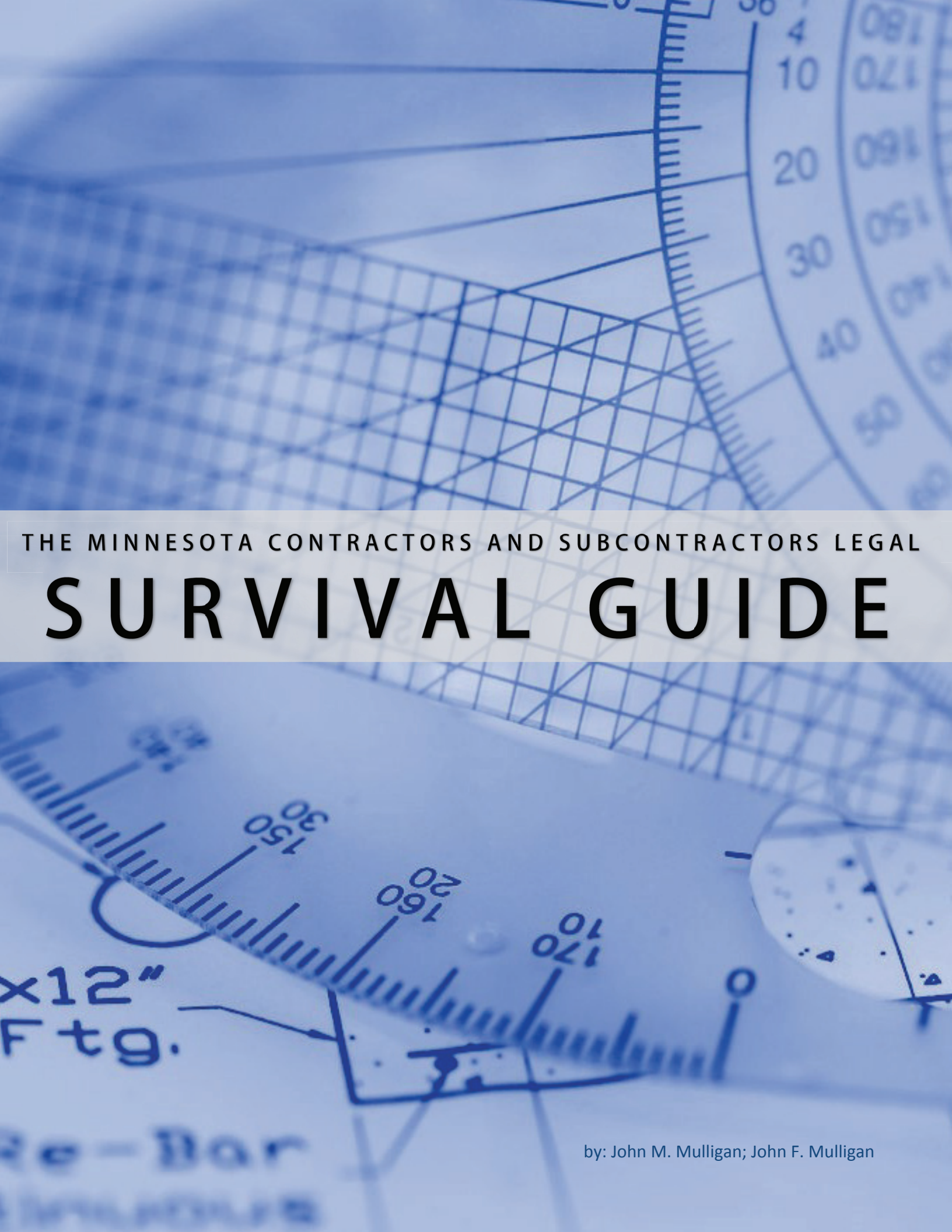

THE MINNESOTA CONTRACTORS AND SUBCONTRACTORS LEGAL

SURVIVAL GUIDE

by: John M. Mulligan; John F. Mulligan

THE MINNESOTA CONTRACTORS AND SUBCONTRACTOR LEGAL SURVIVAL GUIDE

Introduction

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INTRODUCTION

John M. Mulligan

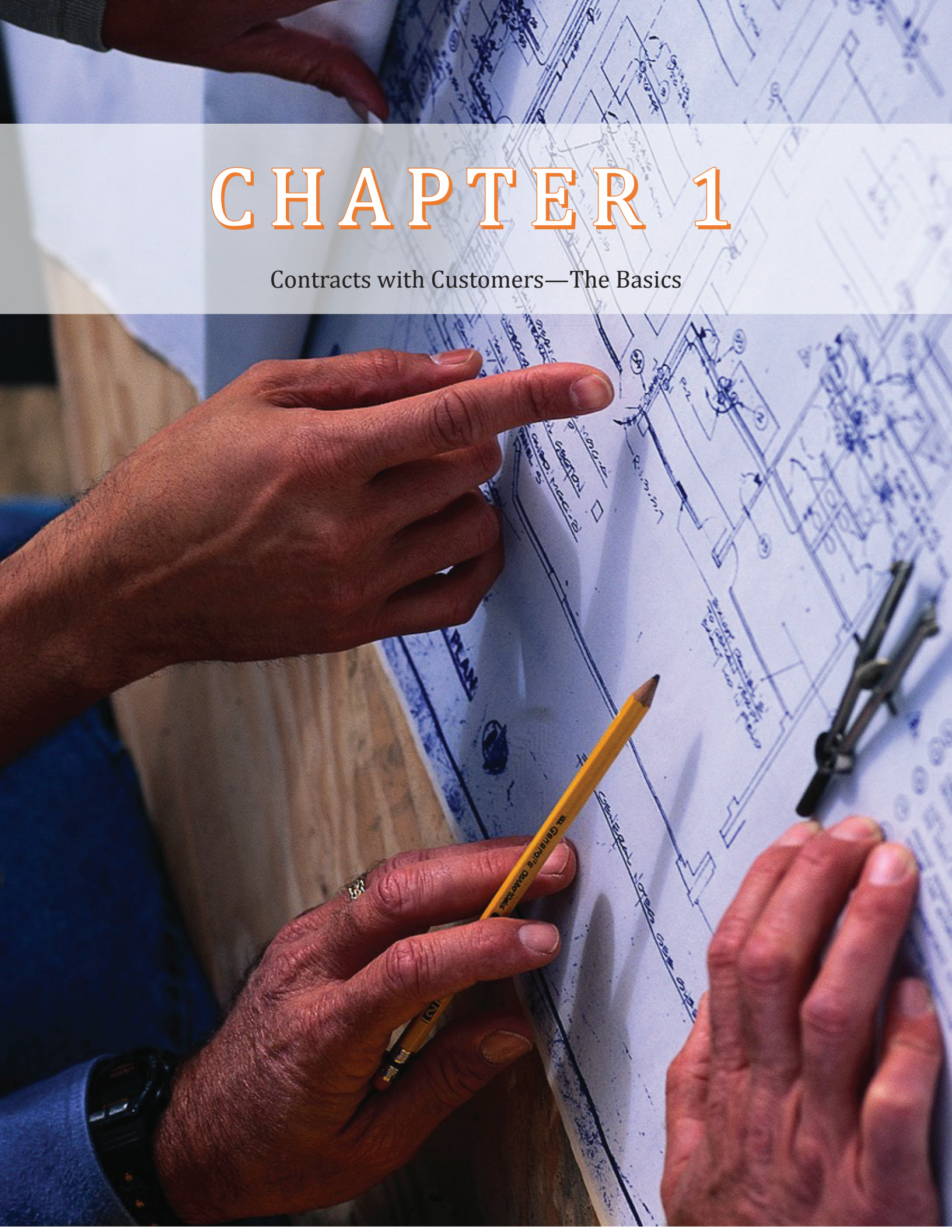
John F. Mulligan

I have been a Minnesota attorney in private practice for over thirty years. During that time period, I have represented new home builders, remodelers of all sizes, and subcontractors in nearly all of the building trades. I have enjoyed seeing my clients succeed, and grow their businesses.

However, beginning in 2007, the downturn in the real estate market and the corresponding decline in the prospects of most new home builders, remodelers, and those in the building trades was un-precedented. It is safe to say that everyone in the building business and the building trades was affected in a highly negative way.

One thing I observed was that the prosperity in the business for many years had caused many con- tractors and subcontractor to drop their guard on the most important legal matters, which resulted in their not getting fully paid for their hard work, and ending up in avoidable legal conflicts.

