

Interpreting and Enforcing Unsigned Construction Contracts

By Michael J. Cook and Bret R. Gunnell

It's a familiar scenario: in the rush and enthusiasm to get the project underway, parties to the construction process postpone or overlook the task of formalizing the terms and conditions of the construction contract or subcontract. Frequently, the negotiation process progresses only to the awkward point where the parties have proposed competing contracts with different terms and conditions before negotiations are suspended in the interest of getting construction underway. If the project runs as planned, the oversight of not obtaining a signed agreement may be inconsequential. When problems arise during construction, however, the realization that the contract was never fully executed raises questions about whether there is any agreement at all and about the terms and conditions of the parties' relationship.

This article explores how courts are likely to interpret and enforce unsigned construction contracts and provides helpful suggestions to owners, contractors and subcontractors for avoiding undesirable results in such circumstances.

Enforceability of Unsigned Agreements

A commonly held misconception is that a party cannot be held to the terms of a contract that it didn't sign. Because even oral contracts are enforceable, it follows that "[t]he absence of an authorized signature does not defeat the existence of [a] contract." *Galloway Corp. v. S.B. Ballard Constr. Co.*, 464 S.E.2d 349, 356 (Va. 1995). Moreover, courts readily imply contracts in fact when circumstances clearly suggest that parties intended to bind themselves to each other in a legal relationship. In the construction context, the point at which a valid and enforceable contract is formed between an owner and contractor or between a contractor and subcontractor typically is the earlier of the signed written agreement or the formal Notice to Proceed with the work. *See Crook v. Mortenson-Neal*, 727 P.2d 297, 303 (Alaska 1986) (holding that when the general contractor notified the subcontractor in writing to proceed, it "unequivocally accepted" the subcontractor's bid). Whether the Notice to Proceed is communicated verbally or in writing generally is not legally significant, although it may substantially impact the ability to prove the existence and substance of the notice. Recognizing when a valid contract is formed, however, often is only half the battle.

Conflicting Bid Proposals and Tendered Agreements

Where no signed agreement exists, disputes often arise concerning the terms and conditions of the parties' legal relationship. For example, a subcontractor may include in its bid proposal certain terms and conditions that it expects to have incorporated into its subcontract. The contractor, on the other hand, may tender to the subcontractor a standard form subcontract from its own files that is significantly at variance with the subcontractor's bid proposal and may well contain terms unacceptable to the subcontractor. If the parties do not successfully negotiate an

agreement, uncertainty arises as to whether the subcontractor's bid proposal, the general contractor's form subcontract, or some compromise agreement, governs.

The common law rule in most jurisdictions is that, to be valid, the language and terms of a purported acceptance must comply exactly with the terms of the offer, neither omitting or adding anything. See *Iselin v. United States*, 271 U.S. 136 (1926); *Parry v. Walker*, 657 P.2d 1000, 1002 (Colo. App. 1982). Under this "mirror image" rule, a general contractor's attempt to bind a subcontractor to terms and conditions at variance with the subcontractor's bid proposal constitutes a counteroffer that does not create a contract unless it is later accepted by the subcontractor. Because of the unique nature of contract law in the construction bidding arena, however, courts have relaxed application of the common-law mirror image rule considerably. The fact that a general contractor unilaterally imposes additional or different terms in its form subcontract that are inconsistent with the subcontractor's bid proposal does not necessarily negate acceptance nor prevent contract formation, provided the variations are immaterial or the collateral added terms do not substantially alter the scope of work or performance requested. See *Raydon Exploration, Inc. v. Ladd*, 902 F.2d 1496, 1500 (10th Cir. 1990).

In *H.W. Stanfield Construction Corp. v. Robert McMullan & Son, Inc.*, 92 Cal. Rptr. 669, 670 (Cal. App. 1971), for example, a painting subcontractor realized that it had not included certain building joists in its bid only after the general contractor had relied upon the bid and asked the subcontractor to verify and confirm its accuracy. The subcontractor argued that by proposing a written contract containing terms and provisions not included in the advertisement for bids nor the telephonic bid submitted, the general contractor rejected the bid offer and no contract was formed. The court, however, "found the terms and conditions in question were not a material element of the parties' negotiations and did not constitute a counter offer."

On the other hand, any attempt to accept the bid on terms materially different from the original bid is a counteroffer, not an acceptance, and no enforceable contract is formed. In *Haselden-Langley Constructors, Inc. v. D.E. Farr & Assocs., Inc.*, 676 P.2d 709, 711 (Colo. App. 1983), for example, a subcontractor submitted a bid for masonry work on a project, which the general contractor mistakenly assumed included within its scope both masonry and insulation work. The general contractor's subsequent attempt to tender a contract for both masonry and insulation work was deemed to be a counteroffer, not an acceptance of the original masonry-only offer.

