

CLAUSE AND EFFECT BASIC CONTRACT LAW PRINCIPLES AND KILLER CONTRACT CLAUSES

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PURPOSE OF CONSTRUCTION CONTRACTS

Allocate between the parties (owner, prime contractor & subcontractors) the various rights, risks, responsibilities and rewards relating to the performance of the construction services involved.

RISKS

- Risks belong with those parties who are best able to evaluate, control, bear the cost and benefit from the assumption of risks.
- Many risks are best shared.
- Every risk has an associated and unavoidable cost which must be assumed somewhere in the process.

THE IDEAL CONSTRUCTION CONTRACT

- The most cost effective.
- Assigns each risk to the party that is best equipped to manage and minimize that risk, recognizing the unique circumstances of the project.

CONTRACT

A contract is an oral or written agreement between two or more parties enforceable by law to do or not to do a particular thing. The agreement must be reached by a meeting of the minds of the parties. The agreement can be written or oral expression, or it can be implied from the conduct of the parties, but it cannot be based on the secret intention or understanding of one party not conveyed to the other. To be enforceable, a contract must be based on consideration, that is, a promise to do something in exchange for something that is a detriment to the other party or a benefit to the first party.

OFFER and ACCEPTANCE

For a valid contract to exist, there must be an offer and acceptance. An offer is the manifestation or expression of a willingness to enter into a contract in such a way as to justify another in understanding that its acceptance of the contract is invited. Typically, in the construction context, the bidding process is understood to be a more formal system of offer and acceptance.

The acceptance of the offer need not be in writing, but must be in the manner and under the terms contemplated by the offer. Where the offer does not specify what manner of acceptance is required, any reasonable acceptance in accordance with customary practice in the industry constitutes an acceptance of the offer.

BIDS – PROMISSORY ESTOPPEL

BEWARE!!

If you submit a bid – be prepared for the consequences of it being used by the general contractor in its bid to the owner and consequently, you may later be bound to perform under the terms and conditions of your bid.

USE CONDITIONAL BIDS

- This bid is conditioned on the use of the AIA A401 Subcontract (2007 edition) or ConsensusDOCS 750
- Define your scope of work
- List inclusions & exclusions
- Payment and retainage terms
- Limit or exclude liquidated damages
- Change orders and backcharges
- Interest and attorney's fees
- Bid to be incorporated into the subcontract

BREACH OF CONTRACT

If one party to a contract does not perform its obligations under a contract, it is called a breach of contract and the other party is entitled to damages. Breach of contract means the failure, in the absence of legal excuse or impossibility of performance, to perform any promise that forms the contract or any part of it.

INCORPORATION BY REFERENCE

- Subcontracts usually contain an “Incorporation by Reference” clause, also known as “Flow-down” or “Conduit” clauses

Reasonably necessary to coordinate the performance of the contract work

INCORPORATION BY REFERENCE

Proprietary Form Example

The general, special and supplemental conditions, drawings, plans, specifications, delivery and construction schedules, and safety rider, referred to herein... Are specifically incorporated by reference... **Subcontractor represents and agrees that has carefully examined and understands this agreement, and all of the referenced and incorporated documents...**

INCORPORATION BY REFERENCE

Proprietary Form Example

...if any provision of this Agreement conflicts with a portion of the reference documents, or if there is a conflict within this Agreement or within any of the reference documents, **the provision imposing the higher-quality, greater quantity or greater duty or obligation on Subcontractor shall govern...**

INCORPORATION BY REFERENCE

(ConsensusDOCS 750 - 2011, Revised 2014)

The Subcontract Documents include this Agreement, the prime agreement, special conditions, general conditions, specifications, drawings, addenda issued and acknowledged prior to execution of this Agreement, amendments, laboratory testing to determine the nature of encountered hazardous materials, other documents listed in this Agreement, and modifications issued in accordance with this Agreement. The Constructor shall provide to the subcontractor, prior to the execution of this Agreement, copies of the existing Subcontract Documents to which the Subcontractor will be bound. The Subcontractor shall provide copies of applicable portions of the Subcontract Documents to its proposed subcontractors and suppliers. Nothing shall prohibit the Subcontractor from obtaining copies of the Subcontract Documents from the Constructor at any time after the Subcontract Agreement is executed.

