

# Prefabrication and Modular Contracting – ConsensusDocs to the Rescue!



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- ▶ Ron's practice is focused on all aspects of the construction industry. He represents general contractors, construction managers, subcontractors, owners/developers, architects and engineers in construction-related matters, including all aspects of construction law, contractual disputes, lien work, bond claims, construction and design defect claims, bid disputes, litigation, and dispute resolution. Ron has been lead counsel in numerous mediations, arbitrations, bench and jury trials and, when necessary, has argued his clients' issues before state Supreme Courts. In addition to helping clients in litigated and disputed matters, he also assists clients in all aspects of construction projects, from planning, bid package preparation and contract drafting to securing bonds and lobbying. Ron has also assisted in the drafting and redrafting of several construction related bills and legislation.

# Today's Advancements – Modular Construction

- ▶ Modular construction dates as far back as the mid-1800s, and Sears Roebuck Company sold over 75,000 modular home kits between 1908 and 1940



**THE WINONA** . . .  
▲ FIVE OR SIX ROOMS AND BATH



**MODERN HOME  
ALREADY CUT AND FITTED  
No. 12010A No. 12010B**

THE Winona bungalow is a popular American cottage type home. Broken roof lines, wide overhanging eaves supported with brackets, and full front porch gives it a pleasing appearance from either perspective. The outside walls are planned to be covered with bevel siding which we suggest painting white, light gray or ivory. The best grade of material and carefully prepared plans are needed for you to reproduce this home. They are included in our low cash price.

**FLOOR PLAN No. 12010A**

**FLOOR PLAN No. 12010B**

**Plan No. 12010A.** The vestibule contains a handy closet for outer wraps. The left side of the plan is devoted to living room (size, 12 ft. 9 in. by 12 ft. 11 in.), dining room and kitchen. The kitchen windows are placed high enough from the floor so sink or table will fit underneath. A plastered arch in the right wall of the dining room leads to small hall which connects the two bedrooms and bath.

**Plan No. 12010B.** This practical plan is 24 ft. wide and 40 ft. in depth and contains six rooms. Living room and dining room with connecting arch have the appearance of one large room, size 12 ft. 5 in. wide and over 26 feet long. Note stairs over cellar stairway, leading to large storage space in the attic. The grade platform is constructed to provide refrigerator space. The right side of the plan is laid out for three bedrooms, each with closet. The bath is planned to accommodate fixtures according to Specification No. 21A or 22B with Venetian mirrored medicine case over the lavatory.

Fill out blank with the type of heating, lighting and plumbing you desire us to include for your complete home. Size 24 ft. by 36 ft.

# Disney's Contemporary Resort Construction



# Today's Advancements – Modular Construction



► Built in 1971 – Almost 50 years ago!!!

# Potential Traps for the Unwary

## ▶ National Institute of Building Sciences Off-Site Construction Council (2018)

*“More than 87% of construction managers, general contractors, engineers, trade contractors, architects, owners and developers used some form of prefabrication in the past 12 months”*



# Byproduct of Change

Advancements in technology and project delivery methods are finally permanently changing the construction industry!

- ▶ These advancements are lending to the spread of modular construction and other prefabrication processes
- ▶ Bringing new challenges and potential **pitfalls in the legal landscape**



# Potential Traps for the Unwary

- ▶ Many issues specific to modular construction:
  - Modular Manufacturer (who is also responsible for the manufactured component's integration into the on-going project) – Subcontractor or Manufacturer?
  - Is the Contract for services or goods (UCC or common law)?
  - Insurance-related issues?
  - Who bears the risk of loss during transport/delivery?



