



**IRMI**<sup>®</sup>

**Workshop Q**

***ANALYZING AND AVOIDING CONTRACT RISKS***

**Presented by**

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Senior Partner  
Katz & Stone, L.L.P.**

***Wednesday, November 10, 1:30–3:00 p.m. and 3:30–5:00 p.m.***

**Gerald I. Katz**  
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Mr. Katz is presenting Workshop Q, "Analyzing and Avoiding Contract Risks," on Wednesday afternoon. He is a partner in the law firm of Katz & Stone, L.L.P., with offices in Vienna, Virginia; Washington, D.C.; and Rockville, Maryland, and specializes in resolving complex construction disputes. He has extensive experience in representing owners, contractors, sureties, and designers in complex construction litigation.

In addition to his practice, Mr. Katz lectures and speaks frequently to owners, contractors, public building officials, subcontractors, suppliers, design professionals, sureties, and others involved in construction on such topics as construction risk management, negotiating construction contracts, construction claims and claims prevention, liability of the design professional, and construction insurance issues.

Mr. Katz has conducted seminars for such construction trade associations as Associated Builders and Contractors; National Electrical Contractors Association; National Utility Contractors Association; American Subcontractors Association; World of Concrete; National Pavement Exposition; Associated General Contractors of America; Contractors Association of West Virginia; Virginia Building Material Association; Maryland General Contractors Association; Construction Management Association of America; National Association of Surety Bond Producers; Reliance Insurance; The St. Paul Companies; Bermuda Contractors Association; American Contractors Insurance Group; Barbados Association of Quantity Surveyors; Korean Contract Management Association; China National Petroleum Corporation; and the Ministry of Works, Government of St. Lucia.

Mr. Katz is a frequent speaker at the IRMI Construction Risk Conference on contractual risk transfer, surety bonds, completed operations coverage, and other construction risk topics. He is a recipient of IRMI's Words of Wisdom (WOW) award.

Mr. Katz received both a bachelor of arts with distinction and a juris doctor degree from the University of Virginia. Mr. Katz is a member of the Bars of the District of Columbia, Virginia, Maryland, United States Supreme Court, and United States Court of Federal Claims. He also serves as an arbitrator on the American Arbitration Association's Construction Industry Arbitration Panel, and is an Associate Member of The Chartered Institute of Arbitrators.

## ***Notes***

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# **ANALYZING AND AVOIDING CONTRACT RISKS**

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**Gerald I. Katz  
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## **I. INTRODUCTION**

A successful project is one in which the “learning curve” is achieved by field employees early on so that production and efficiency are maximized. This happens when employees learn the job, repeat the necessary steps in production and become more efficient as the job proceeds. Repetition is what makes for good production and a financially successful contract.

While the repetition of activities is good for production and, thereby, the bottom line, when problems are repeated, the impact on production and the bottom line is exactly the opposite. Contractors, therefore, should strive to avoid problems which affect the bottom line.

Unfortunately, certain contractual risks are “facts of life” in today’s construction industry. They are facts of life because they are likely to be present in every contract and/or occur on any job. But because they are facts of life, the contractor who is prepared to deal with these risks can successfully manage them so that they do not have a serious impact on his performance. There is a learning curve for problem management and contract administration, just as there is a learning curve for production. The challenge is to identify potential risks before they appear and to manage them until they are resolved, or at least minimized.

Upon close inspection, contractors will see that typical construction contract risks share certain characteristics. An appreciation for these characteristics, as well as a basic understanding of how contracts operate, will enable the contractor to easily develop a coordinated problem response system that has as its goal the early identification, negotiation and resolution of contractual risks. The goal should not be to bring attorneys into the process immediately upon discovering a risk, but rather to try to avoid the risk in the first instance, to detect it early if it cannot be avoided, and to manage it carefully so that it goes away. How can this be done?

Contractors essentially have two opportunities in which to identify, manage and resolve construction contract risks. The **first, and best**, opportunity is in the pre-contract or negotiation stage, while the second opportunity is in the contract administration or performance stage. How much effort the contractor must devote to risk identification, management and resolution in the second stage, that is, during the job, will depend upon how successful he has been in the first stage, in negotiating his contract. The smart, careful contractor will realize that he can make job performance far easier and much less risky if he pays careful attention to his contract before he signs it. Otherwise, he is likely to “buy-in” to unknown, and certainly unnecessary, risks before the job even begins. The contract, therefore, is the contractor’s first line of defense in dealing with risks.

## II. KNOW YOUR CONTRACT AND HOW IT WORKS

Construction contracts are rarely “fair” in the abstract sense and are not always the result of equal bargaining power. Often, contracts are presented on virtually a “take it or leave it” basis. This does not mean, however, that the contractor must surrender and merely sign the document that is put in front of him.<sup>1</sup> The smart contractor knows the handful of vital contract provisions to look for, how they work and what the exceptions and loopholes are. He will know from his understanding of the contract what provisions can be negotiated to mutual satisfaction, and how to spot those provisions which may appear harmful on their face but are not as bad as they seem. The prudent, forward-looking contractor will also know what to do once the job begins in order to manage the risks created by those contract provisions which he does not like but, nonetheless, must accept. In three words, therefore, the approach the contractor should take is: ANALYZE, RESPOND and MANAGE.

**Analyze** means to review the contract to identify the troublesome clauses and negotiate them as best you can. **Respond** means to watch out for the troublesome clauses once the job begins by detecting problems early and giving prompt written notice. **Manage** means to monitor problems once they have been detected, in order to reduce the risk or maximize the recovery.

Reviewing a construction contract before it is signed requires more than merely verifying that the designated contract sum is the price that was agreed between the contractor and his customer. Effective contract review requires that the contractor focus on those provisions which appear in almost all construction contracts and which have potentially the most drastic impact on the bottom line. These risk-creating provisions include “no damage for delay” clauses, condition precedent payment clauses, indemnification clauses, disputes procedures, notice provisions and claim submission procedures. While the entire contract should be carefully reviewed, there are many provisions which are of a routine nature and, except in extraordinary cases, pose virtually no risk to the contractor. By focusing on the key risk provisions, understanding how they work and negotiating them effectively, the contractor can do a lot to minimize the legal problems he is likely to face once the job begins.

There are several common sense rules or principles which ought to guide the contractor in his review and negotiation of the proposed contract. **First, know the exceptions.** A case in point is the “no damages for delay” clause. Understanding what this clause typically covers and knowing what the exceptions are may be enough to satisfy the contractor that he can live with the clause as long as he effectively manages the risk during job performance.

**Second, know local variations in the interpretation of risky contract provisions.** Construction contracts often (though not always) are governed by the law where the project is located. Out-of-state contractors, therefore, should be familiar with local law because this may provide favorable exceptions or even render onerous contract provisions void due to public policy. Such is the case, for example, with “condition precedent” payment clauses in a number of states.

**Third, once risky clauses have been identified, seek a “win-win” solution in negotiations.** By understanding what the clause is intended to do for the other side, the contractor, sometimes, can fashion a compromise which offers his customer protection without

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<sup>1</sup>Of course, knowing when to say “No” to a proposed contract can be the best way to avoid risks and the resulting legal problems.

risking the contractor's basic rights. For example, offering the general contractor a "covenant not to sue" may be enough to convince him to delete a condition precedent payment clause.

**Fourth, if the clause cannot be deleted or negotiated, allocate the risk it presents to a lower-tier.** Make sure that the subcontracts (and purchase orders) you award do not expose you to greater obligations than your customer has assumed toward you.

The contractor who ignores the proposed contract and will sign anything is buying into substantial risks that could be avoided. On the other hand, the contractor who requires a negotiation over every paragraph of the contract is likely to infuriate his customer and, in any event, is wasting valuable time and effort. The prudent contractor takes the middle course: he knows those risk provisions that could harm him, he understands how they work, he tries to negotiate them, he knows the exceptions, and, once he has accepted what he absolutely must, he prepares to deal with such risks in the next phase, project performance.

Set forth below are a number of standard construction contract risk provisions. These clauses, or clauses very similar to them, appear in virtually every written construction contract. These are the contract provisions which should be the focus of the contractor's risk review and negotiation.

In reviewing and understanding these contract clauses, it is important to remember that, while most of these provisions are not beneficial to the contractor's (or subcontractor's) interests and should be deleted from the construction agreement whenever possible, as a practical matter, the general contractor, and more likely the subcontractor, may not be able to negotiate the removal of all of these clauses from the contract documents. Thus, the goal is to recognize the potentially harmful clauses, to understand the situations or conditions under which these clauses apply, to avoid those circumstances whenever possible, and where avoidance is not possible, to manage the risks presented. In most cases, the law recognizes defenses to these troublesome clauses, and if the contractor or subcontractor identifies the problem and is prepared from the outset of the project to manage the risk, this foresight will be rewarded by significantly diminished liability.

### **III. THE SPEARIN DOCTRINE**

To understand how contract provisions work and, more generally, construction law, you need to understand the Spearin doctrine. Under the Spearin doctrine, adopted by most if not all of the states, the owner impliedly warrants the accuracy and adequacy of the contract document issued to the contractor. A similar warranty is given by the general contractor to the subcontractor. If the contract documents are followed, therefore, and if there is a problem with the work owing to a design in the contract documents, under the Spearin doctrine, the contractor (or subcontractor) is not responsible for the design.

The law has created a "gap" between the duty owed by the contractor to the owner, as defined by the Spearin doctrine, and the duty owed by the designer to the owner which is defined by the law of professional malpractice. As a result of this "gap," extra work may be needed to correct design errors which may not be recoverable by the owner from the designer.

Contract provisions are often aimed at shifting the allocation of risk under the Spearin doctrine from the owner back to the contractor and from the contractor to the subcontractor.

#### **IV. YOUR CONSTRUCTION CONTRACT'S RISKIEST CLAUSES**

##### **A. Flow-Down Clause**

###### **EXAMPLE:**

- **FLOW-DOWN RELATIONSHIP.** Subcontractor is bound to the Contractor in the same way and to the same extent Contractor is bound to Owner by the terms of the Contract Documents and shall bear all rights and liabilities with respect to the Contractor as the Contractor has with respect to the Owner, except that the terms of this Subcontract shall govern any inconsistent provision herein and in the Contract Documents. Subcontractor shall not deal directly with or work directly for Owner, Architect or Engineers.

###### **TIPS:**

- Often, flow-down clauses are interpreted to apply only to the technical specifications of the contract documents which deal with the contractor's scope of work. Forfeiture provisions found in the general conditions, for example, waiver of lien clauses or condition precedent payment clauses usually don't "flow down" to the subcontractor.

##### **B. Contract Documents Review and Site Inspection**

###### **EXAMPLE:**

- The Contractor acknowledges that it has taken steps reasonably necessary to ascertain the nature and location of the work, and that it has investigated and satisfied itself as to the general and local conditions which can affect the work or its cost, including but not limited to (1) conditions bearing upon transportation, disposal, handling, and storage of materials; (2) the availability of labor, water, electric power, and roads; (3) uncertainties of weather, river stages, tides, or similar physical conditions at the site; (4) the conformation and conditions of the ground; and (5) the character of equipment and facilities needed preliminary to and during work performance. The Contractor also acknowledges that it has satisfied itself as to the character, quality, and quantity of surface and subsurface materials or obstacles to be encountered insofar as this information is reasonably ascertainable from an inspection of the site, including all exploratory work done by the Government, as well as from the drawings and specifications made a part of this contract. Any failure of the Contractor to take the actions described and acknowledged in this paragraph will not relieve the Contractor from responsibility for estimating properly the difficulty and cost of successfully performing the work, or for proceeding to successfully perform the work without additional expense to the Government.

###### **TIPS:**

- It is essential that the contractor conduct a pre-bid site investigation to protect his rights and a possible later claim in the face of site investigation clauses. Without a site investigation, it will be very difficult to challenge the risk allocation provisions of site investigation disclaimer clauses.

### **CASE EXAMPLE:**

A subcontractor sued the general contractor for additional sums expended after it encountered wet soil while sinking piers for a foundation. The contract contained a provision in which the general contractor "disclaim[s] any responsibility for the accuracy, true location and extent of the soils investigation," including data concerning "the presence, level and extent of underground water." Additionally, the contract stated "the [soil] report is not a warranty of subsurface conditions, nor is it a part of the contract documents." The subcontractor chose not to investigate the site independently but instead relied on the soil reports furnished by the contractor to assist in bid preparation which did not reveal the wet soil condition. The court held that the soil report disclaimer effectively barred the subcontractor's ability to recover for the unforeseen conditions. See Millgard Corp. v. Mckee/Mays, 49 F.3d 1070 (5th Cir. 1995).