My son and I wrote this book to speak to the survivors of the era, and to those who wish to enter or re-enter the business now that prospects are improving. Armed with the basic knowledge in this book, the Minnesota contractor can deal wisely with legal matters and not only survive but prosper in the years ahead.



CHAPTER 1

Contracts with Customers—The Basics

CONTRACTS WITH CUSTOMERS—THE BASICS.

To a great extent, many of the terms for a basic contract with your customers are governed by Minnesota law. These topics include mandatory language regarding the Minnesota Mechanic's Lien Statute, the Minnesota Warranty Law, and the Home Solicitation Sales Act. These terms are all consumer protection statutes intended to protect your customers from overreaching by contractors. It should be noted that Minnesota has very little legislation in the area of contractor protection. Establishing and protecting your legal rights is entirely up to you, and what you put in your contract. Terms need to be in your contract because oral agreements are always going to be difficult to prove, and some kinds of agreements need to in writing by law. As a general principle remember this: **"If it's not in writing, it's not enforceable."**

MANDATORY TERMS

1. **The Mechanic's Lien Notice.** The statute requires that mandatory language of a specific type size must be in the contract, or be in a Notice either delivered to the property owner or sent by certified mail. I highly recommend that the mechanic lien notice be in the customer contract. There can be no argument about whether the customer got statutory notice, on a timely basis, if the mandatory language is in the customer contract, and either precedes the customer signature, or is an attachment that the customer acknowledges to be part of the agreement.

   In addition, to the language, the law specifies that it be in either bold or a minimum of 12 point type. Should you not think that is important, I can tell you that I witnessed a judge deny a contractor his lien rights because the language was in 10 point type, even though there was no dispute that the property owner had received the notice.

   Minnesota law only requires the notice to be given in English, and a contractor has complied with the statute if the text is in English. An astute contractor dealing with individuals with limited or no English-speaking skills would be wise to have other language versions available, translated from the statute, in order to avoid an argument on the subject of whether notice to the customer was given adequate notice.

2. **The Statutory Warranty.** The text of the Minnesota warranty for contractors engaged in remodeling is discussed elsewhere.

   See Chapter 6 on "The Minnesota Statutory Warranty, and Avoiding Arguments"

3. **The Home Solicitation Sales Act.** This statute generally applies to all sales made in the customer's home, and does not exclude remodeling contracts, so it is prudent to include the mandatory language. Generally speaking, it provides for a mandatory three-day cooling off period before a sale is considered finalized, unless the customer opts out of the contract during the three day period.

OPTIONAL TERMS TO PROVIDE ASSURANCE TO YOUR CUSTOMERS.

The following terms are not mandatory, and are optional. However, a contractor should anticipate that the topics will be of great interest to customers, and have some language in their contract.

1. **Insurance.** The Customers will want to know the contractor is insured, so include information on your policy limits and the scope of coverage. Also provide that you will require all subcontractors to give you proof of insurance before entering onto the jobsite. If promised in your contract, be sure to enforce this term on your subcontractors.

2. **Nuisance Items**. Customers will appreciate a pledge on your part to keep music and noise to a minimum, a disclosure of your anticipated working hours, your promises regarding daily clean up, and the means to contact you outside of working hours in the event of an emergency. The language should indicate that you will use your best efforts on all of the foregoing, but be careful not create an iron-clad obligation that justifies non-payment or a claim of breach of contract.

3. **How to Handle Completion Dates**. No Contractor should give an enforceable date of completion to a Customer, because there will always be factors that make performance by any given deadline either difficult or impossible. On the other hand, Customers will appreciate and be given a Target Date of completion, but the contract should have language to make sure

that the Target Date is only a goal, and that no liability attaches to the Contractor in the event that a Target Date is not met. Customers that insist on a specific date of completion tend to fit the profile described in the paragraphs below about Customers and potential difficulties in obtaining payment.

4. **Determination of Quality.** An emerging issue in recent years is who gets to decide if the finished job components meet expectations of quality. The contractor needs to be sure that the test is not solely meeting the customer's expectations, because it hardly need be said, that some customer's expectations are completely unreasonable. Without some reference to objective industry standards, there is no means to determine whether the customer has a legitimate complaint or not. At a minimum, the contract should provide that the building code controls. In addition, there are industry standards for various components such as flooring, tiling, painting and the like, which are useful to have referenced in your customer agreement. Finally, it is highly useful to have spelled out in your contract some quick means to resolve disputes, such as reference to an arbitrator or arbitrators within the industry, so that a contractor does not have to wait for payment endlessly while the customer decides if the paint job is adequate.

TERMS TO PROTECT YOURSELF

Here are some other topics that the State of Minnesota does not compel to be in your contract, but you will want to have, in order to deal with customer expectations and to protect yourself financially. They are as follows:

1. **Payment Amount and Timing**. Specifying the contract amount is rarely a problem, because both the Customer and Contractor have focused on this issue as part of the bidding process. The timing of the payment often gets overlooked. Your contract should never provide that the Contractor will do the work, and the Customer will make payment at the end of the job, regardless of the size of the job. Your contract should provide for progress payments at either specific calendar intervals, or at specific steps of job completion. Payment should be due almost immediately, such as five days after the billing for payment. The Contractor's objective should be to make sure that the final amount due on completion is as small as possible, because at that point the Customer has the benefit of having the work completed, and the Contractor has lost the leverage of stopping work.

It is important to understand why a Contractor should use extreme caution in setting expectations about payment. In my experience, at least five per cent of Customers enter into agreements in bad faith and never intend to pay the entire amount. A similar percentage cannot afford the project, and have inadequately planned for making the final payment. Another five per cent or more are unreasonable individuals, who will seize some opportunity for conflict prior to the completion of the job, and will justify their nonpayment. (Don't worry, it's not you; these individuals usually treat their auto mechanic, doctor, lawyer, and dry cleaner the exact same way.) There are many popular nicknames for this kind of Customer; feel free to choose your own. In my opinion, even the most sophisticated and experienced Contractors cannot anticipate in advance which Customers will end up treating them in this manner.

I will put in bold the next sentence because I think it is so important, and ask you to remember it always. **A Contractor's objective should be to minimize the amount due on the final payment, because if there is going to be conflict with the Customer, that balance is the amount that will be in dispute.** Remember, at that point you have done all the work, the Customer has the benefit of his or her completed improvement, and you have to wait to get paid, and possibly hire an attorney to help you collect the amounts due. This "Arena of Conflict" should be as small as possible.

One other factor to keep in mind is that sometimes the Contractor gets fired or the instruction comes to cease all work. The reason can be that the Customer lost his job, the Customer suffered some kind of unexpected financial reversal, the Customers decide to get a divorce, or the Customer dies. I have seen all of the above happen, all unexpected. When the unexpected happens, the Contractor never wants much of a gap

between the value of the work done, and the amount owed by the Customer.

2. **Remedy for Non-Payment**. Your contract should provide the remedy for the Contractor and the effect on the Customer in case the Customer does not make payment according to the terms of the Agreement. The best remedy, which the Customer should understand in advance because it is clearly set forth in your agreement, is to stop all work on the job. That step provides maximum leverage. Your contract should also provide that in the event that there is a work stoppage due to the Customer's non-payment, there is no liability to the Contractor for stopping work, and the Contractor's only duty is a "best efforts" obligation to prevent weather damage, which extra work will become an additional expense under the Contract to both put in place, and also to remove when it is time to resume work on the job. You never want to be put on the defensive just because it was the Customer who breached the contract in the first place.

