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## The Joint Venture A Bonded Roofing Subcontract

The frantic scene of organized chaos in the offices of Hanley Constructors was common on big bidding days. They were still receiving last minute telephonic and fax bids and incorporating them into the overall breakdown. Subcontract prices were incrementally dropping by the minute. The bid form was all typed up, except for the final price. Hanley's courier was staked out in a phone booth across the street from Paradise Gardens Development Company's offices in Beverly Hills. Bids were due at 2 o'clock from a selected list of six bidders, all experienced general building contractors, all eminently capable of doing the job.

Hanley Constructors' courier was Hanna Hanley, Greg Hanley's daughter who was learning the business from the ground up. She'd enjoyed her stint in the estimating department for the past three months. In her hand she had the envelope containing Hanley's incomplete bid form and the required bid bond in the sum of \$145,000. At 1:53 she'd phone back to the office and get their up-to-the-minute final bid price. She'd then enter the figure in the bid with a ball point pen, seal the envelope, and deliver it handily and safely to PGD before the 2 o'clock deadline.

Hanna, along with representatives of the other bidders, was invited into PGD's impressive conference room to witness the bid opening. PGD was an enlightened developer and always conducted their bidding procedures in the open. As the bids were opened and the figures read out, Hanna kept a running tally. This was intensely interesting to her, as she'd worked hard analyzing the plans, specifications, and take-offs. She'd talked to dozens of subcontractors and suppliers. She knew exactly how the bid went together. As each of the bid prices was revealed, she knew that Hanley would be lower and finally, as Hanley's bid was read out, everyone present knew it as well. The other contractors present begrudgingly and insincerely congratulated her. Their proposals had cost each of them thousands of dollars in time and effort and they were now up in smoke, useless. PGD's representative announced that they would study the bids and in the meantime Hanley should start lining up their surety bond in the sum of the bid, \$14,400,440.

In the next couple of days Hanley Constructors contacted all of their principal subcontractors and suppliers and started getting their contracts and purchase orders organized for release as soon as they had PGD's signed contract in hand. Their bonding company required them to have any subcontract over \$300,000 to be separately bonded.

Bobble Roofing of Norwalk, California was the low bidder on roofing. Their bid of \$573,000 was \$3,400 under the second lowest, Evans & Fogg Roofing. When Anson Bobble got word that he had the contract, he set about getting his bond lined up. He'd never before had to produce a bond. This was the biggest job he'd ever tried for. His insurance broker wasn't much help as Bobble was seriously in arrears in premium payments. He called several other brokers and bonding company agents, but they were all unreasonable.

They wanted to see operating figures, financial statements, and tax returns. They also wanted details of his experience, personnel, and equipment. Finally, Anson realistically concluded that there was little or no chance he could ever get a bond in this lifetime. But the contract was enticing, and he couldn't just let it slip away. So he decided to call the second low bidder and see if he could cobble together a joint venture with them.

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Evans & Fogg were reputable, well-established roofing contractors in Burbank, California. Eric Evans and Fenton Fogg, were the grandsons of the founders. They were raised in the business. Eric ran the office and did all the estimating and bidding, while Fenton ran the work in the field. They were hugely disappointed when they weren't low on the Paradise Gardens job. They really wanted that one. Eric was sure he had the right price and they were both counting on this job to keep their work volume up.

It was a pleasant surprise when Anson Bobble called. He wanted to talk about Bobble Roofing sharing the PGD job with Evans & Fogg. Anson didn't want Eric to see his so-called offices, so he offered to drive the 25 miles to the Evans and Fogg offices in Burbank. Bobble Roofing did business from a grimy desk and telephone in the corner of a small corrugated iron warehouse they shared with a painter.