### **C. Scheduling**

#### **EXAMPLE:**

- The Contractor shall, within five days after the work commences on the contract or another period of time determined by the Contracting Officer, prepare and submit to the Contracting Officer for approval three copies of a practicable schedule showing the order in which the Contractor proposes to perform the work, and the dates on which the Contractor contemplates starting and completing the several salient features of the work (including acquiring materials, plant, and equipment). The schedule shall be in the form of a progress chart of suitable scale to indicate appropriately the percentage of work scheduled for completion by any given date during the period. If the Contractor fails to submit a schedule within the time prescribed, the Contracting Officer may withhold approval of progress payments until the Contractor submits the required schedule.

(48 C.F.R. ' 52.236-15).

#### **TIPS:**

- Scheduling clauses need to be evaluated in the context of the implied duties to schedule and coordinate the work, and other implied duties, which the courts will read into a contract. These other duties include the duty to act in good faith, the duty to cooperate and the duty to not interfere with the contractor's performance.

Often, the implied duties trump written scheduling clauses where the contractor can show that the other party breached an implied duty.

- Add the word "reasonable" where the contract refers to the "progress schedule" and/or "adjusted/updated progress schedule."

### **CASE EXAMPLE:**

A masonry subcontractor sued the general contractor for delay damages and acceleration costs based on the general contractor's breach of its duty to cooperate with the subcontractor and avoid delay to the project. The contract contained a paragraph which stated "Subcontractor shall proceed with the work according to a progress schedule furnished by the Contractor, without interference of the work of Contractor . . . so that the Contractor . . . can complete the work in accordance with the project schedule . . . . Subcontractor acknowledges that it has been informed that the Contractor must complete the general contract [by a date certain] and it is therefore, understood and agreed that the work shall be entirely completed on or before . . . CPM schedule. Time is of the essence in this subcontract." This schedule of work provision obligated the general contractor to properly schedule and coordinate the subcontractor's work, and its failure to do so supported a judgment in favor of the subcontractor. See Bat Masonry Company, Inc. v. Pike - Paschen Joint Venture III, 842 F. Supp. 174 (D. Md. 1993).

### **D. Changes and Extra Work**

#### **EXAMPLES:**

- 7.1.1 Changes in the Work may be accomplished after execution of the Contract, and without invalidating the Contract, by Change Order, Construction Change Directive or order for a minor change in the Work, subject to the limitations stated in this Article 7 and elsewhere in the Contract Documents.

7.1.2 A Change Order shall be based upon agreement among the Owner, Contractor and Architect; a Construction Change Directive requires agreement by the Owner and Architect and may or may not be agreed to by the Contractor; an order for a minor change in the Work may be issued by the Architect alone.

7.1.3 Changes in the Work shall be performed under applicable provisions of the Contract Documents, and the Contractor shall proceed promptly, unless otherwise provided in the Change Order, Construction Change Directive or order for a minor change in the Work.

7.1.4 If unit prices are stated in the Contract Documents or subsequently agreed upon, and if quantities originally contemplated are so changed in a proposed Change Order or Construction Change Directive that application of such unit prices to quantities of Work proposed will cause substantial inequity to the Owner or Contractor, the applicable unit prices shall be equitably adjusted.

(8AIA Document A201, General Conditions of the Contract for Construction, 1987).

#### **TIPS:**

- Changes and change orders present a number of potential legal problems which should be considered and addressed both the contract review and

negotiation stage and during project performance. These problems include the following:

- Duty to proceed with disputed work
  - Change order as an “accord and satisfaction” of price, time and impact issues
  - Reservation of rights regarding time and impact costs in change order proposals
  - Quoting proposal language in the change order itself
  - Ensure that change orders are signed by the other party’s authorized representative who is empowered to do so
- Always look for the word “**waiver**” in clauses dealing with change orders and extra work. Use of the word “waiver” will make it harder to recover in the event of a dispute if you did not get written authorization for the extra work.
  - Beware of “tickets” signed in the field:
    - Tickets might be considered as separate contracts
    - Tickets might contain harmful, boiler-plate language on the back, for example, an indemnification clause
    - Tickets might be signed by field personnel who are not thinking about risk management
    - Adopt a policy for field personnel when they are asked to sign someone else’s ticket so their signature merely verifies quantities or hours and they are taught to cross-out all other language on the ticket
    - Develop your own ticket which makes the work subject to the terms of your contract
  - The “construction change directive” (C.C.D.)

**CASE EXAMPLES:**

- Where a change order was signed by church officials who, by themselves, did not have the power to bind the church, the court held that the instrument executed was not a "change order." The contract defined change order as "a written order to the Contractor signed by the Owner and the Architect . . . authorizing . . . an adjustment in the contract sum, [which] may be changed only by change order." The court held that the change order was not executed by the "owner;" therefore, the instrument failed to fill the requirements of change

orders set forth in the contract, and was invalid. See **Asbury United Methodist Church v. Taylor and Parrish, Inc.**, 452 S.E.2d 847 (Va. 1995).

- A subcontractor sued the general contractor for monies due on various change orders which had been initiated by the subcontractor's "letters of claim" for extra work. The subcontractor and general contractor formalized the extra work in a change order which read: "This change order represents full and final payment and obligation for any and all additional work by [subcontractor] on this contract including, but not limited to [subcontractor's] letters of claim . . . . This change order represents an accord and satisfaction of all claims for additional work and delays . . . pertaining to this project." The court applied the "four corners rule" of contract interpretation and held that the agreement was unambiguous, thus the subcontractor had no claim for monies above the change order amount. See **Vulcan Painters, Inc. v. MCI Constructors, Inc.**, 41 F.3d 1457 (11th Cir. 1995).

## **E. Claims and Disputes**

### **EXAMPLES:**

- 4.3.1 Definition. A Claim is a demand or assertion by one of the parties seeking, as a matter of right, adjustment or interpretation of Contract terms, payment of money, extension of time or other relief with respect to the terms of the Contract. The term "Claim" also includes other disputes and matters in question between the Owner and Contractor arising out of or relating to the Contract. Claims must be made by written notice. The responsibility to substantiate Claims shall rest with the party making the Claim.

4.3.2 Decision of Architect. Claims, including those alleging an error or omission by the Architect, shall be referred initially to the Architect for action as provided in Paragraph 4.4. A decision by the Architect, as provided in Subparagraph 4.4.4, shall be required as a condition precedent to arbitration or litigation of a Claim between the Contractor and Owner as to all such matters arising prior to the date final payment is due, regardless of (1) whether such matters relate to execution and progress of the Work or (2) the extent to which the Work has been completed. The decision by the Architect in response to a Claim shall not be a condition precedent to arbitration or litigation in the event (1) the position of Architect is vacant, (2) the Architect has not received evidence or has failed to render a decision within agreed time limits, (3) the Architect has failed to take action required under Subparagraph 4.4.4 within 30 days after the Claim is made, (4) 45 days have passed after the Claim has been referred to the Architect or (5) the Claim relates to a mechanic's lien.

4.3.3 Time Limits on Claims. Claims by either party must be made within 21 days after occurrence of the event giving rise to such Claim or within 21 days after the claimant first recognizes the condition giving rise to the Claim, whichever is later. Claims must be made by written notice. An additional Claim made after the initial Claim has been implemented by Change Order will not be considered unless submitted in a timely manner.

(8AIA Document A201, General Conditions of the Contract for Construction, 1987).

**TIPS:**

- Owners and general contractors often use claim notice and claim submission requirements to defeat claims on technicalities. To avoid this, you must carefully comply with claim notice and claim procedure requirements.
- Distinguish between timely notice of a claim and when your pricing must be submitted. The two are not necessarily the same.
- Again, beware of the word “**waiver**.”
- If you are a subcontractor, keep in mind the difference between claims which could be pass-throughs to the owner (for example, an error in the contract documents) versus claims that are the responsibility of the general contractor (for example, failure to manage and coordinate the other trades). Often, subcontract claim provisions attempt to restrict subcontractor claims if they have their origin in something done by the owner. You can avoid this depending upon how you give notice of, and describe, the claim so that it is not automatically deemed by the general contractor to be pass-through to the owner.
- Even if the claim becomes a pass-through to the owner, keep in mind that the general contractor has the implied duty to act in good faith in his prosecution of the claim on your behalf.

**F. Differing Site Conditions**

**EXAMPLE:**

- 4.3.6 Claims for Concealed or Unknown Conditions. If conditions are encountered at the site which are (1) subsurface or otherwise concealed physical conditions which differ materially from those indicated in the Contract Documents or (2) unknown physical conditions of an unusual nature, which differ materially from those ordinarily found to exist and generally recognized as inherent in construction activities of the character provided for in the Contract Documents, then notice by the observing party shall be given to the other party promptly before conditions are disturbed and in no event later than 21 days after first observance of the conditions. The Architect will promptly investigate such conditions and, if they differ materially and cause an increase or decrease in the Contractor's cost of, or time required for, performance of any part of the Work, will recommend an equitable adjustment in the Contract Sum or Contract Time, or both. If the Architect determines that the conditions at the site are not materially different from those indicated in the Contract Documents and that no change in the terms of the Contract is justified, the Architect shall so notify the Owner and Contractor in writing, stating the reasons. Claims by either party in opposition to such determination must be made within 21 days after the Architect has given notice of the decision. If the Owner and Contractor cannot agree on an adjustment in the Contract Sum or Contract Time, the adjustment shall be

referred to the Architect for initial determination, subject to further proceedings pursuant to Paragraph 4.4.

(8AIA Document A201, General Conditions of the Contract for Construction, 1987).

**TIPS:**

- Distinguish between a Type 1 and Type 2 condition.
- Is the unknown condition a subsurface condition or elsewhere?
- Is there a remedy clause in the prime contract?
- Written notice is essential.
- Look for disclaimers throughout the contract documents, for example, in the geotechnical reports, technical specifications, etc.
- Look throughout the contract documents for references to the geotechnical report which, it can be argued, incorporate the geotechnical report as a contract document.
- Consider “superior knowledge” and/or misrepresentation as bases for recovery in the absence of an express contractual remedy.
- Remember, for a differing site condition claim to have any chance of success, you must have conducted a pre-bid site inspection.

**G. Delay Claims**

**EXAMPLE:**

- Notwithstanding anything to the contrary in the Contract Documents, an extension in the Contract Times, to the extent permitted under Paragraph 12.1, shall be the sole and exclusive remedy of the Contractor for any: (1) delay in the commencement, prosecution or completion of the Work; (2) hindrance or obstruction in the performance of the Work; (3) loss of productivity; or (4) other similar claims (collectively referred to in this paragraph as Delays) whether or not such Delays are foreseeable. In no event shall the Contractor be entitled to any compensation or recovery of any damages, in connection with any Delay, including, without limitation, consequential damages, lost opportunity costs, impact damages, or other similar remuneration. The Owner's exercise of any of its rights or remedies under the Contract Documents (including, without limitation, ordering changes in the Work, or directing suspension, rescheduling or correction of the Work or terminating this agreement for its convenience), regardless of the extent or frequency of the Owner's exercise of such rights or remedies, shall not be construed as active interference to the Contractor's performance of the Work. If the Contractor submits a progress report indicating, or otherwise expressing an intention to achieve, completion of the Work prior to any completion date required by the Contract Documents or expiration of the Contract Times, no liability of the

Owner to the Contractor for any failure of the Contractor to so complete the Work shall be created or implied.

(\* 9A.14, Stephenson, James E., Esquire, ALTERNATIVE CLAUSES TO STANDARD CONSTRUCTION CONTRACTS, Wiley (Supp. 1994)).

#### TIPS:

- In contract review and negotiation, be careful to identify and try to delete "no damage for delay" clauses.
- Alternatively, be familiar with the generally-recognized exceptions to this clause: active interference, bad faith, beyond contemplation at the time of contracting and abandonment.
  - Know the exceptions where your projects are located.
  - Give notice of delay in the context of one or more of the recognized exceptions and avoid use of the word "delay."
  - Understand the difference between delay damages and damages due to disruption, lost productivity and/or inefficiencies.
  - To protect your exception(s), make a timely request for additional time.
  - Remember that if the no damage for delay clause limits your remedy to a time extension, the time extension must be timely granted.
  - If you are using the 1997 AIA General Conditions, keep in mind Article 4.3.10 which provides for a waiver of consequential damages.

#### CASE EXAMPLES:

Under Illinois law, exceptions to "no damages for delay" clauses exist for delays caused by bad faith, delays that were not in the contemplation of the parties, delays of unreasonable duration or delays attributable to the inexcusable ignorance or incompetence of the engineer. Thus, where the contract as a whole obligated the contractor to coordinate and work with the subcontractors, the general contractor could not prevail on summary judgment based on a "no damages for delay" clause when the subcontractors alleged the contractor's fault as the cause of the delay. See **J&B Steel Contractors v. C. Iber & Sons, Inc.**, 642 N.E.2d 1215 (Ill. 1994).

