, and if by lapse of time or for any other reason the condition cannot be performed no liability can ever arise upon the promise." Martz v. Continental Casualty Co., 14 A.2d 863, 865 (Pa. Super. 1940). In the suretyship context, the failure of an obligee or claimant to satisfy a condition precedent relating to a principal negates any liability on the part of the surety. C.M. Eichenlaub Co., Inc, v. Fidelity & Deposit Co. of Maryland, 437 A.2d 965, 966-67 (Pa. Super. 1981) ("Where, as here, the liability of a surety is concerned, the provisions of the underlying contract must be examined, since the liability of a surety . . . commences only upon breach of the underlying contract."). A surety's obligations will be obviated where there is a "failure of a condition precedent to happen, a contingency

which was in the contemplation of the parties" that relieves the principal of performing. Id; see, e.g., LBL Skysystems, Inc. v. APG-America, Inc., 2005 WL 2140240 (E.D. Pa. Aug. 31, 2005).

So when do such payment terms constitute a timing mechanism as opposed to a condition precedent? Pennsylvania law is unclear. There are two lines of cases that are less than perfectly consistent.

1. Timing Mechanism

In O'Brien & Gere Engineers, Inc. v. Taleghani, 540 F. Supp. 1114, 1116 (E.D. Pa. 1982), the court analyzed a contract provision that required payment to be made by defendant "within fifteen days of the availability of funds" paid by the Iranian government. Defendant claimed that the language obligated it only to pay the debt as a result of "receiving payment from the Iranian government." Id. at 1115-16. The court concluded that the payment term constituted merely a timing mechanism and not a condition precedent. The defendant's obligation to pay, in the court's opinion, was unconditional. The court found that the "[i]ntention of the parties was that payment would be made upon the happening of the event or within a reasonable period of time." Id. at 1117.

The court did not find that the terms of the agreement created a condition precedent. Noting that "[c]onditional promises are not favored by the courts," the court explained that in resolving doubts as to whether a condition was created, the law prefers an interpretation that reduces the risk of the obligee's forfeiture, "unless the event is within the obligee's control or the circumstances indicate that he has assumed the risk."

Id. at 1116. In this case, the language of the agreement, together with the parties' subjective intent, established that the obligation to pay was unconditional and that the receipt of payment by defendant from the Iranian government constituted a timing mechanism and not a condition precedent.

In United Plate Glass Co. v. Metal Trims Indus., Inc., 525 A.2d 468, 470 (Pa. Commw. 1987), the court construed the following provision:

> Final payment shall be due when the work described in this subcontract is fully completed and performed in accordance with the contract documents and is satisfactory to the architect. Such payment shall be made in accordance with Article 5 and with paragraphs 12.3 and 12.6 inclusive of this contract.
>
> Subject to the terms and conditions of this contract, final payment will be made to the subcontractor upon final acceptance of the work by the owner, the approval thereof by the architect and the receipt of payment in full from the general contractor.

The court concluded that the first sentence of the provision addressed the liability of plaintiff to defendant. The terms "shall be due," in the court's reasoning, made defendant liable to plaintiff for payment. The court explained that the third sentence, however, "merely addresses the time at which payment is to be made." Id. at 471. Therefore, the court determined that the "conditions" set forth in the payment provision were not absolute conditions but rather were "a timing mechanism to indicate when, had the project run smoothly," defendant's obligation to pay was triggered. Id.

2. True Condition Precedent

In LBL Skysystems, the federal district court, applying Pennsylvania law, construed the following contract provision:

> Disbursements are anticipated twice monthly. However, disbursement will be processed as funds are received.

The subcontractor in LBL Skysystems argued that this provision was merely a timing mechanism and not a condition precedent. Therefore, according to the subcontractor, the principal/contractor and its sureties were liable to the subcontractor for payment obligations due under the contract. The court rejected this argument and concluded that the quoted language constituted a valid condition precedent. Id. at *30. Because the condition precedent was not satisfied -- that is, the owner had not yet made payment -- the subcontractor had no right to payment. Id. (citing with approval Cumberland Bridge Co. v. Lastooka, 8 Pa. D. & C.3d 475 (1977)).

In Lastooka, the court construed a contract provision that required final payment by the contractor to the subcontractor only after the occurrence of several conditions including "final payment received by the contractor." It was undisputed that the owner had not made final payment to the contractor. Despite that, the subcontractor argued that it was entitled to final payment of the 10% retainage amount within a "reasonable" time. The court rejected that argument explaining:

> [T]he requirements for final payment are stated with clarity. . . . I do not think we have to go to arcane rules of construction to decide what the words "final payment received by the contractor" mean. . . . It seems to me that final payment by the owner to the contractor is a clean-cut condition precedent to the duty of payment of the last 10 percent.