Anson Bobble took off in his decrepit pickup and arrived in Burbank nearly on time, only 40 minutes late, and introduced himself to Eric Evans. He told Eric that he'd like to work out a joint venture with Evans & Fogg. He said he wasn't able to get a bond because they had too much bonded work in progress and their regular bonding company felt they were spread too thin. They would soon be finishing up most of the work and their final payments and retentions would be flooding in. However, they needed a bond right now for the PGD job. They couldn't wait for their bonding capacity to open up in a few weeks.

He offered Eric a sweet deal. They would form a joint venture and Bobble Roofing would run the job, do all the work, purchase all the materials, pay all the bills, and take care of the billings and collections. All Evans & Fogg would have to do was furnish the bond. For this negligible amount of effort Evans & Fogg would receive a hefty ten-percent of the profits. He sat smiling waiting for Eric's answer.

Eric was annoyed by Anson's spraying cigar ashes all over the carpet and desk. He went to another room and brought back a clean ashtray. "Put out the cigar and we can talk about the deal." A deflated Anson squashed out the soggy cigar butt and waited expectantly.

Eric referred to his notes and his own estimate for the job. "I think we can do business but we'll have to make a few changes in the deal. Evans & Fogg will get the bond, keep the checkbook, take care of the billings and collections, and Bobble will do everything else. We'll share the profits equally. On a 50/50 basis."

Anson was incredulous. He sputtered, "But that's ridiculous! Bobble Roofing landed the job."

Eric pointed out, "You've got no job without a surety bond! No bond, no job." Eric's jaw was set. He was dug in.

Bobble, recognizing the bottom line, reluctantly acquiesced, "Okay, Partner. We got a deal. We'll make a lotta money on this. 50/50 partners." They shook hands, both smiling.

## The Joint Venture

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Eric, thinking ahead, said, "Well, Anson, I'll get our lawyers to write a joint venture agreement for us so we can get it signed up and then we can sign the subcontract with Hanley Constructors. We'll also get the bond under way with our insurance broker."

Anson, also thinking ahead, said, "Maybe we ought to skip the joint venture idea and just do it under Evans & Fogg. It'll simplify the deal." He was concerned about having to furnish financial statements and who knows what all to Evans & Fogg's bonding company. Bobble then left and lit a fresh cigar on the way out to his truck. Things were looking up! He suddenly remembered that he'd have to get his state contractor's license reinstated. He'd forgotten to pay the renewal fee and post the license bond a few months back.

Eric wondered to himself if he was teaming up with the right outfit. But then, he reasoned, a job's a job. A 50/50 profit split wasn't too bad when all he'd have to do is get a bond. Sometimes you have to take a few risks to make a buck.

When Anson got back to his office, he phoned Hanley Constructors and asked for Greg Hanley. He explained about the bond and the deal with Evans & Fogg and said that they'd go through with the subcontract for the low bid price. Hanley, at first, wasn't too keen on the arrangement but felt that it was probably okay as long as they had the bond and the price was firm. So, he agreed to send out the subcontract agreement in the name of Evans & Fogg in the sum of \$573,000.

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Hanley Constructors had the Paradise Gardens project well under way, starting a new foundation every other week. The development consisted of 360 condominium units in 20 buildings of 18 units each. The buildings were each a little different but were generally two story, frame and stucco, UBC Type V construction. Each structure was U-shaped in plan with a one-story section at each end of the U. The buildings were interestingly sited on the land. Lush landscaping would surround the buildings and fill the courtyards. Upon completion, it would be a veritable tropical paradise.

According to Hanley's scientifically created computer-generated CPM construction schedule, the roofing would start on the first building in the 13th week of construction on May 24, 1993. Thereafter, a new roof would be started every two weeks. The principals of the two roofing companies figured that they would need only eight days to roof a building so they had an extra two days every other week for picking up loose ends or doing other small jobs. This schedule would give them 40 weeks of work and, at \$28,650 per building, they would have a cash flow of \$14,325 a week. "Fat city!" is the way Bobble described it. "We'll make a killing!"

Eric told Bobble that they would each have to put up about \$7,500 into the new joint checking account to take care of payroll and other costs pending billing and receipt of the regular payments from Hanley. Bobble said, "Okay, Partner."

