Bulletproof your Contracts: Understanding and Negotiating Subcontract Clauses

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• Prior to law school, Tim worked as a civil engineer for over four years, gaining experience in both the private and public sector.
Gray Reed & McGraw

- Over 130 attorneys
- Full-service, commercial law firm
- Offices in Dallas & Houston
- Opened in 1985
- The Construction Law practice group includes three attorneys who were named 2018 Rising Stars by Texas Super Lawyers Magazine (a Thomson Reuters company).
By the End of This Presentation...

You should be able to:

• Identify and understand key provisions in your subcontract.
• Identify whether key provisions you want in your subcontract are included.
• Have strategies and techniques for getting the key provisions you need in your subcontract.
The Subcontract: More Than A License to Invoice

• Subcontracts delegate duties.
• Subcontracts allocate risk.
• What is in your subcontract is important.
• What is not your subcontract is important.

The Problem: How does a subcontractor achieve a fair risk allocation given the typical disparity in bargaining power between subcontractor and contractor?
You’ve Got the Winning Proposal, Now What?

• The good news: The contractor has selected your bid; you’ve won the work.

• The bad news: You have to negotiate a just plain mean subcontract.

• And you’ve been told there will be no changes to the subcontract:
  • “I’m not allowed to make changes to this form.”
  • “If we change that provision for you then all of our subs wouldn’t be treated the same.”
  • “We’ve never had complaints in the past.”
  • “So and so will sign it.”
Key Terms In Your Subcontract

• Scope of work
• Pay-if-paid
• Indemnity
• Schedule; No damage for delay
• Change orders
“Subcontract Work” means all Subcontract Work described in a Work Authorization and thereby assigned to the Subcontractor to be performed according to this MSA and the requirements and the prices and within the time set forth herein, including the furnishing or payment of all labor, supervision, coordination services, materials, tools, equipment, consumable supplies, taxes and other things required to complete in a good and workmanlike manner, and as necessary to deliver the Subcontract Work as a complete and functioning part of the overall Project, including any procurement, manufacturing, furnishing, assembly, construction, installation, training of personnel, start-up, testing or commissioning, and commencing commercial operation of equipment installed hereunder, as further described in the General Contract, and Section 2.0 of this MSA. Subcontractor assumes toward Contractor all obligations Contractor has assumed toward Owner under the General Contract, but only to the extent Contractor is required to fulfill such obligations in order to perform, complete and deliver the Subcontract Work as required under the General Contract. Where this Contract describes a portion of the Subcontract Work in general, but not in complete detail, the Parties acknowledge and agree that the Subcontract Work includes any incidental work that is customarily understood to be included as a part of the Subcontract Work by Industry Standards.
28.01 This MSA and any Work Authorization issued hereunder may not be changed, modified, altered or terminated orally and Contractor assumes no responsibility for any understanding or representations made by any of its officers or agents prior to the execution of this MSA, unless such understanding or representations by Contractor are expressly stated in this MSA. This MSA, combined with each Work Authorization issued hereunder, contains the entire agreement between Subcontractor and Contractor with respect to the applicable Subcontract Work assigned to Subcontractor, and supersedes any prior comments or statements by either party relating in any way to the Contract Documents and this MSA (whether written or oral); provided, however, prior comments or statements by Subcontractor’s employees or agents shall not be superseded to the extent that they do not lessen or diminish or vary Subcontractor’s obligations hereunder, and Subcontractor agrees Contractor may offer such statements in evidence in any proceeding to enforce the same. In the event of a conflict between the provisions of this MSA or any Work Authorization and any other Contract Documents, the provision that confers the greater benefit upon Contractor shall govern.
Scope of Work

• The most important term in the subcontract.
• You know your scope best: Make sure the subcontract reflects what you intended.
  • Scope of “X”.
  • Not “X” and whatever else it takes to make a complete, functioning system.
  • Not “X” and what may reasonably inferable from the contract documents.
  • Not “X” and the architect/contractor’s interpretation of contract documents.
• Crucial for recognizing changed/extra work.
• Proposal qualifications, exclusions, terms and conditions not included.
Scope of Work