# Potential Traps for the Unwary

- ▶ Parties should consider these and other issues at the outset to minimize potential costly disputes and to allocate risk properly
- ▶ Proposed ConsensusDocs 753 addresses these and many other issues
  - The 753 allows parties to specifically negotiate their own allocation of risk



# ConsensusDocs 753

## ► ConsensusDocs 753

- Proposed Form
- First in the nation Standard Agreement Between Constructor and Prefabricator
- Tailored to help parties deal with issues specific to modular construction
- Parties can accept form provisions or contract around them
- Creates new terms, relationships, and terminology consistent with and helpful to the industry

# Modular Manufacturer: Subcontractor or Manufacturer?

- ▶ Modular construction transactions may combine both goods and services
- ▶ Thus, this hybrid transaction has legal implications concerning both UCC and common law



# Common Law or UCC

- ▶ Related to the Subcontractor/Manufacturer issue is:  
*Does the Uniform Commercial Code (UCC) Apply?*
- ▶ UCC Article 2 applies only to transactions in goods
- ▶ UCC defines “goods” as “all things (including specifically manufactured goods) which are movable at the time of identification to the contract for sale . . .,”
- ▶ The UCC does not apply to contracts that are purely for services

# Modular Manufacturer: Subcontractor or Manufacturer?

- ▶ Most courts apply the “Predominant Factor” test
- ▶ Predominant Factor Test:
  - Goods** → UCC applies → Manufacturer
  - Services** → Common law applies → Subcontractor
- ▶ Provision of services is currently the prevailing view
  - Therefore, Subcontractor predominates

# Modular Manufacturer: Subcontractor or Manufacturer?

- ▶ Form construction contract documents treat subcontractors and manufacturers very differently
- ▶ These distinctions create very different rights and obligations



# Modular Manufacturer: Subcontractor or Manufacturer?

- ▶ ConsensusDocs 753 addresses the Subcontractor vs. Manufacturer issue by creating a difference between “Fabrication Site” and “Worksite” as well as a more appropriate definition of “Subcontract Work”



# Modular Manufacturer: Subcontractor or Manufacturer

- ▶ ConsensusDocs 753, Section 2.2
  - 2.2 SUBCONTRACT WORK: Subcontract Work includes labor, materials, equipment, **Components**, and services **provided to and at the Worksite and Fabrication Site** for the construction and installation of all work and **Components** .... Constructor contracts with Prefabricator as an independent contractor to provide all labor, materials, equipment, and services necessary to complete the Subcontract Work.

# Modular Manufacturer: Subcontractor or Manufacturer

- ▶ “Components” means “the prefabricated elements constructed at the Fabrication Site prior to installation at the Worksite.”
- ▶ “Fabrication Site” means location or locations where Components are constructed.

# Modular Manufacturer: Subcontractor or Manufacturer

- ▶ Using this broad definition of “Subcontract Work,” including the term “Component” makes clear the intent that the modular manufacturer (who is also responsible for the manufactured component’s integration into the on-going project) is a subcontractor under ConsensusDocs 753



# Acceptable Performance

- ▶ Under Common Law, a party to a construction contract does not materially breach if it performs its obligations in “substantial compliance” with the contract terms
- ▶ Under UCC – Perfect Tender Rule – if the goods or the tender of delivery fail in any respect to conform to the contract, the buyer may:
  - (a) reject the whole; or
  - (b) accept the whole; or
  - (c) accept any unit or units and reject the rest

# Acceptable Performance

- ▶ ConsensusDocs 753 requires Prefabricator to correct any Work that “is not in conformance with the Subcontract Documents” (Section 3.22)
- ▶ But also requires a “material breach” in order for Prefabricator to be deemed in “default” (Section 10.1).





# Warranties

- ▶ UCC creates both express and implied warranties
- ▶ EXPRESS = Express promise
- ▶ IMPLIED:
  - Merchantability –
    - fit for the ordinary purpose for which such goods are used
  - Fit for a Particular Purpose –
    - seller knows of the buyer's particular purpose for purchasing the goods and the buyer is relying on the seller's skill and judgment to furnish suitable goods

# Warranties

- ▶ ConsensusDocs 753 defines the applicable warranties
- ▶ Section 3.12:
  - Prefabricator warrants that materials, Components, and equipment are in conformance with Subcontractor Documents and are without defect.
  - Prefabricator gives same warranty as to the Subcontract Work, including the Components.
  - Warranties begin at Substantial Completion of the Work or a portion of the Work installed at Worksite.