Lastooka, 8 Pa. D. & C.3d at 479-480.

C. Progress And Final Payments

1. Substantial Completion

Often used in construction contracts, the reference to substantial completion refers to the time when the project is sufficiently complete so that the owner can use the completed structure for its intended purpose. Under the Pennsylvania Procurement Code, substantial completion is statutorily defined as:

> Construction that is sufficiently completed in accordance with the contract and certified by the architect or engineer of the government agency, as modified by change orders agreed to by the parties, so that the project can be used, occupied or operated for its intended use. In no event shall a project be certified as substantially complete until at least 90% of the work on the project is completed.

62 Pa. C.S. § 3902. Certification of substantial completion by the architect or engineer often triggers progress or contract balance payments by the owner, excepting whatever retainage withheld until final completion.

However, substantial completion is not final completion. Substantial completion generally is evidenced by the achievement of specific milestones on a project. Typically, the architect or engineer must certify that the project is substantially complete by an inspection of the contractor's work. The architect or engineer will generate a punchlist of

items that must be added, corrected, modified or repaired before the architect or engineer will certify to the owner that the project is finally complete.

2. Final Completion

Final completion means that the contractor has finished all the work for the project and submitted all requisite documentation to the owner. Once the punchlist items are completed by the contractor, the architect or engineer will usually certify the project is finally complete. Generally, the owner's acceptance of the project as finally complete serves as the owner's acceptance of the contractor's work, with certain exceptions. Final completion is also important because it triggers the owner's obligation to pay the contractor the retainage otherwise being withheld.

3. Retainage

Owners routinely withhold a certain percentage of each progress payment (typically 5% to 10%), known commonly as "retainage," until the contractor has achieved final completion. The amount of retainage to be withheld is generally governed by the terms of the construction contract.

For contracts subject to the Pennsylvania Contractor and Subcontract Payment Act (the "Payment Act"), owner must release retainage to the contractor within thirty (30) days after final acceptance of the work. 73 P.S. § 509(a). The Payment Act also requires contractors to pay their subcontractors the full amount due each subcontractor within fourteen (14) days after the contractor receives the retainage from the owner. Id. at § 509(c). If the owner or contractor has unreasonably failed to pay the retainage amounts, the owner or contractor will be liable for interest in the amount of 1% per

month on the balance due and owing and may be liable for the "substantially prevailing" party's attorneys' fees. Id. at §§ 509(a) and 512 (a) and (b).[3]

The Payment Act applies to all construction contracts, whether oral or written, to perform work on any real property located in Pennsylvania. Id. at § 502. It does not apply to improvements to real property consisting of six or fewer residential units that are simultaneously under construction or to any contract for the purchase of materials by a person performing work on his own real property. Id. at § 503(a) and (b). The Payment Act is not intended to apply where the only work performed by the contractor involves a single family home. Nippes v. Lucas, 815 A.2d 648 (Pa. Super. 2003).

Under the Payment Act, the owner is statutorily obligated to pay the contract "strictly in accordance with [the] terms of the construction contract." 73 P.S. § 505(a). In the absence of an express agreement between the owner and the contractor, the contractor can invoice the owner for progress payments at the end of a billing period and can submit a final invoice for payment in full upon completion of the work. Id. at § 505(b). The owner must pay the interim and final invoices within twenty (20) days after the end of the billing period or within twenty (20) days after delivery of the invoice, whichever is later. Id. at § 505(c). If the owner fails to make these payments within seven (7) days of the due date, the owner shall pay the contractor interest at the rate of 1% per month, beginning on the eighth day. Id. at § 505(d). This is twice the interest

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[3] The issue of who is a "substantially prevailing party" is left to the trial court's discretion. Zavatchen v. Rttf. Holdings, Inc., 907 A.2d 607 (Pa. Super. 2006); see Bridges PBT v. Chatta, 821 A.2d 590 (Pa. Super. 2003), appeal denied, 829 A.2d (contractor who received just over 40 percent of already reduced claim was not substantially prevailing party under the Payment Act).

rate otherwise allowed under Pennsylvania law. See 41 P.S. § 202 (statutory pre-judgment interest rate is 6% per annum).