FLOW DOWN CLAUSES

- Flow down clauses can shift the risks in the contract between the owner and the prime contractor down to the subcontractor.
- “Subcontractor shall assume toward the Contractor all obligations and responsibilities which the Contractor, under the Prime Contract, assumes toward the Owner and Architect.”
- Incorporate both the prime contractor’s rights and responsibilities under the Prime Contract.
- Review the Prime Contract.
- “Where a provision of the Prime Contract is inconsistent with a provision of this Agreement, this Agreement shall govern.”

PROBLEMATIC INCORPORATION/FLOW DOWN CLAUSE

The Subcontractor represents and warrants that it has received, reviewed and carefully examined all of the documents which make up the contract Documents, including, without limitation, the Drawings and Specifications for or related to the Work, and the Subcontractor has found them in all respects to be reasonably complete, accurate, adequate, consistent, coordinated and sufficient for the Work. The Subcontractor, after diligent and careful review of the Contract Documents, has found no significant missing elements, which would result in a change in the Contract Price or a change in its schedule for performance of the Work or a change in Contract Time (as hereinafter defined). The Subcontractor hereby acknowledges and agrees that neither Owner nor the construction manager represents or warrants that the Contract Documents are complete, accurate, adequate, consistent, coordinated or sufficient for the Work.

MUTUAL FLOW DOWN CLAUSE

The Contractor shall assume toward the Subcontractor all obligations and responsibilities that the Owner, under such documents, assumes toward the Contractor, and the Subcontractor shall assume toward the Contractor all obligations and responsibilities which the contractor, under such documents, assumes toward the Owner and the Architect. The contractor shall have the benefit of all rights, remedies and redress against the Subcontractor that the Owner, under such documents, has against the contractor, and the Subcontractor shall have the benefit of all rights, remedies and redress against the Contractor that the Contractor, under such documents, has against the Owner, insofar as applicable to this Subcontract.

AIA A401 - 2007

CONTRACT DOCUMENT CONFLICTS

BEWARE!!

In the event of a conflict between the prime contract and this subcontract, the document with the most favorable provision for the Contractor shall control.

TWO TYPES OF CONTINGENT PAYMENT CLAUSES

- Contingent and Conditional Payment Clauses
 - Pay-When-Paid v. Pay-If-Paid Clauses
 - WHEN paid – Timing Only
 - although some states treat them as being equal
 - IF paid – payment from Owner to General contractor a Condition Precedent to obligation to pay Subcontractor

PAY IF PAID/CONDITION PRECEDENT

All progress or milestone payments and final payment mentioned in the Subcontract are contingent upon and subject to Owner's acceptance of all Work performed by Subcontractor. Anything in the Subcontract or the Subcontract Documents to the contrary notwithstanding, receipt of payment by Contractor from Owner shall be a condition precedent to the right of Subcontractor to receive payment. Subcontractor expressly assumes the risk of nonpayment by Owner.

PAY WHEN PAID

Progress payments to the Subcontractor for satisfactory performance of the Subcontract Work shall be made no later than seven (7) Days after receipt by the Constructor of payment from the Owner for the Subcontract Work. If payment from the owner for such Subcontract Work is not received by the Constructor, through no fault of the Subcontractor, the Constructor will make payment to the Subcontractor within a reasonable time for the Subcontract Work satisfactorily performed.

ConsensusDOCS 750 (2011, revised 2014)

REMEDIES FOR NONPAYMENT

If the Contractor does not pay the Subcontractor through no fault of the Subcontractor, within seven (7) days from the time payment should be made as provided in this Agreement, the Subcontractor may, without prejudice to any other available remedies, upon seven additional days' written notice to the Contractor, stop the Work of this Subcontract until payment of the amount owing has been received. The Subcontract Sum shall, by appropriate Modification, be increased by the amount of the Subcontractor's reasonable costs of demobilization, delay and remobilization.