In circumstances where a subcontractor does not take exceptions to potential contract provisions nor expressly condition acceptance on the inclusion of certain contract terms, a Notice to Proceed under the general contractor's form contract constitutes acceptance of the subcontractor's bid proposal and creates a valid and

binding contract. It is not necessary that all the terms of an agreement be carefully defined and agreed upon prior to a contract being formed. Valid acceptance of an offer can occur even if certain terms are left open for further negotiation and subsequent resolution. It is both unpredictable and dangerous, however, to leave the decision as to which unacceptable contract terms are "material" for a court ultimately to decide. In the absence of a signed agreement, the safest way for parties to assure that critical terms are recognized and avoid being bound to unacceptable terms is to clearly condition work on certain terms, promptly and unambiguously reject objectionable terms and to commence construction only under clearly communicated conditions.

Failure to Object to Unacceptable Provisions

In order to protect against an unfavorable interpretation of a contract, where the terms are disputed or left open for later negotiation, parties should promptly voice their objections to proposed contract terms that they find unacceptable. Failing to do so, a party stands the risk that its words and conduct will be interpreted to acknowledge assent to the proposed terms.

The case of *Crook v. Mortenson-Neal*, 727 P.2d 297 (Alaska 1986), provides a good illustration of how courts analyze and enforce proposed form contracts at variance with bid proposals. In that case, upon receipt of award, the general contractor confirmed in writing its intent to award the subcontract and asked its subcontractor to immediately begin work on shop drawings. The general contractor subsequently provided the subcontractor with its form subcontract, containing numerous important provisions. The only provision to which the subcontractor objected, however, was the provision requiring the posting of a bond. For the next several months, the parties engaged in ongoing negotiations to finalize the written contract. In the first iteration, the subcontractor deleted the bonding requirement, signed the form agreement, and returned it to the general contractor. Rather than sign the amended version of the subcontract, however, the general contractor proposed as a compromise that the individual principals of the subcontractor personally guarantee the subcontractor's performance. In the second iteration, the subcontractor returned this revised version, executed only by one principal, together with an addendum containing proposed changes in the subcontractor's warranty obligations and scope of work. The general contractor never signed this version of the agreement.

When the relationship between the parties ultimately broke down, the subcontractor attempted to avoid its contract obligations by arguing that no contract had ever been formed because the versions of the agreement exchanged between the parties were all different and amounted to nothing but a series of counteroffers. In so arguing, the subcontractor specifically attempted to avoid unfavorable provisions proposed by the general contractor regarding no

damages for delay, payment, indemnity, lien waiver, termination takeover, notice and change order procedures. Rejecting this argument, the court held that:

These terms covered issues which can be implied from industry custom or left open for further negotiations. Their mere inclusion in the subcontract does not demonstrate that [the general contractor] imposed duties on [the subcontractor] materially different from those [the subcontractor] should have known would apply. [The general contractor] sent [the subcontractor] its standard subcontract. The record contains no evidence that [the subcontractor] objected to any of the terms of payment, indemnity, change order procedures, etc. Indeed, [the subcontractor] twice readily signed the subcontract, striking out only the bonding requirement of the first draft and altering product specifications and warranties in the second draft. These other terms can hardly be deemed "material additions" to the contract when [the subcontractor] apparently did not consider them consequential at the time.

The court ultimately concluded that "[b]y its own words and conduct, [the subcontractor] obligated itself to perform."

The clear message and warning of the *Crook v. Mortenson-Neal* case is that subcontractors are deemed to anticipate that reasonable additional terms not present in the bidding documents will be imposed by the general contractor. In explaining its decision, the Alaska Supreme Court stated that:

The bidding documents . . . did not purport to be the exclusive agreement between [the] general [contractor] and subcontractor. Rather, they provided [the subcontractor] with enough information to calculate its bid within the owner's requirements. The documents . . . left the task of detailing the parties' respective obligations for a separate agreement. At the time [the subcontractor] bid on its subcontract, it should have expected to be bound by reasonable additional terms governing standard conditions implicit in the relationship between subcontractor and general contractor. Both industry custom, as expressed in standard form subcontracts, and the circumstances surrounding the particular project, dictate the kinds of provisions [the subcontractor] should reasonably have expected in its final subcontract.