Tips for negotiating boilerplate surrounding scope of work:

• Basic premise for pushbacks are fairness and efficiency:
  • Proposal price is based on the contract documents provided.
  • Don’t know what is “reasonably inferable” until it is too late.
  • Cannot reliably determine what might be necessary for a “complete system”. Depends on other trades.
  • Architect’s determination is inherently subjective.
  • If our scope is unclear we need to raise our proposal price to account for the uncertainty. Would be more efficient to establish an unambiguous scope and then issue change orders if needed.
Pay-if-Paid Clause

3.02 As a condition precedent to Contractor’s obligation to make payment to Subcontractor under this MSA, Contractor must have first received payment from Owner of sums invoiced to Owner for Subcontract Work. Contractor’s receipt of payment from Owner shall be an absolute condition precedent to Contractor’s obligation to pay Subcontractor and Subcontractor’s right to receive such payment. Subcontractor hereby assumes the risk of Owner’s failure or refusal to pay Contractor for the Subcontract Work. Notwithstanding any other provision of this MSA, payment to Subcontractor for the Subcontract Work shall be due and owing only to the extent that (i) Subcontractor has submitted its pay request therefor strictly in accordance with the requirements of this MSA, and (ii) Owner has paid Contractor therefor. Contractor is not obligated to pay any retainage to Subcontractor until Owner has paid Contractor all of Contractor’s retainage in full. If Owner fails to pay amounts invoiced by Contractor for Subcontract Work under this MSA, then Contractor will use reasonable commercial efforts to collect such payments from Owner. Contractor will inform Subcontractor of Contractor’s collection efforts. Approval or payment of Subcontractor’s monthly estimate is specifically agreed not to constitute or imply acceptance by the Contractor or Owner of any portion of the Subcontractor’s Work.
Pay-if-Paid Clause

The upshot:

• Non-payment is a possibility.
• Conditional language necessary to establish pay-if-paid: “If”; “Condition Precedent”).
• Subcontractor does not get paid until Contractor does.
• If Contractor never gets paid then Contractor does not need to pay Subcontractor.

BUT...

• Subcontractor still has payment security -- e.g., lien and (maybe) bond rights.
• Subcontractor can “turn off” pay-if-paid’s effect through statutory notice.
• Contractor cannot use pay-if-paid clause if Contractor’s screw up is the reason for owner non-payment.
Pay-if-Paid Clause

Tips for negotiating pay-if-paid clauses:

• Pushback: Fairness and lack of access to information about Owner’s creditworthiness
  • We contracted with you, not the Owner.
  • We are going to invest and commit to the project and deserve to be paid accordingly.
  • Contractor is in the best position to evaluate Owner creditworthiness.

• BUT MAYBE, this isn’t as big a deal as it might at first appear:
  • Payment security in the form of a lien or payment bond claim.
  • If diligent, the effect of the pay-if-paid can be shut off by providing notice.
Indemnity

15.02 Indemnity and Defense Obligations with Respect to (i) Bodily Injury to or Death of Persons Other Than Subcontractor Personnel and (ii) Damage to Property. Subcontractor shall indemnify, defend and hold the Indemnified Parties harmless from and against any Claim due to bodily injury or death to any person who is not within the classification of Subcontractor Personnel, and any Claim due to loss or damage to any property, arising out of or in any way related to, or alleged to be caused in whole or in part by, the operations of Subcontractor Personnel; provided, however, Subcontractor shall not be obligated under this Section 15.02 to assume liability for an Indemnified Party’s own negligence or Fault.