AIA A401 - 2007

Change Orders

- 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 and ensure that they are satisfied.
- Subcontractors may want to resist provisions which allow the general contractor to direct the changed 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 before “backcharges” or deduct change orders can be assessed.

WRITTEN CHANGE ORDERS

- Documents your changes in a writing signed by the parties before doing the work:
 - In a formal change order
 - In a letter agreement
 - Email
 - On the back of a napkin

WRITTEN CHANGE ORDERS

- Proprietary Form Example.

No Change Order shall be valid or enforceable **unless signed in writing by XXX, President of Contractor** and approved by owner. It is expressly understood and agreed to by Subcontractor that no other person has actual or apparent authority to sign Change Orders on behalf of Contractor.

CHANGE ORDERS

- ConsensusDOCS 750 (2011, revised 2014)
 - The Subcontractor may request or the constructor may order changes in the Subcontract Work or the timing or sequencing of the Subcontract work that impacts the Subcontract Amount or Subcontract Time. All such changes in the Subcontract Work that affect the Subcontract Amount or the subcontract Time shall be formalized in a Subcontract Change Order. Any such requests for a change in the Subcontract Amount or Subcontract Time shall be processed in accordance with this article.

CHANGE ORDERS, CONT'D.

- . INTERIM DIRECTED CHANGES in the absence of agreement on the terms of a Subcontract Change Order, the Constructor may issue a written Interim Directed Change directing the Subcontractor to proceed with the Subcontract Work in question. If such Interim Directed Change is issued as a result of the Owner's issuance of an Interim Directed Change, Construction Change Directive, or equivalent directive, then the applicable provisions of the prime agreement shall govern. Otherwise, the Subcontractor shall separately submit its costs for the resulting change, beginning with its next regularly scheduled application for payment submitted after the issuance of the Interim Directed Change. If there is a dispute as to the cost, the Constructor shall

CHANGE ORDERS, CONT'D.

pay the Subcontractor fifty percent (50%) of its estimated cost to perform the Subcontract Work. In such event, the Parties reserve their rights as to the disputed amount. If and when the Parties agree upon an adjustment in Subcontract Amount or Subcontract Time, such agreement shall be reflected in a Subcontract Change Order, and the payments to date shall be adjusted to reflect the Subcontract Change Order. If no agreement is reached, the Parties shall resolve the matter as provided in ARTICLE 11.

CHANGE ORDERS

- NO OBLIGATION TO PERFORM. The Subcontractor shall not be obligated to perform changes in the Subcontract Work that impact Subcontract Amount or Subcontract Time until a Subcontract Change Order has been executed or written instructions have been issued in accordance with sections 7.2 or 7.8.

ConsensusDOCS 750 (2011, revised 2014)

INDEMNIFICATION

Many states have statutory restrictions on the scope of indemnification in Construction Contracts. Know the applicable law that controls your Subcontract.

BROAD FORM INDENIFICATION

Subcontractor shall defend, indemnify and hold harmless the Owner, Contractor and Architect and their officers, employees, affiliates, parents and subsidiaries, agents and representatives from and against any claims, caused of actions, loss of use, damages, losses, costs, attorney's fees and expenses, in law or in equity, arising out of or in connection with Subcontractor's Work to be performed under this Agreement, including any of the same resulting from Contractor's, owner's or Architect's alleged or actual negligent act or omission, whether active or passive.

INTERMEDIATE FORM OF INDEMNIFICATION

Subcontractor shall defend, indemnify and hold harmless the Owner, Contractor and Architect from and against claims, damages, losses and expenses, including but not limited to attorney's fees and loss of use, arising out of the performance by Subcontractor, or anyone for whom subcontractor is responsible, of Subcontractor's Work under the Subcontract Documents, including any of the same resulting from Contractors, Owner's or Architect's alleged or actual negligent act or omission, whether active or passive.