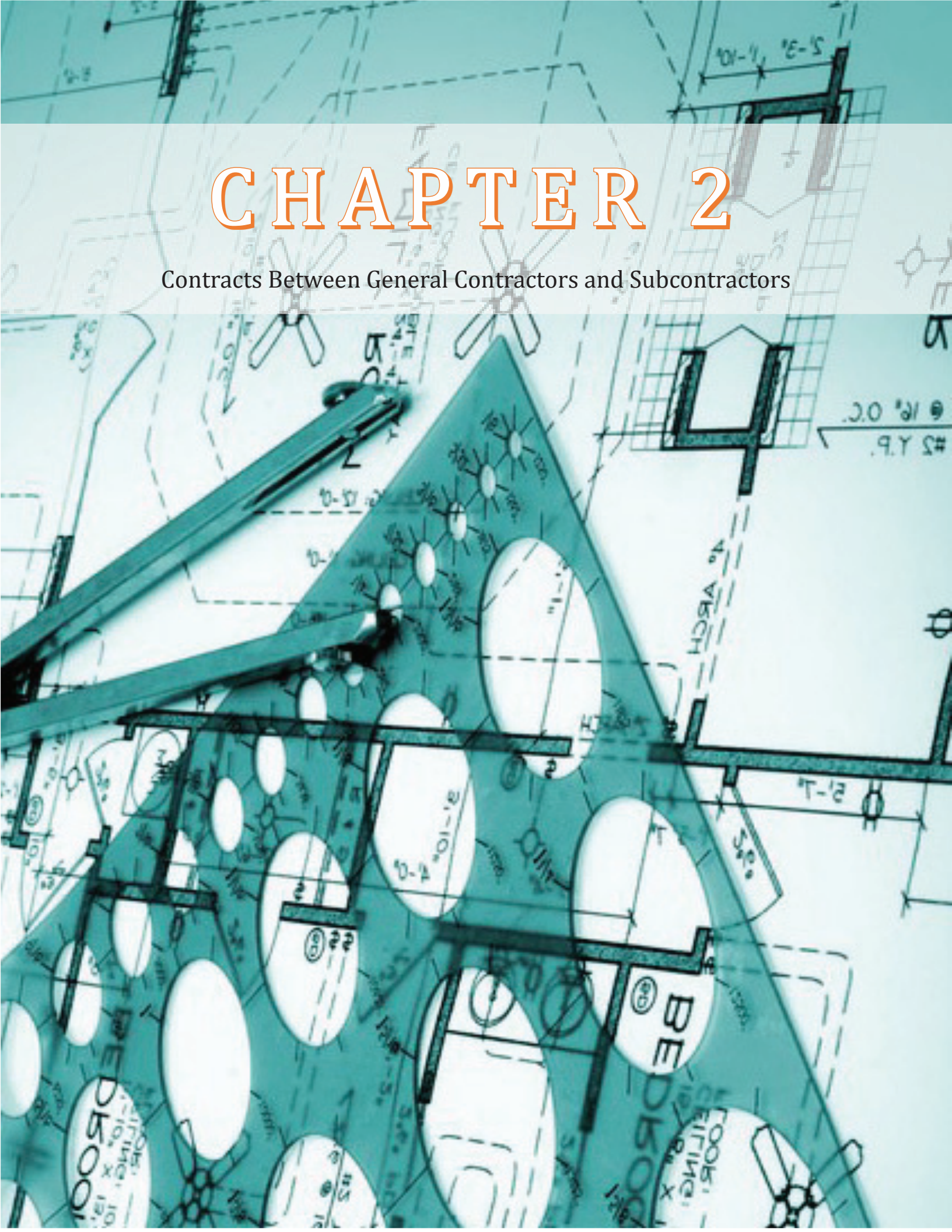
3. **Change Orders.** Your agreement should provide that each time there is a change to the scope of work under the contract, the parties agree to reduce it to a Change Order signed by both parties. You should have a one page form that you keep readily available to accomplish a change, either in hard copy or on your laptop, which shows the amount of the change, and the effect on the total contract price. (It is prudent, though not required, to include the effect on the total contract price because customers often lose track, and then there is an argument at the time of completion because the customer "didn't know it would be that much.") Also, in my experience, home improvement customers can get carried away, and the project grows in scope beyond their original budget and ability to pay. Because a careful contractor ultimately wants to get paid for all work done, it is important to get the customer involved in knowing the effect of the Change Order on the total contract price, and to avoid any misunderstandings at the time of final payment over credits and deductions.

   Change Orders are common in the building and remodeling industry. Overlooking the need to sign Change Orders is also common in the industry, in my experience. Therefore, it is also highly useful to have as part of your written customer contract, a clause that says that if the customer requested the work and got the benefit of the work, the Contractor can still charge the Customer for the reasonable value of the work done, even though the paperwork got skipped.

4. **Non-Interference.** You will want a contract term that prevents the Customer from directing your employees or subcontractors in the performance of their duties, or asking them to do extra work or favors outside the scope of the contract without your knowledge or consent. Similarly, it is useful to provide that the Customer can't hire your employees or subcontractors to "moonlight" or do additional work ***prior to the Closing***, which work is properly part of the Contract, or would otherwise be subject to a Change Order. Because Minnesota law compels the Contractor to give a warranty to the Customer, you want to avoid confusion over whether the work was done as part of the contract or part of some "moonlighting" or extras arranged for by the Customer.

CHAPTER 2

Contracts Between General Contractors and Subcontractors



CONTRACTS BETWEEN GENERAL CONTRACTORS AND SUBCONTRACTORS

The subject of contracts between General Contractors and their subcontractors and material suppliers is an area that has not received sufficient attention. In the past General Contractors and subcontractors had informal working relationships, in which subcontractors submitted bids and were given the go-ahead to proceed, and subcontractors submitted bills and waited patiently to get paid, often waiting until the final closing on the project. Frequently there was a minimum of documentation, and payment was based on simple bid forms, with no other contract terms. This system worked just fine, for the most part, when the industry and the general economy were doing well, and general contractors were able to pay bills. However, when the housing industry suffered a decline, the shortcomings of the system were exposed. Many subcontractors were surprised when they did not get paid. Even worse, they had little recourse because they had not taken the necessary procedural steps to preserve their lien rights, and had little documentation to pursue a claim against their general contractors, or to establish their rights to get paid.

Subcontractors and General Contractors may not feel comfortable, at least in Minnesota, to enter into formal-looking contracts with each other for numerous jobs in what usually develops as a working relationship. There are two ways to deal with that kind of issue:

1. **A short form contract.** A short form contract is typically made a part of a bid document, or an award of a bid authorizing the work. This is commonly done by having terms on the back of a document, frequently known as "the fine print." There are limits to the effectiveness of this approach. Unless the document is countersigned and returned by the other party, there is no guarantee that a court would find that a binding agreement had been entered into. Also, perhaps obviously, space is limited and only the most essential terms can be included in the space allowed.

2. **Continuing or "master" contract**. In a master or continuing contract, once signed it is effective indefinitely, and controls all business dealings between the two parties, even if they happen years later, until one party takes affirmative steps to terminate the contract.

Useful Elements in a Master Contractor—Subcontractor Agreement

1. **Mandatory Arbitration.** Arbitration has many advantages over litigation, particularly when relatively smaller amounts of money are at stake. It is faster because it is not controlled by the court calendar and the limited availability of judges, or the thousands of cases that have been filed ahead of yours. Because most arbitration services require arbitrators to have experience in the subject matter that is being disputed, the person hearing the evidence and making the decision likely has greater expertise than judges, who rarely have significant expertise in construction industry disputes. It is usually less costly, because the conventional steps associated with litigation, such as discovery, court motions, settlement conferences, and the like, are ordinarily not available in arbitration. One disadvantage of arbitration is that usually discovery is not permitted, and so the process is subject to one or both parties ambushing the other party with surprise facts or witnesses. Another disadvantage, at least to some, is that there is no right of appeal. One person decides the case and it is over. When there is a mandatory arbitration clause, neither party can file suit and take the case to court. If one party does so, the case is usually dismissed after a motion to dismiss is heard, and often financial sanctions are applied, such as payment of attorney's fees.

