

Best Practices for Subcontractor Agreements

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NORTH RISK PARTNERS[®]



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Flow Down Requirements

- Sub is bound by all terms of the Prime Contract and another other project documents between the GC and the Owner.
 - Even if the Sub has never seen them.
- Sub must also have written contracts with any of its sub-subcontractors or other vendors that require the sub vendors to agree to be bound by the terms of GC's agreement with the sub.

Scope of Work

- Parties should always make the specifications and responsibilities clear



Subcontractor Review of Plans and Site Conditions

- Sub should acknowledge review of plans and site, that it knows of no issues, and that it can perform its work for the price



Payment Terms

- Clearly state when the Sub must submit payment applications, how long the GC has to make payment, and the reasons that the GC may withhold payment
 - Requirements for pay applications
 - Timing for payment
 - Payment by Sub for its Labor, Materials, and Taxes.
 - Retainage: amount and when released

Pay If Paid Clauses

- **Pay-If-Paid Clause**

- The Sub will not be paid until and unless the Owner pays the GC for the Sub's work.
- Must be worded properly to be enforceable.
- Language to insert to neutralize a pay-if-paid clause without actually deleting it:
- *Notwithstanding any provisions herein to the contrary, any condition precedent to paying Subcontractor shall not apply if Owner has not paid GC for the Work covered by the Subcontractor's application for payment based upon i) negligence, breach of contract or other failure to perform by GC, ii) negligence, breach of contract or other failure to perform by another subcontractor working on the Project, or iii) other circumstances or causes not attributable to Subcontractor.*

Pay If Paid Clauses

SAMPLE PAY-IF-PAID CLAUSE

- Receipt of funds by Contractor from Owner is a condition precedent to the Contractor's obligation to pay Subcontractor, regardless of the reason for Owner's nonpayment. Contractor shall have no obligation, legal, equitable or otherwise, to pay Subcontractor for work performed by Subcontractor unless and until Contractor is paid by the Owner for the work performed by the Sub. Furthermore, in the event Contractor is never paid by Owner for Subcontractor's work, then Subcontractor shall forever be barred from making, and hereby waives, in perpetuity, any claim against Contractor therefor.

Pay When Paid Clause

- **Pay-When-Paid Clause**

- A timing clause that does not make the Owner's payment to the GC and absolute condition precedent to GC's legal obligations to pay the Subcontractor, but only states when the GC must pay.
- i.e. *"GC shall pay Subcontractor within 7 days after GC receives payment from the Owner for Subcontractor's completed and invoiced Work."*
- This wording is not a true pay-if-paid clause and the GC would eventually be required to pay the Sub within a "reasonable amount of time."

Change Orders

- GC will not be obligated to pay for any extra work unless the GC signs a written Change Order before the extra work begins.
- Note notice provisions and timing for asserting claims for extras.



Schedule

- Sub has reviewed and agrees with the project schedule and understands when the work must be completed.
- Often agreement says the schedule is a moving target and the Sub agrees to honor it no matter how it changes.



Delays

- Requires Sub to promptly report any such perceived delays or forever waive them.
- States that failure to promptly report the alleged delay:
 - amounts to the Sub's acceptance of the situation and
 - deprives the Sub of a future delay claim or demand for increased dollars.

Terminations for Convenience

- GC may terminate the Sub for any or no reason, “at the GC’s convenience.”
- If you are a Sub, take sure the clause stats that the GC will pay the Sub for labor and materials contributed through the date of termination, including reasonable profit.
- Sub may not seek any other damages, lost profits, etc.
- The GC will not likely ever terminate the Sub unless there is a default. If Sub is not in default, it would cost the GC more to terminate for convenience, pay the Sub in full for Work to date, and hire someone else.

Insurance and Indemnification

- Requires Sub to maintain a certain level of insurance as specified by the GC's insurer.
- **Waiver of Subrogation.** States that to the extent a claim is covered by insurance, neither party or its insurance company will pursue the other for damages.
- Requires Sub to indemnify and hold GC harmless from all damages and claims related to Sub's work.

Insurance and Indemnification

- GCs are limited to seeking *narrow-form* contractual indemnity from a Sub (337.02), meaning the sub can only be held liable to the extent of its own fault.
 - A GC is not allowed to shift its own liability to the Sub.
- GCs **are** permitted to shift their liability to a Sub's **insurer** via an insurance-procurement agreement, *i.e.* the Sub is required to buy insurance covering the GC (337.05).
- If the Sub fails to obtain the required insurance, the GC may seek indemnity from the Sub to the extent of the specified insurance if the requirements of Section 337.05, subd. 2, are met.