Ian Jason, Hanley's no-nonsense job superintendent, was constantly on top of the work schedule. He had the office notify Evans & Fogg of their starting date right after the subcontract was signed and the bond submitted. He notified them again in the 21st week of construction that they had two weeks to start the first roof.

Jason was on the job early on Monday, May 24th, as he wanted to get the roofers started properly and let them know where they could park and store materials. But the roofers weren't there. At around 10:30, an ungainly truck, listing ponderously to the port side, pulled slowly onto the property towing a two-wheeled

asphalt pot. In among the rolls of roofing felt and ladders on the truck were lumps of bulk asphalt, an open carton of nails, and a crew of four roofers. Following in his decrepit pickup was Anson and two more workers. Jason directed them to the first building to be roofed. He walked over to where Bobble was getting out of the truck, and greeted him, "Where the hell have you been, Bobble? It's almost noon!"

"I was lining up the crew and arranging for the materials. Quality Roofing Suppliers had some problems with our line of credit but it's all straightened out now. Materials'll start arriving later this morning," Bobble explained.

"Well, you better get moving on this roofing. We've got a schedule to meet. This building's gotta be roofed by a week from Friday. If it isn't, I'll get it out of your hide. Y'understand what I'm saying?" He wasn't kidding.

Anson, broadly smiling, placated him with, "Sure, Boss. No problem. Nothing to worry about. Leave it to me. Bobble Roofing is here."

Bobble's crew set up a ladder and a materials conveyor and started getting their limited supply of materials up onto the roof. They were making great time applying felt over the plywood sheathing when they ran out of materials about an hour after lunch. Anson went over to Jason's job shack and asked to use the phone. Jason said, "Sure, help yourself. The pay phone's right over there."

Anson said, "Lemme have a cuppla quarters, willya?"

"Okay, this time. But never again. And you better pay me back tomorrow or you'll regret it." He left, muttering under his breath about flakes and morons.

Anson dialed Quality Roofing Suppliers and was referred to the credit manager. "Look Bobble, we called your bank and they said the check you gave us this morning is worthless. We'll deliver your materials when you give us a good check or cash. And no sooner." He hung up as if he didn't care if he lost this customer.

Anson looked up Jason and hit him up for a couple more quarters. "I'll pay you tomorrow. All I've got on me is big bills, twenties and fifties, no small change. I'll have some quarters tomorrow." Jason couldn't believe this guy. Anson then called Evans & Fogg.

When Eric answered the phone, Bobble said, "Look, Eric, we got the job started but we have a small problem. We need materials and Quality Roofing Suppliers wants to be paid in advance."

"Oh? Why is that?"

Anson, thinking fast, improvised, "Well, uh, Evans & Fogg don't have an account there, so they want cash. I'll drop by your office and pick up a check."

"No dice, Bobble. You haven't put up your \$7,500 yet."

"Haven't you received that check yet? It must be held up in the mail. You know how lousy the postal service is. I'll be there in an hour to pick up the check for Quality. We gotta keep the job going."

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## The Joint Venture

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Bobble told Quality to apply the check in payment of his long overdue account and told them that he would soon be receiving substantial regular payments from Hanley Constructors. Quality agreed to send the first shipment of materials to the job.

Nearing the end of the second week, the first building was ready for application of a flood coat of asphalt and the roofing gravel.

Anson reckoned he better work out some way of getting his costs down if they were going to make any money. He found a source of roofing gravel that would knock off about thirty percent from the normal price and they would deliver to the job directly from the quarry in Colton. Additional savings came from eliminating the sacks. It would be delivered in bulk and dumped on the jobsite. Anson had planned on renting a high lift loader so they could dump the gravel right onto the roofs. They'd save a bundle.

