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## **ALL CONTRACTORS NOW REQUIRED TO REGISTER WITH CONTRACTORS REGISTRATION BOARD OUT-OF-STATE CONTRACTORS MUST DESIGNATE RHODE ISLAND ATTORNEY AS AGENT FOR SERVICE**

Under the revised Rhode Island Contractors' Registration statute most residential and commercial contractors must register with the Board. Contractors must comply with the statute's numerous provisions, including those requiring that out-of-state contractors designate a Rhode Island attorney for service of process. There are also several mandatory contract provisions that must be included in a contract with the owner.

In addition to registering, general contractors must also make sure that their subcontractors are registered as well. The statute states that, "a general contractor, shall not hire any subcontractor or other contractor to work on a structure unless the contractor is registered under this chapter or exempt from registration . . ." The penalties for failing to register can be harsh. Non-registered contractors and subcontractors and contractors that hire non-registered subcontractors may be fined up to \$5,000 for the first offense and up to \$10,000 for subsequent offenses. There are some obstacles to registration however. The Board can refuse to register or renew contractors who have unsatisfied judgments or arbitration awards relating to their work as a contractor.

Some contractors are exempt from the registration requirements. This includes contractors who are already licensed by another Rhode Island government agency such as hoisting engineers, installers of individual sewage disposal systems, plumbers, electricians, pipe fitters and refrigeration technicians. This exemption does not apply to work performed outside the scope of the contractor's license. The exempt contractors also still must comply with the insurance requirements of the statute. Other exempt contractors / projects include: (1) those who work on their own personal property, (2) work performed on federal property, (3) developers, (4) certain manufacturers of mobile homes and (5) persons involved in the movement of modular homes.

The Board also requires that out of state contractors name a Rhode Island attorney to serve as their attorney for service of process. Section 5-65-2 states that "[n]o registration shall be issued to a nonresident contractor until he or she has filed with the board a power of attorney

constituting and appointing a lawful attorney upon whom all processes in any action or legal proceeding against him or her may be served..." If a Complaint is filed against the out of state contractor, the Board can then ensure that the out of state contractor is properly notified by serving the Rhode Island attorney.

The out of state contractor must file an "Agent of Service" form, with their registration. The form states that a lawful attorney is "an attorney in good standing licensed to practice law and with an office in the State of Rhode Island." Since the new law went into effect, Heald & LeBoeuf, Ltd. has agreed to serve as agent for service for a number of out of state companies seeking to register in Rhode Island.

## **RHODE ISLAND CONTRACTORS CAN FILE MECHANICS' LIENS FOR RETAINAGE OUTSIDE OF THE LIEN PERIOD**

A mechanic's lien is a powerful vehicle for any contractor or supplier that has not been paid on a project. Rhode Island law provides that certain contractors, subcontractors and suppliers of materials that perform work or supply material have a right to file a lien against the owner's property to secure the value of the labor and materials they have provided.

*continued on page 2*

### **Firm Profile:**

The practice of Heald & LeBoeuf, Ltd. is concentrated in the area of construction law. The firm is dedicated to the delivery of the highest level of legal services to construction related business concerns.

Heald & LeBoeuf, Ltd. practice areas include:

- Construction Law and Litigation
- Arbitration and Mediation
- Public Bidding
- Public Contract Law
- Mechanics' Lien Law
- Surety and Bond Law

Rhode Island does not have a procedure for certification or recognition of specialization by lawyers.

## **IN THIS ISSUE:**

Contractors Registration Board .....	1
Liquidated Damages.....	2

Mechanics Lien-Retainage.....	1-2
Mechanics' Lien-Subordination.....	3-4

## RHODE ISLAND CONTRACTORS CAN FILE MECHANICS' LIENS FOR RETAINAGE OUTSIDE OF THE LIEN PERIOD

*continued from page 1*

Mechanics' liens, however, are very time sensitive. Under the Rhode Island statute, a mechanics' lien will only cover work performed in the 200 days before the filing of the lien (as well as work performed in the future).

The one exception is retainage. The recovery of retainage used to be a "gray area" under the Mechanics' Lien Statute, particularly when the retainage was on work performed more than 200 days prior to the filing of the lien. However, the legislature has eliminated this uncertainty in a revised statute, R.I. Gen. Laws § 34-28-9. Section 9 of the statute now provides the following:

"A notice of lien shall be effective as to any retainage earned but not paid, for work furnished pursuant to section 34-28-1 et. seq., and said notice of lien shall be effective from commencement of said work. Retainage is a percentage of the total contract amount that is withheld by the owner from the general contractor and by the general contractor from the subcontractor until the entire job is completed and the project is accepted by the owner and by the general contractor, at which time the retainage due is paid."

