

## Most Important Subcontract Terms

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Subcontracts are a distinct type of construction contract with differing obligations than a prime contract. Oftentimes subcontractors undertake greater contractual risks than perhaps their limited scope of work should entail. Sometimes a subcontractor will accept those added risks based on a long-term relationship of fairness with the general contractor. Other times, an owner or general contractor imposes unfavorable terms simply by means of their greater bargaining power by presenting the subcontract on a take it or leave it basis.

While some of the risk can be reduced or eliminated by using ASA or other industry forms, one of the best ways to reduce unnecessary risk is to have a knowledgeable construction lawyer review and comment on the subcontract before it is entered into. Even if the subcontract is non-negotiable, having a construction lawyer review extraordinary contractual risks may assist the subcontractor in deciding whether the profit on the work is worth undertaking the added risk. To help understand the risks, this article explores ten of the most important subcontract terms:

1. Flow-Through. Most general contractor forms have terms which require the subcontractor to assume the same obligations that the general contractor owes to the owner. While this is fine with respect to agreeing to perform the scope of the subcontractor's own work, problems arise where the prime contract contains broader obligations than the subcontract. For example, is the prime contractor liable for consequential damages if the work is not completed on time? If so, then the subcontractor may be exposed to substantially increased risk. Hence, it is important to review the prime contract to determine what additional obligations the general contractor is assuming on behalf of the owner. If the additional obligations are substantial, then the subcontractor will need to limit or negotiate the flow-through terms.
2. Scope of Work. Many disputes arise when a project is fast-tracked or the plans and specifications are not 100% complete. If all of the subcontractor's work is not shown on the plans or the materials are not fully called out in specifications, does the subcontract require that the work will be inferred? Is the scope of work clearly called out to ensure there is no overlap between other trades or the general contractor? Changes in the work and unforeseen conditions also expose the subcontractor to the risk of claims. The change clause should spell out required notice, and a signed change order should not only address the change work, but also the agreed impact on price and schedule.
3. Payment. Subcontractors require timely payment to meet payroll and material purchases. In private works, however, general contractors may seek to make payment contingent on receiving payment by the owner. Obviously, the subcontractor will want to ensure that it gets paid as the work progresses, regardless of whether the owner pays

the general contractor on time. In addition, the subcontractor will want the right to stop work if payment is not made on time.

4. Schedule. Sometimes subcontracts are executed which bind the subcontractor to a general contractor's schedule which the subcontractor has never seen or even participated in creating. If there is a schedule, are the time durations appropriate for the subcontractor's work? Does the subcontractor have a right to provide schedule input or perform its work unimpeded by other trades? What are the consequences for delays which are not the subcontractor's entire fault? Will liquidated damages be apportioned according to fault? Are there notice and cure provisions that allow the subcontractor to recover lost time or mitigate delays? Delay clauses should specify responsibility for weather, the fault of other parties, and force majeure.
5. Wrap Insurance. There was a time when subcontractors were unable to obtain liability insurance because of construction defect claims. That gap has now been largely filled with non-negotiable OCIP and CCIP programs. Keep in mind, however, that wrap policies might not provide coverage for claims asserted by the owner or other contractors. Also, wrap insurance may be lost or never come into existence if the insurer becomes insolvent or a high self-insured retention is not satisfied. Because a large, uninsured claim may put a subcontractor out of business, it is very important to review the terms of the wrap policy and negotiate deductibles. If possible, the subcontractor should obtain umbrella insurance to protect against claims that are not covered by a wrap policy.
6. Indemnity. Not long ago, owners, general contractors and their privies demanded that subcontractors provide a full and immediate defense and indemnity by counsel of their choosing for nearly any type of claim asserted on a project, regardless of the subcontractor's fault. More recently, such broad subcontractor indemnities have been outlawed in California. Nevertheless, indemnities are a legal specialty that must be looked at very closely to ensure the subcontractor is not being asked to defend claims that more appropriately should be undertaken by the owner, architect, or general contractor.
7. Liquidation. Subcontractors lack privity of contract to directly assert claims caused by the owner. Liquidation agreements allow the subcontractor's claims to be passed through to the owner via the general contractor. Typically, the subcontractor will be required to assert its claims in the same manner as the general contractor, and cooperate and pay the legal expense in prosecuting the claim. Problems arise where the general contractor may be partially at fault, the general contractor is prosecuting multiple pass-through claims at high legal cost, or the subcontractor desires to participate in the claim or settlement process. To avoid unintentional loss, the subcontractor must be careful not to release the prime contractor for such claims, e.g., broad change order and payment releases.
8. Unlimited Liability. Owners desire that their contractors be exposed to unlimited consequential or liquidated damages should the work not be performed as required. A

subcontractor will seek to avoid such unlimited liability exposure, especially where its scope of work is limited. In the end, liability exposure should be in proportion to the work undertaken, and by the party who is in the best position to manage the risk.

9. Warranty. Typically, contractors will warrant their completed work for one year. However, owners and general contractors may attempt to impose longer warranty durations, effectively putting the subcontractor in the position of an on-call repairman. In addition, the prime contract may specify higher standards and finishes than simply performing the work in a good and workmanlike manner. A subcontractor will desire to limit its liability to making its own repairs.
10. Disputes. A subcontractor will desire to have its claim considered promptly on its own merits, rather than being part of an expensive and protracted multi-party dispute. There are important strategy considerations in determining whether to utilize escalating resolution procedures, mediation, arbitration, or court, and who should be joined in that process. Likewise, the value of claims and economic strength of the parties must be considered before agreeing to a prevailing party attorney fee provision.

Obviously, a subcontractor might not wish to disrupt a long-term beneficial relationship with a preferred general contractor by attempting to negotiate terms in a form subcontract that the general contractor will not negotiate. However, the refusal to negotiate terms may not be a good reason by itself to blindly sign a subcontract. The subcontractor should still have its subcontract reviewed by knowledgeable legal counsel, if for no other reason than to better understand the contractual risks. That said, there is an art to negotiating a good subcontract which fairly balances the risks and rewards of construction. Having a lawyer push too hard may create an adversarial relationship in circumstances where what the client really needed was a long term partnership with its general contractor.