The loader dumped the first few loads of gravel onto one of the one-story sections of roof. Bobble was watching the unique operation and congratulating himself on his innovative logistical brilliance. He didn't notice that one of the loads of loose gravel landed squarely over the toilet vent. About half the load poured into the gaping 4-inch diameter vent. The rest of the gravelling operation went smoothly and the first building was completed within the allotted time. Bobble phoned Eric and told him to send in the bill for the first building. Eric responded, "Swell, we'll get some cash flowing. Incidentally, Bobble, your \$7,500 check never arrived."

"Oh. I may have forgotten to mail it. I sent out so many checks last week and I've got so much on my mind. I'll take care of it when I get back to my office today. No problem. You can count on it."

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About the third or fourth day into the third building, Anson was on the roof barking orders when he backed into an asphalt bucket, fell, and rolled to the edge of the roof. He grabbed a roll of roofing felt but it shifted and he plummeted to the ground like a rock. The roll of felt and the asphalt bucket landed on top of him. The crew heard him yell but couldn't reach him in time. The ambulance took him to Riverside Memorial Hospital where he was patched up and was bedbound for nearly three weeks. The doctors ordered additional home recuperation. Anson didn't object, as he couldn't straighten up or walk without excruciating pain.

It was six more weeks before he returned to the job. By then his crew was roofing the seventh building. They seemed to make as good progress without him as with him. During his home stay he phoned Eric once a week to ask for a check to be mailed to him. Eric objected but Anson complained, "How am I going to live without money?" Eric didn't want to kick him while he was down, so he sent the checks. Eric also had to keep Bobble's payroll up so the job wouldn't stop. Meanwhile Quality kept sending materials to the job as Anson got Eric to send enough money to keep Quality quiet.

On Anson's second day back on the job, he couldn't get his pickup started when it was time to go home. One of his men who knew a lot about cars looked it over and advised, "This old heap is finished. You've driven the life out of it. It's thirteen years old. How long do you think it ought to last?" So Bobble rode home with his crew on the company truck. That night he called Eric to get some money to buy a new truck. Eric said, "Hell, no, Bobble. We can't buy a truck out of this contract. Are you crazy?" Then, relenting a little from his harshness, he offered, "Look, Anson, we've got an old truck in our yard. It's a 1979 Ford pickup with almost 400,000 miles on it. But it still runs. You can have it." Anson picked it up the next day. It wasn't so bad. Not much worse than his old truck.

## Construction Nightmares

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A couple of weeks later when Bobble's crew was finishing up the eighth building, they had the asphalt pot parked fairly close to the building and one of the apprentices had it fired up full blast to get the operation moving faster. Jason came by and shouted to Anson up on the roof to move the pot away from the building and not take any chances with a fire. Anson shouted down, "Okay, Boss, right away." He was going to tell the apprentice when he came down the ladder. But, rotten luck intervened. The asphalt burner, having lost its thermostatic control years ago, was hotter than the fires of hell and ignited the plaster backing paper and studs and the building started to smoulder. The wood framing, now drier than a chip, burst into flames. The apprentice, utterly overwhelmed with the enormity of the situation, was rushing about frantically shouting at Bobble and the crew to come down off the roof. They scurried down the ladder and tried to get the flames controlled but there was no ready supply of water and it soon got away from them. By the time Jason got the Riverside Fire Department on the scene it was a lost cause. Building #8 was gone except for the lower parts of the first floor studs and the concrete floors and foundations.

Eric Evans prepared the bi-weekly invoice as usual, billing for the roofing of Building #8. Upon receipt of the invoice, Greg Hanley phoned Evans & Fogg and got Eric on the line. "You guys must be out of your minds. There's no way we're going to pay you clowns for roofing the building you burnt down. You can forget it." He hung up.

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In the 30th week of construction Bobble and his crew were finishing work on Building #9. They had to borrow an asphalt pot from Evans & Fogg as their own was a complete write-off after the fire. Bobble wanted to buy a new one but Eric wouldn't hear of it. Bobble was driving the high-lift loader depositing gravel on the roof, when Jason showed up shouting at him to shut off the motor. When it was quiet, he said, "Bobble, your supplier has filed a lien on the job. You better take care of it. And damn quick. The office says no more payments until you do."