But see **Marriott Corp. v. Dasta Constr. Co.**, 26 F.3d 1057 (11th Cir. 1994), where the court refused to grant the contractor relief even though evidence showed the owner had been responsible for delays, because the contract contained a "no damages for delay" clause which stated "to the fullest extent permitted by law, Owner . . . shall not be held responsible for any loss or damage

sustained by Contractor, or additional costs incurred by Contractor, through delay caused by Owner . . . or [its] agents or employees, or any other Contractor or Subcontractor, or by abnormal weather conditions, or by any other cause, and Contractor agrees that the sole right and remedy therefor shall be an extension of time." The general contractor's failure to request an extension of time constituted breach of contract which barred recovery against the owner.

(8AGC Document No. 640, Standard Form Construction Subcontract, 1994).

## H. Condition Precedent Payment Clauses

### EXAMPLE:

- Payment to the Contractor by the Owner shall be a condition precedent to the right of the Subcontractor to final payment from the Contractor, unless failure of the Contractor to receive payment is solely the fault of Contractor. Final payment shall be made ten days after receipt of same by the Contractor from the Owner.

(' 16.13, Stephenson, James E., Esquire, ALTERNATIVE CLAUSES TO STANDARD CONSTRUCTION CONTRACTS, Wiley 1990).

### TIPS:

- Know the difference between pay "when" paid and pay "if" paid.
- Look for condition precedent payment language throughout the contract: progress payments, final payment, change orders, claims, extras, delays.
- Know your options:
  - Just say no.
  - Covenant not to sue.
  - Variations in state law.
  - Add language to preserve lien rights.
  - Is there a payment bond? Is the surety protected by the condition precedent clause?
  - The implied duty of good faith/preservation doctrine.
- At the end of these materials, you will find a chart which summarizes the law regarding the enforceability of condition precedent payment clauses in each of the states. This chart is believed to be accurate, however, you should consult your legal advisor to ensure that there have been no new cases or statutory changes in your state, or where the project is located, since the chart was prepared.

### CASE EXAMPLE:

The U.S. Court of Appeals for the Second Circuit certified a question to the New York State Court of Appeals: whether the provision of the New York lien law providing that any contract waiving the right to file or enforce a lien is void against public policy prohibits a clause in a subcontract that makes payment by the owner a condition precedent to the subcontractor's payment. The effect of this case is to illustrate that the federal law, at least in the Second Circuit, is in flux regarding the enforceability of condition precedent payment clauses. See **West-Fair Electrical Contractors v. Aetna Cas. & Sur.**, 49 F.3d 48 (2nd Cir. 1995).

### I. Indemnification

#### EXAMPLE:

- 12.1 INDEMNIFICATION. The Subcontractor shall indemnify and hold the Contractor, Owner, Architect, their agents, consultants and employees harmless from and against all claims, losses, costs and damages, including but not limited to attorneys' fees, pertaining to the performance of the Subcontract and involving personal injury, sickness, disease, death or property damage, including loss of use of property resulting therefrom but not damage to the work itself, **but only to the extent** caused in whole or in part by the negligent acts or omissions of the Subcontractor, or any of the Subcontractors' subcontractors, suppliers, manufacturers, or other persons or entities for whose acts the Subcontractor may be liable. This indemnification agreement is binding on the Subcontractor, to the fullest extent permitted by law, regardless of whether any or all of the persons and entities indemnified hereunder are responsible in part for the claims, damages, losses or expenses for which the Subcontractor is obligated to provide indemnification. This indemnification provision does not negate, abridge or reduce any other rights or obligations of the persons and entities described herein with respect to indemnity.

(8AGC Document No. 640, Standard Form Construction Subcontract, 1994).

#### TIPS:

- Beware of “sole” negligence indemnity clauses.
- Does the indemnity clause refer to “defend”?
- Is the indemnity clause overbroad and void as a matter of public policy and, therefore, unenforceable?
- Does the clause require “negligence” to trigger coverage?
- Understand the meaning and consequences of intermediate indemnity clauses.
- Try to add language providing for indemnity “but only to the extent” as used in the AIA and AGC standard form documents.

- What work is covered by the indemnity clause?
- Revise the indemnity clause to state that you will not be responsible for OSHA/safety violations by others.
- Beware of the arbitration of indemnity claims.
- Be sure that the indemnity provisions in your contracts are “reciprocal.”

**J. Resolution of Claims and Disputes**

**EXAMPLE:**

- In case of any dispute between Contractor and Subcontractor, due to any action of Owner or involving the Contract Documents, Subcontractor agrees to be bound to Contractor to the same extent that Contractor is bound to Owner, by the terms of the Contract Documents, and by any and all preliminary and final decisions or determinations made thereunder by the party, board or court so authorized in the Contract Documents or by law, whether or not Subcontractor is a party to such proceedings. In case of such dispute, Subcontractor will comply with all provisions of the Contract Documents allowing a reasonable time for Contractor to analyze and forward to Owner any required communications or documentation. Contractor will, at its option, (1) present to Owner, in Contractor's name, or (2) authorize Subcontractor to present to Owner, in Contractor's name, all of Subcontractor's claims and answer Owner's claims involving Subcontractor's work, whenever Contractor is permitted to do so by the terms of the Contract Documents. Contractor will further invoke on behalf of Subcontractor, or allow Subcontractor to invoke, those provisions in the Contract Documents for determining disputes. If such dispute is prosecuted or defended by Contractor, Subcontractor agrees to furnish all documents, statements, witnesses, and other information required by Contractor, and to pay or reimburse Contractor for all costs incurred in connection therewith. The Subcontract price shall be adjusted by Subcontractor's allocable share determined in accordance with Article 9 hereof.

- With respect to any controversy between Contractor and Subcontractor not involving Owner or the Contract Documents, Contractor shall issue a decision which shall be followed by Subcontractor, without interruption, deficiency, or delay. If the Subcontractor is correct as to the controversy, Subcontractor shall be entitled to an equitable adjustment in the contract price as its sole remedy. Notification of any such claim for equitable adjustment must be asserted in writing within ten (10) days of Subcontractor's knowledge of the claim.

**TIPS:**

- In reviewing contract language dealing with the resolution of claims and disputes, look for the following:
  - Arbitration versus litigation
  - Forum selection clause

- Waiver of right to jury trial
  - Controlling law clause
  - Exhaustion of administrative remedies
  - Notice requirements
  - Is the architect's decision a condition precedent?
  - Distinguish between claims which are pass-throughs and claims which are not.
- Be aware of state laws which may trump forum selection clauses.
  - Mandatory mediation in the 1997 AIA General Conditions.
  - For general contractors and subcontractors, ensure you have reciprocal remedies provisions.

**K. Liquidated Damages**

**EXAMPLE:**

- 13.3.3 LIQUIDATED DAMAGES. If the Contract provides for liquidated or other damages for delay beyond the completion date set forth in the Contract, and such damages are assessed by the Owner against the Contractor, then the Contractor may assess such damages against the Subcontractor in proportion to its share of the responsibility for such delay and damage, but no more. The amount of such assessment against the Subcontractor, if any, shall not exceed the Subcontractor's proportionate share of the responsibility for such delay and damage and shall never exceed the amount assessed against the Contractor by the Owner.

Nothing in Subparagraph 13.3.3 shall limit the Contractor's right to claim all actual damages sustained by the Contractor as a result of Subcontractor delay.

(8AGC Document No. 640, Standard Form Construction Subcontract, 1994).

**TIPS:**

- Can the party asserting liquidated damages prove some actual delay damage?

**L. Attorneys' Fees**

**EXAMPLE:**

- 7.4 ATTORNEYS' FEES. Should either party employ an attorney to institute suit or demand arbitration to enforce any of the provisions hereof, to protect its interests in any manner arising under this Subcontract, or to recover on a surety bond furnished by a party to this Subcontract, the prevailing party shall be entitled to recover reasonable attorneys' fees, costs, charges, and expenses expended or incurred therein.

(8AGC Document No. 640, Standard Form Construction Subcontract, 1994).

**TIPS:**

- There will be no recovery of attorneys' fees without a specific contract clause to this effect.
- Be sure the clause is "reciprocal."

**CASE EXAMPLE:**

In a subcontractor's action on a Miller Act bond, the court held that the subcontractor was entitled to its attorneys' fees incurred both in trying the action and prior to bringing suit where the language in the payment bond stated: "In case suit is brought upon this bond [the surety] will pay, in addition to the face amount [of the bond], costs and reasonable expenses and fees, including reasonable attorneys' fees incurred . . . in successfully enforcing such obligation . . ." The court held that the term "obligation" was broad enough to include not only attorneys' fees incurred during trial, but also those spent in pre-trial efforts against the general contractor since all fees were expended to enforce payment for the subcontractor's project work. See Granite Constr. v. American Motorists Ins., 34 Cal.Rptr.2d 835 (Cal. App. 3rd Dist. 1994).

**M. Waiver of Liens**

**EXAMPLE:**

- Subcontractor hereby waives and releases all liens or right of liens now existing or that may hereafter arise for any and all work or labor performed or material furnished under this Subcontract upon said facility, or monies due or to become due to Contractor, and agrees to furnish a good and sufficient waiver of lien in proper form for filing from every person or entity furnishing labor or materials for this Project under Subcontractor.

### TIPS:

- Be sure you understand the required waiver and release form before you sign it.
- The first waiver could be the deadly one so read it carefully and modify it if necessary.
- What is the extent of the waiver/release?
  - For money paid to-date?
  - For work performed to-date?
  - For all work to be performed?
  - Does it include “claims and causes of action”?
  - Does it include the surety?
- Be familiar with state law regarding the enforceability of waivers in the subcontract itself.
- Is there a waiver form in the contract documents which is different from the one you are asked to sign?

### CASE EXAMPLE:

Subcontractor executed a waiver of liens that stated, in part, that it would "look to and hold Contractor personally liable for all subcontracts, materials, furnished work and labor done so that there shall not be any legal or lawful claim of any kind whatever against Owner for any work done or labor or materials furnished under the contract . . . or any under contract for extra work or for work supplement thereto . . . ." The subcontractor sought to avoid the waiver of liens on the ground that the contractor was "one in the same" as the owner. The court held that the owner and the contractor had observed all required formalities between related corporations, and the court gave the lien waiver its full effect. See **B&B Builders, Inc. v. TCR Byberry Creek LP**, 27 Phila. 556, 1994 Phila. Cty. Rptr. LEXIS 52 (Com. Pl. Phila. Cty. 1994).

### N. Termination for Convenience

#### EXAMPLE:

- TERMINATION FOR CONVENIENCE. Contractor shall have the right to terminate this Subcontract for its own convenience for any reason by giving notice of termination effective upon receipt thereof by Subcontractor. Termination for default under Paragraph 10, if wrongfully made, shall be treated as a termination for convenience. Settlement of the Subcontract upon termination shall be accomplished in accordance with a provision of the

Termination for Convenience clause in the Contract Documents. If no such clause exists, the Subcontractor shall be paid only the actual cost for work and labor in place, plus fifteen percent (15%), or a pro rata percentage of the Subcontract price equal to the percentage of completion, whichever is less. Subcontractor shall not be entitled to anticipated profits on unperformed portions of the Work.

**TIPS:**

- Generally, profit on unperformed work is not recoverable.
- Termination for convenience may be voided if there is bad faith, bad motive or failure to follow the requirements of the termination for convenience clause.

**CASE EXAMPLE:**

A city housing authority elected to terminate a contract with the general contractor, although initially the housing authority did not rely upon the termination for convenience clause in the contract. The court held that the housing authority was entitled to the benefits of the termination for convenience clause under the doctrine of "constructive" termination for convenience, which arises when the circumstances between the government and a contractor change such that the original termination for cause is "converted" to termination for convenience. In this case, changed circumstances were found to result from the deterioration of the relationship between the housing authority and the contractor. Absent proof of bad faith or unfair dealing, the contractor was limited to compensation for the value of "work performed" up to the point of termination. See Linan-Faye Constr. Co., Inc. v. Housing Auth. of Camden, 49 F.3d 915 (3rd Cir. 1995).

**V. THE IMPORTANCE OF PROMPT NOTICE**

Notice requirements appear throughout construction contracts. They are found in those clauses which deal with changes or extras, claims, disputes, differing site conditions, delays, time extensions, adverse weather, and elsewhere. Important notice requirements are also found in payment and performance bonds. One purpose of notice requirements is to give the other party an opportunity to resolve a problem or a delay, or avoid a cost, before it is too late. Another purpose is to ensure that the other party knows that the contractor has a problem or a claim which he intends to pursue so that all parties are operating with the same degree of knowledge.

Perhaps more than any other requirement in construction contracts, contractors tend to ignore or disregard notice requirements. By doing so, they jeopardize their rights, reduce the likelihood of recovering their claims, and allow the other party to portray them as incompetent, deceitful, or worse.

The careful contractor will identify all notice requirements **before** he signs the contract. Where the notice period is too short (for example, 24 hours), the contractor should negotiate a more reasonable time period for giving notice, for example, three days. The contractor should also try to negotiate uniform notice periods throughout the contract.