# Warranties

- ▶ ConsensusDocs 753, Section 3.12.1:
  - Materials, equipment, etc. specified and purchased by Owner or Constructor are covered ONLY by manufacturer's warranty
  - Section 3.12.1 then expressly DISCLAIMS all other expressed or implied warranties, including Warranty of Merchantability and Warranty of Fitness for a Particular Purpose

# Still Need to be Aware of Impact of State Law

- ▶ **BE CAREFUL –**  
Contractors/Prefabricators will still have to be aware of the local legal implications
- ▶ May be impacted in by state laws in the jurisdiction of an out-of-state manufacturer / subcontractor



# Impact of State Law

- ▶ Statutes of Limitation / Repose
  - Out-of-state manufacturer of modules may effect differing statutes of limitation / repose
- ▶ OSHA Implications
  - Module manufacturer and project site may be subject to different state plans, or even different industry standards (e.g., 29 CFR 1926 – Construction Industry Standard; 29 CFR 1910 – General Industry Standard)
- ▶ State Licensing Requirements
- ▶ Labor-Related Jurisdictional Issues
  - conflicts with local collective bargaining agreements, etc.

# Impact of State Law

- Mech. Contractors Ass'n of New York, Inc. v. New York City Dep't of Bldgs.
- Mechanical and plumbing contractor associations brought suit - argued that the DOB failed to apply construction code licensing requirements to off-site modular construction operations
- Supreme Court for the State of New York dismissed action
- Judge Rakower stated “[the DOB] did not exceed its mandate in permitting the *manufacture* of these systems”





# Impact of State Law

- ▶ ConsensusDocs 753 allows the parties to choose applicable law and choose UCC or Common Law
- ▶ Section 12.5 Governing Law:
  - The Law in effect at the location of the Project governs, including the construction, transport, and installation of the Components, BUT...
  - The Parties agree that the law that governs the construction, transport, and installation of the **Components** shall be either Common Law or the UCC to the extent that the Common Law or the UCC conflicts with the law in effect at the location of the Project (and if permitted by law)



# Bound by Terms of Prime Contract?

- ▶ Limited precedence / commentary as to whether modular or prefab contractors/manufacturers are bound by the terms of the Prime Contract
- ▶ Modular/Prefab subcontracts must be drafted to account for proper “flow-down” of Prime Contract terms and provisions

Contract  
**Risk**  
Flowdown



# Bound by Terms of Prime Contract?

- ▶ UCC, like service contracts, allows those entering into contract (buyers/sellers) to agree to liquidated damages
- ▶ Under UCC, parties can also agree to refund of purchase price, or repair / replace non-conforming modules
- ▶ UCC also permits the waiver of consequential damages, so long as waiver is not unconscionable
- ▶ A Contractor may need to preserve its rights through flow-down provisions

# Bound by Terms of Prime Contract?

## ConsensusDocs 753 Provisions

- ▶ ConsensusDocs 753 Draft form contains “Flow-Down” provisions that allow Parties to manage their risks
- ▶ Section 5.4.1 Limited Waiver of Consequential Damages
  - Parties waive consequential damages except for: (a) any damages that Owner is entitled to recover vs. Constructor and (b) losses covered by insurance

# Protection Against Modular/Prefab Sub Default

- ▶ Modular/Prefab subcontractors are highly specialized and difficult to replace
- ▶ Contract provisions concerning liquidated damages and bonding requirements must be properly carried down to modular/prefab subcontracts
- ▶ UCC remedy allows for Specific Performance for unique goods



# Protection Against Modular/Prefab Sub Default

- ▶ Section 5.5.1 Liquidated Damages
  - If Subcontract Documents allow Liquidated Damages or other delay damages that are not addressed in this Agreement, and such damages are assessed, then Constructor can assess them against Prefabricator in proportion to Prefabricator's share of responsibility.

