

Application of the Concept of Accord and Satisfaction in Dealing with Project Invoice and Payment Operations

John D. Murphy Jr.
Colorado State University,
Fort Collins, Colorado

Brendan R. O'Marra
Atlanta, Georgia

Donald A. Jensen Jr.
Southern College of Technology,
Marietta, Georgia

Like most other businesses, the construction industry is based on agreements (formal or otherwise) involving the delivery of material and/or services (i.e., subcontracts and/or purchase orders). One of the many duties of the construction project manager is the approval and processing of monthly applications of vendors for payment (payment operations). In addition, the project manager must also process monthly applications for payment for his or her contract with the owner or other party (billing operations). The project manager uses the contractual agreement along with other measures of scope and progress in the valuation of work complete. Monthly billing cycles facilitate the periodic discussions between parties of the agreement regarding what is owed and what will in fact be paid. At these times the parties, as they attempt to negotiate a decision, take into account factors such as how much work has actually been completed, what is the value of the completed work, and does the amount and value of the work meet the conditions of their agreement. Sometimes these negotiations end in an impasse.

What are the contractual rights of a construction contractor, represented by the project manager, versus those of a material supplier or subcontractor when the project manager, as a result of a dispute over the dollar amount owed to the

supplier/subcontractor, pays less than the dollar amount demanded in the hope of satisfying the debt? Even with carefully crafted contract provisions addressing value of work in place, quantification can be very difficult, and thus a source of disagreement [7]. With an ongoing construction project being a concern, the project manager is often put in the position of wanting to pay "something" to the subcontractor in order not to effect jobsite progress. To take it one step further, what are the legal implications when the supplier/subcontractor writes "under protest," or "without prejudice," on the same check, before depositing it in the bank? Do these or similar words mean what they explicitly say? Does such written language, by one or both parties, act to nullify the other party's contractual intent, and thereby keep the disputed dollar amount alive? What body of contract law controls? These are very real business transaction problems that can have serious legal impacts on constructors, material suppliers, subcontractors, and owners.

This paper presents the concept of accord and satisfaction as an explanation of the legal implications confronted in these types of situations. This scenario and the principles discussed herein are applicable to project managers of all types, whether employed by a general contractor, subcontractor, or sub-subcontractor. Understanding these concepts will help project managers in their decision-making processes and will help limit possible future claims through a proactive approach to claims avoidance [4].

Accord and Satisfaction

Defining the Concept. The phrase "accord and satisfaction" is often associated with the method of discharging a debt or claim whereby the parties agree to give and accept something other than

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what is due in settlement of the claim. That *something* is usually less than what was agreed to in the original contract. The element “accord” means an agreement to discharge the debt, while “satisfaction” denotes the execution of the agreement [1]. A valid accord and satisfaction will discharge the debt in question. But, what actually makes such a business transaction valid? The process of creating an accord and satisfaction is similar to that in which other contracts are created. There must be a valid offer, proper acceptance, and the presence of consideration. Although a detailed discussion of contract law is beyond the scope of this paper; suffice it to say that the debtor (in construction litigation, the party who owes money for either goods or services rendered) and the creditor (the party rendering those goods or services) agree to accept a lesser amount in satisfaction of the full amount owing under the original contract.

Differentiating Between Contract Law and Uniform Commercial Code. An important distinction must be made here so as not to confuse the legal rules of contract law. The general rule of contract law maintains that there must be new or different consideration to support a valid accord and satisfaction [1]. Consideration is defined as being the inducement to a contract. Consideration can be described by such constructs as cause, motive, price, or impelling influence that causes a contracting party to enter into a contract [2]. In construction litigation, however, the Uniform Commercial Codes (UCC) will generally apply because the majority of business activities involve commercial transactions [9, 1–102]. Under the UCC, the rules of contract

law are different from the general common law of contracts. Any claim or right arising out of an alleged breach can be discharged in whole or in part *without* consideration by a written waiver or renunciation signed and delivered by the aggrieved party [9, 1–107].

Illustration

Common Law Application. To understand the distinct difference between common law contract requirements and those of the UCC, an example of a common law transaction may be more illustrative. A contractor (debtor), needing funds to cover payroll, borrows \$12,000 from a bank (creditor), agreeing to pay the debt back in \$500 installments until paid in full. In the last payment period, the creditor sends the debtor a statement indicating what the debtor believes to be a higher current balance than he or she calculated. The two compromise and the debtor sends the creditor the last payment and writes on the check “paid in full.” The creditor subsequently deposits the check. In this case, the amount owed is in good faith dispute, otherwise referred to as an “unliquidated claim.”