Insurance and Indemnification

- **Primary and Non-Contributory**
 - This may not be something you already have in place and may required an endorsement.
 - The word “primary” means that your insurance policy will defend and pay damages on behalf of the GC as an additional insured for a covered claim due to your actual or alleged negligence. The word “non-contributory” means that your insurer will not ask the GC’s insurer to “contribute” to the defense or settlement of the claim.

Insurance and Indemnification

- **Requiring Insurance for Indemnity Obligations:**

- Subcontract might require that “such insurance shall include coverage and endorsements that will insure Subcontractor’s indemnity obligations under this Agreement” or similar language.
- This could require an endorsement beyond the normal insurance.
- Review the indemnity provisions elsewhere in the agreement to confirm if there is any requirement to procure any separate insurance for the GC.

Insurance and Indemnification

- **Provide 30-day Notice of Cancellation or Non-Renewal:**
 - This is standard, but many insurance policies no longer require the insurer give an additional insured a 30-day notice.
 - Insurers do not want to be responsible for notifying numerous certificate holders when insurance policies are cancelled for non-payment or when they are not renewed.
 - Discuss with your insurance agent as this may not be what your standard policy says and may require a specific endorsement.

List of Sub Vendors

- Sub must provide GC with list of all of the sub's vendors and suppliers.



Correction of Work/Warranty

- State time frame for sub to correct work and complete punch lists.
- Sometimes these time frames are covered by the Prime Contract and not stated in the Subcontract.



OSHA Compliance/Project Safety/EPA/Lead Paint

- Sub acknowledges duty to follow all safety laws and rules
- GC can develop a safety manual or plan and Sub agrees it has read it and will follow it
- Sub must attend safety meetings when scheduled
- Sub must indemnify GC for all OSHA issues

Substance-Free Workplace

- Prohibits use of drugs or alcohol or impairment from any substances, often including tobacco.



Citizenship/Authorization to Work

- Sub agrees that is and all of its works are legal to work in United States
- Sub agrees to indemnify and hold GC harmless from all claims, damages or issues related to citizenship of its workers



Attorneys' Fees

- Language stating the Sub must pay all attorneys' fees that GC incurs for any reason.
- If you are a Sub, push for a prevailing party attorneys' fee clause:
 - *Notwithstanding any provisions herein to the contrary, the prevailing party in any dispute shall be entitled to an award against the non-prevailing party of the prevailing party's attorneys' fees and costs, including arbitrator fees, expert fees, and filing fees, incurred before, during, and after any mediation, arbitration, litigation, or other court proceeding and the non-prevailing party agrees to pay such amounts to the prevailing party.*

Liquidated Damages

- Usually a daily penalty for failure to complete the project within the agreed upon schedule.
- Subcontract often simply states that if the GC's contract with the Owner has a liquidated damages clause, the same terms apply to the subcontract and against the Sub.
- If a Sub, seek to add qualifying language that the Sub is only responsible for LD's to extent directly caused by Sub's actions or failure to act.

Dispute Resolution

- Many Subcontracts will call for disputes to be resolved through binding arbitration.
 - Meetings
 - Mediation
 - Continued Performance
 - Arbitration vs. Litigation
- An arbitration clause can impact enforcement of future mechanic's lien or payment bond actions, which must be pursued in district court.
 - Can end up with two separate cases, one in court and one through arbitration

Leaving Materials and Equipment on Site

- If the Sub is terminated or otherwise leaves the project for any reason (for example, the GC's failure to pay), the Sub is required to leave all of its materials, tools, and equipment on the job site so that the GC or a replacement Sub may use them.
- If you are a Sub, limit this to only leaving materials on site and not your tools and equipment.

Proprietary Information/ Non-Solicitation

- Sub agrees not to solicit GC's customers or use GC's information for any purpose outside of the project.



Independent Contractor Status

Sub should meet all independent contractor criteria:

- maintains a separate business with own office, equipment, materials and other facilities;
- holds or has applied for a federal employer identification number;
- operates under contracts to perform services for specific amounts of money and controls the means of performing the services;
- incurs the main expenses related to its services;
- responsible for the satisfactory completion of the services is liable for a failure to complete the services;
- receives compensation for services performed only on a commission, per-project or competitive bid basis;
- may realize a profit or suffer a loss on the services;
- it has continuing or recurring business liabilities or obligations; and
- the success or failure of its business depends on the relationship of business receipts to expenditures

Questions?

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