The Payment Act permits owners to withhold payments for deficiency items according to the terms of the construction contract. 73 P.S. § 506(a). The owner must notify the contractor of the deficiency items with seven (7) days of the date that the owner receives the invoice. Id. at § 506(b). Thus, parties to a construction contract should be aware if the Payment Act and its implications on progress and retainage payments due to the contractor. Failure to comply with the payment terms of the contract or the Payment Act itself can substantially increase the cost of a project, given the statutory interest penalties imposed by the Payment Act.

II. Scheduling

Scheduling of events required in connection with the construction of the project is important. Routinely, construction contracts contain provisions guiding and setting the schedule for the completion of the project. While the terms of the specific construction document will govern the conduct of the project, owners, contractors and sureties should be aware of any requirement for changes to the schedule to be in writing.

In most contracts, the time limits set forth in the document are considered "of the essence." By agreeing to those time limits, the contractor represents to the owner that the limits are a reasonable period to complete the project. Under Pennsylvania law, the general rule is that where "the time of performance is not strictly limited to that specified in a contract unless it is stated in the contract, or circumstances show, that time is of the essence." James v. Silverstein, 306 A.2d 910, 911 (Pa. Super. 1973).

III. Changes And Modifications

Construction contracts typically contain provisions designed to deal with changes or modifications to the project. These changes can be minor adjustments or significant additions to the scope of the contractor's work.

A. The Need for Written Modifications

1. Public Contracts

Pennsylvania law provides that "[w]here a public contract states the procedure in regard to work changes and extras, claims for extras will not be allowed unless these provisions have been strictly followed." Nether Providence Township Sch. Auth. v. Thomas M. Durkin & Sons, Inc., 476 A.2d 904 (Pa. 1984). The Pennsylvania Supreme Court stated that its primary purpose in requiring provisions concerning change orders or extras to be strictly enforced was to prevent the "unwarranted plundering of public funds" and "to uphold the integrity of the bidding process." Id. at 907. Therefore, in the context of public works contracts, this doctrine usually renders oral modifications a nullity. The Nether Providence Doctrine has been routinely applied. See J.C. Snavely & Sons, Inc. v. WEB M& E, Inc., 594 A.2d 333, 336 (Pa. Super. 1991); School Dist. of Philadelphia v. Tri-County Associates Builders, Inc., 2005 WL 1278113, *10 (Pa. Com. Pl. 2005); Dep't of Public Welfare v. Childrens' Rehabilitation Center, Inc., 505 A.2d 1043, 1046 n.10 (Pa. Commw. 1986).

2. Private Contracts

Under well-established Pennsylvania law, a private contract can be modified orally even though the terms of the contract state that it can be modified only in writing.

Universal Builders, Inc. v. Moon Motor Lodge, Inc., 224 A.2d 10, 15 (Pa. 1968) ("The requirement of a written authorization may also be considered a condition which has been waived."); Wagner v. Graziano Constr. Co., 136 A.2d 82, 84 (Pa. 1957) ("Even where the contract specifically states that no non-written modification will be recognized, the parties may yet after their agreement by parol negotiation."); In re Franks, 95 B.R. 346, 352 (E.D. Pa. Bankr. 1989) (recognizing under Pennsylvania law, "[t]he law is crystal clear that a written contract may be modified orally.").

B. Construction Change Directives

Sometimes in a construction project, the owner requests a change to which the contractor will not agree. A change directive provision authorizes the owner, through the design professional or project administrator, to issue a written order requiring the contractor to do the work. The following is an example of such a provision:

> 7.3.1 A Construction Change Directive is a written order prepared by the Architect and signed by the Owner and Architect, directing a change in the Work and stating a proposed basis for adjustment, if any, in the Contract Sum or Contract Time, or both. The Owner may by Construction Change Directive, without invalidating the Contract, order changes in the Work within the general scope of the Contract consisting of additions, deletions or other revisions, the Contract Sum and Contract Time being adjusted accordingly.[4]

C. Cardinal Change Doctrine

In the context of public contracts, the doctrine of "cardinal change" protects a contractor from being forced to perform work "materially different from those originally

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[4] Construction Change Directives, AIA Document A201 (AIA 1987).

bargained for." JHE, Incorporated v. Southeastern Pennsylvania Transp. Auth., 2002 WL 1018941, *3 (Phila. Cty May 17, 2002) (quoting PCL Constr. Servs., Inc. v. United States, 47 Fed. Cl. 745, 804 (2000)). A cardinal change takes place when the government effects a "drastic" alteration. Id. Absent this drastic change, the law generally bars a contractor from complaining about changes or modifications "if the project it ultimately constructed was essentially the same as the one it contracted to construct." Id. Generally, a cardinal change has been found where the change "altered the nature of the thing constructed." Id.