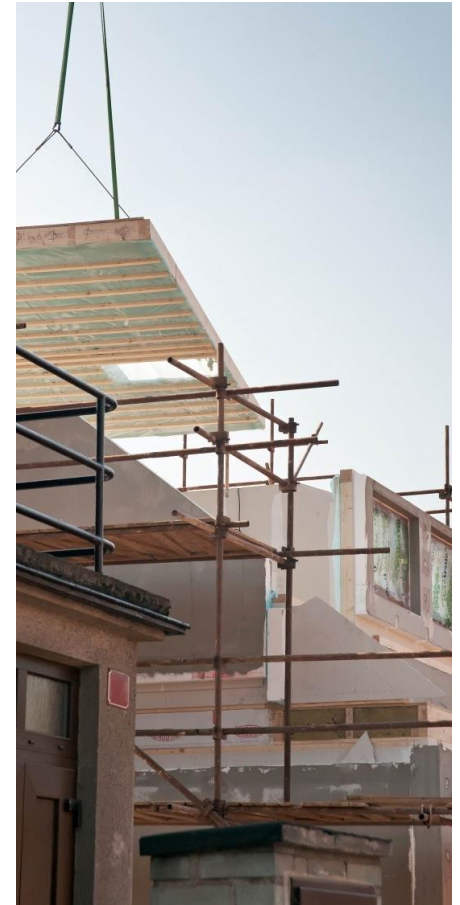


# Protection Against Modular/Prefab Sub Default

- ▶ As noted, Section 5.4.1 allows Prefabricator to flow-down LD and consequential damages liability to its subcontractors
  - Section 5.4.1 provides that LD's and consequential damages are not waived if they are recoverable by Owner
  - Section 5.4.1 requires Prefabricator to include the same waiver (excluding LD's and consequential damages recoverable by Owner) in its subcontracts

# Quality Assurance / Quality Control

- ▶ Who is responsible for QA/QC inspection?
  - Is the Owner / General Contractor allowed access during fabrication?
  - Right to enter land / possession issues



# Quality Assurance / Quality Control

- ▶ ConsensusDocs 753, Section 3.31 Shipping:
  - Constructor must provide Prefabricator a written QA/QC protocol for inspection of Components at the Fabrication Site
  - Parties must agree on terms of the protocol before work begins
  - Prefabricator cannot release Components to a Carrier until Constructor's Rep confirms that each Component conforms with the Subcontract Documents and satisfies QA/QC protocol

# Quality Assurance / Quality Control

- ▶ ConsensusDocs 753, Section 4.8 Constructor's Right of Inspection
  - With 48 hours written notice to, Constructor may enter the Prefabrication Site(s) to inspect the Subcontractor Work
  - Prefabricator must provide access to the Constructor to all Subcontract Work, including partially completed Components
  - Constructor agrees to execute a Confidentiality Agreement before being provided access

# Insurance-Related Issues

- ▶ **Builder's Risk Policy**
  - Whether policy schedule / coverage includes materials and manufactured products at fabrication site
- ▶ **ConsensusDocs 753, Section 9.2.5 – Builder's Risk**
  - Builder's Risk shall cover damage/losses to Subcontract Work occurring during storage and/or installation at the Worksite
  - Subcontract Work includes Components
  - Once Components are stored at Worksite, they are to be covered by Builder's Risk

# Insurance-Related Issues

- ▶ ConsensusDocs 753, Section 9.2.1 – Prefabricator's Insurance
  - Insurers must be licensed in states of Fabrication Site and of Project



# Insurance-Related Issues

## ► Bonds

- ConsensusDocs 753: Section 9.3 – Bonds
- Sureties must be admitted in states of Fabrication and Project
- Bonds must cover Work at Worksite and at Fabrication Site



# Transportation Issues

- ▶ Who covers the expense and risk of loss / damage?
- ▶ Risk of Loss / Damage:
  - If module manufacturer is considered a **UCC merchant** (i.e. manufacturer selling modules/goods), risk of loss **passes to buyer upon receipt**
  - If module manufacturer is not considered a merchant (i.e. **subcontractor** performing services), risk of loss **passes to buyer on tender of delivery**
- ▶ Control through careful contract drafting!