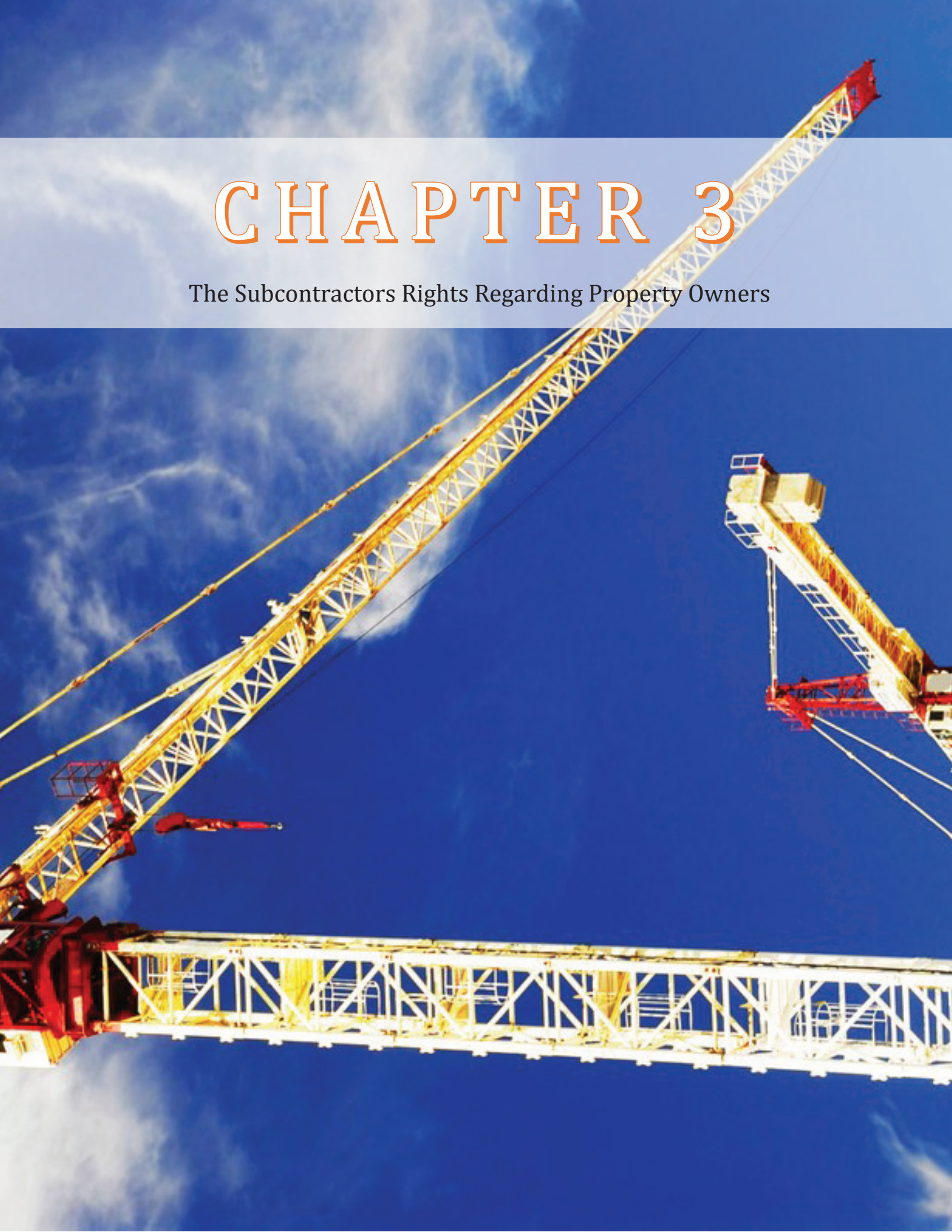
2. **Timing of Payment**. A written clause about timing of payment clears up all ambiguity as to when payment is actually due. In home construc-

tion and remodeling, it is often the expectation that the subcontractor or material supplier is not due to be paid until job is completed, and final payment is made. This was often the case when the subject of the construction was a model home built on a speculative basis. This worked out badly for many when spec homes went unsold, or were sold only for amounts sufficient to pay off the construction loans. For remodeling projects, a common practice is to make payments or partial payments out of progress payments as received by the general contractor. In any event, both parties would benefit if this issue were clearly decided upon prior to the work or materials being provided to clarify expectations. If one party expects the other to wait for payment, then an understanding on interest should also be included, as provided below.

3. **Finance Charges and Interest**. A typical practice of a subcontractor or supplier is to send invoices with a claim for a finance charge or interest for each month the bill remains unpaid. These finance charges often claim to be 1.5% per month, or 18% per year. If a party is willing to pay finance charges in that amount, there is no problem. However, the general rule in Minnesota is that unless there is a written agreement to pay interest, a court will not compel interest to be added to the amounts due. A mere invoice is not a written agreement to pay interest, and in my experience, courts will not enforce that kind of a term. A mutually signed agreement, such as a master agreement, is a written agreement and will be enforced by the courts, and so will a short form agreement, but only if it meets all the specifications set forth in the section above. One other factor that can sometimes apply is the issue of usury, which limits the amount of interest that one can lawfully charge an individual, though there is no interest ceiling on charges to corporations.

4. **Protection and Cleaning of Job Site.** Language clearly setting forth the obligation to protect the job site from the elements, and at what intervals it is to be cleaned, will save arguments later. Most importantly, if there is a written agreement, additions to invoices or offsets from payments are legally authorized.

5. **Termination of Agreement.** Agreements get terminated before they are fully performed on a regular basis. Sometimes it is the contractor and sometimes it is the sub-contractor who elects to terminate the job; sometimes early termination occurs because the customer terminates the project. There should be a clear agreement about entitlement to payment in the event of termination.
6. **Insurance.** A contract should specify the amount of coverage, and the duty to provide proof of insurance, and in appropriate cases, add a party as a named insured.
7. **Attorney's Fees.** An attorney fee clause serves the dual purpose of discouraging unnecessary legal arguments, and ensuring that a party who must pursue a breach of an agreement can add the legal fees to the amount of the claim, so that a party in the right need not have to absorb the cost of legal fees, reducing the amount to which they are entitled.



CHAPTER 3

The Subcontractors Rights Regarding Property Owners

THE SUBCONTRACTOR'S RIGHTS REGARDING PROPERTY OWNERS

The general concept of Minnesota's lien law, as it applies to sub-contractors can be summed up in simple form as follows. A sub-contractor (or material supplier) who does not get paid has the right to file a lien on the property and get paid by the property owner, but only if the sub-contractor has timely given a statutory Pre-Lien Notice to the property owner at the start of the job that the sub-contractor will be asserting lien rights. (The previous statement has exceptions for commercial property, which will be discussed below, but this general discussion applies to residential construction and remodeling.)

As an attorney, I can tell from experience that subcontractors too often think about their lien rights only after they learn that the general contractor is not going to be paying them, which is frequently after the job is finished and the typical time for payment has come and gone. When I am asked to help a subcontractor file a lien on a residential property, the first question I ask is if a pre-lien notice has been given. Far too often, the answer is no, and in almost all cases I am obligated to tell the subcontractor that it is too late, and that statutory lien rights are no longer available to them. In almost all cases, the subcontractor still has a contractual action against the general contractor, but that may be of limited use if the general contractor is having cash flow problems. The subcontractor does not have a claim against the property owner in that situation, unless the subcontractor has made a contractual arrangement directly with the property owner, which is rare.

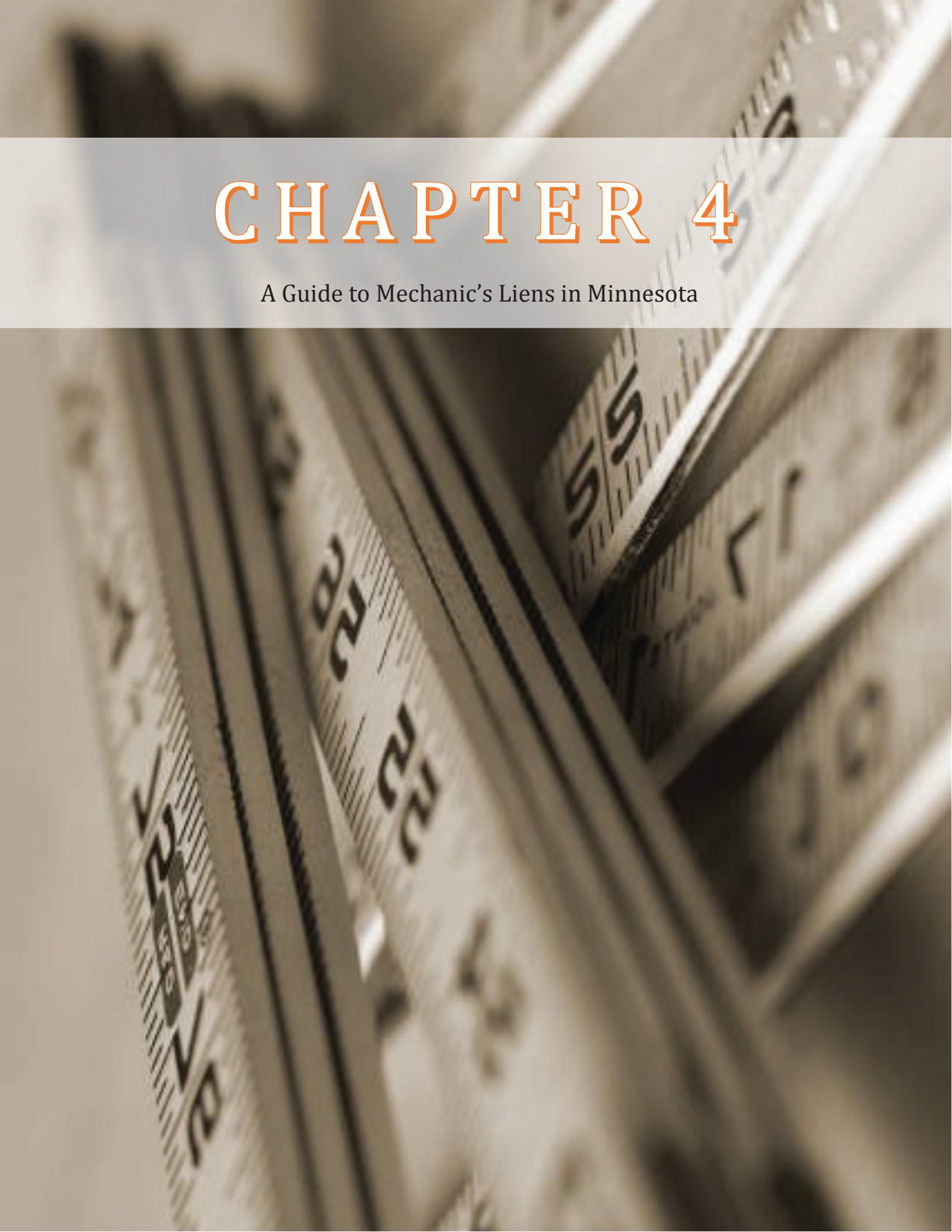
Subcontractors should note that the largest and most successful material suppliers and subcontractors almost always give the mandatory pre-lien notice to the property owner. They know that making it a regular practice almost always pays off, and is cheap insurance to make sure they will get paid. Any subcontractor, large or small, can be taught to send a pre-lien notice on every job; preparing the documentation will take less than 10 minutes. Many subcontractors have an idea that by sending a Pre-Lien Notice that the property owner or general contractor will take offense or somehow have a negative reaction to the Notice. Nothing is further from the truth, in my experience. It is simply a fact of life, and can be explained by the contractor giving this simple statement "I always do this, regardless of who the general contractor is."