Once the contract has been signed, the contractor should ensure that those personnel who will administer the contract and manage the work are familiar with all notice requirements. He will also ensure that notice is given promptly according to the requirements of the contract.

Just as important as giving timely notice is the contents of the notice. First, the contractor should review the notice requirement to see whether it defines what must be included in the notice. For example, some notice requirements require the contractor to identify the problem and to state an estimate of the probable impact of the problem on cost and schedule. Where this type of requirement exists, it is not enough merely to advise the other side that a problem exists without also estimating the cost and schedule impact of the problem.

Second, apart from any special requirements described in the notice clause, the notice should state clearly what the problem is, the source of the problem, how and when the problem was detected and its impact on the contractor's work. If the impact is ongoing, the contractor should so indicate in his notice. Where reference to a contract drawing or specification would be helpful in understanding the problem, the notice should include this information.

What ought not to be in the notice is any reference to personalities or speculation as to why someone has done something or failed to do something. The notice should be objective and factual. Giving notice is intended to comply with the contract's notice requirements and, also, to provide documentation for use at a later date. An otherwise effective notice letter could be less effective if it disparages somebody's motives or describes someone unfavorably.

In reviewing contract provisions for notice requirements, the contractor must be alert to the word "**waiver**." Where this word appears, the intent of the parties is that, if the notice is not given, or not given within the time stipulated, the claim is waived, that is, legally abandoned. Hence, failure to give timely notice where such failure is deemed to be a waiver could mean that the contractor loses the right to pursue claims which could be worth thousands of dollars. To paraphrase Shakespeare, "for want of a letter, a fortune was lost."

Third, prompt compliance with notice requirements is helpful for another reason as well. Giving notice to the other side ought to result, at the same time, in internal, notice of the problem to upper management. This affords management an opportunity to monitor the effectiveness of the project team in dealing with the problem. While the temptation is to let project management run the job, senior management ought to remain aware of ongoing problems to ensure that they are adequately dealt with and resolved. Complying with contract notice requirements serves this purpose.

Arbitrators and judges have come to believe (and virtually require) that good, professional contractors give notice. Many a construction claim has been lost, or at least weakened, because the contractor failed to give notice when his contract, and common sense, required him to do so. The sharp contractor will not let this happen to him.

## **VI. GOOD DOCUMENTATION IS ESSENTIAL**

Just as arbitrators and judges have come to expect that contractors will give timely notice of their claims and problems, they also expect that the problem or claim will be well-documented by internal records prepared contemporaneously. Again, a good claim, or a defense to another's claim, can be lost where the documentation is non-existent or at best sketchy.

Contracts ordinarily do not require the contractor to maintain documentation. However, this should be done as a matter of good common sense and business practice. When a problem is first detected and notice of it is given, it should be a signal to start documenting the problem internally. Indeed, prompt notice and good record-keeping go hand-in-hand.

Good documentation is important for a number of reasons. First, as previously noted, it is something which arbitrators and judges expect. Contractors who want to recover tens or hundreds of thousands of dollars for claims are expected to have good documentation of the event or events which gave rise to the claim and the costs incurred as a result.

Second, documentation is important because it creates a contemporaneous record of events that will remain long after memories fade and employees are gone.

Third, good documentation often can have important psychological effects on the other side. The party to a dispute who sees that his adversary has a well-documented claim may draw the conclusion that the claim is one which should be settled, rather than arbitrated or litigated. Conversely, the adversary who sees that the contractor did not give proper notice and did not maintain good documents may be inclined to resist a settlement knowing that the lack of notice and documentation will weigh in his favor.

As important as documentation is, it is something which field personnel, even at the project management level, often neglect to do because of other demands on their time, such as ensuring production and getting the job done. One solution to the ever-present conflict between doing a day's worth of work versus writing letters is to make it as easy as possible for people in the field to document problems without doing so at the expense of their many other responsibilities. Contractors can do this by providing project management and field personnel with simple, easy-to-use forms to record the impact of changes, errors and omissions in the documents, schedule impacts and the like. Examples of such forms follow:

## CHANGE ORDER DATA SUMMARY

PROJECT: \_\_\_\_\_

NUMBER \_\_\_\_\_ OWNER/A/E NUMBER \_\_\_\_\_

SCOPE OF CHANGE WORK \_\_\_\_\_

INITIATION DATE \_\_\_\_\_ INITIATION SOURCE \_\_\_\_\_  
(RFI, RFQ, etc.)

DATE PROPOSAL REQUESTED \_\_\_\_\_

ORIGINAL PROPOSAL DATE AND AMOUNT \_\_\_\_\_

ORIGINAL TIME REQUESTED \_\_\_\_\_

REVISED PROPOSAL DATE AND AMOUNT \_\_\_\_\_

REVISED TIME REQUESTED \_\_\_\_\_

NOTICE TO PROCEED DATE AND AMOUNT \_\_\_\_\_

DATE FORMAL CHANGE ISSUED \_\_\_\_\_ CHANGE ORDER NO. \_\_\_\_\_

TIME EXTENSION GRANTED \_\_\_\_\_ (Calendar Days)

DATE FIELD WORK COMMENCED \_\_\_\_\_

DATE FIELD WORK COMPLETED \_\_\_\_\_

FLOOR AND AREA AFFECTED \_\_\_\_\_

CPM (IJ) ACTIVITY AND EVENT AFFECTED \_\_\_\_\_  
(Use IJ Code Numbers and Description)

IMPACT AND DISRUPTION TO BASE CONTRACT \_\_\_\_\_

(Describe type of Base Contract Work impacted, the crew size and effect; *i.e.*, slow downs, stop work, or having to move crews to other work areas)

REMARKS \_\_\_\_\_

PREPARED BY \_\_\_\_\_

DATE \_\_\_\_\_

**SHOP DRAWING AND MATERIAL APPROVAL  
DELAYS AND WRONGFUL REJECTION SUMMARY**

PROJECT: \_\_\_\_\_

SUBMITTAL NUMBER: \_\_\_\_\_

DESCRIPTION OF SUBMITTAL \_\_\_\_\_

DATE OF ORIGINAL SUBMITTAL \_\_\_\_\_

DATE OF FIRST REJECTION \_\_\_\_\_

REASON FOR REJECTION \_\_\_\_\_

DATE OF SECOND RESUBMITTAL \_\_\_\_\_

DATE OF SECOND REJECTION \_\_\_\_\_

REASON FOR SECOND REJECTION \_\_\_\_\_

(Use additional forms attached hereto to record additional Resubmittals and Rejections)

DATE OF FINAL APPROVAL \_\_\_\_\_

NUMBER OF CALENDAR DAYS BETWEEN ORIGINAL SUBMITTAL DATE AND FINAL APPROVAL DATE \_\_\_\_\_

DATE THAT APPROVAL WAS REQUIRED TO MEET ORIGINAL CONSTRUCTION SCHEDULE \_\_\_\_\_

CALENDAR DAYS DELAY TO THE FIELD WORK PER ORIGINAL SCHEDULE CAUSED BY LATE APPROVAL \_\_\_\_\_

IMPACT AND DISRUPTION TO BASE CONTRACT WORK: DESCRIBE IN DETAIL

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

PREPARED BY \_\_\_\_\_

DATE \_\_\_\_\_

## ERRORS AND OMISSIONS DATA SUMMARY

PROJECT: \_\_\_\_\_

ERRORS & OMISSIONS NUMBER \_\_\_\_\_

CHARACTER OF ERRORS AND OMISSIONS \_\_\_\_\_

\_\_\_\_\_

FLOOR AND AREA AFFECTED \_\_\_\_\_

\_\_\_\_\_

SPECIFICATION SECTION REFERENCES \_\_\_\_\_

\_\_\_\_\_

DRAWING REFERENCES \_\_\_\_\_

\_\_\_\_\_

OTHER DOCUMENTATION AVAILABLE (Photos, special drawings, as-specified vs. as-built drawings, etc.)

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

DATE OF NOTIFICATION TO GENERAL CONTRACTOR, ARCHITECT/ENGINEER, OWNER

\_\_\_\_\_

METHOD OF RESOLUTION AND DATE (e.g., A/E issues Change Request; Clarification Memo, etc.)

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

IMPACT AND DISRUPTION TO BASE CONTRACT WORK. DESCRIBE IN DETAIL (e.g., stopped work, moved to other work, lost hours, etc.) \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

PREPARED BY \_\_\_\_\_

DATE \_\_\_\_\_

## IMPACT ANALYSIS OF CHANGE ORDERS ON CPM SCHEDULE

PROJECT: \_\_\_\_\_

DESCRIPTION	CHANGE ORDER NO.	CHANGE ORDER NO.	CHANGE ORDER NO.	CHANGE ORDER NO.	CHANGE ORDER NO.	CHANGE ORDER NO.
LABOR DATA						
Trade						
Crew Size						
Crew Days						
Manhours						
CPM DATA						
I-J Networks Affected						
Activity Description						
Duration						
Float						
Adjusted Duration						
Adjusted Float						
Adjusted End Date						

PREPARED BY \_\_\_\_\_

DATE \_\_\_\_\_

No contractor would undertake a project for a fixed price without first doing a take-off to determine the quantities of labor and materials he will be expected to provide for the payment he has agreed to accept. Likewise, no contractor can expect to resolve a construction legal problem without being prepared through timely notice and proper documentation.

## VII. PUTTING IT ALL TOGETHER: CONCRETE ANSWERS TO TEN LEGAL PROBLEMS

From what has been reviewed so far, the contractor can develop a common method of responding to the typical construction legal problems which contractors often face. The elements of this response include the following:

- Review and negotiate the key contract provisions in order to get the best contract you can.
- Understand how those provisions you are forced to accept operate and ensure that project management is capable of managing the risks created by these provisions once the project begins.
- Ensure that prompt notice is given of all performance or payment problems.
- When a problem is important enough to justify notice, it is important enough for documentation of the problem to begin.

To this list of the elements of a response mechanism for dealing with construction problems, there should be added an appreciation for the leverage which **may** be available to the contractor to bring about a desired result. A keen appreciation of when this leverage exists, and when it is gone, is vital.

This means that the ability of the owner or general contractor to bring the project in on-time and on-budget is, in the first instance, often controlled by the progress of the work. Realizing this may give the contractor considerable leverage in the resolution of problems depending upon when they occur in the construction cycle. For example, problems which develop very early in the work and which threaten timely completion, can give the contractor leverage to force a resolution of problems on his terms. By the same token, those problems which develop, or are not identified, until the punchlist stage of the contractor's work generally come at a time when the contractor has little, if any, leverage left to exert. Put differently, the threat of suspending the work early in the job is far greater and carries with it more leverage than the threat of doing so during the punchlist stage.

Leverage is not a legal issue. It should not be used to enhance the likelihood of recovering claims which lack merit. It can be used, however, to give added emphasis to the resolution of claims which have merit. Knowing when the contractor has leverage, or does not have leverage, is simply one of the many good business instincts which a successful contractor will develop.

Using what we have reviewed so far, let's examine some frequently-occurring construction legal problems and find out what the answers are.

## **A. The Missed Requisition**

A missed requisition can be merely the result of an oversight, a missing piece of paper required for payment approval or, worse, the first sign that the customer is having serious financial problems. The contractor needs to react quickly, yet often does not have immediately available to him all of the information he needs to determine whether there merely has been a little glitch in the approval process, or he has a real problem. He should take quick action while he seeks additional information:

1. Give immediate written notice to the customer and all affected parties. The latter includes the owner (if the customer is the general contractor), the construction lender and the bonding company (if there is a payment bond). The notice should specify the exact amount due and owing and when it was due. Notice should be sent by facsimile **and** certified mail/return receipt requested.
2. If your customer is the general contractor, ask the owner for a joint check. The owner may be willing to issue a joint check in order to avoid a mechanic's lien claim and keep you on the job.
3. Refer to the contract to see whether it requires any additional notice and/or how long the contractor must wait before he is free to stop working due to nonpayment. In the pre-contract negotiation phase, the contractor should review this provision in the first instance to ensure that he is not obligated to continue working for an unreasonable amount of time in the event of nonpayment.
4. Depending upon when the contract allows the contractor to cease working, he may want to slow down the work until the dispute is resolved.
5. Review the availability of a mechanic's lien and/or payment bond claim. Where the missed requisition is really a symptom of a more serious financial problem, the contractor should be familiar with his lien and bond rights.
6. Check the contract for an interest provision. Again, this is something that should be examined in the pre-contract negotiation phase.
7. Don't wait to allow the customer to make up the missed requisition with the next payment. This merely allows the customer to put his hand deeper into the contractor's pocket.
8. Carefully assess whether you have the leverage to force a resolution. If the missed requisition payment comes early in the work, the contractor may have the leverage to slow down or even suspend the work until payment is made. He may also have the leverage to ensure that there will be no future missed payments. If the missed payment comes toward the end of the job, the leverage may not be there any longer.

