Deal Or No Deal?

Clarifying Gray Areas in Construction Contracting

by K. Brett Marston and J. Barrett Lucy

"Do we have a deal?"

This may seem like a simple question, but it can be a difficult issue when posed by a construction client to its attorney. In a business focused on margins and progress, paperwork often lags behind. Knowing if there is a deal and understanding its terms can be challenging. In an environment where a "handshake" was "a bond," the movement toward enhanced use of written price quotes, contract documents and change orders ought to help clarify the existence and boundaries of the deal, right? Not so fast.

In three common aspects of construction contracting, the answer to the question of whether there is a deal is a resounding "maybe." When a subcontractor submits a price quote that the general contractor relies upon to bid on a project, is there a deal? When a proposed contract is sent by the general contractor to a subcontractor but is not signed even though work has begun, is there a deal? If so, what are its terms? When an owner tells a contractor to proceed with extra work during the course of a project but a written change order is not signed, is there a deal, and what is it? Understanding the legal analysis of those issues in advance can help attorneys educate clients so they will understand the risks inherent in each of those situations, and help them prepare better to handle those situations.

"Let's Make a Deal . . . to Make a Deal"

Before the first shovel of soil is moved on a construction project, agreements and contracts between general contractors and bidding subcontractors and suppliers can be confusing. What is the impact of a subcontractor providing the lowest quote for a portion of the work to the general contractor and then the general contractor

using that quote as a part of its successful bid on the project at large? Can the subcontractor withdraw that price with impunity at any time prior to signing a formal subcontract? Can the general contractor "shop" that price with other potential subcontractors?

To resolve that issue, remember that Virginia courts distinguish between intention to contract and an actual agreement.

> The whole question is one of intention. If the parties are fully agreed, there is a binding contract, notwithstanding the fact that a formal contract is to be prepared and signed; but the parties must be fully agreed and must intend the agreement to be binding. If though fully agreed on the terms of their contract, they do not intend to be bound until a formal contract is prepared, there is no contract, and the circumstance that the parties do intend a formal contract to be drawn up is strong evidence to show that they did not intend the previous negotiations to amount to an agreement.

Boisseau v. Fuller, 96 Va. 45, 46, 30 S.E. 457 (1898) (citation omitted); *see also Atlantic Coast Realty Co. v. Robertson's Ex'r*, 135 Va. 247, 116 S.E. 476 (1923) ("when it is shown that the parties intend to reduce a contract to writing, this circumstance creates a presumption that no final contract has been entered into, which requires strong evidence to overcome."). Conversely, the Court has differentiated that "[w]here the minds of the parties have met and they are fully agreed and they intend to be bound there is a binding contract, even though a formal contract is later to be prepared and signed." *See Agostini v. Consolvo*, 154 Va. 203, 153 S.E. 676 (1930).

Focusing on whether the general contractor's use of a subcontractor's quote is a binding agreement, parties trying to enforce those as "deals" have tried to rely upon the theory of promissory estoppel, with at least one circuit court prior to 1997 suggesting this approach would constitute a viable claim. *See R. L. Dixon Inc. v. Hendrick Constr. Co.,* 19 Va. Cir. 503, 505 (1980). However, the Supreme Court of Virginia held in 1997 that a claim for promissory estoppel is not cognizable. *See W.J. Schafer Assocs. v. Cordant Inc.,* 254 Va. 514, 521, 493 S.E.2d 512, 516 (1997); *Virginia Sch. of the Arts v. Eichelbaum*, 254 Va. 373, 377, 493 S.E.2d 510, 512 (1997); *Ward's Equip. v. New Holland N. Am.,* 254 Va. 379, 385, 493 S.E.2d 516, 520 (1997). The Court did not adopt the Restatement (Second) of Contracts §90(1) (1981) approach that provides, in part, that a promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee . . . and which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.

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In reaction to this, some general contractors send "letters of intent" to award subcontracts to subcontractors to try to bind subcontractors to the submitted price. Care should be taken in drafting these, as Virginia courts are suspect of these efforts. *See, e.g., Marketplace Holdings Inc. v. Camellia Food Stores Inc.* 64 Va. Cir 144, 145 (2004) (in sale of a business situation, "an agreement to negotiate is not enforceable in Virginia," as "there must be mutual assent of the contracting parties to terms reasonably certain under the circumstances in order to have an enforceable contract"); *Nuline Industr. Inc. v. Media General Inc.,* 32 Va. Cir. 352, 354 (1994) ("[a]n agreement to make an agreement fails because there is no mutual commitment").

