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Prefabrication and modular construction: A growing trend with evolving legal implications - by Ronald Ciotti and Logan Bergeron

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The tech boom of the late-1990s and early-2000s gave rise to countless technological advancements that forever changed the landscape of nearly every industry within every sector. Industries that experienced little technological change over multiple decades began to see a rapid shift in the way they do business. The real estate and construction industries were no exception to this phenomenon.

The arrival of construction-design software, including Building Information Modeling (BIM) and Virtual Design and Construction (VDC), quickly altered the way in which projects are constructed. These and other industry advancements also spawned many new and innovative project delivery methods, including Integrated Project Delivery (IPD), Private-Public Partnerships (PPP), and Lean Construction. While these tools and processes are now well-established in the construction industry, pre-fabricated or modular construction has emerged as one of the latest byproducts of these industry improvements.

Individual prefabricated building components, or “modules,” can now be efficiently constructed at off-site locations, transported and quickly assembled at the project site, often saving time and money on the project schedule and budget. Modular construction has seen recent expansion into commercial construction, including retail. With the benefits of this innovation, however, come new legal challenges and potential pitfalls that may not be easily reconciled with established law, but instead must be identified with a prospective eye toward the future of the legal landscape. A few of these potential issues include:

Modular Builder: Subcontractor or Manufacturer?

Because modular construction transactions combine both goods and services, a hybrid transaction of this nature may create legal implications concerning both common law and Article 9 of the Uniform Commercial Code (UCC). While case law concerning modular construction is limited, in disputes concerning both UCC and common law, courts have applied the “Predominant Factor” test to determine which law applies. In short, if the provision of goods is the predominant factor the party to the contract is a manufacturer under the contract, and the UCC applies. If the provision of services is the predominant factor under the contract, the party to the contract is a subcontractor and the common law applies. Although each determination will depend upon the factual circumstances, provision of services is the present prevailing view among courts and therefore modular builders will likely be viewed as subcontractors.

As modular construction continues to grow in popularity, however, the legal issues presented will likely become more nuanced, creating the potential for a shift toward the UCC view. If courts interpret modules as “fixtures” or “commingled goods” as defined under the UCC, and not as “building materials” (which do not create a security interest under the UCC), disputes involving defaulting modular builders may turn on issues of prioritization of and subordination to competing security interests, as opposed to the typical attachment and bonding relief sought under common law. To date, however, courts have yet to interpret how the UCC would apply, if at all, to commercial modular construction disputes.

Impact of State Law

Standard form contract documents can leave project owners exposed to the implications of local laws not otherwise accounted for. Failing to account for the possible effects of contracting with an out-of-state modular builder can have significant ramifications concerning both statutory and

administrative law.

Some of the potential pitfalls include:

- Statutes of Limitation and Repose: Out-of-state modular builders may effect differing statutes of limitation and repose. Failure to be aware of conflicting statutes and to draft modular subcontracts accordingly can have disastrous implications on the viability of a subsequent claim.
- Licensing requirements and labor agreements: Trade licensing requirements and labor agreements applicable to the project site may or may not be applicable to the off-site location at which the modules are constructed. Failure to draft modular subcontracts according to the jurisdictional reach of applicable trade licenses and labor agreements can lead to labor disputes and/or work stoppages.
- OSHA standards: The modular manufacturing site and project site may be subject to different OSHA state plans, or even different industry standards. It is important to understand the difference and draft modular subcontracts accordingly.

Transportation Issues

Contract drafting in the context of modular construction also demands attention to liability and risk of loss in the event modules are damaged or destroyed while in transit. Generally, if a modular builder is considered a UCC merchant (i.e. manufacturer selling modules/goods), the risk of loss passes to the buyer upon receipt. Conversely, if the modular builder is not considered a merchant (i.e. subcontractor performing services), the risk of loss passes to the buyer on tender of delivery. Other important transportation considerations include time and cost associated with customs and international shipping, truck weight and height limitations, storage, and insurance. Management of the risk, from manufacture through delivery, is essential.

Delivery Issues

Delivery in modular construction does not conform to the same requirements of standard construction contracts by requiring a Certificate of Occupancy or Certificates of Substantial/Final Completion. For that reason, modular subcontracts must establish a protocol for when and how modules are to be received. Any protocol concerning delivery of modules to the project site must specify survey and inspection procedures, as well as final sign-off or acceptance procedures.

Of course, these are only a few of the many issues that could befall modular construction when used on a project, and offer only a prospective view of the changing legal landscape. For that reason, and because there is little precedence concerning the particulars of commercial modular construction, owners must ensure that their contracts adequately insulate themselves from any loss that may arise from a modular subcontract. While modular construction offers the potential for great savings in time and money, it offers equal risk of loss if undertaken haphazardly.

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