This means that all retainage earned dating back to the beginning of the job (even prior to the 200-day period) can be included and is covered by a mechanics' lien.

An owner and its construction lender recently challenged the new retainage statute. In *J.D. Cement Works, Inc. v. SBER Royal Mills, LLC, et al.* (K.M. No. 2008-1718) (consolidated), the owner and lender tried to argue that the subcontractor could only recover retainage that was earned within the 200 days prior to the filing of the mechanics' lien. In that case, a subcontractor performed work on a condominium project from November 2005 to August 2008. It filed a mechanics' lien on September 4, 2009, well over 200 days after its work was complete, for the total retainage.

The Superior Court rejected the lender and owners' argument that the lien was out of time because it was for retainage earned outside of the 200 day period. The court reasoned "[i]f retainage liens were subject to the same 200 day limit, there would be no need for the legislature to discuss retainage at all [in Section 9]." The Court held that the subcontractor's lien applied to the total retainage held by the owner on the project.

The lesson to be learned from the new Section 9 is that contractors should not assume that they have no mechanics' lien rights simply because the debt has been outstanding for some time. The contractor must determine whether any of the amount owed is retainage. If it is, the contractor may have mechanics' lien rights for months and even years after it completed work on the project.

## SUPERIOR COURT ENFORCES CANCELLATION FEE IN HOME IMPROVEMENT CONTRACT.

When an owner signs a construction contract, the contractor makes a serious commitment. The contractor has to order materials, mobilize its work force to the job site, shift workers from other jobs, and incur other significant expenses so that it can comply with the obligations that it has made to the owner.

Unfortunately, some owners do not take their contractual responsibilities as seriously. After signing a contract, they sometimes continue to shop around for another contractor offering to do the work for less. The owner will terminate the contract immediately prior to mobilization, in ignorance or disregard of the costs that the contractor has incurred prior to termination.

Some contractors will chalk this up as the cost of doing business. Some will sue to recover their damages. They encounter difficulty in Court because it is sometimes difficult to quantify their actual out of pocket costs. The contractor is either unable to prove its claim or can only recover a fraction of its real costs.

Others, have tried to deal with this recurring problem by including a "cancellation" or "liquidated damages" clause in their contracts. These clauses will specify a particular amount to be paid to the contractor if the customer wrongfully cancels the contract before the contractor performs their work. The advantage to this clause is ease of proof. Upon wrongful cancellation, the contractor can send their the owner a bill for a specific amount. If the owner does not pay, the contractor can sue the owner in Court for the cancellation amount specified in the contract. The contractor will not face the scrutiny of having to try to itemize every single item of damage.

The disadvantage to such a clause is that there is little Rhode Island case law as to how a court would view such a cancellation clause. Thus, until now, contractors could not be sure that the Court would enforce the cancellation clause.

That has changed. The Rhode Island Superior Court recently enforced such a clause in *Rhode Island Home Improvement, Inc. vs. Andrew Daigle*, K.D. No. 09-497 (Lanphear, J.), holding that such a clause in a home improvement contract was "reasonable and enforceable." In that case, Rhode Island Home Improvement, Inc. ("RIHI") had entered into a \$4,536 contract with Mr. Daigle to replace the windows at his home in Portsmouth. Mr. Daigle signed the contract, provided an initial deposit, and allowed the windows to be measured. However when RIHI attempted to begin work, Mr. Daigle declared he no longer wanted the windows.

RIHI had a cancellation / liquidated damages provision in its contract. The RIHI contract stated that the owner agreed to pay all expenses incurred in the event of any default and that if the owner refused to have RIHI proceed with the work, RIHI would be entitled to payment from the owner "of a sum of money equal to 25% of the Contract Amount, as fixed, liquidated and ascertained damages, and not as a penalty."

The case was initially heard in the District Court. The District Court entered Judgment in favor of RIHI. Mr. Daigle appealed to the Superior Court. The case was heard by Superior Court Judge Jeffrey A. Lanphear. Judge Lanphear enforced the clause and affirmed Judgment in favor of RIHI. Judge Lanphear held that RIHI could enforce a cancellation fee in the amount of 25% of the contract price as long as RIHI could show that it suffered actual damages as a result of Mr. Daigle's breach. RIHI was able to show that it paid a consultant to make the sale, expended resources in marketing, measuring, seeking collection, and lost its anticipated profit when the owner refused to comply with the contract. The court was careful to distinguish between RIHI and cases in which the contractor "suffered no damages" or cases where the liquidated damages are considered a penalty and not a "fair and reasonable approximation of the real damages suffered" by the contractor. In other words, the Court will not enforce the cancellation clause when the contractor cannot show that it was actually damaged by the breach.