15.03 Indemnity and Defense Obligations with Respect to Bodily Injury to or Death of Subcontractor Personnel. Subcontractor shall indemnify, defend and hold the Indemnified Parties harmless from and against any Claim due to bodily injury or death to Subcontractor Personnel even if caused or alleged to be caused by an Indemnified Party’s negligence or fault, in whole or in part, or breach or violation of a statute, ordinance, governmental regulation, standard, or rule, or breach of contract, negligent misrepresentation, gross negligence, negligence per se, or fraud. The term “Fault” as used herein includes fault based upon strict liability, whether arising by statute or common law, including strict liability arising out of the performance or failure to perform any non-delegable duty.
Indemnity

INDEMNITY: TO THE FULLEST EXTENT PERMITTED BY LAW, THE SUBCONTRACTOR EXPRESSLY AGREES TO DEFEND (AT SUBCONTRACTOR’S EXPENSE AND WITH COUNSEL ACCEPTABLE TO THE CONTRACTOR), INDEMNIFY, AND HOLD HARMLESS OWNER, CONTRACTOR, ARCHITECT, ENGINEER, CONSTRUCTION MANAGER, LENDER AND ANY OTHER PARTIES WHICH CONTRACTOR HAS AGREED TO INDEMNIFY IN THE CONTRACT DOCUMENTS AND THEIR RESPECTIVE OFFICERS, DIRECTORS, SHAREHOLDERS, EMPLOYEES, AGENTS, SUCCESSORS, AFFILIATES AND ASSIGNS (HEREINAFTER REFERRED TO COLLECTIVELY AS THE "INDEMNITEES"), FROM AND AGAINST ANY AND ALL CLAIMS, SUITS, LOSSES, CAUSES OF ACTION, DAMAGES, LIABILITIES, FINES, PENALTIES AND EXPENSES OF ANY KIND WHATSOEVER, INCLUDING WITHOUT LIMITATION, ALL EXPENSES OF LITIGATION AND ARBITRATION, COURT COSTS, AND ATTORNEY’S FEES, ARISING ON ACCOUNT OF OR IN CONNECTION WITH INJURIES TO OR THE DEATH OF ANY PERSON, OR ANY AND ALL DAMAGES TO PROPERTY, INCLUDING LOSS OF USE, REGARDLESS OF POSSESSION OR OWNERSHIP. THIS DEFENSE AND INDEMNITY PROVISION APPLIES TO ALL INJURIES, DEATH, OR DAMAGES ARISING FROM, OR IN ANY MANNER CONNECTED WITH THE WORK PERFORMED BY OR FOR THE SUBCONTRACTOR UNDER THIS SUBCONTRACT, OR CAUSED IN WHOLE OR IN PART BY REASON OF THE ACTS OR OMISSIONS, NEGLIGENCE OR GROSS NEGLIGENCE OF SUBCONTRACTOR OR BY ANY OF SUBCONTRACTOR’S EMPLOYEES, AGENTS, REPRESENTATIVES, SUBCONTRACTORS, OR SUPPLIERS, INCLUDING WITHOUT LIMITATION, BODILY INJURY, DEATH, OR PROPERTY DAMAGE WHICH ARISE FROM OR IN CONNECTION WITH, OR ARE CAUSED BY ANY ACT, ERROR, OMISSION, NEGLIGENCE OR GROSS NEGLIGENCE OF ANY INDEMNITEE. THE FOREGOING DEFENSE AND INDEMNITY PROVISION DOES NOT COVER INJURIES, DEATH, OR PROPERTY DAMAGE CAUSED BY THE SOLE NEGLIGENCE OF ANY INDEMNITEE. THE
Indemnity

Indemnity explained:

• Indemnity is a promise to pay someone for liability he/she may sustain to a third party.

• Three general types:
  1. Broad Form: Indemnity obligation even though not at fault (0% at fault, 100% liability). Think of an insurance policy.
  2. Intermediate form: All liability even though not completely at fault (10% at fault, 100% liability)
  3. Narrow Form: Liability co-extensive with fault (10% at fault, 10% liability)
Indemnity

Tips for how to tell what form of indemnity is in your subcontract:

• Under TX law, broad and intermediate form must be conspicuous. Look for ALL CAPS, **BOLD** and/or **UNDERLINED LANGUAGE**.

• Under TX law, broad and intermediate form must expressly state that you are indemnifying the other party for its own negligence.

• Intermediate form indemnity clauses will state that you are not required to indemnify for the other party’s **sole** negligence.

• Narrow form indemnity will limit the indemnity obligation **to the extent** of your fault.
Indemnity

Texas’ anti-indemnity statute:
• Only narrow form is allowed. A provision providing for intermediate or broad form indemnity is void.
• BUT, there is an exception:
  • If an indemnitor’s employee gets injured, then broad form indemnity is available.

