Legal Pitfalls in Construction Contracts

Wall and Ceiling Contractors Should Be Aware of the Dangers Lurking in Legal Clauses

Contractors must be knowledgeable about the legal effect of provisions and clauses in their general contracts and subcontracts and in the general and special conditions which usually accompany the general contract. In signing a contract, contractors must avoid getting boxed in to contract provisions which are loaded to their legal and practical detriment.

It is preferable to use standard construction documents, including standard forms sponsored by the American Institute of Architects which are now in wide use throughout the country.

The question “When is the subcontractor paid?” involves progress payments, retention, and final payment. These payment terms govern whether the sub will have an adequate amount of cash flow to cover his current costs and expenses during construction. Subcontractors should specify in their contract a certain date on which payment is to be made each month, and to insist upon payment on that date.

The contract should clarify whether the progress payments provision includes payment, not only for the percentage completion of the work in place, but also for materials and equipment suitably stored at the site or at an off-site location agreed to by the owner. A subcontractor who discovers belatedly that the progress payment clause in his contract does not include payment for stored materials and equipment may have a serious cash-flow problem. His material and equipment suppliers will expect payment as soon as materials are shipped to the jobsite. Yet, the sub would not yet be entitled to progress payments covering these items and, therefore, would have to pay for stored materials and equipment with his own funds. This is particularly serious in those cases where a project falls well behind schedule, and a subcontractor must wait for a long period to install the material. It is doubly frustrating to one who manufactures his material because he has already financed the fabrication period and must then wait even longer to recover his out-of-pocket costs.

Subcontractors should push for elimination of retention. Many private owners have eliminated retention and major governmental contract awarding agencies, such as the Gen-

(Editor’s Note: When a subcontractor signs a contract he should be especially wary of the language, especially in these inflationary times. Now that AGC has renounced the AIA’s standard subcontract agreement, subcontractors have an increased need to manage contracts effectively.)
eral Services Administration, have eliminated retention entirely. The elimination of retention from contract payments would improve cash flow and would cut down on the overall cost of the buildings to the owner, as well as improve the incentive for both subcontractors and general contractors to finish their portion of the work within the time limits allowed in the contract. The elimination of retention would also benefit the owners by the reduction of their contract prices, since the subcontractors and general contractors would no longer have to cover themselves and their prices from late payments on retained money.

Avoid Waiving Basic Rights

Contractors and subcontractors should avoid signing contracts which contain waivers of liens or bond rights and should avoid signing broad form hold harmless clauses which impose liability upon them for the fault of others. They must also determine the extent of liabilities which they may incur in contracts under warranties, liquidated damages and other clauses which typically appear in the contract contracts.

Too often, subcontractors sign subcontract forms which are furnished them by general contractors, without having any knowledge of the very serious legal implications of many of the subcontract clauses that give general contractors unnecessary legal and practical advantages. Many subcontractors fail to read the subcontract carefully, or if they do read it, they fail to appreciate fully the implications and consequence of much of the language which create unexpected liabilities to the subcontractor.

This has become increasingly a problem as subcontracts have become more and more lengthy, complicated, and deliberately devised to protect the interest of the general contractor at the expense of the subcontractors. To avoid unnecessary financial risk and burdensome legal involvement, subcontractors must read every subcontract carefully and be aware of the legal and practical effects of clauses which give the general contractors unnecessary legal and practical advantages.

In many cases subcontractors substitute a more neutral standard subcontract form sponsored by the American Institute of Architects or the standard subcontract form sponsored by the Associated General Contractors of America and the Associated Specialty Contractors, Inc., which will be referred to as the AGC subcontract form.

Many subcontractors also include stipulations in their bids that the subcontractor’s bid be conditioned upon use of an AIA or AGC standard sub
contract form between the parties if their bid is accepted. If the subcontractor’s bid is accepted, the use of the stipulated standard form subcontract is then legally required to be used by the general contractor. Many subcontractors are also drafting either the AIA or the AGC subcontract form and initially sending the form to the general contractor after the general contractor has indicated that the subcontractor’s bid has been accepted.

Typically, “contingent payment clauses” appear in subcontract forms devised by general contractors, and provide that the subcontractors will not be paid until the general contractor is paid by the owner or until the architect approves the work. Under a contingent payment clause the general contractor has attempted to shift the risk of nonpayment by the owner from the general contractor to the subcontractor. Many things may happen on a construction project that are totally beyond the control or responsibility of the subcontractor and that may cause payment by the owner from the general contractor to the subcontractor. Many things may happen on a construction project that are totally beyond the control or responsibility of the subcontractor and that may cause payment by the owner or certification by the architect to be substantially delayed or even permanently prevented. Under contingent payment clauses general contractors often attempt to deny responsibility for paying the innocent subcontractors if anything occurs which causes the job not to be certified by the architect or causes the owner not to pay the general contractor.

The best approach is for the subcontractor to add a savings clause which clearly establishes that the subcontractor will be paid if the general contractor is not paid by the owner or the architect does not certify the work for any reason that is not the fault of the subcontractor. General contractors typically accept such savings clauses, and a subcontractor should never sign a contingent payment clause unless language similar to the following savings clause is included:

If the architect fails to issue a certificate for payment the contractor does not receive payment for any cause which is not the fault of the subcontractor, the contractor shall pay the subcontractor, on demand, progress payments and the final payment.

The preceding clause is essentially the language included in Article 12.5 of the AIA Standard Subcontract Form A401. If a subcontractor substitutes the AIA standard subcontract form, he automatically includes the savings clause.