Having received several Pre-Lien Notices on a typical job, a property owner will be careful to determine that the subcontractors and material suppliers who have preserved their rights will get paid, to avoid any liens resulting on the property. A property owner has the right to pay the subcontractors directly, and subtract the payment from the amount due to the general contractor.

Timing is important. The only exception to lien rights being preserved occurs if the property owner has fully paid the contractor prior to receipt of the Pre-Lien Notice, which is rare, but it does happen. The statute provides that a Pre-Lien Notice from a subcontractor needs to be personally given or mailed by certified mail to the property owner within 45 days after the subcontractor first starts work or the materials supplier first provides supplies to the job site. Because the opportunity is available, an astute subcontractor or material supplier should be sending the Pre-Lien Notice on the very first day of the job. The form of delivery of the notice is important also. The statute requires personal delivery or use of certified mail.

No Pre-Lien Notice document is required for commercial projects and multi-unit apartment buildings, providing that the latter has more than four residential units. No notice is necessary when the contractor is also the owner.

A copy of the statutory Pre-Lien Notice for subcontractors is set forth below. Note that it has different language than the language for contractors. Using the wrong form for the notice can defeat your lien claim.



CHAPTER 4

A Guide to Mechanic's Liens in Minnesota

A GUIDE TO MECHANIC'S LIENS IN MINNESOTA

The Minnesota mechanic's lien statute provides an important remedy for unpaid contractors, subcontractors and materials suppliers. The State sets forth very specific steps and time frames that need to be complied with in order to preserve and perfect mechanic's lien rights. Failure to comply with the statutory requirements will most likely mean that rights will be lost.

I. PRE-LIEN NOTICE REQUIREMENTS

Generally, the first step towards preserving mechanic's lien rights is that of giving notice (referred to as a 'pre-lien notice') to the property owner. However, this pre-lien notice is not required in the following situations:

1. When the contractor is the owner of the property;

2. When the work done on an apartment building of more than four dwelling units; and

3. When the work done on non-agricultural commercial property containing more than 5,000 square feet or an improvement that would add more than 5,000 square feet to an existing commercial property.

(Note that the only exception for single family dwellings is when the contractor is the owner.)

When the project does not fit within one of the above situations, pre-lien notice must be given to the property owner. There are separate pre-lien notice requirements for contractors and for subcontractors or materials suppliers.

A. CONTRACTOR PRE-LIEN NOTICE REQUIREMENTS

Where a contractor enters into a written contract with the property owner and the project will involve subcontractors or materials suppliers, the written contractor between the property owner and the contractor must include a Notice. Generally, this Notice must include provisions notifying the property owner of the following:

1. Subcontractors or material suppliers may file a lien against the property upon which the work is being done if they are not paid for their contributions.

2. The property owner has the right to pay subcontractors or materials suppliers directly and deduct the amounts paid from the contract price, or withhold the amounts due them under certain circumstances.

Where there is no written contract between the owner and the contractor, the provisions set forth above must be included in a separate Notice. A Notice form is available at legal forms supply companies. This separate Notice must be given to the owner either by personal delivery or mailed by certified mail within ten (10) days after the work or improvement is agreed upon. If the Notice is not included in the written contract or separately provided to the owner with the required (10) day period, an unpaid contractor will not be entitled to file a mechanic's lien against the real estate.

B. SUBCONTRACTOR PRE-LIEN NOTICE REQUIREMENTS

If a subcontractor or materials supplier wants to preserve their mechanic's lien rights in the owner's real property, they must give pre-lien Notice to the property owner. The pre-lien Notice for subcontractors or materials suppliers must contain a description of the type of services or materials to be provided and the estimated charges for these services or materials. In addition, the notice must include provisions similar to those required for the contractor's pre-lien Notice, as set forth above. This type of Notice form is also available at legal forms supply companies.

The Notice must be either

1. personally given; or

2. mailed by certified mail to the property owner

The Notice must be given or mailed within 45 days after the subcontractor first starts work or the materials supplier first provides supplies to the site. It is important to note that even if the Notice is provided within this 45 day period, it will not protect the mechanic's lien rights if the Notice is given after the property owner has already paid the contractor in full. As a result, subcontractors and materials suppliers should provide Notice immediately after the work is started or materials are delivered to the site.

C. PROCEDURE FOR SERVICE OF PRE-LIEN NOTICE

Whenever a Notice is required to be personally given or mailed by certified mail to a property owner, the appropriate Notice form should be obtained and completed. After the original of the form is completed, a photocopy of the front and back of the Notice should be made. The original of the Notice is then personally delivered or mailed by certified mail to the property owner.

Upon completion of deliver or mailing, one of the service Affidavits on the back of the retained copy of the Notice needs to be completed. If the property owner was mailed a copy by certified mail, complete the Affidavit by Mail, having the signor's signature notarized. If the owner was handed a copy personally, fill in the Affidavit by Personal Service portion of the form, again having the signor's signature notarized. The completed photocopy of the Notice and Affidavits of Service should be kept with records for the job. It must be produced later if it is necessary to enforce the lien.

II. MECHANIC'S LIEN STATEMENT

If a contractor, subcontractor or materials supplier has complied with the applicable pre-lien Notice requirements and does not receive payment for the work performed or materials supplied, a Mechanic's Lien Statement must then be recorded against the owner's real property.

The recording of the Mechanic's Lien Statement must be completed within 120 days after the last day work was done or materials were supplied on a job.

A contractor, subcontractor or materials supplier cannot go back to the project solely to extend this 120 day period. Thus, it is very important that this time period be monitored so it does not expire without the appropriate action being taken. Further, it is important to preserve proof of the last day of work or delivery of supplies.

The Mechanic's Lien Statement that is recorded contains, among other things, the property address, legal description of the real estate, amount owing on the job, name of owner (if known), name of the party contracted with, the first and last dates of work performed on the job, the mailing address and State of Minnesota license number for the contractor or subcontractor and a statement that the statutory pre-lien notice requirements were met, if pre-lien notice is required. It is advisable for contractors to set up their files to collect this information right from the start.

If the Lien Statement is not recorded during the 120 day period, the contractor, subcontractor or materials supplier cannot pursue their mechanic's lien foreclosure rights. Instead, a regular civil collection action would need to be commenced in court to collect what is owed. In addition to recording the Lien Statement, the statute requires personal service or service by certified mail on the property owner, the authorized agent, or the person who entered into the contract with the contractor. Thus, preserving the lien rights and timely recording of the Mechanic's Lien Statement are vitally important.