In the surety context, a cardinal change may completely discharge the surety's liability under the bond. The Pennsylvania Supreme Court explained:

> Cognizant of the problems posed by the three-party composition of suretyships, Pennsylvania courts have uniformly recognized that where the creditor and the debtor materially modify the terms of their relationship without obtaining the surety's assent thereto, the surety's liability may be affected. A material modification in the creditor-debtor relationship consists of a significant change in the principal debtor's obligation to the creditor that in essence substitutes an agreement substantially different from the original agreement on which the surety accepted liability. Where, without the surety's consent, there has been a material modification in the creditor-debtor relationship, a gratuitous (uncompensated) surety is completely discharged. A compensated surety is discharged only if, without the surety's consent, there has been a material modification in the creditor-debtor relationship and said modification has substantially increased the surety's risk.

Reliance Ins. Co. v. Penn Paving, Inc., 734 A.2d 833, 838 (Pa. 1999); see also Restatement of Security, § 128 ("Where, without the surety's consent, the principal and the creditor modify their contract otherwise than by extension of time of payment (a) the

surety, other than a compensated surety, is discharged unless the modification is of a sort that can only be beneficial to the surety, and (b) the compensated surety is (i) discharged if the modification materially increases his risk ....").

If the surety has given prior consent to the material modifications, however, the surety's obligations will not be discharged. McIntyre Square Assocs. v. Evans, 827 A.2d 446, 452 (Pa. Super. 2003). To determine "whether a surety has consented to a material modification, the suretyship contract must be given effect according to its own expressed intention as gathered from all the words and clauses used, taken as a whole, due regard being had also to the surrounding circumstances." Id.

IV. Damages Provisions

A. Liquidated Damages

Under Pennsylvania law, liquidated damage clauses "are universally accepted as a necessary part of the law governing construction contracts." A.G. Cullen, 898 A.2d at 1162. "Liquidated damages is a form of art originally derived from contract law; it denotes the sum a party to a contract agrees to pay if he breaks some promise, and which, having been arrived at by a good faith effort to estimate in advance the actual damage that will probably ensue from the breach, is legally recoverable . . . if the breach occurs." A.G. Cullen Constr. Inc. v. State System of Higher Educ., 898 A.2d 1145, 1162 (Pa. Commw. 2006).

These damages are meant to compensate a party for difficult-to-prove losses. See Calabra v. Dep't. of Aging, 689 A.2d 347, 350-51 (Pa. Commw. 1997). The courts will generally enforce such clauses "where they are reasonable, and fair attempts to fix just

compensation for anticipated loss caused by breach of contracts." Id.; see also A.G. Cullen, 898 A.2d at 1163 (liquidated damages of $500 per day were reasonable, in light of complexity of construction project and attendant difficulty in accurately proving damages resulting from delay in completion of project). Therefore, parties to a construction contract are free to include a liquidated damages provision "where computation of actual damages would be speculative." A.G. Cullen, 898 A.2d at 1162; see also Pantuso Motors, Inc. v. CoreStates Bank, 798 A.2d 1277, 1282 (Pa. 2002); Brinich v. Jencka, 757 A.2d 388 (Pa. Super. 2000).

The clauses are enforceable if they are meant to represent "a reasonable approximation of the expected loss rather than an unlawful penalty." A.G. Cullen, 898 A.2d at 1162 (*citing* Restatement (Second) of Contracts, § 365(1)(1981)). If the purpose of the clause is to inflict a form of punishment to secure compliance, the provision will be unenforceable. Holt's Cigar Co. v. 222 Liberty Assocs., 591 A.2d 743, 747, 749 (Pa. Super. 1991) (liquidate damages of $500 a day was unenforceable penalty because sum was not a reasonable forecast of anticipated damages due to delay but was meant to penalize non-complying party). To determine if a liquidated damages clause constitutes an unenforceable penalty, the court "must examine the entire contract in light of its text, what it is about, the parties' intentions, and the facility of measuring damages or lack thereof." Dep't. of Transp. v. Interstate Contractors Supply Co., 568 A.2d 294, 295 (Pa. Commw. 1990).