Anson called Eric and said, "Eric, there's some sorta mix-up at Quality Roofing Suppliers and they've liened the job. Will you please phone 'em and find out what's eating 'em? I can't understand those guys. After all the business I've thrown their way. We've always got along just fine and now they're getting greedy. They've got no appreciation."

Eric called Quality and spoke with the credit manager, who complained that Quality had shipped over \$102,000 worth of materials to the Paradise job and had been paid only \$40,000. So they filed a lien in the sum of approximately \$62,000. Eric replied, "Hey, wait a minute. We've sent you over \$100,000. There must be something wrong with your records."

"Our records are okay, but the first \$62,000 was applied to the long outstanding balance on Bobble's account. From now on, we won't ship any more materials except on a C.O.D. basis. The account's frozen until it's brought up to date."

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Bobble called Eric with the demand that his weekly check be increased. "Look, Eric. I can't live on it any more. My expenses have gone up."

## The Joint Venture

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"Bobble, we've got to have an understanding here. You've got the job all screwed up in the field and our costs have risen out of sight. We're going to lose money." Eric sounded desperate.

"How can we lose money on a \$573,000 contract? You must be mishandling the checkbook. I never should've agreed to a 50/50 split. You can't be trusted." Bobble hung up.

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Jason's general construction was following the schedule fairly well and they were just finishing up Building #1. The plumbers, after installing all the fixtures and hooking up the water supply, were testing the plumbing in the one story section. Suddenly there was water all over the floors. One of the toilets was overflowing. There was obviously an obstruction in the soil line. They tried to clear it but found it immovable. They removed the toilet, tore out some gypsum wallboard, removed some flooring, and broke into the piping. There they found the plug of roofing gravel that had been dropped into the vent by the roofers. By the time the piping was cleared and repaired and the wall and floor finishes restored, the total cost was over \$3000. Jason told Bobble that it would be deducted from their next payment. Anson didn't say anything about it to Eric, as he'd only fly off the handle. He was getting a little touchy lately.

Bobble wasn't too happy with Eric as the gift truck had thrown a rod and had to be abandoned. He left it where it fell, next to Building #7. Eric told Bobble to find his own transportation.

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Eric was sitting at his desk taking stock of the situation. He had produced reams of notes and schedules and yards of adding machine tape. He was unkempt and distraught as his partner Fenton Fogg came in and sat next to the desk. Fenton inquired, "How's the Paradise job coming along? Are we making any money?"

Eric winced and started a realistic update, explaining, "Fenton, we're in big trouble on this job. We've completed about half the contract and collected almost half the money. The checkbook is depleted and we still owe our suppliers nearly \$100,000. I've advanced over \$20,000 of Evans & Fogg money to keep the job going. Bobble has paid out nothing. Hanley's fire insurers have paid for the burnt out building but they plan to sue us for \$275,000 to recover their losses. Hanley has backcharged us \$3200 for the gravel that got in the plumbing vent and won't pay us for the roof on Building # 8. The architect is complaining about the quality of the roof rock and it'll have to be replaced on ten buildings. Now Hanley is complaining about the two trucks abandoned on the site and threatens to have them removed and backcharged to our next payment."

Fenton suggested, "Why don't we try to get out of the deal with Bobble and finish it up ourselves? If we work hard we may be able to cut our losses."

"Well, it may be too late for that. As it stands, if we finish the job and collect all the money we'll still have a deficit of nearly \$400,000. Bobble will be of no help to us. He's got nothing. We'd be better off to let our bonding company finish up the job and we'll have to go into bankruptcy. We've lost our business."

Fenton sadly concluded, "Maybe the bonding companies knew what they were doing when Bobble couldn't get a bond. Tell me, why did we ever go in with that idiot Bobble in the first place?"

"Well, at the time it seemed like a good idea," observed Eric.