## **B. The Delay Claim**

Errors and omissions in the contract documents, the failure of an earlier subcontractor to perform the work (for example, excavation), and lack of timely responses to RFIs can delay the work. Delays of an unusual duration can push the work into periods of bad weather that were not contemplated at the time the job was bid, thus resulting in less efficient and more costly production and the need for winter protection. When delays occur, it is important that the contractor do everything required by his contract to preserve his right to recover the increased costs of delay:

1. Negotiate a contract that does not include a “no damages for delay” clause. Alternatively, if you must accept such a clause, know what the exceptions are in the jurisdiction where the work is being performed.
2. As soon as you experience a delay, give prompt written notice in careful compliance with the terms of the contract. If there is a “no damages for delay” clause, describe the delay in terms of an exception to the clause. Even further, try to avoid using the word “delay” in describing what has impacted the work; instead, if possible, use the words “disruption,” “lost efficiency,” or “lost productivity.” “Interference” is another possible synonym.
3. Follow-up the initial notice with written reminders as long as the delay continues. Indeed, some construction contracts require that periodic notice be given of the same delay until the delay has been resolved. Do not conclude that merely because you gave one notice, no further notice is necessary.
4. Keep in mind that, not only does giving notice satisfy the terms of your contract, it also conveys to the other party that you are doing a good job of protecting your rights and that you are documenting impacts for which you are not responsible. Parties involved in construction disputes (or their attorneys) take into account such things as the adequacy of notice in assessing the strength of the case against them and their defenses. Give the other side something to be concerned about by giving effective notice.
5. Start developing and maintaining good project records when the delay begins. The records should be contemporaneous with the events which delay you and should record the essential details: when did the delay begin; what is the cause or nature of the delay; what activities are affected by the delay; describe the impact on the work in terms of why the work cannot proceed; what are the related impacts, for example, are you forced to resequence the work; and what resources (labor, materials and equipment) are wasted or rendered less efficient due to the delay.
6. If the project is being scheduled by a CPM schedule, identify the specific activities which are affected by the delay and reference these activities in your notice.

7. Remember the distinction between “delay” and “disruption.” Most “no damage for delay” clauses do not attempt to prevent the recovery of damages for disruption, that is, lost efficiency. Even if your contract bars true delay damages, you may still be entitled to recover the cost of lost productivity. Job cost records, therefore, should be maintained which allow you to quantify this cost, as well as prove that your work was rendered less efficient.
8. If you are affected by a delay or disruption, when you give notice, ask for direction, that is, try to make the other party tell you where to work or what to do under the circumstances.

### **C. The Disputed Change Order**

Change order disputes are a fact of life in the construction industry. These disputes often occur simply because of ambiguities in the drawings which require additional work for which the owner does not want to pay. The owner’s attitude is that either it is the contractor’s fault or the architect’s fault. Unfortunately, owners often fail to realize that architects are not required to produce perfect plans and there, indeed, may be gaps which generate additional work which is not the responsibility of the contractor. When faced with a demand that the contractor perform additional work which he believes to be beyond the scope of his contract, he should respond as follows:

1. Check the contract to see what provisions are made for change orders and extra work and what notice you must give if you are directed to perform work which you believe entitles you to a change order.
2. Give prompt notice in conformance with the contract’s requirements. Note, notice requirements for change orders can appear in a variety of different places in the contract. They may appear in the change order clause, there may be a clause that deals with extra work which prescribes notice requirements, and there may be a separate clause which deals with claims which prescribes notice requirements. Often, the various notice requirements are not the same. A disputed change could fall into any one, or all, of these categories and you should ensure that the notice you give complies with each notice requirement.
3. Explain in your notice why you do not believe the work you are being required to do is part of the base contract, that is, why it is a change. Cite references to the contract drawings or specifications which you believe support your position.
4. If your contract is, or incorporates, an AIA contract, you might want to take advantage of the “Construction Change Directive” (“CCD”). CCDs were introduced in the AIA documents in 1987 for the purpose of resolving disputed change orders on an interim basis. Under the CCD concept, the architect is supposed to recommend for payment those portions of the disputed change which he believes are reasonable. Under the 1997 edition of the AIA General Conditions, language was added to reinforce the owner’s obligation to pay CCDs on an ongoing basis. Thus,

invoking the CCD provision (if it is available) could result in at least some cash flow to the contractor for disputed change orders.

5. Must you do the work? In virtually all construction contracts, there is a provision which obligates the contractor to proceed with the disputed change pending a determination of the claim on its merits. What this invariably means is that the contractor cannot legally or safely refuse to do the work. To do so risks creating a material breach of contract and inviting the other side to retain another contractor to perform the work at your expense and at a considerably greater cost. Having said this, there may be **some** leverage available to you insofar as you can refuse to do the work for some time in order to see if the other side will finally acknowledge the validity of your claim. Good business instincts will tell you when you have used up this leverage and you must now do the work.
6. Once the disputed work begins, be sure to give additional notice of the cost of the work you are incurring and maintain good cost records which you can use to quantify the direct and indirect costs of the disputed work. When the disputed work is completed, finalize your costs and submit a change order proposal, even though you know it will be rejected. Impact costs, however, may not be quantifiable at this time and your proposal should reserve the right to submit the impact costs at a later date when they have been ascertained.
7. In rare cases (for example, where the cost of the disputed work is substantial), you may not want to wait until the project is over in order to pursue your claim. If you have an arbitration clause in your contract, you are entitled to demand arbitration as soon as the claim arises, that is, when you are directed to do the disputed work. You need not await completion of the entire contract in order to proceed to arbitration.

#### **D. The OSHA Inspection**

Safety inspections, whether conducted by federal OSHA officials or state safety inspectors, often can result in penalties for alleged safety violations. In addition, some subcontracts allow the general contractor to backcharge the subcontractor where the general contractor is cited for conditions created by the subcontractor. While the contractor cannot control when an inspection occurs, if properly prepared, he can do a lot to control the outcome of the inspection. Here are some suggestions:

1. Have a written safety program and be sure you have a copy of it on site. Your project manager and superintendent both should know where the written safety program can be found.
2. If you conduct toolbox meetings or similar safety meetings on-site, keep a sign-up sheet for each meeting and require your employees to sign it when they attend the meeting. The sign-up sheet should indicate the date of the meeting and the subject covered. Ideally, it should be a subject which reflects some safety aspect of your work. The contractor who has toolbox meetings on working in confined spaces does not do

himself much good in the event of a OSHA inspection which focuses on fall protection.

3. Have a written company policy, a copy of which is kept on the job, that states that the OSHA inspector is not to begin the inspection until your company's designated safety representative arrives. This is intended to help you control the inspection. Generally, OSHA inspectors will conform to this request.
4. Train your personnel on how to deal with a safety inspection, whether conducted by OSHA or a state agency. In particular, instruct your employees that they are not required to speak to the OSHA inspector. While he may ask to interview them in private, they are not obligated to agree to an interview. Anything they say can be used against you. It is rare, indeed, that the interview given by an employee helps you avoid a safety citation. In this regard, if the inspector arrives and you know you have a troublesome employee on-site, give him the day off and send him home.
5. Train your supervisory personnel on the project to follow the inspector around the job closely to carefully observe and record what he does. Photograph the inspector as he conducts his inspection. If he takes a measurement, try to get a close-up photo of how and where he takes the measurement. Record the time he enters the site and the time he leaves the site.
6. If the inspector complains about or cites you for safety conditions which you believe have been created by other trades, notify the general contractor or the other trades in writing and demand that they correct the alleged unsafe condition.
7. At the conclusion of the inspection, ask the inspector whether he has seen anything for which he intends to cite you. If he says that he saw no violations or intends to issue no citations, your representative should ask him to sign a statement to that effect. If he refuses to sign it, then he should be asked to repeat his statement in the presence of at least two of your employees, or preferably a non-employee, for example, the representative of another contractor.

#### **E. You Made a Bid Mistake**

Unfortunately, bid mistakes occur from time-to-time. In the pressure of putting an estimate together, errors are made. Quantities are not properly recorded or unit prices are not correctly extended. Even worse, an error of judgment could occur. While relief for bid mistakes should not be taken for granted, the contractor who discovers a bid mistake must act promptly by doing the following:

1. Give written notice promptly to the person to whom you bid. Explain the type of mistake you made (whether arithmetical or an error of judgment)

and, if possible, provide a copy of the estimate sheet on which the mistake appears.

2. If the job is a public job, check the local procurement law (both state law and the rules of the actual procuring agency) to see how bid mistakes are handled. Your customer may be unaware that he may be entitled to relief for your bid mistake. He may also not be aware of the short time limitations usually imposed by public procurement codes on seeking relief for bid mistakes.
3. Did your bid mistake have a material impact on your customer's bottom line price? Try to determine the amounts of the other bids your customer received. Your bid may have been noticeably low because of the mistake, in which case it may be more difficult for your customer to rely on it and try to hold you to it.
4. When you discover the mistake and report it to your customer could have a bearing on whether you can avoid the consequences. Mistakes that are reported before you sign a contract may be easier to avoid than mistakes found after you have begun the project, even though a contract has not been executed.
5. Accurately assess how much is at stake because of the mistake. While the job may not be as profitable because of the mistake, you may still be much better off in the long run to absorb the mistake and maintain a good relationship with your customer rather than lose the customer and risk litigation.

#### **F. Your Subcontractor Refuses to Sign a Subcontract**

Occasionally, someone who bids to you may decline to honor his bid. It could be because he has too much work to do, makes a mistake in his bid or for some other reason. Meanwhile, you relied on his bid and to procure the same work from someone else will cost you significantly more money, which you cannot pass on to your customer. What can you do in this situation to try to convince your subcontractor that he should honor his bid and perform for the price he gave you? Here are some ideas.

1. If your subcontractor gave you a reasonable bid, but refuses to sign a contract, you may be able to enforce the bid, either by compelling him to perform or reprocurring the work from someone else and recovering the difference from the reluctant subcontractor.
2. The basis on which you are able to enforce his bid will depend upon when he refuses to perform and the communications between you as of that time. If he refuses to perform shortly after you receive his bid and before you have sent him a letter of intent, then your right to enforce the bid will depend upon the doctrine of "promissory estoppel." This legal concept merely means that you may have the right to hold him to his bid if (a) your reliance on his bid was reasonable, and (b) it would be detrimental (i.e., more expensive) to you to have the work done by someone else. If the

subcontractor's bid was reasonable and you relied upon it in your bid, then the law will enforce his bid if the jurisdiction recognizes promissory estoppel.

3. For you to take advantage of the doctrine of promissory estoppel, your reliance on the subcontractor's bid must be reasonable. This means that his number cannot have been so far below that of other bidders that it should have raised a question in your mind as to whether or not it was a good bid. If you receive a bid which you would like to use, but it seems suspiciously low, ask the bidder to provide you with confirmation of his bid by facsimile prior to use of the bid in your bid. If the subcontractor's bid is confirmed, then you are safe in using it and your reliance will be reasonable.
4. If the subcontractor's refusal to perform comes later, for example, after you have sent him a letter of intent, then you may have a contract argument to enforce his bid, rather than promissory estoppel. Under this circumstance, your letter of intent acts as a written confirmation of your agreement. If he refuses to perform, he is breaching the agreement, that is, he has breached a contract between the parties, even though the ordinary subcontract has not yet been signed.
5. Depending upon which of the two conditions you face, give the subcontractor prompt written notice of your intent to hold him to his bid and to charge him the difference between his bid and the next low bidder.
6. Until the reluctant subcontractor communicates his intention to perform, do not get into a negotiation over contract terms and conditions. If you do so, the subcontractor is not obligated to accept your terms and conditions and, indeed, can use the terms and conditions to justify his refusal to perform. Keep the correspondence and communication limited, therefore, to the simple question of whether he will honor his bid.
7. If you are forced to repro cure the work, ensure that the scope of work of the repro curement subcontractor is the same as the scope of the subcontractor who refused to perform. If you intend to recover the difference, you have to demonstrate that the work remained the same. If there is any additional work the new subcontractor does, add it to his subcontract by change order, as opposed to putting it into the original subcontract you sign with him.

#### **G. The Unfair Backcharge**

Backcharges are a common irritation in the construction industry. Often, the contractor will not learn about the backcharge until the work has already been done. It is too late for him to complain about it at that time. Because the general contractor controls the money, the subcontractor either has to accept the backcharge or risk a fight over what is usually a nominal amount of money. However, backcharges can add up and result in significant set-offs at the time of final payment. What should you do to prevent backcharge problems?

