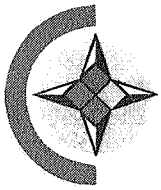

Legally Speaking

# Negotiating a Contract You Can Live With

*by Donald Gregory, Esq.*

*Construction owners have become accustomed to inflicting terribly one-sided contracts upon contractors that then force subcontracts with language at least as one-sided or worse upon their subcontractors. Unfortunately, none of the parties typically discuss the nature of the contract to be agreed upon until after they agree on scope of work and price. Beyond that point, it becomes increasingly difficult for a subcontractor to withdraw because of inequitable contract language, often leading to contentious relationships from the very start of a project. Subcontractors can employ several simple strategies to minimize this risk-shifting down the "construction food chain," instead encouraging an equitable sharing of risk.*

## What Are the 'Dealbreakers'?

Assuming a subcontractor has maintained the leverage to negotiate subcontract terms, it will be walking a fine line between removing onerous provisions and chasing away new business. Therefore, subcontractors may want to focus on taking care of the true "deal breakers."

Following is a personal "top 10" list of frequently encountered "deal breakers."

### 1. Contingent Payment Clauses: 'Pay-When-Paid' vs. 'Pay-If-Paid'

"Pay-when-paid" subcontract clauses are structured in such a way that payment from the general contractor or at-risk construction manager to the subcontractor is conditioned upon the general contractor's or construction manager's receipt of payment from the owner. Ordinarily, the subcontract will state that payment is due to the subcontractor within a certain period of time after the general contractor's or construction manager's receipt of the owner's payment. Such conditioning of payment in a subcontract is known as a "pay-when-paid" clause.

Many courts traditionally interpret a "pay-when-paid" provision as an unconditional promise to pay, with the time of payment being postponed until the happening of a certain event, or after a reasonable period of time has elapsed if such event does not take place. That means that the general contractor or construction manager must pay within a "reasonable time" if the triggering event does not occur, not that the general contractor or construction manager need not ever pay the subcontractor if the owner fails to pay.

With increasing frequency, general contractors and construction managers insert "pay-if-paid" provisions in their subcontracts, stating something to the effect that the subcontractor assumes the risk of non-payment by the owner and payment by the owner to the general contractor or construction manager is a condition precedent to paying the subcontractor. In this way, the general contractor or construction manager attempts to insulate itself from any liability to the subcontractor at any time in the event of non-payment by the owner.

A "pay-if-paid" clause shifts not only the credit risk associated with the owner to the subcontractor, but also the risk that the owner will not pay the contractor because of disputes involving performance wholly unrelated to the subcontractor's scope of work.

Court decisions in many states have upheld the validity of "pay-if-paid" provisions if they unambiguously express the intention of the parties to shift the credit risk to the subcontractor.

Yet there is a growing legislative and judicial trend finding "pay-if-paid" provisions against public policy and unenforceable. In states such as California and New York, contractors must pay subcontractors within a reasonable period of time for their work.

### 2. No Damage for Delay

Despite the unalterable fact that "time is money" on any construction project, "no damage for delay" clauses purport to limit the subcontractor's remedy for

delay to a time extension, but no additional compensation.

### 3. Waiver of Lien and Bond Rights

Contrary to popular belief, the waiver of lien and bond rights in advance of payment at the time of contract formation is enforceable in many states. Subcontractors should vigorously resist giving up the additional payment security provided by lien and bond rights.

### 4. Unconditional Lien Waivers Before Payment

Many subcontracts require unconditional lien waivers from subcontractors in advance of payment, which may waive lien rights even if promised payments are never received. An acceptable compromise might be to offer a conditional lien waiver in advance of payment to be followed by an unconditional lien waiver once payment is received.

### 5. Incorporation by Reference

All subcontractors should be alert to prime contract provisions that contain "incorporation by reference" clauses. Particularly inequitable are provisions that incorporate only the contractor's *responsibilities*, but not its *rights*, against the owner.

### 6. Change Orders in Writing

As change orders are typically the most contentious issue between parties on a construction project, subcontractors should pay special attention to the notice and approval provisions for change orders contained in both the subcontract and prime contract. Subcontractors may want to resist provisions that allow a general contractor or construction manager to direct a change in work without an agreement in advance to pay a mutually acceptable price for the change.

Subcontractors should also insist upon similar notice from the general contractor or construction manager before backcharges or "deduct" change orders can be assessed.

### 7. Dispute Resolution

Many subcontractors favor arbitration over litigation. Virtually all subcontractors should resist venue and jurisdiction provisions that attempt to force a dispute to be resolved in an inconvenient forum far from a project. It is also important that a subcontractor's claim not be stayed pending resolution of any contractor/owner dispute.