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## Points of Law 8

### THE JOINT VENTURE

#### Choose Your Joint Venturer More Carefully Than Your Spouse

##### 8.1 Bonding Capacity

In our story, Bobble Roofing is the low bidder on a \$573,000 roofing contract, but is not qualified for an award of the contract because it can't make bond. The bond requirement is imposed by prime contractor Hanley Constructors in order to guarantee that Bobble Roofing has the working capital, equipment, and qualified personnel to perform the contract. Hanley Constructors' own bonding company insists that the major subcontractors be bonded so as to protect Hanley Constructors from subcontractor defaults that could jeopardize the ability of Hanley Constructors to perform the work. After all, a breach of contract by a subcontractor turns into a breach of contract by the prime contractor. If such a breach occurs, and both the prime contractor and the subcontractor have supplied performance bonds, the breach of contract gives the owner a claim against the prime contractor and the prime contractor's surety, and the subcontractor's breach gives the prime contractor and the prime contractor's surety a claim against the subcontractor and the subcontractor's surety. By this mechanism, the prime contractor's surety lays off some of the risk on the sureties of the principal subcontractors.

Anson Bobble, a flagrant bad actor, would never be able to get a performance bond for his company because sureties make a thorough investigation of the licensure and credit ratings of any contractor who seeks to establish bonding capacity. Bobble Roofing is not properly licensed and does not pay its bills. That's why Anson Bobble conceives the idea of joint venturing the job with the second low bidder. When Anson proposes his deal to Eric he pretends that Bobble Roofing has plenty of bonding capacity but that the bonding capacity is tied up in a few jobs that are nearing completion. So he needs Evans & Fogg to tide him over. Anson is not going to admit that his insurance agent would not supply a bond since Anson has not been paying his insurance premiums. Eric falls for the story and agrees to joint venture the job for half the profit. This is a serious mistake. By agreeing to joint venture the job with Bobble Roofing, Evans & Fogg will become legally liable for any default by Bobble Roofing. Of all the different forms of business organization available, the joint venture relationship is perhaps the most dangerous.

##### 8.2 Joint Venture

Most contractors are organized as either sole proprietorships, corporations, partnerships, or joint ventures. The corporate form is preferred because the officers, directors, and shareholders of a corporation are not usually responsible for the debts of the corporation. The construction business is recognized as a risky one. By organizing as a corporation, a contractor can avoid personal liability. If the worst should happen, and the corporation should have to file bankruptcy, the assets and the credit of the officers, directors, and shareholders may be unaffected.

Partnership is a different story. With some exceptions, partners are personally liable for the debts of a partnership. (The exceptions are for limited partners.) The distinguishing feature of a partnership is that partners jointly manage their business and split the profits and losses.

A joint venture is a special kind of partnership. In the construction industry, a joint venture is a partnership to do a single job. When the job is over, the business of a partnership is over. (Many joint ventures in the construction industry undertake more than one job. The joint venture confines its business to the particular jobs, and when the jobs are finished, the business of the joint venture is over.)

Construction industry joint venture agreements can be simple – only a few pages long. The joint venture agreement assigns the operating responsibilities between the joint venturers, identifies the job to be performed, and includes a formula for a split of profits and losses.

Although a joint venture is usually established by a written document, it is possible to enter into an enforceable joint venture agreement on a handshake. This is the kind of simple joint venture that we find in our story: a joint venture between two corporations each of which is to contribute \$7500 working capital with the understanding that the corporations will split the profits 50/50. Evans & Fogg is to handle collection of the bank account, and bonding and Bobble is to purchase the materials, supply equipment, provide workers and run the job. If the venture makes a profit, Evans & Fogg will get half of it. If the joint venture should default, however, the injured party can collect 100% of its claim from either corporation, and the corporation that pays the claim would have the right to even the books by collecting half of the loss from the other venturer.