The Court also will not enforce the clause when the cancellation amount is not a reasonable estimate of the amount of damages that the contractor has incurred. For example, if the RIHI contract called for a \$1million cancellation fee on a \$4,500 contract, the Court would throw out the cancellation fee as being unreasonable.

Rhode Island Superior Court decisions are not binding precedent. Nevertheless, they are generally followed. The RIHI decision provides a blue print for Rhode Island contractors seeking to enforce cancellation fees in their contracts. Contractors have to be careful to make sure that the clause is drafted properly. The Court will enforce a properly drafted clause if it is reasonable and the contractor can show that they incurred actual damages as a result of the wrongful cancellation.

### **SUPERIOR COURT JUDGE ALLOWS CONTRACTORS TO JUMP AHEAD OF BANKS FILING LATE RESPONSES TO MECHANICS' LIEN COMPLAINTS**

After filing a Rhode Island mechanics' lien, the contractor will begin the litigation process by filing a Complaint To Enforce the lien in the Superior Court. The legislature has set forth the initial process in the mechanics' lien statute. After the Complaint is filed, a Citation is served on any bank, mortgage company and other entity that has a recorded interest on the property where the work was performed.

Many banks and mortgage companies are apparently under the mistaken assumption that they do not have to respond to the mechanics' lien Citation. These banks and mortgage companies believe that their mortgages will take priority over the mechanics lien as long as they do not make any further advances to the property owner.

While that may be true in some states, it is not the case in Rhode Island. R.I. Gen. Laws Section 34-28-16 states that any person served with a mechanics' lien citation must enter their appearance into the case and file a response to the citation with the Court within twenty (20) days after the return date set forth in the citation. There is a harsh penalty for failing to do so. The legislature has stated that any lender who does not submit a timely response "shall be subordinated to the claim of the plaintiff." In other words, the bank or mortgage company which does not respond in a timely manner loses the priority of their mortgage, and falls behind the mechanics' lien plaintiff. This is obviously a significant development for a contractor liening a heavily mortgaged project.

The only exception is when the bank or mortgage company files a motion with the Court identifying an exceptional reason why they failed to respond on time such as "excusable neglect." This is a high standard. The parties lack of knowledge of the law is not enough.

In the Summer and Fall of 2009, the Superior Court issued significant decisions involving two major lenders – Rockland Trust Company and M&T Bank. The cases involve two large mill renovation projects in West Warwick with a large number of mechanics' liens. They are Northern Site Contractors et. al. v. SBER Royal Mills, LLC, et al., and J.D. Cement Works, Inc. et. al. v. SBER Royal Mills, LLC, et al. In the first case, a Vice-President at Rockland received several of the citations and put them aside believing that a response was not necessary. In the other case, M&T Bank hired a large New York city law firm to advise it on the Rhode Island mechanics' lien statute. The attorney mistakenly advised M&T that it did not have to respond to the mechanics' lien citations.

In both cases, the banks filed motions to file their mechanics' lien cases out of time arguing "excusable neglect." They also argued that the "subordination provision" in the mechanics' lien statute was unconstitutional.

*(continued on page 4)*

## **SUPERIOR COURT JUDGE ALLOWS CONTRACTORS TO JUMP AHEAD OF BANKS FILING LATE RESPONSES TO MECHANICS' LIEN COMPLAINTS**

*continued from page 3*

After extensive hearings, the Superior Court issued written decisions denying both motions. The Court upheld the constitutionality of the statute. The Court also relied on the mandatory language in the mechanics' lien statute and held that the mortgage companies did not meet their burden of proving excusable neglect. The mortgage companies did not establish any such "extraordinary and unusual factors" that would have constituted relief under the statute. As a result, a number of contractors moved ahead of the banks on both projects.

Those receiving mechanics' lien citations and mechanics' lien plaintiffs, must approach this process with great care. First, all parties who receive mechanics' lien citations should immediately forward those citations to Rhode Island counsel with knowledge of the mechanics' lien statute. The citations can be overwhelming on large distressed projects where there are a number of mechanics liens. There are severe potential consequences if one ignores these documents. As M&T Bank learned, one needs to consult with Rhode Island counsel with knowledge of the Rhode Island mechanics' lien statute.

The mechanics' lien plaintiff needs experienced counsel who can monitor proper service of the citations, and identify situations where the

contractor has established priority. In these difficult economic times, this is particularly important on heavily mortgaged, distressed projects. Without diligence and understanding of its rights, a contractor may not get paid.

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