Related insurance issue:
• Texas has closed the additional insured loophole.
Indemnity

Tip for negotiation: Getting to narrow form

• Pushback: Fairness and the law
  • We should not be liable to you for your own fault.
  • Anti-indemnity statute prohibits anything other than narrow form (except in special circumstances).
The Subcontractor acknowledges that the Subcontract Price is based on the fact that the Contractor is not liable to the Subcontractor, except as otherwise provided in and subject to the written notice requirement of Section 6.02(b) for any damages or costs due to delays, accelerations, nonperformance, interference with performance, suspension or change in the performance or sequence of the Subcontract Work.

Should the Subcontractor’s performance of the Subcontract Work, in whole or in part, be delayed due to Force Majeure, then Subcontractor shall be entitled only to seek an extension of time in which to complete the Subcontract Work so affected. Subcontractor agrees that Contractor has no duty, obligation or liability to Subcontractor for any loss, cost or damages suffered by Subcontractor due to Force Majeure, except to seek an extension of time from the Owner. Except as otherwise expressly provided in Section 6.02(c) Subcontractor shall only be entitled to seek an extension of time for delay if Subcontractor has, within forty-eight (48) hours after the first occurrence of the cause of any delay, requested in writing an extension of time, stating in detail the reasons therefor, certifying that the extension sought is limited to the amount of delay caused by circumstances for which an extension is permitted hereunder, and stating Subcontractor’s detailed plans for recovering as much as possible all time lost by reason of the event of Force Majeure in order to mitigate the delay. Subcontractor’s right to an extension of time shall be deemed waived if Subcontractor fails to timely comply with these requirements.
Schedule and No Damage for Delay

- No damage for delay clauses are enforceable
  - Subcontractor remedy limited to an extension of time
- There are exceptions recognized in TX case law
- Contractor’s desire to control schedule is understandable. But, it shouldn’t cost you money.
Schedule and No Damage for Delay

Tip for Negotiating Schedule and Delay Terms:

• Instead of relying on case law to save you, negotiate a better clause

• A compromise recognizing Contractor’s right to control schedule (e.g., accelerate, suspend, postpone, resequence) while at the same time appropriately compensating Subcontractor

• Basic Premise:
  • Contractor acceleration -> Subcontractor gets additional cost of manpower (i.e., overtime and weekend premium).
  • Contractor delays -> Subcontractor gets extension of time plus extended field general conditions.
Change Orders

• Construction is unique in that the purchaser can essentially force the seller to deliver a different product.

• A change order is an agreement regarding
  1. Change in scope,
  2. Change in time, AND
  3. Change in contract sum.

• NOTE: a change order ALWAYS involves all three—silence means “no change”.

• A change is a mini-contract and requires the same attention as the original contract.
Change Orders

• Contractor directed/initiated
  • Design changes revising the plans and specifications;
  • Changes altering method, manner or sequence;
  • Responsibility changes (e.g., with respect to furnishing of materials); and
  • Risk allocation changes.

• Subcontractor or circumstance originated
  • Time changes extending, delaying, suspending, or accelerating the time for completion;
  • Design defects
  • Causes originating with other contractors
  • Problematic site conditions
Change Orders

• Special Problem: Constructive Changes
• A constructive change occurs when changed work is ordered but the Contractor refuses to issue either a change order
• Three basic categories:
  1. The drawings or specifications are defective and, as a result, the contractor is required to perform extra (or more costly) work (*Spearin* doctrine issue);
  2. The Contractor misinterprets the contract, for example, where work that actually satisfies contract requirements is erroneously rejected or where an unreasonably high standard of performance is required; or
  3. The Contractor denies the Subcontractor a justified time extension, requiring compliance with the original completion schedule, and thereby forces the contractor to accelerate performance.
Change Orders

• Recall a change order is change in scope, sum and schedule
• SO ...
  • What is your scope?
  • What is your contractually-required quality?
  • What are your intended working conditions?
  • What is your budget? What is your current performance relative to anticipated cost?
  • What is your intended work sequence?
  • What are your intended work hours?
  • What is your schedule? What is current performance relative to anticipated completion date?
Change Orders

- Most contracts require the parties execute a change order before work commences
  - This is not always possible due to inability to secure pricing information before work must occur.
  - Best practice: At the very least, secure an agreement that changed work has been ordered and it will be compensated.
- Written change order requirements are enforced, but can be waived expressly or impliedly.
Change Orders

Waiver of the Writing/Notice Requirement?