III. MECHANIC'S LIEN FORECLOSURE

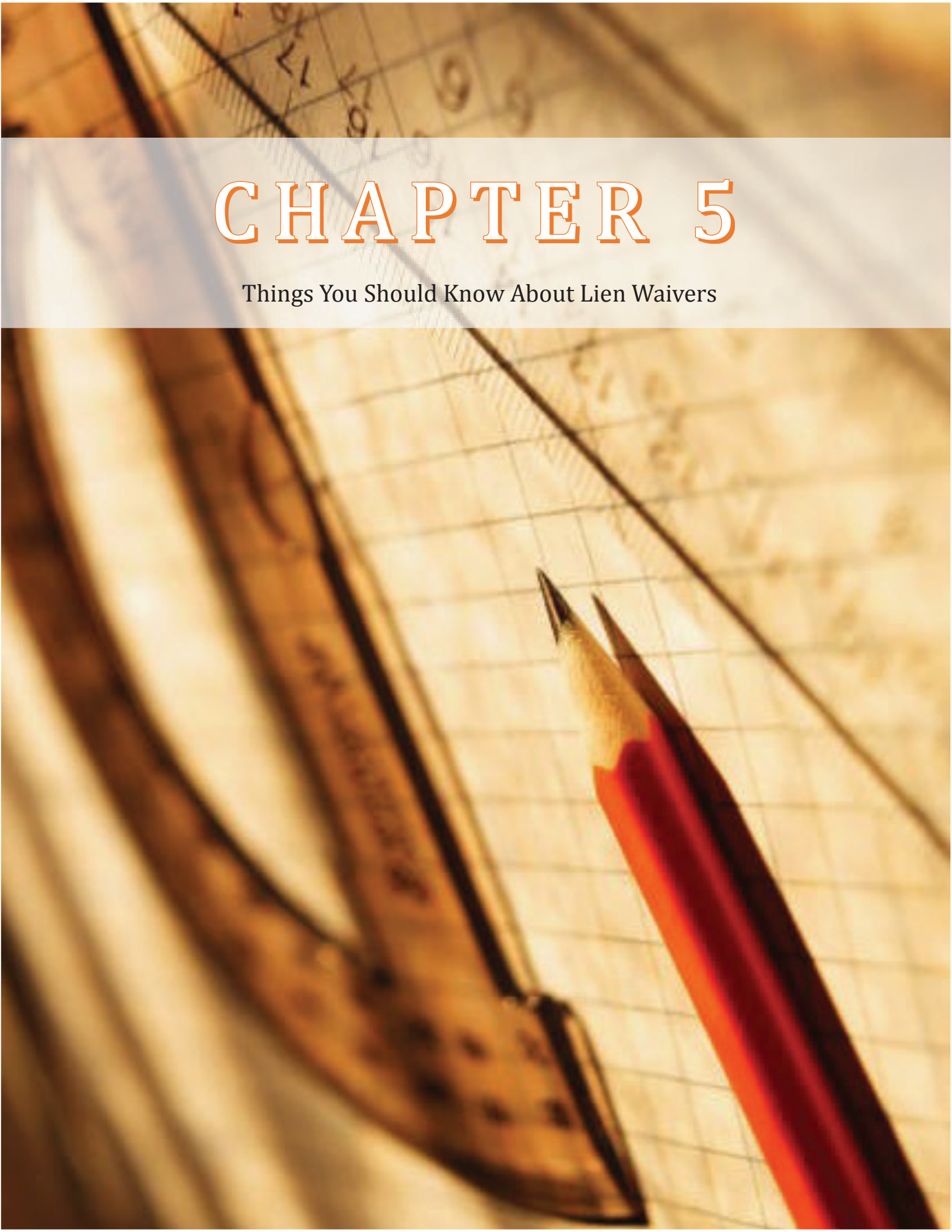
In order to secure the benefit of a mechanic's lien, the contractor, subcontractor, or materials supplier must foreclose its lien claim in a process similar to that of

foreclosing mortgage.

This foreclosure action must be commenced within one year after the last day work was done or materials were supplied on the project, and not from one year from the date of the Lien Statement, which is a common error. If a contractor or supplier has completed the pre-lien notice and Lien Statement recording on its own, it is important to involve an attorney in advance of this deadline.

There are many advantages to a Mechanic's Lien foreclosure over a regular civil action; the right to collect attorney's fees and an earlier court hearing are two of them.

Once the action is commenced, the suit will proceed as a litigation matter through the court system until the case is settled or a judgment is entered. If judgment is entered in favor of the contractor, subcontractor, or materials supplier, the property will be sold at a Sheriff's sale to satisfy the amounts owning.



CHAPTER 5

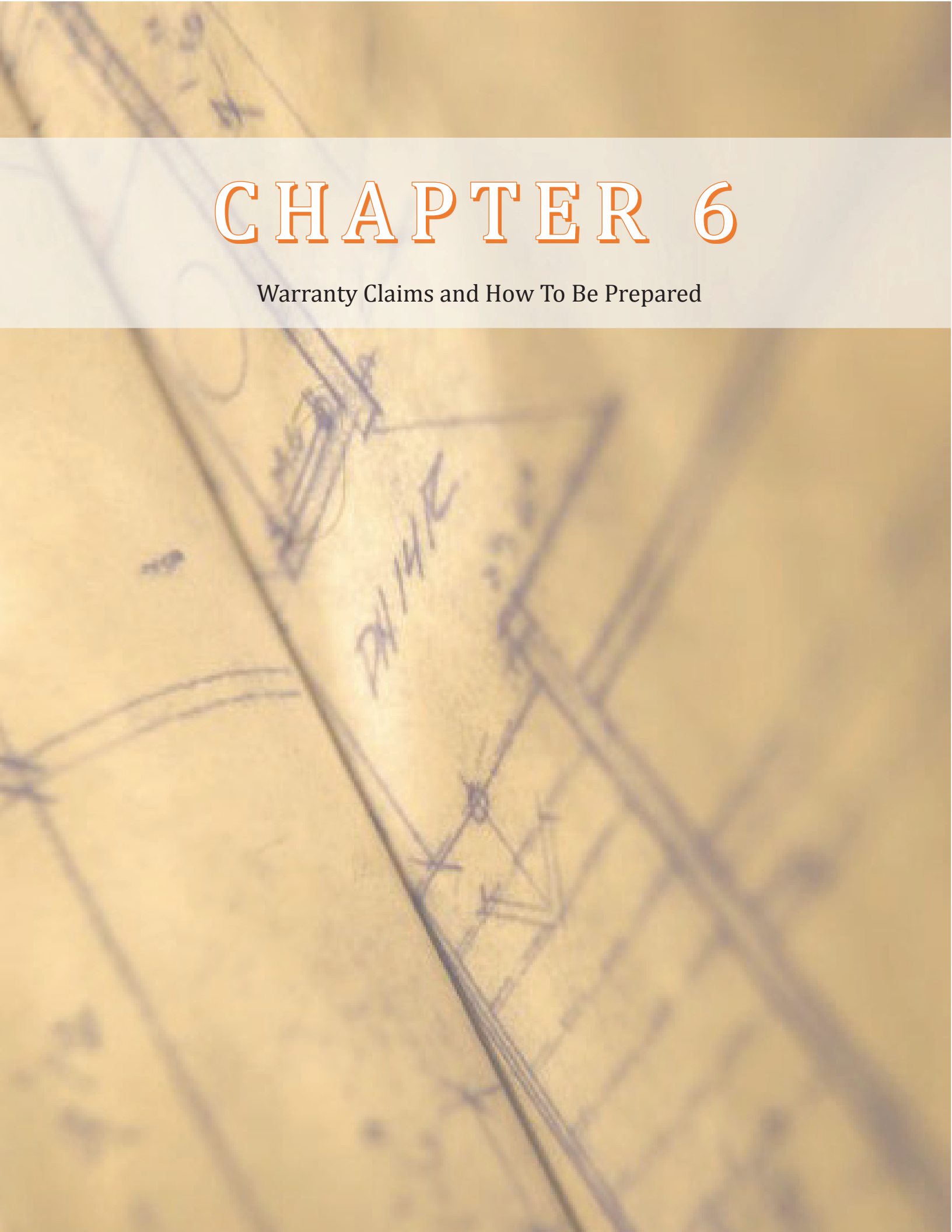
Things You Should Know About Lien Waivers

THINGS YOU SHOULD KNOW ABOUT LIEN WAIVERS

It is standard practice for general contractors to collect lien waivers from subcontractors as the end of the job nears, and the general contractor is getting organized for a closing and final payment on the contract. The general subcontractor is obligated, in jobs of any size, to deliver lien waivers to the property owner or to the title company acting on behalf of the lender in exchange for final payment. Contractors should know the following information about the legal consequences relating to lien waivers:

1. When a subcontractor delivers a lien waiver without full payment, the subcontractor is releasing all lien claims against the property and from that point forward relying on the goodwill of the general contractor to get paid. Saying it another way, the subcontractor is releasing all lien rights and claims against the property, and simply trusting the general contractor to make payment. Whether that grant of trust is appropriate or not is a judgment call for the subcontractor to make.