"A Handshake . . . and a Prayer"

Even once parties have agreed to work together, the contract paperwork can drag far behind. Work might even begin before the signatures on the bottom line. What then, if anything, forms the basis of the deal between those parties? What are the terms of the deal if some dispute or accident occurs before the contract is signed?

Several considerations determine the state of that relationship. It may be that the parties have an oral agreement (subject to any Statute of Frauds considerations) to perform the work, and that the paperwork is just documentation of that deal. In *Brooks & Co. Gen. Contrs. Inc. v. Randy Robinson Contr. Inc.,* 257 Va. 240, 245, 513 S.E.2d 858, 860 (1999), the Supreme Court confirmed that an oral agreement was formed by the subcontractor saying that it "stood by its" prior bid and the general contractor responded that the subcontractor "would be given the work."

In the *Brooks* decision, the general contractor also sent a proposed written contract to the subcontractor. The subcontractor never signed that contract and the general contractor later tried to enforce an arbitration provision embedded in it. The Court concluded that the general contractor had not informed the subcontractor of its intent to replace their oral agreement with the written contract, and there had been no "meeting of the minds" on the written form or that the case would be arbitrated. *Id.* at 245, 513 S.E.2d at 860. The Court concluded, based upon the existence of the oral agreement and the failure to agree on the replacement with a written contract, that the subcontractor's performance would not be deemed to be acceptance of the written document. *Id.*

Even though the *Brooks* decision resolved that last issue in the negative, ignoring a proposed written contract that is tendered by the other party but beginning to perform the work is not risk-free. To the contrary, a subcontractor that begins its work may be deemed to have accepted an otherwise unfavorable subcontract. Under Virginia law, acceptance of a contract proposal "need not be given in express words,

but may be inferred from the acts and conduct of the offeree." *Bernstein v. Bord,* 146 Va. 670, 675, 132 S.E. 698, 699 (1926).

This principle was applied in the construction context in *Galloway Corp. v. S.B. Ballard Constr. Co.,* 250 Va. 493, 464 S.E.2d 349 (1995). There, the Supreme Court explained that "[t]he absence of an authorized signature does not defeat the existence of the contract . . ." *Id.* In *Galloway*, the Court held that a subcontractor had accepted the terms of the modified American Institute of Architects subcontract by performance, despite the fact that the subcontractor had failed to sign the written agreement as a result of an oversight.

There remain instances, though, where a court may determine that there was not any express contract, whether written or oral, between the parties, or any unsigned contract that has been accepted by performance. What then? Most likely those cases will require a *quantum meruit* analysis. In *Hendrickson v. Meredith*, 161 Va. 193, 170 S.E. 602 (1933), the Supreme Court of Virginia explained the general rule of law "that he who gains the labor or acquires property of another must make reasonable compensation for the same. Hence, when one furnishes labor to another under a contract which, for reasons not prejudicial to the former, is void and of no effect, he may recover the value of his services on a *quantum meruit*." *Id.* at 198, 170 S.E. at 604. (internal citations omitted).

"The Show Must Go On"— The Change Order Two-Step

Even where businesses have taken care to sign a formal, written construction contract containing myriad provisions about changes, extra work, oral directives and modifications to the contract, those are frequently ignored or discarded in the heat of the moment. Disputes arise because oral directives are given, promises are made, and execution of a written change order—which is usually a contractual requirement—is deferred. Under this typical scenario, disputes arise later because the price and related time extensions have not been agreed to.

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The determination of what effect these changes may have on the obligations of the parties involves issues of modification, waiver and estoppel. The Supreme Court of Virginia faced whether and how a written construction contract can be modified in the absence of an express agreement to that effect in *Cardinal Development Co. v. Stanley Constr. Co. Inc.,* 255 Va. 300, 497 S.E.2d 847 (1998). Stanley Construction claimed it was entitled to payment of additional funds because the developer, Cardinal, had increased the number of lots being developed and had promised verbally and in written communications to pay Stanley Construction. Cardinal took the position that Stanley Construction was bound to the fixed-price contract amount.