• The Contractor has orally agreed or promised to pay additional compensation for the work in question; or
• The Contractor has knowledge of the additional work (and does not object); or
• The Contractor has accepted the work in question upon its completion; or
• Similar conduct in other instances: The parties to the contract, throughout its performance, have entirely or repeatedly disregarded the writing requirement.
  • E.g., the Contractor makes progress payments that include payments for extra work without insisting on a written change order.

• BUT HOW DO WE PROVE THIS???
Change Orders

• Waiver?
  • Oral “evidence”
    • Claim preparation
    • Deposition testimony
    • Trial/arbitration testimony
    • Dealing with counter-arguments
  • Documentation/exhibits attempting to indirectly prove argument
• Still might lose

• Documented change — You win.
Change Orders – Best Practices

1. Learn your scope.
2. Learn your schedule.
3. Learn your budget.
4. Read the changes clause in the contract—who has authority to order changes and how is a change accomplished?
5. Always assume the worst—even a simple favor can mushroom into a problem project disaster.
Change Orders – Best Practices


7. Be an advocate—sell the change!
   a. Know your audience.
   b. Well organized documents: clearly communicate facts.
   c. Overcome adverse interests: could involve the need to convince the reviewer of a mistake.

8. Try to resolve anticipated problems early in project—when less animosity.
Key Terms (Probably) Not In Your Subcontract

• Warranty that the contract documents (read: plans and specs) are accurate and complete
• Differing site conditions
• Waiver of consequential damages
Warranty of Plans and Specs

24.01 Subcontractor acknowledges having carefully reviewed and examined this MSA, the Contract Documents for each Applicable Project, and by its execution of any Work Authorization issued hereunder, Subcontractor acknowledges having also carefully reviewed it, as well as all attachments, exhibits and addenda to any of the foregoing. Subcontractor agrees by its execution thereof that no conditions exist which would adversely affect the progress, performance or price of the applicable Subcontract Work; that any and all prior ambiguities and discrepancies have previously been clarified and/or corrected and that it will not make any claim or demand upon Contractor based upon or arising out of any misunderstanding or misconception on its part of the provisions and requirements of those documents. However, in the event any ambiguity or discrepancy in the

2.14 The Subcontractor, before proceeding with any Subcontract Work, will accurately check and verify all previous and surrounding Work to determine the correctness of same, and shall field measure all dimensions relating to the Subcontract Work. Subcontractor’s failure to detect and disclose any existing discrepancies or nonconformities and report same to the Contractor, in writing, before commencing its Subcontract Work shall relieve the Contractor of any and all responsibility for same, and the Subcontractor shall be responsible and liable for all resulting damages, costs and expenses arising as a result of discrepancies and nonconformities that should have been discovered by the Subcontractor.
Warranty of Plans and Specs

• *Spearin* Doctrine: Implied warranty by the Owner to the Contractor that the plans and specifications are accurate and complete.

• Does not officially exist in Texas. See *Lonergan*. But more recently case law has taken pains to find an express warranty.

• *Spearin* doctrine does not necessarily apply to subs. Very few jurisdictions have considered the issue.
Warranty of Plans and Specs

Why the *Spearin* Doctrine (or its express surrogate) is the second most important item in subcontracting:

- The *Spearin* Doctrine provides teeth to the underlying assumption in your bid: That the documents you used to formulate your bid accurately represent what you will be required to do/perform.
- Foundation of the vast majority of claims for additional compensation (even if not expressly acknowledged as such).
- If you can’t rely on the plans and specs then no basis to recover additional time and compensation for changes to them.
Warranty of Plans and Specs

Tips for getting changes to the subcontract:

• Change provisions requiring you to carefully review contract documents to something you would actually do as a subcontractor (i.e., review for facilitating your work and not for purpose of discovering errors and omissions).