While many states in recent years have adopted statutes mandating that disputes be arbitrated or litigated in the state where a project is located, there are some legal impediments to the enforceability of these laws in some situations. Therefore, subcontractors should not necessarily rely on these statutes, but instead insist that a subcontract state that the law of the state where a project is located should apply and that any dispute should be arbitrated or litigated in that state.

### 8. Broad-Form Indemnity

Subcontractors will want to minimize the risk-shifting of indemnity clauses, particularly in regard to non-insurable risks. Examples of unacceptable risk-shifting might include an indemnification relating to matters other than personal injury and property damage, indemnification of a party from its own negligence ("broad-form indemnity") and indemnification for Occupational Safety and Health Administration fines, particularly any enhanced penalties based upon the contractor's prior experience on unrelated projects.

Remember that when a subcontractor names contractors, owners and others as "additional named insureds," the subcontractor in essence is agreeing to broad-form indemnity where any losses, even those caused by the negligence of the additional insured, will be covered by the subcontractor's insurance policy and reflected on its risk history.

### 9. Integration

Subcontractors that neglect to carefully compare the scope of work in a subcontract to an earlier bid proposal are greatly disappointed to learn that the standard integration clause ("the subcontract supersedes any prior negotiations, etc.") will allow the subcontract to control over the bid proposal or any prior negotiations. Some add the bid proposal as an exhibit to the subcontract to deal with this problem.

### 10. Acceptance of Final Payment as Waiver

Under this clause, unresolved subcontract claims or change order requests may be inadvertently waived when final payment is received for the original contract sum. Therefore, subcontractors are counseled to avoid this provision, or in the alternative, to be careful not to request payment in full until all claims are resolved. An acceptable compromise might be to exclude from such an inadvertent waiver prior written claims which remain pending when final payment of the contract balance is received.

## What Tools for Negotiating a Fair Subcontract Are in Your Toolbox?

Once a subcontractor knows which are the deadliest provisions to avoid, the next challenge is to secure more equitable language. There are four major tools from which to choose.

### Tool No. 1 — Use Conditional Bids

One way to avoid the unpleasant experience of receiving an inequitable subcontract "after the fact" is for a subcontractor to condition its bid upon acceptable contract language.

An example of such a conditional bid might be: *"This bid is conditioned upon the use of the AIA A401 Subcontract (1997 edition)."* No matter what inequitable subcontract language may be proposed later, the subcontractor that thus conditions its bid is bound by it if the contractor relies

on the bid and is awarded the job. A subcontractor that conditions its bid upon the AIA A401 subcontract or other acceptable subcontract language can force a general contractor or construction manager to decide up-front whether to use that subcontractor or not, based upon not only the price, but also the contractual risk terms assumed in the subcontract. Some subcontractors even specifically describe in their bid proposals the types of provisions (i.e., "pay-if-paid") that they will never agree to in a subcontract to increase their leverage when subcontract negotiations begin.

If the general contractor or construction manager elects to use the subcontractor's qualified bid, it will not be able to force unacceptable one-sided subcontract language upon the subcontractor later, and the subcontractor will maintain leverage in those negotiations.

### Tool No. 2 — Use the ASA Addendum

ASA has invaluable contract resources at www.asaonline.com (in the members-only section) including commentary on the AIA and AGC subcontract forms. Educated subcontractors can "redline" offensive provisions from their subcontracts.

In addition, ASA has prepared a "generic Addendum" to defuse the typical proprietary subcontract form. While the "generic Addendum" is not perfect for all circumstances, it will address most of the offensive provisions typically encountered.

### Tool No. 3 — Educate Your Customer

Contractors want subcontractors not only with a low price, but also that read and strictly follow all the details in the plans and specifications. Yet, they seem also to desire subcontractors that are not knowledgeable about the details (and risk) inherent in subcontract agreements. Subcontractors should explain that they pay detailed attention to the contract documents (including subcontract forms). Let the contractor know up-front what subcontract terms are acceptable to your company and be prepared to explain why certain language is one-sided and unfair.

### Tool No. 4 — Walk Away From Unfair Subcontracts (Principal Costs!)

It is always hard to lose out on a job when you have spent time getting the job and are working hard to cover your overhead. Yet, nobody needs to work for free or take on a problem project. You must be prepared to "walk away" absent an equitable agreement. Only when you are willing to walk away from a job will you be empowered to secure fair language.

If you take the time to educate your employees and customers on the unfair risk-shifting in most form subcontracts and retain the courage and leverage to "Stand Up!" for fair language and walk away from one-sided language, you will best be able to level the playing field, and get a contract you can live with. ■

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