The Supreme Court concluded that Stanley Construction had proved by "clear, unequivocal, and convincing evidence . . . that Cardinal and Stanley Construction intended to modify the terms of their contract and that Cardinal agreed to pay for the additional work that Stanley Construction had performed." *Id.* at 306, 497 S.E.2d at 851 (citing *Stanley's Cafeteria Inc. v. Abramson*, 226 Va. 68, 73, 306 S.E.2d 870, 873 (1983)). The Court found the necessary, sufficient consideration for the modification in Cardinal's agreements to pay for the additional work and in Stanley Construction's actual performance of that work.

It is unclear from the *Cardinal* decision whether the written contract between those parties contained a "changes" clause requiring that any changes to the contract be made in writing by means of a change order or a construction change directive—the two general processes contained in most construction industry form contract documents. This requirement is often lost in the mix of oral directions and need for progress.

In those circumstances, if the party performing the work does not get paid in the way it anticipated, it may argue, in addition to modification, that the party who owes the money has "waived" the writing requirement through the verbal directions or course of conduct that occurred. Some courts refer to the results of these situations as "constructive" change orders. There are numerous reported decisions across the nation resolving those issues in many different ways depending upon the facts. *See, e.g., McKeny Constr. Co. v. Town of Rowlesburg,* 187 W.Va. 521, 420 S.E.2d 281 (1992) (rejecting contractor's argument that owner had abandoned the written change order process where there were written change orders for some parts of the work); *cf. Huagn Int'l Inc. v. Foose Constr. Co.,* 734 P.2d 975 (Wyo. 1979) (finding waiver of written change order requirement by owner based upon statements that they were not necessary).

In Virginia, the Supreme Court has not addressed a specific situation where an owner is alleged to have waived a written change order requirement; however, a longstanding decision by the Court provides what may be surprising guidance on how the Court might rule in such a debate. *See Zurich General Accid. & Liab. Insur. Co. v. Baum,* 159 Va. 404, 165 S.E. 518 (1932). That case involved a provision in an insurance policy that stated that

> No change in the agreements, general conditions, special conditions or warranties of this policy, either printed or written, shall be valid unless made by endorsement signed by the manager and attorney or an assistant manger . . . nor shall notice to or knowledge possessed by any agent or any other person be held to waive, alter or extend any of such agreements,

> general conditions, special conditions or warranties.

Id. at 408, 165 S.E. at 519. The issue addressed by the Court was

> Where it is stipulated in a contract that changes or modifications must be made in only one way, can the parties by mutual agreement change or modify the contract in any other way?

Id. Citing the general, common-law principle that "the provisions of a simple contract in writing, by subsequent parol agreement of the parties before breach, may be waived, rescinded, added to, changed or modified" the Court concluded that the principle would still apply "notwithstanding the fact that the parties have stipulated in the contract that it can be changed or modified in only one specific way." *Id.* at 409, 165 S.E. at 519 (citing Williston on Contracts, Vol. 3, Section 1828, other citations omitted).

Since its decision in the *Baum* case, the Supreme Court of Virginia has cited, though infrequently, that decision with approval. *See, e.g., Reid v. Boyle,* 259 Va. 356, 527 S.E.2d 137 (2000); *Keepe v. Shell Oil Co.,* 220 Va. 587, 260 S.E.2d 722 (1979). In *Reid,* the contract contained an integration clause with the following language: "This Agreement may not be modified in any way unless by a written instrument signed by both the Company and the Executive." Despite that clear provision, the Court concluded that the parties had modified the written contract both orally and by their "course of dealing." 259 Va. at 370, 527 S.E.2d at 145.

Conclusion

While it is easy to identify these issues and predict that they will continue to occur for as long as there are construction projects, it is more difficult to predict their outcomes and to fully prepare clients to perform preventative maintenance. The details of the conversations, directions, promises and "deals" all factor into the analysis of whether there is a binding agreement and what the terms are. Communication and documentation of a party's understanding is essential to trying to establish whether there really is "a deal . . . or no deal." ⚖

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