

conference preview

Wait! Before you bid, it's important to look for these legal pitfalls in your contracts and subcontracts.

AVOIDING LEGAL PITFALLS IN YOUR CONTRACTS AND SUBCONTRACTS

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MANAGING RISK on a construction project starts long before the kickoff meeting.

It actually begins with the submission of bid proposals and contract negotiations. The most important documents that will control a fabricator's risk on a construction project are its contract with the general contractor (which typically includes the prime contract) or owner, and its subcontracts with vendors and subcontractors. Negotiating fair contracts and subcontracts that equally allocate the risk on the project will help avoid disputes and disruptions during the project. Unfortunately, many contracts contain onerous provisions that do not fairly allocate the risk and place undue risk on lower-tier contractors. Your ability to eliminate those provisions in your contract and subcontracts will avoid claims and disruptions to the construction project.

Risk Management

Let's start with risk management, which is the practice of identifying and analyzing loss exposure and taking steps to minimize the financial impact of the risk it imposes. In negotiating contracts and subcontracts, you should implement a risk management process that minimizes your risk and requires that any risk you do assume, you can control. There are different ways to manage risk. These include transferring risk, insuring against risk or assuming risk. The following rules of risk management should be employed when negotiating your contract and subcontracts:

1. The party that is in the best position to control a risk should be the party to take responsibility for the risk.
2. If you are in a position where you cannot control a risk, you should try to transfer it to someone else who can control it.
3. If you cannot control a risk and cannot transfer it to someone else, then you should manage it through purchasing insurance.

When negotiating your contract and subcontracts, you should avoid assuming a risk that you cannot control. For example, fabricators should not be required to indemnify a contractor for the contractor's own negligence. The fabricator cannot control whether the contractor is negligent and, therefore, the fabricator should not be responsible for claims arising from the contractor's own negligence. The contractor should be responsible for its own negligence. Implementing these risk management rules will reduce the risk of financial exposure to the fabricator on the construction project.

Don't "Bet the Company"

Your goal in negotiating a contract with the owner or general contractor should be to ensure you have a contract that clearly defines the scope of work, payment for the work and roles and responsibilities of the owner, contractor and fabricator. Most importantly, your contract should appropriately allocate risk between the parties. The following contract provisions are ones that are often found to be "bet the company" clauses, which can cause severe financial problems for a fabricator on a construction project.

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Know what your contract consists of. The first issue when negotiating a contract is knowing what constitutes the contract. Your contract with the owner or contractor may include much more than you think it does. The contract typically not only includes your contract but also incorporates, by reference, many other documents. These often include the contract between the owner and contractor, modifications to that agreement, plans and specifications and possibly other codes and industry standards. Therefore, it is critically important that you read these other documents incorporated into your contract and ensure that you can comply with their terms.

Payment provisions. Almost every contract dispute involves disagreement over payment by one party to another. For this reason, it is essential that the payment terms in the contract be fair and clear.

One of the payment terms a general contractor may put in its subcontracts is the “pay-if-paid” clause. This term provides that before the contractor is required to pay the fabricator, the contractor must first be paid by the owner. This term is a problem for the fabricator for many reasons, not the least of which is that it places the risk of payment on the relationship between the general contractor and the owner, something the fabricator cannot control. It is possible that the general contractor is not getting paid by the owner due to an issue that has nothing to

do with the fabricator’s work. In order to mitigate this risk, it is important to negotiate this clause out of your contract—or make sure you have either mechanic’s lien rights or a payment bond under which you can pursue payment.

Change Order Provisions. A majority of the claims arising on construction projects have to do with disputes over changes to the scope of work. The key issues in change order disputes involve the following questions:

1. Is it indeed a change?
2. Who is responsible for the change?
3. How much will the change cost?
4. How much additional time is needed?
5. Should work proceed if an agreement on the change cannot be reached?
6. Was appropriate notice of the change given?

The first step in avoiding change order disputes is to have a clearly defined scope of work. In order to know if there is a change to the work, you must first be able to define the original scope of work.

Contract time and delays. Delays on a construction project can result in significant additional cost to all parties involved. Therefore, it is important to have clear and fair provisions dealing with the manner in which delays will be compensated.

One way to avoid delay claims is to develop a clear and realistic schedule. The contract must contain a realistic contract schedule (preferably one that has been reached by agreement prior to the start of work), a procedure for changing the schedule where necessary and an agreement for entitlement to time and compensation for changes to the schedule.

Poor structural design documents or uncoordinated drawings, which lead to RFIs, are a significant contributor to fabricator delays. The *Code of Standard Practice for Steel Buildings and Bridges* (ANSI/AISC 303, www.aisc.org/specifications) contains provisions regarding design documents that are clear and fair to both the fabricator and the engineer preparing the design. These provisions can provide protection for the fabricator for delays caused by bad drawings.

Some contracts contain “no-damage-for-delay” clauses that state that in the event of a delay, the fabricator may be allowed additional time but will not be allowed monetary compensation. These clauses should be avoided because they unfairly prevent a fabricator from recovering legitimate delay costs. No-damage-for-delay clauses are unenforceable in many states, but nevertheless should be removed from the subcontract if possible.