2. There is such a thing as a partial lien waiver. Partial lien waivers are a useful way to obtain progress payments without giving up all rights to liens. As the name implies, the subcontractor is waiving lien rights in the amount that the subcontractor is getting paid, but not releasing all rights, including rights for future work.



CHAPTER 6

Warranty Claims and How To Be Prepared

WARRANTY CLAIMS

Minnesota law obligates both new home builders and anyone engaged in "home improvement" to give the property owner a specific warranty for the materials and workmanship. "Home improvement" is defined in the statute, but does not include all construction activities, because it excludes driveways, patios, detached garages, and fences, by way of example. The contract with the property owner cannot waive the statutory warranties. The essence of the statute provides for warranty periods as follows:

- One year for all work done (consider it a "bumper to bumper" warranty);
- Two years for plumbing, electrical, heating, and cooling systems;
- Ten years for major construction defects, which is by and large limited to the load bearing portion of the dwelling, including expansion or movement of the soils, with certain limited statutory exceptions.

Minnesota law has had the mandatory warranty language for some time now so that it is widely known by both contractors and homeowners. What is not known is that there are two additional grounds by which a contractor or sub-contractor can become liable to a property owner. They are:

- By contract, if the contractor's written agreement with the owner has broader warranty language than what is provided by statute;
- By the common law of negligence, if the property owner can show that the contractor or subcontractor was negligent in the providing of services or materials, as provided by reference to industry standards. This type of claim is harder to prove than a statutory warranty claim because it takes an expert witness to help establish what industry standards and prevailing practices in the community are, but that does not make it an impossible type of claim to assert. The subject of negligence is much more complex than a warranty claim, and therefore it would be wise for a contractor to involve legal counsel promptly should one of these claims arise.

It should be noted that the statute of limitations for these latter types of claims extend six years from completion of the project, whereas a warranty claim frequently has a one or two year time limit, as provided by the statute.

In an attempt to balance the rights of the parties in this law and provide some clarity, the legislature added on to the statute to give contractors an opportunity to inspect and repair those items that are the subject of a warranty claim. For the contractor or subcontractor, it should be noted that the property owner is obligated to give notice of the claimed construction defects, and provide an opportunity to inspect and make a repair proposal, prior to commencing legal action. The statute provides for specific (and arguably short) periods of time to act, and therefore when a contractor receives a notice of this type, prompt attention to the matter is prudent.

Useful Advice About Warranties

1. **Be Careful So That Your Contract Does Not Expand the Statutory Warranties**. I wince whenever I see a contractor's contract that attempts to paraphrase or summarize the Minnesota statutory warranties, because an exercise of that kind potentially exposes the contractor to a claim that the contractor was offering a warranty greater than required by the statute. Experienced contractors know that it does not take much to provide a homeowner's attorney with grounds to assert a legal argument. The careful way to deal with warranty language in the customer contract is to indicate that the contractor is providing the statutory warranty, and then attach the statute as an exhibit to the contract.
2. **Pays to Educate the Customer In Advance About Industry Standards.** The language of the Minne-

sota warranty statute ties all claims to "defects" to "noncompliance with building standards." In summary, whether the results of the work are defective will be resolved by reference to building standards. Most material suppliers, and many builders' groups have established building standards that create boundary lines between what is a standard result and what is defective. For example, floor coverings, sheetrock taping, and masonry work inevitably result in cracks over time. Whether those cracks are typical and to be expected, or are out of the ordinary can usually be resolved by reference to published industry standards, and publications from building product manufacturers. How much better it is to tell the customer at the conclusion of the job as to what cracking is typical and should be expected, rather than have homeowners watch the cracking process with rising anxiety and potential hostility. Smart contractors have printed industry standards ready and deliver them during the job, but not later than completion of the job.

3. **Remodeling Contractors Should Be Careful About Unwanted Warranty Exposure.** The following developments create confusion about warranty liability, and great care should be taken to either avoid them, as well as create a written record about exclusion from warranty liability. They include:

- When the property owner provides some of the materials;

- When the property owner does some of the work, wants to complete the work, or selects one or more subcontractors on his own;

- When remodeling includes integrating new work with defective existing construction or conditions.

In each of the above situations, be sure to have a written understanding with the property owner as to what is excluded from your warranty responsibility.

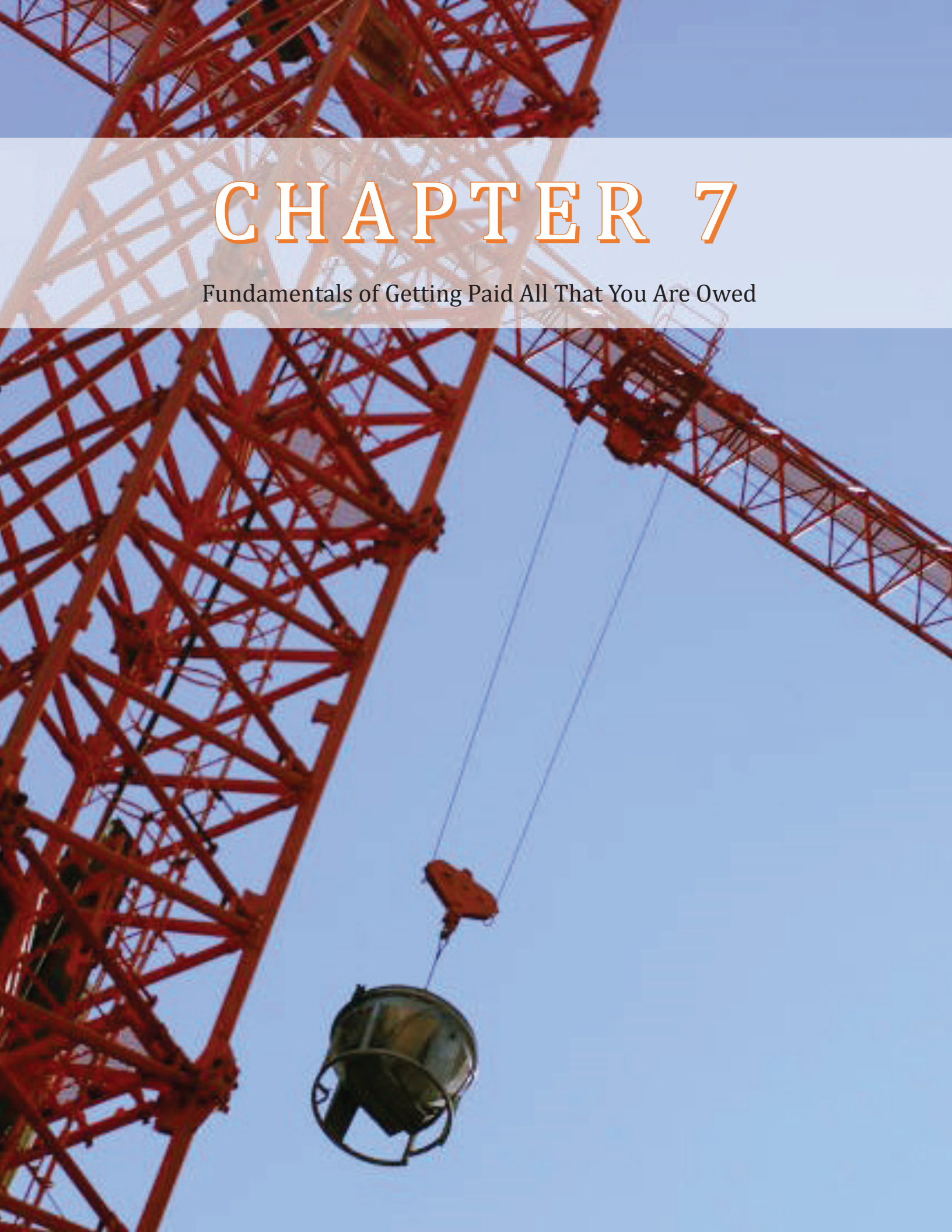
4. **Consider Tying Warranty Performance to Payment in Full**. By statute, a contractor cannot obtain a valid waiver of the warranty obligations. However, there is no law or case to my knowledge that prohibits conditioning warranty performance on payment in full. In my view, more contractors should provide that their duty to provide warranty service is dependent upon the property owner making full performance of the customer's responsibilities, including making payment in full. This helps prevent a scenario of a contractor having to return to a job for which payment was not made to do warranty work.