In our story, we have another wrinkle because the joint venturers have decided to do business in the name of Evans & Fogg. However, the fact that the existence of the joint venture may be a secret from Hanley Constructors does not affect any of the liability relationships discussed above.

### 8.3 The Account to Which a Payment Is Credited

Eric has paid more than \$100,000 to Quality Roofing Suppliers for felt, asphalt, and other roofing supplies. Unfortunately for, and unknown to, Eric, Bobble was already a customer of Quality before the joint venture came into existence. At the time Eric started making payments to Quality, Bobble already owed Quality \$62,000. Without making any inquiry about where the payments came from, Quality just applied the first \$62,000 that came in to the old account. As a result, even though Eric may have paid for all the roofing materials that were delivered to the job, Quality's accounts receivable ledger shows a deficit of \$62,000. This was the basis upon which Quality recorded a \$62,000 mechanics lien claim against the Paradise Garden project.

### 8.4 Crediting Payments

Subcontractors often utilize materials from the same supplier on scores or even hundreds of different jobs.

Furniture stores have no reason to keep track of sales on a job-by-job basis. The ultimate destination of the furniture is pretty much irrelevant. But things are different in the building material business. Building material dealers have a vital interest in keeping track of the different jobs to which their materials are supplied because it is only by knowing the balance due for materials supplied to a particular project that a building material dealer can take advantage of the mechanics lien law. The mechanics lien system gives a material supplier a lien against the property where its materials were installed. Material dealers keep separate accounts on a job-by-job basis in order to protect their mechanics lien rights. Since Quality is selling roofing materials to Bobble on credit, it should keep separate accounts for each job.



When a subcontractor makes a payment, the supplier must credit the payment as directed by the subcontractor. If the subcontractor gives no direction, then the supplier can credit the payment to any account.

In our story Eric failed to designate the job to which the payment should be credited and therefore Quality simply credited the payment to Bobble's most delinquent old account. Quality might have a motive to credit the delinquent old account, because that would be the account on which Quality's mechanics lien rights most likely would have expired because of the lapse of time.

### 8.5 Mechanics Liens

There is an issue here that wants further investigation. In many states, construction funds are held in trust to pay for work or materials supplied to the job that provides the funds. In these states, a material supplier is required to credit payments to the proper job if the supplier had enough information to know what job produced the funds.

To resolve this issue, we have to find out what Quality knew, and when Quality knew it. Even though Eric did not give Quality any specific directions as to how the payments should be applied, maybe Quality had enough information from other sources to impress the funds with a trust. For example, maybe Quality delivered roofing materials to the job site and maybe the amount of the payment matched a bill which would have enabled Quality's accounts receivable clerk to match the payment to the job.

Such information could be a good defense to the mechanics lien claim, but it does not do Eric much good right now because the owner is going to withhold the amount of the mechanics lien claim (plus attorneys fees) from Hanley Constructors, the prime contractor, which will in turn withhold that amount from Evans & Fogg until the mechanics lien issue is cleared up. It could take years to work its way through the court system. Meanwhile, the money is tied up.

### 8.6 The Fire Loss

Bobble carelessly set fire to one of the buildings, and the owner's fire insurer paid for the loss.

Under a legal doctrine known as *subrogation*, an insurance company that pays a property owner's loss steps into the shoes of the property owner to enforce claims against the party that caused the loss. Therefore, the insurance company has a claim against Evans & Fogg because Evans & Fogg is a joint venturer with Bobble, and Bobble caused the loss by locating its kettle too close to the building.

Before he throws in the sponge and puts his company into bankruptcy, Eric should make a careful review of the contract between the owner and Hanley Constructors. The most popular form of construction contract nationwide, known as AIA Document A201 (General Conditions of the Contract), includes a *waiver of subrogation* clause. This provides that the owner waives its subrogation rights against the contractor and subcontractors for losses that are covered by its fire insurance policy. As we said, the insurance company steps into the shoes of the owner. If the owner has waived its rights against the subcontractor then the insurance company has no claim against Bobble or Evans & Fogg.