Indemnification. An indemnification clause is a provision that obligates one party (indemnitor) to defend and pay for a loss or damage incurred by another party (indemnitee). The scope of an indemnification clause should be closely scrutinized to assure that the indemnifying party is only indemnifying for claims arising from the indemnifying party’s own conduct. In other words, the indemnifying party should not be required to indemnify another party from claims arising from either that party’s negligence or some other party’s negligence over which the indemnifying party has no control.

Incorporating the Code. The current edition of the *Code* should always be incorporated by reference in your contract. The *Code* represents the best practices for the design, fabrication and erection of structural steel. By incorporating these provisions, the parties shall be required to follow the highest standards for steel construction.

There are several specific provisions of the *Code* that are important to have in your contract. For example, Section 3 of the *Code* addresses design documents and specifications. Section 4 of the *Code* describes the responsibilities of the owner and fabricator for the development of fabrication and erection documents. And Section 6 describes the requirements for shop fabrication and delivery.

Again, because the *Code* provisions set forth the criteria for trade practices for the design, fabrication and erection of structural steel, it is important for them to be incorporated into your contract.

The concept of “bet the company clauses” is further detailed in the March 2017 article “‘Bet the Company’ Contract Clauses and How to Avoid Them,” available at www.modernsteel.com.

Negotiating Subcontracts

While it is important to negotiate a fair contract with the owner or general contractor, it is equally important to negotiate subcontracts with vendors and subcontractors that clearly define the scope of work, “flow down” all appropriate risks and ensure that the subcontractor can either pay for or obtain insurance for all risks that it assumes.

Flow-down provision. It is important for the fabricator to make sure that the subcontract flows down all appropriate risks to the subcontractor that the fabricator has assumed in its contract. This is normally done in a contract provision that defines the “Contract Documents” to include the contract between the fabricator and the general contractor or owner. It is particularly important for the subcontractor to be bound by the same payment terms, warranties, schedule and change provisions that the fabricator has assumed in its contract with the general contractor or owner. For example, if the general contract contains a pay-when-paid provision, which states that the general contractor does not pay the fabricator until the contractor is paid by the owner, then the fabricator must include a similar provision in its subcontract in order to ensure it is not obligated to pay the subcontractor before it gets paid by the general contractor. Likewise, the subcontractor should issue the same warranties for its scope of work that the fabricator issues in its contract. By flowing down these key contract provisions to the subcontractor, the fabricator will limit its risk by ensuring that the subcontractor has the same obligations to it that the fabricator has to the general contractor or owner.

Changes. The change order provision in subcontracts should provide for notice of changes, a procedure for agreeing on changes and a method for pricing changes. To the extent the fabricator’s contract with the general contractor contains any limitations on changes, these same provisions should be in the subcontract. For example, if the general contract contains a no-damage-for-delay clause, which prevents the fabricator from recovering money for delay damages, the fabricator should ensure that its subcontract contains the same limitation. In general, the subcontract change provision should state that the subcontractor is only entitled to an adjustment to the contract price or schedule if the fabricator receives an adjustment for the subcontractor’s work from the owner or contractor.

The subcontract should also address what happens if the fabricator and subcontractor cannot agree on a change order. If the general contract contains a provision requiring the fabricator to proceed with disputed work, the fabricator should ensure the same provision is contained in the subcontract.

Indemnity. The fabricator’s subcontract, like its contract with the general contractor or owner, should contain an indemnification provision. At a minimum, the indemnification provision in the fabricator’s subcontract should require the subcontractor to indemnify and defend the fabricator, owner, general

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contractor and architect from claims or liens arising from or relating to the subcontract work. It should also assume the indemnity obligations in the fabricator's contract with the general contractor regarding work related to the subcontractor.

If the fabricator's contract with the general contractor or owner contains an onerous indemnity provision, which requires the fabricator to indemnify the contractor for its own negligence, a similar provision should be included in the subcontract. However, it should be noted that many states have anti-indemnity statutes that prohibit contract provisions that require one party to indemnify another party for that party's sole negligence. Therefore, to the extent such a provision is placed in the subcontract, it may be unenforceable under certain states' anti-indemnity statutes.

Insurance. It is critical that the fabricator's subcontract contain a requirement for the subcontractor to have insurance. At a minimum, the subcontractor's insurance requirement should be the same as those in the contract between the fabricator and general contractor. This will normally include general liability, worker's compensation and umbrella insurance. If the

subcontractor is providing services such as connection design, then it may be advisable for the contract to require professional liability (errors and omissions) insurance. The limits of coverage should be adequate to cover any risk that might arise from the project. The insurance provision should also require that the subcontractor's insurance policy name the fabricator as an "additional named insured." As an additional named insured, the fabricator should be covered under the subcontractor's insurance policy for all covered losses.

In summary, it is imperative to spend the time and effort at the beginning of the project to negotiate a fair and reasonable contract and subcontract. Your ability to eliminate or mitigate "bet the company" contract clauses will pay dividends during the project and when a dispute arises. ■

This article is a preview of Sessions L2 "You Never Give Me Your Money: How to Avoid Bet the Company Mistakes" and L5 "Every Rose Has Its Thorns: It's Time to Take Another Look at Your Subcontracts" at NASCC: The Steel Conference, taking place April 11–13 in Baltimore. Learn more about the conference at www.aisc.org/nascc.