In this hypothetical situation, the general rule of law is partial payment may be the basis for an accord and satisfaction of a claim that is unliquidated. Similarly, where there is an unliquidated or disputed claim and one party pays more than he or she admits is due, but less than the other party claims is due, there are sufficient mutual concessions upon which a valid accord and satisfaction may be based. Settlement of a claim in this manner clearly constitutes good consideration. The adequacy of such payment is immaterial [1].

Because the above example does not involve the sale of goods, UCC rules do not apply, thus general principles of contract law control. Under contract law, in order for there to exist a valid accord and satisfaction, there must be additional consideration provided. Here, the new consideration was the compromise of the debtor paying, and the bank (creditor) accepting, an amount other than what is due. Upon cashing a check explicitly conditioned on its acceptance as payment in full of an unliquidated claim, the creditor is deemed to have accepted its terms. Therefore, generally speaking, acceptance and use of a check marked “paid in full” or with similar language constitutes a valid accord and satisfaction resulting in a complete discharge of the entire disputed claim [1].

In an attempt to preserve his or her rights and still transact the check, the creditor may explicitly

About the Authors

John D. Murphy Jr., Ph.D., is assistant professor of construction management at Colorado State University. Dr. Murphy's research interest areas include construction cost estimating, international construction, and the legal aspects of the design and construction process.



Donald A. Jensen, Ph.D., is assistant professor of construction at Southern College of Technology. Dr. Jensen is in the final steps of his law degree and has research interest in the legal aspects of construction, contract litigation and claims, and other aspects of construction management and planning.

Brendan O'Marra, J.D., is a practicing attorney in Atlanta, Georgia.

indicate in written terms on the check that acceptance of payment does not constitute full payment in satisfaction of the debt. Words such as “under protest” or “without prejudice to my rights to pursue the balance,” or similar may help.

It appears, however, that the courts are not uniformly decided as to the efficacy of these steps. Some courts have ruled that such words reserving such future rights are totally ineffective. This seems to be the situation where there is an explicit written indication that there is a condition attached to the acceptance of the check. The condition being that of waiver and the right to pursue future collection of the debt by the creditor. In these jurisdictions, accord and satisfaction is achieved by: (a) the recipient being notified of the dispute, (b) the fact that payment is less than demanded, and (c) that cashing the check acts as a waiver of rights to the remaining amount in dispute.

It would appear that the safest way to preserve a creditor’s rights would be to refuse the entire remittance of a disputed payment by the debtor. Thus, the creditor’s legal position will remain unchanged. Actual retention of the check by the creditor, without cashing it, may over time carry with it the presumption of a valid accord and satisfaction. But usually this alone is not enough to terminate the creditor’s rights to future collection. There is, of course, the real-world problem of complete collection. Creditors have the self-imposed responsibility to collect as much from the debtor as is possible. Therefore, with the future of a debtor always being uncertain, the creditor often feels the need to cash whatever payment is made to get as close as possible to complete repayment. Since this scenario may cause some ambivalence between parties, sound business decision making and instinct may lessen any negative financial or legal impact.

A different result may occur when the amount due is *not* in good faith dispute under the general principles of contract law. Here, the claim is certain as to the amount owed and outstanding. Such “liquidated” claims cannot be discharged by paying a lesser amount and simply writing “paid in full” on the check. If the debtor acknowledges the amount due and pays less, such payment will not constitute a valid accord and satisfaction because the debtor’s payment would be deemed a preexisting obligation, and therefore not be new or additional consideration. In this instance, there is no accord and satisfaction because there is no notice of dispute nor compromise to the dispute. The “accord” portion of the transaction

fails insofar as there has been no agreement to accept a lesser amount by the debtor.

Uniform Commercial Code Application. With the three basic rules of contract law explained, the discussion will continue with the Uniform Commercial Code because that is the body of law that will control litigation in cases involving construction disputes over purchases of materials. As indicated earlier, the UCC governs all transactions involving the sale of goods. Also, if a transaction involves both the sale of goods and the sale of services, such as purchase of construction materials and the actual construction itself, where the greater weight of the contract price is based on the sale of material, then the UCC will apply.

If the scenario involves a supplier and contractor (represented by a project manager) the UCC now applies to the dispute. A project manager claims the product the supplier delivered is defective or otherwise substandard. The project manager claims that the supplier is in breach of contract and refuses to pay the supplier the purchase price. Consequently, the supplier claims the project manager is in breach of contract for refusing to pay as agreed in the original contract. This situation has the potential for litigation; however, because the parties regularly do business and wish to maintain their business relationship, they decide not to litigate. The problem, however, is not that easily resolved. The parties are now in dispute over the “real” value of the materials supplied. This situation would create an “unliquidated” claim, because the parties to the contract are involved in a good faith dispute regarding the amount owed.

