



Negotiate a Fair Subcontract by Identifying Dangerous Provisions

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The terms and conditions of the subcontract control the outcome of virtually every dispute between a general contractor and a subcontractor. It is therefore essential to be able to identify the provisions in the subcontract that are most likely to come into play if there is a dispute. Only then will the subcontractor be equipped to bargain for more reasonable terms. Even if the

subcontractor is not able to negotiate more reasonable terms, subcontractors also need to be able to gauge the level of risk they are assuming by signing the subcontract. Subcontractors are well-advised to ensure that their right to payment is protected. Many general contractors issue one-sided subcontracts that actually compromise a subcontractor's right to payment.

When the subcontract is presented to the subcontractor, it is often after many weeks of discussions regarding scope and pricing and often when the subcontractor's work is nearing commencement. It is crucial to avoid being caught up in the honeymoon stage and feeling that any issues that arise during construction will be worked out amicably despite the subcontract

language. Below is a non-exhaustive list of key subcontract provisions that should be scrutinized in every subcontract.

Contingent Payment Clauses

Clauses that condition your right to be paid on events you cannot control – such as payment to the GC by the owner or a lender – are very risky. These are known as *pay-if-paid* clauses and should be aggressively resisted. You should only rely on the creditworthiness of your customer, not some third party with whom you have no contract. Your customer is in a much better position to evaluate the creditworthiness of its own customer and if it decides to enter into a contract with a risky customer, you should not share in that risk. If your customer refuses to strike the clause altogether, ask for a compromise in which your customer agrees that if the owner falls behind in payments, the customer agrees to pay you after a certain specified time (such as 60 days, 75 days, or even 90 days). Having an outside date by which the customer must pay you no matter what is much better than a pure conditional payment clause. Note that in some jurisdictions, conditional payment clauses are not enforceable. If you are in such a jurisdiction, you may not need to focus as heavily on this type of clause.

Contingent Payment Clauses for Change Orders

Many subcontracts also contain clauses providing that the GC does not have to pay you for change order work unless the owner approves and pays for the change order. These clauses are problematic for the same reasons as those above. Your right to be paid is at the mercy of a third party. You should insist that the subcontract be clear that you will be paid for performing additional work and that you will not agree to condition it on the owner's approval (*"Subcontractor's entitlement to adjustments in the subcontract time or price for changes in the work shall not be contingent upon or limited to the amount that the Contractor receives from the Owner."*).

Ability to Stop Work if Not Paid

The ability of a subcontractor to stop work due to nonpayment is a powerful weapon in the subcontractor's toolbox to enforce its payment rights. Realizing this, subcontracts often require subcontractors to continue working in the event of payment disputes and they often do not contain clauses allowing you to stop work for nonpayment. Make sure your subcontract is clear that if payment is not made when due (or within some grace period such as 7 days, 10 days, etc.), you will be stopping work until payment is made (*"If the Contractor does not pay the Subcontractor through no fault of the Subcontractor, within seven (7) days from the time payment should be made as provided herein, Subcontractor may, without prejudice to any other available remedies, stop the Work of this Subcontract until payment of the amount owing has been received."*).

Gap Filler Provisions

Most construction disputes arise out of some type of disagreement as to what is and what is not in the project's scope of work. GCs realize that design professionals often overlook or omit requirements and there are therefore gaps in the design. When the contractors discover these gaps during construction, the owner and its design team often attempt to require the contractors and the appropriate subcontractor to perform the work at no additional cost even though it is not expressly called out in the plans and specifications. GCs are increasingly including provisions in the subcontract requiring subcontractors to not only perform all work shown in the plans and specifications, but also work which is "implied," "reasonably inferable" and/or "all work necessary to bring about a complete and satisfactory system." The intent of these provisions is to transfer the risk of gaps in the design to the subcontractor. Agreeing to perform work beyond that expressly and clearly shown in the plans and specification is perilous. You are therefore well-advised to insist that these clauses be changed such that you are required to perform only work shown in

the plans and specifications. If it is not shown and you are required to perform it, additional charges should apply.

Schedule Compliance Provisions

GCs often provide in their subcontracts that the subcontractor agrees to comply with any schedule provided by the general contractor without additional compensation including any schedule revisions. These provisions are very dangerous and can be very costly because they require the subcontractor to absorb the cost of delays, accelerating work and second shift and/or overtime work. You should agree to work in accordance with the bid schedule, which should be expressly identified in the subcontract, and the subcontract should be clear that if you are required to deviate from that schedule as a result of delays or disruptions caused by others, additional costs apply (*"The project schedule and any modification shall allow Subcontractor a reasonable time to complete its Work in an efficient manner considering the contract completion date or times set forth in the Subcontract Documents. Subcontractor shall be entitled to an equitable adjustment in the price of the work, including but not limited to any increased costs of labor, including overtime, or materials, resulting from any change of schedule, acceleration, out of sequence work or delay caused by others for whom Subcontractor is not responsible."*).