1. In negotiating the contract, be alert to backcharge provisions. Require the general contractor to give you written notice of his intention to perform backcharge work before the work is actually done.
2. During the job, if situations develop in which you expect a backcharge (for example, other trades are failing to police the site and you expect the general contractor to backcharge you a portion of its clean-up costs), before you actually receive the backcharge, give notice to the general contractor that you will not accept a backcharge.
3. Document that you are doing your work so that you give no cause for a backcharge; for example, you are cleaning up the site with respect to rubbish generated by your activities.
4. When you receive the backcharge, be sure it has been given timely in accordance with the terms of the contract you negotiated. Respond to the backcharge in writing promptly if you disagree with it.
5. Demand to see copies of all back-up to costs backcharged to you. The costs should be fair and reasonable.
6. Try to resolve backcharges as and when they are issued. Don't allow the general contractor to accumulate backcharges and then use them at the final settlement of the contract in an effort to offset your claims for extras and change orders.
7. If you get notice of a valid backcharge before the work is actually done, do the work yourself. Invariably, it will cost you less than to have the general contractor do it for you.

#### **H. Final Payment is Not Made When Due**

By the time final payment falls due, the contractor probably has little, if any, leverage left in which to force payment. By this point in the project, threatening to walk off the job if you are not paid will not get you anywhere, and probably is a bad idea. Instead, the focus should be on preserving your lien and/or bond rights. If it is the general contractor who owes you final payment, approach the owner about a joint check. Otherwise, do the following:

1. Give all notices required by your contract. Notice should be given to the customer as well as all interested parties (owner, construction lender, payment bond surety, tenant, etc.).
2. Verify your lien rights to ensure that if you must file a lien, it is timely.
3. Is there a payment bond? If so, obtain a copy if you do not already have one. Usually, you can get a copy of the payment bond from the architect or the owner. On a public job, you have a right to a copy of the payment bond which you can obtain from the contracting officer or, on federal jobs, from the Comptroller General of the United States, General Accounting Office, 441 G Street, N.W., Washington, D.C. 20548.

4. Pay strict attention to the bond's notice requirements. For second-tier subcontractors, in particular, bond notice provisions often include a requirement that the general contractor and/or surety be notified within ninety (90) days of the subcontractor's last work. Failure to give this notice can be fatal.
5. Try to get a joint check. Contact the owner (or general contractor, as the case may be) directly and see if they will agree to issue a joint check to your customer and to you. The advantage to them in doing so is that they can avoid a mechanic's lien claim.
6. Be wary of using your leverage at this stage of the project. Usually, by the time final payment is due, you have little, if any, leverage left to exert. Likewise, walking off the job at the end due to nonpayment is not usually effective. Instead, finish the work since you can control the cost of completion. Also, by finishing the work, you are ensuring that the person who owes you the money has no other excuse not to pay you.
7. Do not give your customer a final release of lien unless and until you are paid. Exchange of the release of lien should be concurrent with receipt of the funds. By giving a final release of lien to the customer who owes you final payment before you receive the funds, you are taking the risk that the funds will not be paid or the check will not clear. You may not be able to avoid your release of liens under these circumstances.

#### **I. Making a Claim on a Payment Bond**

Payment bonds are a last resort in collecting contract monies. The good news about payment bonds is that most bonding companies have the resources to pay your claim and, sooner or later, will do so. The bad news about payment bonds is that bonding companies will not write you a check merely upon receipt of your claim. Be prepared to wait, but be sure you have done everything you need to do to preserve and protect your claim:

1. First, be sure there is a bond on which to make a claim if the need arises. Don't assume the job is bonded, particularly if it is private job.
2. Ask about whether there is a bond and get a copy, early in the project. You may need to react quickly later, and time could be wasted in trying to get a copy of the bond if you wait until a payment problem arises.
3. If your customer is bonded but refuses to give you a copy of the bond, go to the owner or architect, or contracting officer on public work.
4. Read the bond carefully. Bonds usually contain a number of conditions precedent to making a claim. Typically, these conditions may include: (a) notice within a designated time period, (b) notice must be given by certified mail, and (c) suit must be filed within a designated time period. Comply with all of the requirements.

5. Regardless of whether the bond requires you to notify the surety, do so. However, don't expect the surety to respond by sending you a check. For a variety of reasons, sureties take their time in assessing and paying claims.
6. Send the surety a claims package with your notice. The package should consist of all of the invoices and back-up required to establish the amount of money you are owed.
7. Stay in contact with the surety by telephone and by written correspondence. Keep the pressure on.
8. The jurisdiction in which the project is located may have a statute which makes it bad faith for the surety (i.e., an insurer) not to pay a valid claim in a timely manner. Investigate this and if you find that such an act exists, remind the surety of it. This may be enough added pressure on the surety to get your claim resolved, sooner rather than later.

#### **J. Your Insurance Claim is Denied**

Occasionally, an insurance company will deny a construction-related claim which it should have paid. Sometimes, the adjuster does not understand the facts, or is inexperienced or overly protective of his company. Sometimes the claim is denied because it has not been presented in a way which allows the claim to be viewed as a covered claim, that is, one that is not barred by an exclusion. How you word the claim notice letter can be very helpful in securing payment of the claim. When your claim is denied, here are some ideas on how to respond:

1. Respond promptly to the denial letter and ask for clarification or an explanation, particularly if the insurance company has not set forth in detail the basis for its denial.
2. Once the basis is explained to you, if you are still not satisfied, take issue with it. Not all claim adjusters make the right decision the first time. Their first perception of a claim is not necessarily the correct one.
3. Get your insurance broker involved early. He may have some clout with the carrier to convince them to view a good customer's questionable claim as a valid claim.
4. If the claim is one for the cost of repairing defects in your work, keep in mind that related work damaged by the repairs or by the defects may be covered, even though the cost of repairing your work ordinarily is not covered. For example, if work you have completed has to be replaced, and if in the process, damage necessarily has to be done to the work of other trades, then the damage to the other work and repairs to the other work probably are covered, while the cost of repairing your work may be excluded. Keep this distinction in mind when you pursue your insurance claim for defective work.

5. Be familiar with local laws pertaining to insurance claims. Insurance companies are strictly regulated. There may be local laws which affect their ability to deny your claim. Don't count on the insurer to advise you of such laws.
6. Once you have determined the cost of your claim, send a complete claim package to the carrier. Periodically monitor the status of your claim. Large carriers have been known to misplace claims. In addition, some carriers suffer from rapid personnel turnover. This could affect the disposition of your claim. By staying on top of the claims review process, you can determine whether your claim is receiving proper attention.

## **VIII. CONCLUSION**

A successful project requires more than a good estimate, good supervision, and productive field labor. These ingredients, alone, will not enable an unprepared contractor to overcome a construction legal problem.

Being prepared merely means understanding how construction contracts operate, what the key provisions are, and how those provisions work to affect your rights. Knowing this and knowing what the exceptions are will help you to better manage, and be more successful at, the contract negotiating process.

Regardless of how successful you are in equalizing the terms of the contract, you will have a better appreciation for the risks presented by those contract provisions you can't change. Knowing what the remaining risks are will assist you in developing project management techniques to manage these risks before they get out of hand.

Good notice and good documentation will always serve the contractor well in resolving legal problems. Early identification of a risk, prompt notice, good documentation and monitoring will assist in bringing most problems to an early and successful conclusion.

A successful construction project is subject to many variables over which the contractor has relatively little control. These include the adequacy and accuracy of the contract documents, the weather, the availability of skilled labor, and the performance of sub-subcontractors and suppliers. Other potential risks are just as troublesome, but can be managed and controlled. A fraction of the effort spent on managing men, materials and equipment, if spent on managing the contract process, can yield dramatic results.

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Alabama	Majority <sup>1</sup>	<u>Crass v. Scruggs</u> , 115 Ala. 258, 22 So. 81 (1897).	"Payments based on engineer's estimates, and to be made on the 15th of each month, or as soon thereafter as said railroad company pays or causes to be paid the said J. T. Crass."	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor.	
Alaska	Minority <sup>2</sup>	<u>Industrial Indem. Co. v. Wick Constr. Co.</u> , 680 P. 2d 1100 (Alaska 1984).	"Final payment shall be made within five days after CONTRACTOR has received his final or complete payment involving SUBCONTRACTOR'S portion of work."	Clause enforced as creating a valid condition precedent to payment. Because the contractor was not required to pay the subcontractor unless and until the owner paid it, interest did not begin to accrue until the owner paid the contractor.	
Arizona	Majority	<u>Pioneer Roofing Co. v. Mardian Constr. Co.</u> , 152 Ariz. 455, 733 P.2d 652 (1986).  <u>Watson Constr. Co. v. Reppel Steel &amp; Supply Co.</u> , 123 Ariz. 138, 598 P.2d 116 (1979).  <u>Darrell T. Stuart Contractor of Arizona v. J.A. Bridges and Rust-Proofing, Inc.</u> , 2 Ariz. App. 63, 406 P.2d 413 (1965).	"Contractor shall not, however, be liable for a greater sum than Contractor obtains from the Owner for such additional work . . . and the recovery by Subcontractor for such work shall be conditioned upon a prior recovery therefor by Contractor from the Owner."  "THE CONTRACTOR AGREES . . . to pay the Sub-Contractor, promptly upon receipt thereof from the Owner, the amount received by the Contractor on account of the Sub-Contractor's work to the extent of the Sub-Contractor's interest therein . . . . At all times subcontractor shall be paid to the extent that the contractor has been paid on his account."  "The contractor shall pay the . . . subcontractor's pay estimate within ten days after receipt of payment by the Contractor . . . ."	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor. Court looked for language specifying payment to be made "exclusively" or "only" from a particular area.  ". . . [P]rovisions such as those found in the subcontracts in question do not create a condition precedent in the absence of additional language which clearly shows that the payments were to be made 'exclusively' or 'only' from the specified fund and no other."  "If the defendant did not receive all of its money from the contractor, the defendant nevertheless remained indebted to the [subcontractors] and the [subcontractors] were entitled to payment within a reasonable period of time following the completion of the performance of their contract obligation."	

<sup>1</sup>For purposes of this handout, the majority rule is that, unless the parties explicitly and unambiguously provide otherwise, a general contractor must pay a subcontractor within a "reasonable time" after the subcontractor completes its work, regardless of whether the owner has paid the general contractor for the work.

<sup>2</sup>For purposes of this handout, the minority rule is that contract language which provides that payment is due after receipt thereof from the owner, is an enforceable conditional payment clause and shifts the risk of owner nonpayment to a subcontractor.

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Arkansas	Majority	<u>Trinity Universal Ins. Co. v. Smithwick</u> , 222 F.2d 16 (8th Cir. 1955), cert. denied, 350 U.S. 837, 100 L.Ed 747, 76 S.Ct. 74 (1955).	Exact contract language not given in case.	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor.	
California	Clause void as against public policy	<u>William R. Clark Corp. v. Safeco Ins. Co.</u> , 15 Cal. 4th 882, 64 Cal. Rptr. 2d 578, 938 P.2d 372 (1997).	"Receipt of funds by Contractor from Owner is a condition precedent to the Contractor's obligation to pay Subcontractor under this Agreement, regardless of the reason for Owner's nonpayment, whether attributable to the fault of the Owner, Contractor, Subcontractor or due to any other cause. Subcontractor shall assume the risk that if [sic] the Owner does not, for any reason . . . pay Contractor money owing to it for the work provided by Subcontractor. Accordingly, Subcontractor agrees that: 1. Contractor shall have no obligation, legal, equitable or otherwise, to pay Subcontractor for Work performed by Subcontractor. 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 therefore. . . ."	Condition precedent payment clauses are not enforceable in California. The clauses are against public policy because they amount to a waiver of mechanic's lien rights. In California, mechanic's lien rights can only be waived under certain circumstances. Neither the general contractor nor its payment bond surety could rely on the clause.	

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Colorado	no cases - related case indicates application of quasi-majority rule	<u>Mularz v. Greater Park City Co.</u> , 623 F.2d 139 (10th Cir. 1980).	Architect to be paid final 20% of fee after completion of bidding and negotiations phase.	“An intent to create a condition [precedent] in a contract must appear expressly or by clear implication . . . . [S]uch rule of construction is founded on a policy of avoiding, if possible, forfeitures . . . . It is logical to infer that [the architect’s] agreement to defer the balance of his fee until the time that the construction financing became available was made as an accommodation to [the owner]. It was made in anticipation of the bidding and negotiation phase being carried out. There is not the slightest indication that [the architect] intended to risk a portion of his fee on the non-occurrence of events over which he had no control . . . . [W]here, as here, a debt constitutes an absolute rather than a contingent liability, and payment was agreed to be made on occurrence of an event which does not occur, payment must be made within a reasonable time . . . . The clause regarding payment was indeed facially ambiguous, and the trial court was correct in its ruling as to the admissibility of parol evidence.”	