B. No-Damages-For-Delay

A no-damage-for-delay provision usually provides that if the contractor experiences delay on the job, the owner is not liable for the payment of any additional funds to compensate the contractor for the delay. Under Pennsylvania law, "no-damages-for-delay" provisions are generally enforceable. See Guy M. Cooper, Inc. v. East Penn School Dist., 903 A.2d 608, 613 (Pa. Commw. 2006). The law, however, recognizes a common law exception to the enforceability of these provisions where: "(1) there is an affirmative or positive interference by the owner with the contractor's work, or (2) there is a failure on the part of the owner to act on some essential matter necessary to the prosecution of the work." See e.g. Henry Shenk Co. v. Erie County, 178 A. 662 (Pa. 1935). Positive interference with the work may involve lack of access to the project site or design problems that pre-existed the bidding process and were known by the owner but not by the contractor. See Coatesville Contractors & Engineers Inc. v. Borough of Ridley Park, 506 A.2d 862 (Pa. 1986) (pre-existing problem of access to site caused by undrained lake known by owner but not contractor); Commonwealth of Pa. v. S.J. Groves & Sons, Co., 343 A.2d 72 (Pa. Commw. 1975) (contractor's inability to access site for 14 weeks while other necessary work was being done was known by owner and not contractor).

An owner is estopped from invoking a no-damages-for-delay exculpatory provision when the owner is essentially at fault for the delay. See e.g., Gasparini Excavating Co. v. Pa. Tpk. Comm'n, 187 A.2d 157 (Pa. 1963) (owner directed contractor to proceed but failed to coordinate contractor's work along with other contractor causing

five-month delay); Commonwealth of Pa., State Highway & Bridge Auth. v. Gen. Asphalt Paving Co., 405 A.2d 1138 (Pa. Commw. 1979) (owner obligated to renegotiate relocation of sewer line failed to do so thereby causing denial of access to site); but see Guy M. Cooper, 903 A.2d at 620 (school district not obligated to ensure timely construction by general contractor and therefore could invoke no-damages-for-delay clause against subcontractor).

V. Claims And Disputes

A. Notice Of Termination Provisions

Provisions allowing the owner to terminate the contractor for default are commonplace in construction contracts. These provisions typically obligate an owner to notify both the contractor and the surety that the owner intends to terminate the contactor's right to complete the construction contract within a prerequisite number of days, as set forth in the contract documents. These provisions serve several purposes: to prevent forfeiture by termination, to allow the breaching party to mitigate damages, to avoid similar future deficiencies in performance, and to promote the informal settlement of disputes.

The law enforces such provisions and provides that the owners' failure to follow the terms of the notice provision can be fatal to the owners' claim for coverage under the performance bond. In fact, courts in several states have held that termination of a construction contract without providing the proper notice to cure can itself be a material breach of the construction contract. See Cuddy Mountain Concrete, Inc. v. Citadel Constr., Inc., 824 P.2d 151, 158 (Idaho Ct. App. 1992) (general contractor breached

construction contract by failing to provide subcontractor with seven days' written notice of termination); Blaine Econ. Dev. Auth. v. Royal Elec. Co., 520 N.W. 2d 473, 477 (Minn. Ct. App. 1994) (owner breached construction contract by failing to provide contractor with seven days' written notice of termination); Bruning Seeding Co. v. McArdle Grading Co., 439 N.W.2d 789, 792 (Neb. 1989) (failure to provide five days' notice for opportunity to cure under construction contract constituted breach of contract).

The right to receive notice is considered a fundamental one. Some courts have held that owners must provide a "cure notice" to contractors and their sureties, whether or not the notice requirement is contained in an express provision of the parties' agreement. See Carter v. Krueger, 916 S.W.2d 932, 936 (Tenn. Ct. App. 1995) (failure to give notice of claimed defects and afford contractor an opportunity to cure, even in the absence of contract provision, was a material breach of the construction contract.); McClain v. Kimbrough Constr. Co., 806 S.W.2d 194, 198 (Tenn. Ct. App. 1990) (failure to provide opportunity to cure even in absence of express provision was a material breach of the contract). Accordingly, "[a] provision in the contract for the termination thereof upon certain conditions can be enforced only in strict compliance with the terms of those conditions." Blaine, 520 N.W. 2d at 476.

Case Illustration: In Donald M. Durkin Contracting, Inc. v. City of Newark, Delaware, 2006 WL 2724882 (D. Del. 2006), the general contractor sued the owner for, among other things, breach of contract for the owner's improper termination of the construction contract between it and the general contractor. The owner asserted a third-

party claim against the general contractor's bonding company, which had, along with the principal, provided a performance bond in connection with the contractor's work.