# Transportation Issues

- ▶ Risk of Loss / Damage (cont'd.)
  - When modules are shipped by carrier (or bailee holds modules to be delivered) the risk of loss passes to the buyer at the moment the seller delivers the goods to the carrier



# Transportation Issues

- ▶ ConsensusDocs deals with Risk of Loss/Damage during Transportation in Sections 3.16.2 and 3.31
- ▶ Sec. 3.16.2 – Damage during transportation:
  - Prefabricator bears the risk
  - Prefabricator shall promptly remedy the damage in compliance with applicable insurance policy and/or contractual terms with a third-party carrier
  - If Prefabricator fails to do so, after 48-hour notice, Constructor may remedy damage and deduct costs not covered by insurance otherwise due to Prefabricator

# Transportation Issues

- ▶ Section 3.31 – Shipping:
  - Risk of loss or damage is on Prefabricator until the Components are physically delivered to the Constructor at the Worksite or other authorized destination, unless otherwise agreed to in writing and signed by the Constructor, or if covered by builder's risk insurance



# Transportation Issues

- ▶ Other transportation considerations:
  - Time and cost associated with customs and international shipping
  - Truck and/or container height/weight limitations
  - Storage
  - Insurance



# ConsensusDocs 753 – Other Risk of Loss

- ▶ Section 3.16 deals with other Risk of Loss/Damage situations:

3.16.1 Damage during prefabrication and/or at prefabrication site

3.16.3 Damage post-delivery where Prefabricator is not the installer

3.16.4 Damage post-delivery where Prefabricator is the installer

# ConsensusDocs 753, Section 3.16

- ▶ Protection during prefabrication/at prefabrication site (Sec. 3.16.1):
  - Prefabricator bears risk and will promptly remedy damage in compliance with the conditions of applicable insurance policies
  - If Prefabricator fails to do so, after 48-hour notice, Constructor may remedy the damage and deduct costs not covered by insurance otherwise due to Prefabricator

# ConsensusDocs 753, Section 3.16

- ▶ Post-delivery damage where Prefabricator is not the installer (Sec. 3.16.3):
  - Constructor bears the risk of damage and shall promptly remedy such damage in compliance with the conditions of any applicable insurance policies



# ConsensusDocs 753, Section 3.16

- ▶ Post-delivery damage where Prefabricator is the installer (Sec. 3.16.4):
  - Prefabricator bears the risk of damage from the time of delivery through the completed installation of the Subcontract Work
  - Prefabricator shall promptly remedy such damage in compliance with the conditions of applicable insurance policies
  - If Prefabricator fails to do so, after 48-hour notice, Constructor may remedy the damage and deduct costs not covered by insurance otherwise due to Prefabricator



# Risk of Loss at Substantial Completion

## Sections 3.8.1 and 3.8.2

### ▶ Section 3.8.1

- Upon substantial completion of the Subcontract Work, Constructor becomes responsible for security and protection of Subcontract Work pending substantial completion of the Project
- But accepting Subcontract Work for purpose of allowing succeeding Work to proceed does not start warranty period

### ▶ Section 3.8.2

- Partial occupancy by Owner of completed portions of Subcontract Work constitutes substantial completion of that Work and starts the warranty period

# Scope Issues

- ▶ Who performs survey/inspection and acceptance sign-off prior to delivery of modules?
  - ConsensusDocs 753, Section 3.31 (Constructor obligated to perform)
  - ConsensusDocs 753, Section 4.8 (Constructor's inspection rights)
- ▶ ConsensusDocs 753, Section 4.5
  - Constructor bears cost for additional off-site storage caused by delay
- ▶ How are delays in delivery compensated?
  - Compensate for storage, maintenance and continued insurance
  - Preserve LD's



# Questions?



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