Subcontract Documents

Many subcontractors incorrectly assume that their proposal is part of the subcontract and is the controlling document regarding their scope of work and other terms. However, in most jurisdictions, unless the subcontract itself expressly incorporates the proposal into the subcontract, it will not be included. Consequently, your obligations will be controlled exclusively by the GC's subcontract. Many subcontractors' proposals contain important limitations, exclusions, and clarifications. In all likelihood, the subcontract will not contain the same exclusions, limitations, and clarifications. Therefore, insist on

making your bid, quote, or proposal a part of the subcontract in order to ensure that your proposal controls. Also, include a provision that if there is an inconsistency or discrepancy between the proposal and any other term of the subcontract, the proposal controls. (*"Subcontractor's proposal shall be considered a Contract Document. In the event of an inconsistency between the Proposal and any other Contract Document, the Proposal shall control."*).

Advance Notice of Proposed Back Charges

Subcontractors are understandably frustrated when they learn that back charges are being assessed after the costs have been incurred and they were not given an opportunity to address the situation before the costs were incurred or they disagree with the basis. You should insist that before the customer can back charge you, it provides you with written notice and an opportunity to address it. GCs are usually strict in requiring advance written notice before you perform additional or changed work, so it is equally fair that subcontractors get advance notice before charges are assessed to them. (*"No back charge or claim of the Contractor for services shall be valid except by an agreement in writing by the Subcontractor before the work is executed, except in the case of the Subcontractor's failure to meet any requirement of the Subcontract. In such an event, the Contractor shall notify the Subcontractor of such default, in writing, and allow the Subcontractor reasonable time to correct any deficiency before incurring any costs chargeable to the Subcontractor."*).

Liquidated Damages

Liquidated damages are always risky, and you should seek to limit, reduce, or eliminate them. Many subcontracts have long lists of work that needs to be complete and/or documentation that needs to be submitted in order for your work to be considered substantially complete. If you cannot eliminate these additional requirements, make sure you comply with them so that you don't incur

liquidated damages for technicalities, such as late submission of O&M's or written warranties. Avoid agreeing to submit documents not specifically listed in the Subcontract to obtain final payment such as "any documents that Contractor may require." (*"Contractor will not require any contract closeout procedures or any forms that have not been provided to and specifically accepted by Subcontractor prior to signature of the Subcontract."*).

Dispute Resolution

If the payment dispute requires you to invoke the subcontract's dispute resolution procedures, make sure that the process is not unnecessarily burdensome, expensive, and time-consuming. Subcontracts often require you to "stay" all dispute resolution efforts during the pendency of a dispute between the GC and owner. Disputes between the owner and GC can drag on for years depending on the method of dispute resolution required by the prime contract. To make matters worse, these clauses often require you to agree to be bound by the outcome of the GC's dispute with the owner. They are another form of a *pay-if-paid* clause, and you should resist them. Additionally, consider insisting on arbitration as the method of binding dispute resolution, or some other procedure that is faster and less expensive than litigating the dispute in court. Litigating disputes in court was slow even before COVID, and backlogs due to COVID have made it even slower. Do not agree to resolve disputes in an inconvenient forum. Whether resolved by arbitration or litigation, you should insist that all disputes be resolved in the state (and preferably the locality) in which the project was constructed (*"The law of the state where the project is located shall govern any dispute and the federal or state courts in the state where the project is located shall have exclusive jurisdiction and venue."*).

Price Escalation

It is well-known that the price of construction materials and fuel has increased dramatically in the past year or so. Very few subcontracts contain

clauses that permit the subcontractor to pass on these increases. The law is not very accommodating for those seeking to recover costs for price increases. It is difficult to obtain relief unless a contract provision specifically permits recovery of the additional costs. Absent a contract provision, the general rule is that in a lump sum or a fixed-price contract, the subcontractor bears the risk of price increases. For that reason, it is essential to insist on a clause like this: *"In the event of a significant delay or price increase of material, equipment or energy occurring during the performance of the Subcontract through no fault of the Subcontractor, the Contract sum, time of completion or Subcontract requirements shall be adjusted in accordance with the procedures of the Contract Documents."*

The list above is not intended to be all-inclusive as word limitations prevent a more comprehensive discussion. There are other provisions in a subcontract that could adversely affect your payment rights. An experienced construction attorney can assist you in revising the subcontract to make it fair. Most subcontracts can be reviewed and revised by an experienced construction attorney in a few hours' time. Don't wait until a payment dispute arises to find out what the subcontract says – some extra time and effort during negotiation can make all the difference in ensuring a profitable project. In order to gain leverage to negotiate a fair subcontract, condition your bid on acceptable subcontract terms being negotiated. See my article in the January 2018 Contractor's Compass, *Condition Your Bid for Leverage to Negotiate a Fair Subcontract*, for a detailed discussion of how to condition your bid.

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