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Connecticut	Majority	<p><u>Star Contracting Corp. v. Manway Constr. Co.</u>, 32 Conn. Supp. 64, 337 A.2d 669 (1973).</p> <p>Related case: <u>Blakeslee Arpaia Chapman, Inc. v. El Constructors, Inc.</u>, 239 Conn. 708, 687 A.2d 506 (1997).</p>	<p>“Partial payments by the Contractor to the Subcontractor hereunder shall be made only at such time or times as payments made by the Owner to the Contractor shall include work completed by the Subcontractor, and then only in the ratio that work performed by the Subcontractor bears to all work to be done by him under this subcontract or the extent that the Contractor has received payment for such work, whichever is the lesser. . . . payment will not be made . . . until the Owner has made payment to the Contractor for the work.”</p> <p>“[P]ayment of the approved portion of the Subcontractor’s monthly estimate shall be conditioned upon receipt by the Contractor of his payment from the Owner.”</p>	<p>Clause enforced as creating a valid condition precedent to payment. The contractor was not required to pay the subcontractor unless and until the owner paid the contractor. Subcontractor must allege that the condition precedent is fulfilled in order to recover from surety.</p> <p>Even if language constituted a condition precedent, that condition was satisfied. The general contractor was paid less money than it sought, but was nonetheless required to pay the subcontractor the entirety of the amounts owed to it: “[The general contractor] was paid for the work performed by the [subcontractor], albeit based on a different schedule of values than those agreed to by the [subcontractor] and [general contractor] in the subcontract. Although the project engineer for [the Owner] disallowed some of the value for the work performed, it is the subcontractual value that the [subcontractor] and [the general contractor] placed on the work performed that controls.”</p>	

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Delaware	Majority	<u>Acierno v. Worthy Bros. Pipeline Corp.</u> , 1996 Del. Super. LEXIS 347 (1996), <u>aff'd</u> , 693 A.2d 1066 (Del. 1997).	<p>“Final Payment . . . shall be made . . . when the Subcontractor’s work is completed. If an Architect and/or Engineer represents the Owner for the work and if the agreement between the Prime Contractor and/or Owner and/or Architect provides . . . that the Prime Contractor must receive payment from the Owner prior to paying the Subcontractor, neither the certificates of payment nor prior payment to the Subcontractor and final payment to the Subcontractor shall be made on demand by the Subcontractor.”</p> <p>On the front of the contract, the subcontractor’s representative had written: “Payment schedule: 30 day draws upon payment from Owner with 10% retainage till (sic) release &amp; payment from Owner.”</p>	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor.	
District of Columbia	Majority	<u>Urban Masonry Corp. v. N&amp;N Contractors, Inc.</u> , 676 A.2d. 26 (D.C. 1996).	<p>“1(a) Payments will be made to the Subcontractor promptly as they are received. Receipt of payment by Contractor shall be a condition precedent to payment being owed to Subcontractor . . . 1(e) Invoices for work performed by Subcontractor will be paid within five (5) days after receipt of the corresponding payment from General Contractor. . . . Late payments shall bear an interest at the rate of ten percent (10%) per annum . . . .”</p>	Although the court noted that it would normally enforce the clause as creating a valid condition precedent to payment, it refused to do so in this case because the contractor had failed to defend the subcontractor’s interests in settlement negotiations with the owner. The court held that the contractor may only assert the pay-when-paid clause as a defense if it has not done anything to hinder the satisfaction of the condition precedent.	

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Florida	Majority	<p><u>OBS Co. v. Pace Constr. Co.</u>, 558 So.2d 404 (Fla. 1990).</p> <p><u>Peacock Constr. Co. v. Modern Air Conditioning</u>, 353 So.2d 840 (Fla., 1977).</p>	<p>“. . . Final Payment shall not become due unless and until the following conditions precedent to Final Payment have been satisfied . . . . receipt of Final Payment for Subcontractor’s work by Contractor from Owner . . . .by the Owner.”</p> <p>Final payment to be made “within 30 days after the completion of the work included in this sub-contract, written acceptance by the Architect and full payment therefor by the Owner.”</p>	<p>Although the subcontract clearly made payment from the owner a condition precedent, the general contract required the general contractor to submit an affidavit certifying that its subcontractors had been paid before final payment became due. The court found that the conflict between the subcontract and the general contract created an ambiguity. In these circumstances, “the intent to shift the risk of nonpayment is not clearly expressed, the payment provision must be interpreted as establishing a reasonable time to pay by the contractor rather than creating a condition precedent to the Contractor’s obligation to pay the subcontractor.”</p> <p>“[The] intent in most cases is that payment by the owner is not a condition precedent to the general contractor’s duty to pay the subcontractors . . . . There is nothing in this opinion, however, to prevent parties to these contracts from shifting the risk of payment failure by the owner to the subcontractor. But in order to make such a shift the contract must unambiguously express that intention. And the burden of clear expression is on the general contractor.”</p>	<p>SURETY: FLA STAT. ' 713.245 (1996): “if the contractor’s written contractual obligation to pay lienors is expressly conditioned upon and limited to the payments made by the owner to the contractor, the duty of the surety to pay lienors will be coextensive with the duty of the contractor to pay, if the bond contains on the front page, in at least 10-point type, the statement:</p> <p>THIS BOND ONLY COVERS CLAIMS OF SUBCONTRACTORS, SUB-SUBCONTRACTORS, SUPPLIERS, AND LABORERS TO THE EXTENT THE CONTRACTOR HAS BEEN PAID FOR THE LABOR, SERVICES OR MATERIALS PROVIDED BY SUCH PERSONS. THIS BOND DOES NOT PRECLUDE YOU FROM SERVING A NOTICE TO OWNER OR FILING A CLAIM OF LIEN ON THIS PROJECT.”</p>

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Georgia	Minority	<p><u>St. Paul Fire &amp; Marine Ins. Co. v. Georgia Interstate Electric Co.</u>, 187 Ga. App. 579, 370 S.E.2d 829 (1988).</p> <p><u>Sasser &amp; Co. v. Griffin</u>, 133 Ga. App. 83, 210 S.E.2d 34 (1974).</p> <p><u>Peacock Constr. Co. v. West</u>, 111 Ga. App. 604, 142 S.E.2d 332 (1965).</p>	<p>“ . . . no payment shall be due Subcontractor for such changed or extra work until Contractor has received payment from the Owner for said changes or extra work performed by Sub-contractor.”</p> <p>Subcontractors to be paid “as the work progresses, based on estimates and certificates of the Architects or Contractor and payments will be made from money received from the owner only and divided Pro Rata amount [sic] all approved accounts of subcontractors labor and material.”</p> <p>“Final payment shall be made within 30 days after the completion of the work included in this subcontract, written acceptance by the Architect, and full payment therefor by the Owner.”</p>	<p>Clause enforced as creating a condition precedent to payment. Court noted that the condition precedent to payment was clearly expressed in this subcontract.</p> <p>“A provision in a contract may make payment by the owner a condition precedent to a subcontractor’s right to payment if “the contract between the general and the subcontractor should contain an express condition clearly showing that to be the intention of the parties’ . . . . The condition is clearly expressed in this subcontract.”</p> <p>“[A]s we construe the plain and unambiguous language of the agreement, there are clearly expressed conditions precedent to defendants’ liability for the final payment of the contract price.”</p>	
Hawaii	No cases				
Idaho	Minority	<u>Hoff Cos. v. Danner</u> , 121 Idaho 39, 822 P.2d 558 (1991).	Language not given: Court concluded that parties, through their language and conduct, had impliedly agreed that the contractor’s payment obligation was conditioned on its first receiving payment.	Pay-When-Paid terms of the parties’ agreement created a valid condition precedent to payment. However, this is only the case when the payment by the Owner is <u>not</u> under the control of the Contractor.	



**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Iowa	Majority	<u>Grady v. S.E. Gustafson Constr. Co.</u> , 251 Iowa 1242, 103 N.W.2d 737 (1960).	"Contractor shall pay [] Sub-contractor in full within three (3) days after final acceptance of the project and payment of the final estimate by the Owner."	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor.	
Kansas	Majority	<u>Shelley Elec., Inc. v. United States Fidelity &amp; Guaranty Co.</u> , 1992 W.L. 319654 (D.Kansas 1992).	"Payment shall be made to Subcontractor within ten days after payment has been received by Contractor respecting such work or material, less any applicable percentage thereof retained in accordance with the aforesaid General Contract."	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor. The parties may shift the risk of payment but that intention must be clearly and unambiguously expressed. (It noted that there was no express condition precedent language or use of terms like "if" or "unless.")	
Kentucky	Majority	<u>A.L. Pickens Co. v. Youngstown Sheet &amp; Tube Co.</u> , 650 F.2d 118 (6th Cir. 1981).	"We will pay you a sales commission of 5% on our F.O.B. net realized mill value of our products covered by this agreement. This commission will be paid once each month on sales of our products on the invoices which have been fully paid."	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor.	
Louisiana	Majority	<u>Southern States Masonry, Inc. v. J.A. Jones Constr. Co.</u> , 507 So.2d 198 (La. 1987).	". . . Contractor shall pay to Subcontractor, upon receipt of payment from the Owner, an amount equal to the value of Subcontractor's complete work, to the extent allowed and paid by Owner on account of Subcontractor's Work. . . . final payment. . . shall be made within forty-five (45) days after the last of the following to occur. . . (c) final payment by Owner to Contractor. . . ."	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor.  (Note: LA courts appear willing to consider extrinsic evidence.)	

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Louisiana (cont.)		<u>C. Bel for Awnings, Inc. v. Blaine-Hays Constr. Co.</u> , 532 So.2d 830 (La. Ct. App. 4th Cir. 1988).	"The contractor agrees to pay the subcontractor . . . as the work progresses on estimates made and approved by the Contractor and/or Architect and payment received from the owner." Additionally, by subsequent agreement: [the] "parties acknowledge that . . . Subcontractor is not entitled to receive payment from [the general contractor] until [the general contractor] receives payment from [the owner]."	The subsequent agreements remove this case from the factual context of <u>Southern States</u> . The provision creates a condition precedent.	
Maryland	Majority	<u>Gilbane Bldg. Co. v. Brisk Waterproofing Co.</u> , 86 Md. App. 21, 585 A.2d 248 (1991).	"Monthly and final payments will be made to the trade contractor within five (5) days after receipt of payment by the construction manager from the owner. . . It is specifically understood and agreed that the payment to the trade contractor is dependent, as a condition precedent, upon the construction manager receiving contract payments, including retainer from the owner."	Clause was enforced as creating a condition to payment because the parties utilized express condition precedent language to shift the risk of owner non-payment or owner insolvency. (Case preceded statute).	<p>"(b) A provision in an executory contract between a contractor and a subcontractor that is related to construction, alteration, or repair of a building, structure, or improvement and that conditions payment to the subcontractor on receipt by the contractor of payment from the owner or any other third party may not abrogate or waive the right of the subcontractor to: (1) Claim a mechanics' lien; or (2) Sue on a contractor's bond . . . .</p> <p>(c) Any provision of a contract made in violation of this section is void as against the public policy of this State. Maryland <u>Real Property Code</u>, '9-113. (Applies only to contracts executed after 10/1/94.)</p>

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Massachusetts	Majority	<u>A.J. Wolfe Co. v. Baltimore Contractors, Inc.</u> , 355 Mass. 361, 244 N.E.2d 717 (1969).	"Payments were to be made, A. . . within 10 days after . . . [the owner's] payment of such monthly progress payments . . . [has] been received by . . . [general contractor]. The balance of the contract price shall be paid . . . within thirty . . . days after full and final payment for the work by . . . [the owners]. . . ."	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor.	Pending: 1997 MA H.B. 1813 (introduced Jan. 1, 1997; now in Joint Comm. on State Admin.): "Performance by a subcontractor in accordance with the provisions of its contract shall entitle it to payment from the party with whom it contracts. Payment by the owner to a contractor is not a condition precedent for payment to a subcontractor and payment by a contractor to a subcontractor is not a condition precedent for payment to any other subcontractor, and as [sic] agreement to the contrary is unenforceable."
Michigan	Minority	<u>Berkel &amp; Co. Contractors v. Christman Co.</u> , 210 Mich. App. 416, 533 N.W.2d 838 (1995), <u>appeal denied sub. nom.</u> , 450 Mich. 1019, 549 N.W. 2d 562 (1996).	"All payments received by Christman for the work done, 'the receipt of such payments received by the Christman Company being a condition precedent to payments of the subcontractor.'"	Clause enforced as creating a valid condition precedent to payment. Therefore, the contractor was not required to pay the subcontractor unless and until the owner paid the contractor. Court held that, because the pay-when-paid clause did not contain any language limiting the condition precedent and requiring payment in a reasonable amount of time, the court refused to read the limitation into the clause.	