To advance this example further, consider when the project manager sends the supplier a check for less than the amount agreed upon, and indicates on the check or in an accompanying letter, “Acceptance and negotiation of this check will be considered full and final release of any claims ...” The supplier, receiving the check and not wanting to waive any rights to the disputed balance, adds the following to the check: “Under protest and with full reservation of rights to collect the balance owing,” and then deposits or cashes the check.

It appears the courts are split as to the parties’ rights when language such as the above appears on the negotiable instrument. New York’s highest court, for example, ruled that the creditor’s rights to collect the balance are protected [5]. A holding by Vermont’s Supreme Court rendered a similar decision [3]. A contrary decision was reached, however, by the Missouri Court of Appeals, which

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maintained that the creditor's attempt to preserve his rights by so indicating on the check was of no consequence. In essence, his cashing of the check for a disputed amount acted as a valid accord and satisfaction when the debtor conditioned the payment as such [6]. A similar result occurred in Wisconsin, where the Court of Appeals ruled the creditor was without recourse despite adding the words "under protest and without prejudice" to a check offered as an accord and satisfaction of a debt with the words "paid in full" on it [8]. There is also case law at the federal level. The Federal District Court for the District of Nevada ruled the creditor's scratching out of the condition that cashing the check acted as a waiver of the creditor's rights was of no consequence. The court indicated that the creditor's act alone (of cashing it) was sufficient grounds for acceptance. The court also advanced the proposition that the precatory words were explicitly clear and unambiguous. As long as there was a good faith dispute as to the amount owing, the creditor lost his or her rights to future collection of the balance [10].

The last issue is liquidated claims (those that are not in dispute) and the general rule of law as provided by the UCC in commercial settings. If, for example, a material supplier is owed \$10,000 for concrete, and due to extreme and unforeseen financial hardship the contractor can only afford to pay \$8,000, the parties may agree (accord) on the latter amount. The payment (satisfaction) would act to discharge the obligation. The important difference here is that because the transaction is strictly for the sale of goods, the UCC unequivocally applies. Thus under UCC 2-209, the parties when agreeing to modify a contract under these rules, need no consideration to render the agreement binding. This is the opposite of the general rule of contracts. The project manager will be able to assert, as a defense against any subsequent litigation by the supplier, the fact that there was a valid accord and satisfaction; the obligation is completely discharged.

Summary

The progress of a construction project is often difficult to evaluate with regard to value of work in place. It requires a project manager who is very familiar with construction operations and procedures. Even then, there is often disagreement between project manager and vendor as to value of work complete. In such cases of disagreement it is advantageous for the project manager, whether employed by the general contractor or a subcontractor, to be familiar with the

principles of accord and satisfaction as well as when the different rules of law control.

A valid accord and satisfaction will act to extinguish an existing claim. However, there are four possible situations: (a) a non-commercial situation where there is a good faith, "unliquidated," dispute, (b) a non-commercial situation where there is a "liquidated," no good faith, dispute, (c) a commercial situation where there is a good faith dispute, and (d) a commercial situation where there is a no good faith dispute.

The first two situations are controlled by contract law while the latter two scenarios are controlled by the Uniform Commercial Code because the subject matter of the contract involves the sale of goods. However, when the contract calls for both the sale of goods and services, the UCC will generally apply and control as the general rule of law.

In non-commercial settings, when there is a good faith dispute as to the amount owed, a valid accord and satisfaction will discharge the obligation. This occurs when the debtor and creditor compromise. It is this compromise that satisfies the requirement that there be new or additional consideration and thus makes the accord and satisfaction binding. If there is a no good faith dispute, then there can be no accord and satisfaction. This is because there is no compromise to accept a lesser amount, i.e., there is no new or additional consideration. No amount of precatory language accompanying the debtor's remittance will discharge an obligation to pay in full. Consequently, the rights of the creditor to subsequent collection are not impaired by such language. As a result, the words of protest by the creditor are generally not necessary in this situation, and the act of depositing or cashing the check in no way impairs the rights of the creditor in pursuance of the amount outstanding on account.

In commercial settings, those involving the sale of goods, the Uniform Commercial Code controls. In situations where there is a good faith dispute, courts are not in agreement as to the ramifications of writing "paid in full" on the check and the recipient writing words of protest on it. Some courts treat the act of cashing a check as acceptance of the payor's condition, and as such, a valid accord and satisfaction regardless of language of protest, while others say words of protest act to preserve the recipient's rights to future collection of the balance.

Those in the construction industry, as well as those similarly situated, need to be aware of the ramifications of such transactions, and they should also be acutely aware that case law varies from one jurisdiction to the next.

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