• For best results, add a provision allowing you to rely on the accuracy and completeness of the contract documents.
  • Do not phrase this as an express warranty by Contractor. Not: “Contractor warrants...”
  • Instead make it something that the subcontractor may do “Subcontractor may rely...”
Differing Site Conditions

2.03 Surface and Subsurface Conditions. The Subcontractor shall inspect surface and/or subsurface conditions affecting the Subcontract Work to assure that the Subcontract Work will be properly performed in accordance with the applicable Contract Documents. If any remedial work is required to the surface or subsurface, Subcontractor shall immediately notify Contractor in writing. IF SUBCONTRACTOR PERFORMS SUBCONTRACT WORK WITHOUT PROVIDING NOTICE THAT SUCH REMEDIAL WORK IS REQUIRED, SUBCONTRACTOR ACCEPTS ALL SURFACE AND SUBSURFACE CONDITIONS AND WAIVES ANY CLAIMS FOR EXTRA COMPENSATION TO REPAIR OR REMEDY SUCH CONDITIONS OR FOR REPLACEMENT OF THE SUBCONTRACT WORK ARISING OR RESULTING FROM DEFECTS IN THE SURFACE OR SUBSURFACE.
Differing Site Conditions

Full risk transfer is typical.

• In the typical subcontract, subcontractor expressly or impliedly assumes the risk of concealed conditions.
  • Subcontractor assumes the risk of DSC if the subcontract is silent on the topic.

Importance:

• Differing concealed or subsurface conditions may not be factored in to subcontractor’s bid.
• Differing site conditions can be much broader than unanticipated soils or existing building features (think scaffolding and other obstructions).

What to do:

• Include a differing site conditions clause.
Differing Site Conditions

Two Types of Differing Site Conditions

• Type I:
  • Certain conditions are indicated by the plans, specification and other contract documents;
  • Subcontractor relied on the physical condition indicated in the plans, specification and other contract documents;
  • The actual conditions differ from those indicated in the plans, specification and other contract documents;

• Type II:
  • To recover under a Type II condition, subcontractor must prove the conditions encountered were unusual and differed materially from those reasonably anticipated, given the nature of the work and the locale. Need not be a geological freak.
  • It is possible to recover under a Type II situation even where the contract is silent about the nature of the condition.
  • The key to recover for Type II DSC is the comparison of actual conditions with what was reasonably expected at the time of bidding/contracting.
Differing Site Conditions

Negotiating a DSC clause into your subcontract:

• The Contactor likely has one in its agreement with the owner.

• Subcontractor’s bid does not account for adverse site conditions.

• Keep the clause short. Type I and II can be covered in a sentence or two.
Waiver of Consequential Damages

Consequential Damages can be astronomical.

• Costs typically arise from delays:
  • Contractor home office overhead and extended general conditions
  • Contractor lost profits
  • Owner lost revenue
  • Owner substitute space
  • Owner financing costs

• The Answer: A mutual waiver of consequential damages.
Waiver of Consequential Damages

Tips for negotiating a mutual waiver:

• Contractor likely already has one in its favor in both the subcontract and the prime contract

• Mutual = fairness

The clause and its effect are simple. But the importance of incorporation of the clause into the subcontract cannot be overstated.
Strategies for Negotiating All Changes to the Subcontract

- **Know your audience.**
  - Beware of their likely level of sophistication and authority.
  - Evaluate whether you may need to elevate things up the chain.

- **Be Cognizant of Contractor Negotiation Defense Mechanisms.**
  - Don’t immediately give up if they say no changes.
  - Consider ways to elevate the discussion. E.g., get your counsel involved so that the Contractor’s counsel gets involved.

- **Consider using a one page rider or addendum.**
  - Everything discussed tonight can be accomplished in a one page document.
  - A good answer to “we can’t change our form” and that’s too many changes.
  - A good way to satisfy a lower-level contractor employee.
Questions/Comments?
Thank you!

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