5. **Make a Habit of Creating a Digital Record.** Technology now allows photos to be taken with telephones and tablet computers, as well as cameras, and the images to be stored permanently at online storage sites. Contractors should make it a habit to take plenty of photos of the work environment they encountered, and record their work in progress, and the completed state of the project. Photos are usually the best evidence if a factual dispute arises as to a warranty claim, or arguments about completion. It is a cheap way to make a record, and allow the prompt settlement of disputes. Your attorney will thank you.

6. **Clarify That You Are Not Extending the Warranty Period**. As discussed below, when doing warranty work either within or beyond the warranty period, or punch list work, it is helpful to educate the property owner that performing warranty work does not extend the warranty period.

7. **Dealing with the Rising Perception that Contractor's Warranty Periods Are Extensive.** As an attorney representing contractors and homebuilders, one social development that I have watched with alarm over the years is the rise in expectations as to how long the contractor is to provide repairs to the property. I observe expectations as to warranty service calls that extend years beyond the actual warranty period. I tell my clients that they should learn to say "no" gracefully, because there is no legal obligation that compels them to act. Sometimes, my clients will perform

warranty work for a customer as a marketing function to keep a good customer happy or to protect their reputation. I instruct them to make it clear to the property owner in writing that they are doing so as a volunteer, and to make it clear that the warranty period has expired. This will keep it clear that the work done was not warranty work, and it does not extend the warranty period; what the contractor wants to avoid is a claim that the warranty period has been extended or revived.



CHAPTER 7

Fundamentals of Getting Paid All That You Are Owed

Fundamentals of Getting Paid All That You Are Owed

"Failing to plan is the same as planning to fail."
-UCLA Basketball Coach John Wooten

The saying set forth above is one of my favorites. It is from one of the most successful coaches of all time. I urge you to approach the issue of getting paid for your work as a strategy that you will need to consciously employ, and pursue with great care. It should be seen as an alternative to merely trusting that someone will respect your work and see that you get paid, regardless of circumstances. The great meltdown of the housing industry starting in 2007 should have taught all contractors and sub-contractors that merely hoping that the party you are dealing with will not only be insufficient, it could put you in financial jeopardy.

Getting paid involves both a philosophy and a strategy. The philosophical points that I would make and ask you to adopt are set forth above:

1. **Value Yourself**. A very important first step is to accept as a governing philosophy that the work you do is very worthwhile, and that you deserve to get paid. Understand that your work is often difficult, and the result you deliver is derived from your hard work, years of experience, and considerable personal talent. If you take that understanding to heart, it makes adopting the strategies set forth below easy to accomplish.

2. **Always Create and Keep Written Documentation.** Lawyers know this axiom: "If it is not in writing, it is not enforceable, and therefore you have nothing". All agreements and change orders should be in writing. E-mail is sufficient as a written document, so long as you are able to preserve the e-mails that have been sent and received. Sometimes people are reluctant to send written confirmations because they are concerned that it shows mistrust. Don't ever think that way; a written confirmation of an agreement preserves the promises of both parties, and both parties benefit. This leads to my next point.

3. **It Is Not Very Important That Someone Likes You; It is More Important That They Respect You.** It is my observation that people in small businesses worry too much about whether their customers, their vendors, and their general or sub-contractors like them, so that they will get i) future business, ii) paid promptly, or iii) an enhanced reputation. While maintaining a good relationship with the people they do business with is important, having people they do business with respect their integrity and the business skills is even more important, in my view. The two objectives do not have to be an either-or proposition. Rather, when faced with a choice as to what is more important in any situation, having the respect of the party they are dealing with is more important. Earning a party's respect first usually leads to being liked by that party over time.

4. **Understand the Need to Be Clearly Right.** There is an adage in baseball concerning close plays at first base-- "A tie goes to the runner." After having represented contractors and sub-contractors (and homeowners, too!) numerous times, there is no doubt in my mind that in court or arbitration, a tie goes to the homeowner every time. In other words, most judges have a bias in favor of homeowners and treat most disputes between contractors and homeowners as a consumer protection function. After all, most judges are homeowners, and have had experiences, good and bad, dealing with contractors. Most judges attribute to the contractor superior knowledge about construction issues, and superior bargaining power, even if that is not always the case. While I find most judges to be very capable and fair-minded, I don't think I have ever encountered a judge that was once a contractor or a sub-contractor, and I don't expect to do so. Therefore there is a need to not only make a good showing in any legal dispute, but to make a clear showing of your right to prevail. That can be accomplished by following the recommendations set forth in this book.

5. **A Legal Claim is Like a Wall.** Good legal claims (whether presented in arbitration or in court) do not come ready made. Rather, you should think of a legal claim as a wall, which is built brick by brick. The first bricks are discussed in this book; the need for a good contract, compliance with the mechanic's lien law, and careful documentation of the entire transaction. If you make those your standard practices, then working with your attorney to either present or defend a claim will be much easier and your case will be much stronger.

6. **Every 20th Customer Will Be Totally Unreasonable.** I am not positive that my ratio is correct, but I think it is wise to use that number as a rule of thumb. Those nineteen customers that valued your work, treated you well on the job-site, and paid you promptly and fairly are to be treasured. However, they are not the only type of customer that you will encounter. In the general population, you will find customers that due to either being improperly socialized by their parents, having had difficult life circumstances, or due to their unhealthy personalities, will not treat you well once the job has started. In America, cigarettes and power tools come with warning labels, but people don't. Learning to find warning signs takes years and years for a contractor to learn, and that education will never be fully completed. Many times when contractor clients tell me about how badly they have been verbally abused, or how many times they have been unfairly criticized or treated like dirt, I find myself telling them "It's not you." What I want you to understand is that you should be prepared *from the start* for the 20th customer, because you will learn too late, in most cases, that you are dealing with one. At that point you will want to ensure that you have complied with all the points in this book.

7. **The Most Important Strategy.** The most important strategy you should employ can be summed up as follows. The amount you are owed any one point for work done but not yet paid is what I call the "Arena of Conflict." You will want to keep the Arena of Conflict as small as possible. That way if the customer i) never planned to pay you, ii) has run out of money, iii) has gone over-budget, or iv) lost his or her job (all of which, you should note, have nothing to do with the work you did) the amount remaining in dispute should be as small as possible. You can keep the Arena of Conflict as small as possible by the use of the following strategy.

- Get a partial payment prior to starting work. If you have trouble doing that, re-read paragraph 1 above.

- Obtain as part of your agreement that you will be paid on the installment basis.

- Bill periodically, and obtain installment payments.

- Be ready to stop work if you are not paid on time. Ideally, this is part of your contract.

- Do not be reluctant to pre-bill, if possible, particularly as the job comes to a close.

CHAPTER 8

Cautions Regarding Copyrights in Home Designs

CAUTIONS REGARDING COPYRIGHTS IN HOME DESIGNS

I see a rising incidence in recent years of builders and contractors caught up in issue of copyright infringement over designs for homes or buildings being built. Therefore a short lesson in copyright fundamentals for contractors would be useful for a contractor using this book as a reference.

Truly original creative works of design are proprietary to the person who created the work, until ownership somehow gets transferred. If ownership never gets transferred, then the creator of the work still owns it, and is the sole person entitled to the use of that creative work.

One way that ownership gets transferred is by assignment, in which by a written agreement, the creator transfers ownership to another party. Another common way is not an outright transfer, but rather a license to use the design for a limited purpose, such as building one house. Until there is either an assignment or a license, use of someone's creative work without their consent is copyright infringement.

Therefore a design for a home or a remodeling project is likely owned by someone, if it involves original work product. Frequently ownership gets transferred by license or by outright sale. For example, an architect or home designer may design a home, or an addition to a home, and has either a written or an unspoken understanding that there is a license for use of the design to build one home.

The most common scenario in which builders get caught up in infringement disputes is when a customer finds a design or floor plan they like, find a means to have it copied without obtaining rights from the original designer, and then take the set of plans to a new builder to use in building a house. A careful builder should inquire about the source of the plans, and whether all rights have been properly secured, because in an infringement action involving home plans, all parties involved in the infringement get named as defendants.

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