LIMITED FORM OF INDEMNIFICATION

To the fullest extent permitted by law, the Subcontractor shall indemnify and hold harmless the owner, Contractor, Architect, Architect's consultants, and agents and employees of any of them from and against claims, damages, losses and expenses, including but not limited to attorney's fees, arising out of or resulting from performance of the Subcontractor's Work under this Subcontract, provided that any such claim, damage, loss or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the Work itself), but only to the extent caused by the negligent acts or omissions of the Subcontractor, the Subcontractor's Sub-subcontractors, anyone directly or indirectly employed by them or anyone of whose acts they may be liable, regardless of whether or not such claim, damage, loss or expenses is caused in part by a party indemnified hereunder.

AIA A401 - 2007

SAFETY

Subcontractor shall indemnify and save Contractor harmless from any liability, loss, cost, damages or expense, including attorneys' fees, which Contractor may suffer or incur as a result of any causes of action, proceeding, citation or work stoppage arising out of or in any way connected with the alleged violation by Subcontractor of any such safety order, rule, regulation or requirement whether such violation is ultimately proved or not.

OSHA FINE INDEMNIFICATION LIMITATION

The Subcontractor shall indemnify the Contractor for fines or penalties imposed on the Contractor as a result of safety violations, but only to the extent that such fines or penalties are caused by the Subcontractor's failure to comply with applicable safety requirements, rules and regulations, and then only to the extent that such fines or penalties are determined to be the Subcontractor's responsibility based on the particular failure of compliance cited, and not due to prior or repeated safety violations by the Contractor.

CONTROLLING LAW & VENUE FOR CLAIMS

This subcontract shall be controlled and interpreted by the laws of the State of Colorado and the sole venue for any claim that arises under this Subcontract shall be the District Court for the City and County of Denver, Colorado.

PROSPECTIVE LIEN WAIVERS

- When requesting a draw, does your lien waiver release your lien rights before you have received and negotiated your check?
 - Be careful, lien waivers are EVERYWHERE

PROSPECTIVE LIEN WAIVERS

- Proprietary Form Example
 - **For good and valuable consideration, including the negotiated price** for the Merchandise, Services or Work under this Agreement, **Subcontractor unconditionally waives and releases any and all mechanics' lien rights...**

PROSPECTIVE LIEN WAIVERS

As a prerequisite for payments, the Subcontractor shall provide, in a form satisfactory to the Owner and Constructor, partial lien or claim waivers in the amount of the application for payment and affidavits covering its subcontractors and suppliers for completed Subcontract Work. Such waivers may be conditional upon payment. In no event shall the Constructor require the Subcontractor to provide an unconditional waiver of lien or claim, either partial or final, prior to receiving payment or in an amount in excess of what it has been paid.

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Mark is an attorney and director of the Denver, Colorado firm, Senn Visciano Canges PC. His practice primarily focuses on construction law, alternative dispute resolution and litigation (commercial and real estate). He is counsel for many construction industry clients, including owners (both public and private), developers, contractors, construction managers, specialty trade contractors, subcontractors, suppliers and trade associations. He is a member of the American Bar Association Forum on the Construction Industry and Public Contract Law Section as well as the Colorado Bar Association's Construction Law Forum. Mark has served as the Chapter Attorney for the American Subcontractors Association's Colorado Chapter since 1991 and has been a member of the Steering Committee of Division 9 of the ABA Forum on Construction Industry (Specialty Trade Contractors and Suppliers). Mark is a member of the construction industry panel of arbitrators of the American Arbitration Association and has served as a sole arbitrator and arbitration panel member in construction related arbitrations. He has experience as a court appointed and private mediator in construction and commercial disputes. Mark has assisted in passing legislation of interest to the construction community, including drafting key portions of the Colorado statute limiting risk transfer/indemnification in construction contracts. Mark been selected as a *SuperLawyer* in Colorado for construction litigation matters for 2009, 2010, 2013, 2014, 2015 and 2016 and was also selected by his peers for inclusion in the 2016 and 2017 editions of *The Best Lawyers in America*® in the field of construction law. He is a frequent author and lecturer on construction litigation and contracts, and other related topics. Mark is also admitted to the Illinois bar.

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