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Minnesota	Majority	<u>Mrozik Constr., Inc. v. Lovering Assoc., Inc.</u> , 461 N.W.2d 49 (Minn. Ct. App. 1990).	"At all times the Subcontractor shall be paid to the extent that the Contractor has been paid on the Subcontractor's account."	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor.	Pending: 1997 MN H.B. 335 (introduced Jan. 30, 1997; House Comm. on Commerce, Tourism and Consumer Affairs recommended passage) (same as 1997 MN S.B. 256): "A provision contained in, or executed in connection with, a building and construction contract whereby payment from a contractor to a subcontractor or supplier is conditioned upon receipt of payment from any other party, including the state, a political subdivision of the state, or a private owner, is void and unenforceable."
Mississippi	No cases				
Missouri	Majority	<u>Havens Steel Co. v. Randolph Eng. Co.</u> , 613 F. Supp. 514 (W.D. Mo. 1985), <u>aff'd</u> , 813 F.2d 186, (8th Cir. 1987).	Payment due ". . . after Supplier/ Subcontractor has satisfied Havens . . . and Owner of its compliance with all the terms and conditions hereof and, if also satisfied, twenty (20) days after Havens has received final payment from the . . . Owner."	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor. The parties may shift the risk of payment but that intention must be clearly and unambiguously expressed.	Mo. Rev. State ' 431.183 (1996): "Any provision in a contract, agreement or understanding that provides that a payment from a contractor to a subcontractor, trade contractor, specialty contractor or

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Missouri (cont.)		<u>American Drilling Service Co. v. Springfield</u> , 614 S.W.2d 266 (Mo. Ct. App. 1981).	“Upon complete performance of this subcontract by [the subcontractor] . . . [the general contractor] will make final payment to [the subcontractor] of the balance due to [the subcontractor] under this Subcontract within 30 days after full payment for such work and materials has been received by [the general contractor] from [the owner].”	“A clause which provides that the contractor shall pay a subcontractor within a stated number of days after the contractor has received payment from the owner merely fixes the time when payment is due and does not establish a condition precedent to payment.”	supplier is contingent or conditioned upon receipt of a payment from any other private party, including a private owner, is no defense to a claim to enforce a mechanic’s lien pursuant to the provisions of Chapter 429, RS Mo.”
Montana	No cases				
Nebraska	Majority	<u>D.K. Meyer Corp. v. Bevco, Inc.</u> , 206 Neb. 318, 292 N.W.2d 773 (1980).	“[T]he Contractor shall not be liable for, nor bound in any respect to the Sub-contractor for the payment to him of his monthly or final estimates of any monies in excess of the amount which the Contractor receives from the Owner for the Subcontractor’s work.”	Clause not enforced as creating a condition precedent to payment, the clause merely established a reasonable time for payment by the contractor to the subcontractor.	
Nevada	No cases				
New Hampshire	No cases				
New Jersey	Majority	<u>Seal Tite Corp. v. Ehret, Inc.</u> , 589 F. Supp. 701 (D. N.J. 1984).	“The contract price [ ] shall be payable in the following manner: Ninety (90) percent monthly of work completed, within seven (7) days of receipt of payment by the Owner, or his Agent . . . [t]he balance to be paid within thirty (30) days after acceptance and receipt of final payment by the owner. . . .”	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor.	
New Mexico	No cases				



**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Ohio	Majority	<u>Thos. J. Dyer Co. v. Bishop Int'l Eng. Co.</u> , 303 F.2d 655 (6th Cir. 1962).	"The total price to be paid to Subcontractor shall be . . . (\$115,000.00) . . . no part of which shall be due until five (5) days after Owner shall have paid Contractor therefor, provided however, that not more than . . . (90%) thereof shall be due until thirty-five (35) days after the entire work to be performed and completed under said contract shall have been completed to the satisfaction of Owners, and provided further that Contractor may retain sufficient money to fully pay and discharge any and all liens, stop-notices, attachments, garnishments and executions . . . ."	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor.	
	Majority	<u>Power &amp; Pollution Services, Inc. v. Suburban Power Piping Corp.</u> , 74 Ohio App.3d 89, 598 N.E.2d 69 (1991), <u>mot. overruled</u> , 62 Ohio St. 3d 1441, 579 N.E.2d 214 (1991).	"[General contractor] shall not be required to pay any such monthly billing of the subcontractor prior to the date [the general contractor] receives payment of its corresponding monthly billing from the Owner . . . . Within ten (10) days after said final payment by the Owner, [the general contractor] shall pay the subcontractor the balance of the subcontract sum."	"[Although] a promise to pay 'if and when funds are available' was conditional and did not impose any obligation to pay until funds were available . . . the provision in dispute here does not set a condition precedent to the general contractor's duty to pay the subcontractor, but rather constitutes an absolute promise to pay, fixing payment by the owner as a reasonable time for when payment to the subcontractor is to be made. If the parties intended to shift the risk of solvency of the owner to the subcontractor, such intention should have been unambiguously expressed."	

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Oklahoma	Majority	<u>Byler v. Great American Ins. Co.</u> , 395 F.2d 273 (10th Cir. 1968).	"Contractor . . . will pay to the said Subcontractor, in monthly payments . . . as follows: . . . (100%) of all labor and material which has been placed in position and for which payment has been made by said 'Owner' to said Contractor, . . . except the last payment, which the said Contractor shall pay to said Subcontractor immediately after said materials and labor installed by said Subcontractor have been completed, approved by the said Architect, and final payment received by the Contractor . . . ."	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment, by the contractor to the subcontractor. (See also, <u>Moore v. Continental Cas. Co.</u> , 366 F. Supp. 954 (W.D.Okla. 1973) (following <u>Byler</u> )).	
Oregon	Majority	<u>Mignot v. Park Hill</u> , 237 Ore. 450, 391 P.2d 755 (1964).	"It is fully understood by and between the parties hereto that Contractor shall not be obligated to pay Subcontractor for any of the work until such time as Contractor has himself received the money from Bate Lumber Co. . . . In consideration of the prompt and faithful performance by Subcontractor . . . Contractor agrees to pay without interest thereon the . . . total value and price of the road construction work. . . ."	The parties may shift the risk of payment, but that intention must be clearly and unambiguously expressed. Where, as here, the contract contains a definite and unambiguous promise to pay for labor and materials performed and furnished, or for other services, the pay-when-paid clause will not be enforced.	

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Pennsylvania	Majority	<u>United Plate Glass Co. Div. of Chromalloy American Corp. v. Metal Trims Indust., Inc.</u> , 106 Pa. Commw. 22, 525 A.2d 468 (1987).	"Subject to the terms and conditions of this contract, final payment will be made to the subcontractor upon final acceptance of the work by the owner . . . ."	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor.	8 P.S. ' 194 (1996) 73 P.S. " 501-516 (1996) 73 P.S. ' 507 (1996).  "A contractor or subcontractor shall disclose to a subcontractor, before a subcontract is executed, the due date for receipt of payments from the owner. Notwithstanding any other provision of this act, if a contractor or subcontractor fails to accurately disclose the due date to a subcontractor, the contractor or subcontractor shall be obligated to pay the subcontractor as though the due dates established [elsewhere in the act] were met by the owner."
Rhode Island	No cases				

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
South Carolina	Majority	<u>Elk &amp; Jacobs Drywall v. Town Contractors, Inc.</u> , 267 S.C. 412, 229 S.E.2d 260 (1976).	"Subject to the receipt of corresponding payments by the Contractor covering the work requisitioned by the Subcontractor, and subject to the approval of quantities in place by the Contractor, ninety (90%) percent of the value of the work actually completed by the Subcontractor during said period shall be paid to the Subcontractor . . . . The retainage will be paid sixty (60) days after the later of the following events. . . iv) Full and final payment to the Contractor of all the funds due him for this project; and. . . . Subcontractors have been paid in full."	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor.	
South Dakota	No cases				
Tennessee	Majority	<u>Koch v. Constr. Technology, Inc.</u> , 924 S.W.2d 68 (Tenn. 1996).	"Partial payments subject to all applicable provisions of the Contract shall be made when and as payments are received by the Contractor. The Subcontractor may be required as a condition precedent to any payment to furnish evidence satisfactory to the Contractor that all payrolls, material bills, and other indebtedness applicable to the work have been paid."	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment by the contractor to the subcontractor. The parties may shift the risk of payment, but that intention must be clearly and unambiguously expressed.	
Texas	Majority	<u>Wisznia v. Wilcox</u> , 438 S.W.2d 874 (Tex. 1969), (superseded by statute in part on other grounds).  <u>Gulf Constr. Co. v. Self</u> , 676 S.W.2d 624 (Tex. App., 1984).	"The engineer shall be paid in the same proportionate manner as the architect is being paid by the Overlook Development Corporation."  "Under no circumstances shall the general contractor be obligated or required to advance or make payments to the subcontractor until the funds have been advanced or paid by the owner or his representative to the general contractor."	Clause not enforced as creating a condition precedent to payment. The clause merely established a reasonable time for payment.  The clause was simply a modification of the time for payment provision preceding it and did not create a condition precedent to payment.	

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Utah	Majority	<u>Zions First Nat'l Bank v. Christiansen Bros., Inc.</u> , 66 F.3d 1560 (10th Cir. 1995).	[Statutory language:] a contractor must pay his suppliers "within 30 consecutive days after receiving construction funds from . . . another contractor . . . or after the last day payment is due under the terms of the billing, whichever is later . . ."	"[T]he general rule is that such pay-when-paid provisions do not operate as conditions precedent under which the duty to pay is contingent upon receipt of funds from a third party. To the contrary, these provisions are viewed only as postponing payment for a reasonable time and merely establishing a convenient time for payment."	
Vermont	No cases				
Virgin Islands	Void as against public policy	<u>Shearman &amp; Assocs., Inc. v. Continental Cas. Co.</u> , 33 V.I. 192, 901 F. Supp. 199, (D.V.I. 1995).	"Subcontractor agrees that as a CONDITION PRECEDENT to the contractor's obligation to make any payment to subcontractor under the subcontract agreement, including final payment, the contractor must receive payment therefor from the owner. In the event the contractor does not receive all or any part of the payment from the owner with respect to the subcontractor's work, whether because of a claimed defect or deficiency in the subcontractor's work, or for any other reason, the contractor shall not be liable to the subcontractor with respect to any sums thereto."	A surety cannot defeat a subcontractor's claim on a payment bond, which replaces the mechanic's lien remedy, by asserting the contractor's pay-when-paid clause defense. It is against public policy in light of the Construction Lien Law as a whole.	

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Virginia	Quasi-minority	<u>Galloway Corp. v. S.B. Ballard Constr. Co.</u> , 250 Va. 493, 464 S.E.2d 349 (1995).	<p>“The Contractor shall pay the Subcontractor each progress payment within three working days after the Contractor has received payment from the Owner.</p> <p>Final Payment, constituting the entire unpaid balance of the Subcontract sum, shall be made by the Contractor to the Subcontractor when the Subcontractor’s Work is fully performed in accordance with the requirements of the Contract Documents, the Architect has issued a Certificate of Payment covering the Subcontractor’s Completed Work and the Contractor has received payment from the Owner.”</p>	In the absence of a clear and unambiguous statement of the parties’ intent as to the time of payment, an absolute pay-when-paid defense is available to a general contractor only if it can establish by parol evidence that the parties mutually intended the contract to create such a defense.	
	surety case	<u>Moore Bros. Constr. Co. v. Brown &amp; Root, Inc.</u> , Civ. No. 96-1809-A (E.D.Va. 1997).	“Notwithstanding any other provision hereof, payment by Owner to General Contractor is a condition precedent to any obligation of General Contractor to make payment hereunder; General Contractor shall have no obligation to make payment to Subcontractor for any portion of the Sublet Work for which General Contractor has not received payment from the Owner.”	Surety could not rely on pay-when-paid clause in its principal’s subcontract because the language was not explicitly incorporated into the payment bond.	
Washington	Majority	<u>Amelco Elec. v. Donald M. Drake Co.</u> , 20 Wash. App. 899, 583 P.2d 648 (1978), <u>rev. denied</u> , 91 Wash. 2d 1020 (1979).	“Contract Cancellation: If the Contract between Owner and Contractor is cancelled in whole or in part through no fault of Contractor this Subcontract may be cancelled by Contractor in whole or in part without liability for damages and Contractor shall be liable to Subcontractor only for the reasonable value of Subcontractor’s work completed to the extent that Contractor has received payment for said work from Owner.”	Clause did not create a condition precedent to payment, the clause merely established a reasonable time for payment by the contractor to the subcontractor.	
West Virginia	No cases				

**STATE-BY-STATE SUMMARY ON CONDITIONAL  
PAYMENT CLAUSES IN CONSTRUCTION SUBCONTRACTS (cont.)**

STATE	RULE	CASE NAME	CONTRACT LANGUAGE	HOLDING	STATUTES
Wisconsin	Void by statute.				<p>“The following provisions in contracts for the improvement of land in this state are void: . . .</p> <p>(3) Provisions making a payment to a general contractor from any person who does not have a contractual agreement with the subcontractor or supplier a condition precedent to a general contractor’s payment to a subcontractor or a supplier. This subsection does not prohibit contract provisions that may delay a payment to a subcontractor until the contractor receives payment from any person who does not have a contractual agreement with the subcontractor or supplier.” Wis. Stat. ‘779.135 (1994).</p>
Wyoming	No cases				