The construction contract required the owner to provide both the general contractor and its surety with seven days' written notice of the owner's intent to declare a contractor default and terminate the construction contract. Through a vote of its city council, the owner voted to immediately terminate the contractor's rights under the construction contract. The owner notified the general contractor and its surety the very next day of the termination. Thus, the owner did not provide the contractor and the surety with seven days' written notice of its intent to terminate the construction contract.

The court dismissed the owner's claim against the bonding company under the performance bond for the owner's failure to comply with the notice of default and termination procedures established by the construction contract. The owner's claim against the bonding company was in excess of $6 million. These types of notice provisions, therefore, are critically important in properly terminating a contractor's right to complete a construction contract.

B. Notice Of Claims

Disputes arising between the owner and the contractor are generally governed by notice of claim provisions in the construction contract. These provisions commonly require the aggrieved party to submit a notice of its claim within a certain time period. Courts across the country have repeatedly enforced such provisions and hold that the contractor's failure to satisfy the notice requirements defeats the claim. See e.g., American Nat'l Elec. Corp. v. Pothyress Commercial Contractors, Inc., 604 S.E.2d 315,

317 (N.C. App. 2004) (the 21-day notice provision in Paragraph 4.3 "binds the parties to a time certain during which notice of delay for compensation must be given. That the time was not observed by [plaintiff] here, and thus [plaintiff's] complaint is defeated."); Kingsley Arms Inc. v. Sand Robin Const. Co., 791 N.Y.S.2d 196, 197 (N.Y. App. Div. 2005) (notice of delay sent 11 months after substantial completion obviously violated 21 day notice provision which "was a condition precedent to plaintiff's claim" thus "its failure to strictly comply is a waiver of its claim."); JRJ Constr. Co. v. R.W. Granger & Sons, Inc., 1999 WL 706717 (Mass. Super. 1999) (USF&G dismissed from 16 of 18 claims for failure by the subcontractor to assert its claim within 21 days as required by Paragraph 4.3.3); Standard Elec. Serv. Corp. v. Gahann-Jefferson Pub. Schools, 1998 WL 542696 (Ohio App. 1998) (affirming award of summary judgment against contractor which did not assert claim within 21 days as required by Paragraph 4.3.3); A. Hedenberg and Co., Inc. v. St. Luke's Hosp., 1996 WL 146732 (Minn. App. 1996) (hospital precluded from recovering delay damages for failure to assert claim with the 21 days specified in the contract).

C. Arbitration

In an effort to avoid litigation in the courts, many standard construction contracts provide that any disputes relating to the agreement itself or the work contemplated by the agreement shall be subject to either arbitration or mediation. Often termed "alternative dispute resolution" forums, arbitration and mediation are meant to function as faster, less expensive and more practical options to traditional litigation in the court system. "An agreement to arbitrate a dispute is an agreement to submit oneself as well as one's dispute

to the arbitrators' jurisdiction." Gaslin, Inc. v. L.G.C. Exports, Inc., 482 A.2d 1117, 1122 (Pa. Super. 1984); see also Flightways Corp. v. Keystone Helicopter Corp., 331 A.2d 184 (Pa. 1975).

1. Enforceability Of Arbitration Provisions

Pennsylvania's Uniform Arbitration Act provides:

> A written agreement to subject any existing controversy to arbitration or a provision in a written agreement to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law or in equity relating to the validity, enforceability or revocation of any contract.

42 Pa.C.S.A. 7303. The Federal Arbitration Act, 9 U.S.C. § 1 et seq., provides:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 2.

As a matter of public policy, Pennsylvania courts "strongly favor the settlement of disputes by arbitration." Smith v. Cumberland Group, Ltd., 687 A.2d 1167, 1171 (Pa. Super. 1997); see also Langston v. Nat'l Media Corp., 617 A.2d 354, 356 (Pa. Super. 1992); Dickler v. Shearson Lehman Hutton, 596 A.2d 860, 864 (Pa. Super. 1991), allocatur denied, 616 A.2d 984 (Pa. 1992). Similarly, the Federal Arbitration Act "requires rigorous enforcement of arbitration agreements." United States v. St. Paul Fire and Marine Ins. Co., 2006 WL 3231948, *12 (W.D. Pa. 2006). "[W]hen parties agree to