

# Demand for claim waiver in exchange for final payment

by Scott D. Cessar

The project is drawing to a close. Substantial completion is achieved. The punch list is completed. The contractor has submitted its final application for payment. The contractor is anxious to receive final payment in order to pay its suppliers, subcontractors, and itself for its work and overhead costs.

The contractor has previously submitted a good-faith claim or a certified request for equitable adjustment (REA) under the contract for additional direct and indirect costs. The claim or REA has been denied or is still being negotiated or dispute resolution has commenced or will soon commence.

The owner knows the contractor is cash-strapped and needs the release of the contract monies to meet its obligations. With this knowledge, the owner says to the contractor: "Here is the check for final payment. However, you need to sign this release of your claim or REA. You may not strike out the language in the release or amend the release to exclude your claim or REA or otherwise the check will not be released to you."

To some, this scenario sounds like hard bargaining with the owner using the leverage that it possesses to settle the claims. To others, this scenario

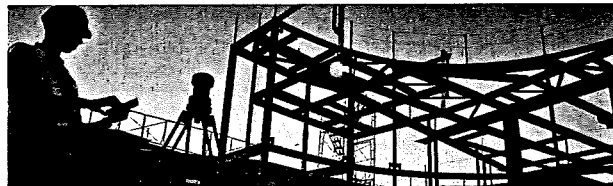
sounds like coercion and unfair administration of the contract.

Who is right and what should the contractor do?

Under federal law and the law of most states, and assuming the contractor's claim or REA was made in good faith, the owner's actions most likely constitute a breach of the contract. The reason is that the submission of a good faith claim or REA is not a breach of the contractor's performance obligations, as the right to submit a claim or an REA is an express or implied right. As such, the submission of a good-faith claim or REA does not serve as a legitimate contractual basis to withhold payment. Absent such a basis, the owner does not have a contractual right to condition payment based on the release of an outstanding claim or an REA.

The contractor's position is legally strengthened by what is known in the law as the implied duty of good faith and fair dealing, which is extant in every contract. This implied duty of good faith and fair dealing imputes to both parties the obligation to act with honesty, to cooperate by not hindering or interfering with its counterpart's performance, and to not willfully render imperfect performance of contractual obligations.

A number of legal cases in the area of federal procurement have found a



breach of contract and violation of the implied duty of good faith and fair dealing by the government when a contracting officer has, for example, used his or her authority in issuing payments or by withholding a favorable rating of the contractor's work as leverage to attempt to settle meritorious claims previously submitted by the contractor.

The bottom line of these decisions is that the owner has an implied duty of good faith in administering contracts, and compulsion and coercion and the placing of unreasonable conditions on the prosecution of meritorious claims violates that duty.

A good number of states also have both private and public construction payment statutes that place affirmative obligations on owners and contractors with reference to the withholding of payments. These payment statutes are generally intended to protect contractors and subcontractors from the wrongful withholding of payments that are due, as they require that the basis for the withholding be timely provided to the party requesting payment and that the basis be grounded in contract performance and in good faith. The withholding of monies based on issues that are not rooted in work performance by the contractor is generally a prohibited basis for non-payment.

What should the contractor do if faced with the scenario of the owner dangling the payment check in exchange for the release of claims?

The contractor should immediately send a letter to the owner stating on the record the facts and circumstances of the owner's demand. In the letter, the contractor should, pursuant to the terms of the contract, either give notice of its intent to declare a breach or declare a breach of contract and request that the breach be cured by the owner by releasing payment in exchange for an amended release of claims reserving the claim or REA.

In fact, the letter should enclose the amended claims release, so there is no misunderstanding. The letter should reference that the owner's conduct violates the duty of good faith and fair dealing. To the extent the jurisdiction has enacted a payment statute, the statute should be reviewed and the appropriate provisions (including those that provide for recovery of attorney fees and penalty interest for violation of the statute) should be referenced in the letter as a further legal support that the withholding is wrongful, illegal and will have consequences beyond being required to just release the amount withheld.

The contractor may want to consider closing the letter by noting that its claim must be meritorious, if the owner would resort to such improper tactics in an effort to circumvent the claims process by extorting a release by compulsion. Indeed, a prudent owner may well want to avoid the implication otherwise that its coercive conduct evidences its concern that the claim or REA has merit.

In short, all pressure should be brought to bear on the owner, demonstrating that its conduct is wrongful as a matter of contract and of law and will not be tolerated. If the letter does not wrest free payment from the owner, legal action that highlights this wrongful conduct, in addition to demonstrating the merits of the claim or REA, should be quickly commenced by the contractor. ■

*About the Author: Scott Cessar is the member-in-charge of the Pittsburgh office of Eckert Seamans Cherin & Mellott. He is also a member of the board of directors and chair of the construction and alternate dispute resolution groups. He focuses on a broad range of civil litigation with a primary focus on construction law. He has extensive trial and ADR experience, representing clients before state and federal courts, arbitration panels, and mediators across the country.*