Contractors and subcontractors should particularly be aware that because of the complexities and the chaotic last-minute nature of construction bidding against strict deadlines essentially make the pre-award drafting and negotiation of written agreements impossible, courts generally are willing to enforce unilaterally presented post-bid agreements containing standard terms. Accordingly, to avoid an unfavorable result, it is necessary to clearly communicate the intent not to be bound to unfavorable terms and to

unequivocally condition acceptance of a contract on the inclusion of terms deemed critical and non-negotiable. *See KN Energy, Inc. v. Great Western Sugar Co.*, 698 P.2d 769, 779 (Colo.), cert. denied, 472 U.S. 1022 (1985) (explaining that the primary goal of courts in interpreting contracts is to give effect to the intent of the parties).

Acceptance by Performance

One legal means of establishing assent to the proposed terms of an agreement is through the parties' conduct. Courts typically recognize that once a party performs substantial acts invited by a proposed agreement, such conduct amounts to acceptance of the proposed terms. *See Colo-Tex Leasing, Inc. v. Neitzert*, 746 P.2d 972, 974 (Colo. App. 1987); *Long v. Allen*, 906 P.2d 754 (N.M. App. 1995) (holding that a counteroffer is accepted by performance).

As explained in *George Pridemore & Son, Inc. v. Traylor Brothers, Inc.*, 311 S.W.2d 396 (Ky. App. 1958), commencing performance may signal acceptance of unilaterally proposed contract terms. In that case, a subcontractor submitted a \$40,000 bid for certain HVAC work on the express understanding that air-conditioning would be omitted from the scope of the subcontract. Before commencing performance, however, the general contractor issued a purchase order to the subcontractor that included air-conditioning work. The subcontractor never signed the purchase order, but nevertheless proceeded to commence performance without objecting to its scope. A dispute subsequently arose when the subcontractor had difficulty collecting the balance of the subcontract because the air-conditioning had not been installed. The subcontractor sued, alleging that no valid contract had been formed because the parties had not reached agreement as to terms. The court disagreed, holding that:

[t]he difficulty with [the subcontractor's] position is that it assumes no contract existed simply because it has a different version of the agreement than that of the [general contractor]. If there is sufficient evidence to show a meeting of the minds even though the [subcontractor] denies it, then a court or jury may be justified in finding a contract existed.

[T]he 'purchase order' . . . specifically referred to Air-Conditioning work. Since this instrument authorized the [subcontractor] to proceed, the [subcontractor] should have taken notice of its contents. The trial court could have determined that [the subcontractor] did have such knowledge. Having proceeded to work on the basis of this order, [the subcontractor] can be held to have assented to its terms. In another case, *American Aluminum Products Co. v. Binswanger Glass Co.*, 391 S.E.2d 688 (Ga. App. 1990), a subcontractor filed suit against the general contractor alleging nonpayment for certain work included in its subcontract agreement. The

contractor counterclaimed, alleging that the subcontractor's work was not in conformity with the workmanship standards specified in the contractor's purchase orders. The subcontractor argued that the purchase orders were not part of the contract between the parties. Applying common law, the court held that the contractor's purchase order contained terms materially at variance with the original proposals submitted by the subcontractor and, therefore, constituted a rejection of that proposal and a counteroffer. The court then determined that the subcontractor accepted this counteroffer by beginning performance. In so holding, the court explained that the general contractor's purchase orders, not the subcontractor's proposal, constituted the binding contract between the parties, because upon receiving the purchase order the subcontractor "lodged no objection to its terms, proceeded to manufacture the metal frames, and sent a supervisor to the job site."

Conclusion

The best business practice is to hammer out the terms of an agreement and make sure both parties sign the written contract before any work begins. Recognizing that such an approach is not always followed and may well be viewed as impractical, however, it is important to understand what may be done to avoid being surprised by an unintended interpretation of the contract. Even where parties in the construction process have never reached a meeting of the minds upon the terms of disputed contract provisions, the parties generally have a valid and enforceable contract containing the terms upon which they do agree. In circumstances where a written agreement has never been signed, but the parties nonetheless have been performing, courts are particularly reluctant to find that no contract exists. Courts have little difficulty concluding that a valid and enforceable contract is formed when the Notice to Proceed is given, although certain important terms of the parties' arrangement are left open for later negotiation. Courts are well equipped to fill in the gaps of the parties' agreement, if necessary. To avoid being held to an unfavorable interpretation of a contract, parties should clearly condition their relationship upon non-negotiable terms they consider essential and promptly and unambiguously reject proposed nonstandard and unacceptable terms.

Reprint permission by: Michael J. Cook