



### *The Most Dangerous Subcontract Clauses That Affect Payment*

*by Timothy Woolford*

Most of the disputes attorneys handle on behalf of subcontractor clients are payment-related. In almost every payment dispute, the terms and conditions of the subcontract control the outcome. Consequently, identifying the subcontract provisions that are most likely to come into play, if there is a payment dispute, is essential. Being able to do so quickly and efficiently is also necessary because general contractors often afford subcontractors little time to review and sign subcontracts, sometimes only a few days or less. Since the subcontracts of many GCs are getting longer and more complex, thorough subcontract review can be a time-consuming task. Can you spot the provisions most likely to come into play in a payment dispute?

#### **1. Contingent Payment Clauses.**

Clauses that condition your right to be paid on events you cannot control—such as payment by the owner or a lender—are very risky. The most dreaded of such clauses is the “pay-if-paid” clause, which conditions your customer’s duty to pay you on its receipt of payment. These clauses should be

aggressively resisted. You should only rely on the creditworthiness of your customer, not some third-party with whom you have no contract. Your customer is in a much better position to evaluate the creditworthiness of its own customer and if it decides to enter into a contract with a risky customer, you should not share in that risk. If your customer refuses to strike the clause altogether, ask for a compromise in which you customer agrees that if the owner falls behind in payments, the customer agrees to pay you after a certain specified time (such as 60 days, 75 days, or even 90 days). Having an outside date by which the customer must pay you no matter what is much better than a conditional payment clause like “pay-if-paid” in which your customer is never obligated to pay you if it does not receive payment from the owner. Note that in some jurisdictions, conditional payment clauses are not enforceable. If you are in such a jurisdiction, you may not need to focus as heavily on this type of clause. (See the [ASA Contingent Payment Clauses in the 50 States.](#))

**2. Contingent Payment Clauses for Change Orders.** Many subcontracts also contain clauses providing that the GC does not have to pay you for change order work unless the owner approves and pays for the change order. These clauses are problematic for the same reasons as those above. Your right to be paid is in the hands of a third party. Tell your customer your subcontract is with him/her and if you are required to perform work outside the scope of your subcontract, you must be paid for it. If the GC is relieved of the obligation to pay you for change order work unless the owner pays, it reduces the GC’s incentive to aggressively pursue payment for your change order work. Whether or not that work justifies a change order under the prime contract between the GC and the owner is often a separate and distinct inquiry from whether you are entitled to a change order under the subcontract. (See the [ASA Contingent Payment Clauses in the 50 States.](#))

### 3. Ability to Stop Work If Not Paid.

Many GCs realize that the ability of a subcontractor to stop work if it is not paid is a very powerful tool—perhaps the most powerful of all—for a subcontractor to enforce its payment rights. For that reason, many GCs include provisions requiring you to continue working in the event of a dispute. Agreeing to continue working despite not being paid is a prescription for disaster. Understandably, the first impulse of subcontractors who are not paid on time is to stop work. They are often surprised to discover that they signed a subcontract with a “continuing work clause” that prohibits them from stopping work. Make sure your subcontract is clear that if payment is not made when due (or within some grace period such as seven days, 10 days, etc.), you will be stopping work until payment is made. And, you should be afforded additional time to complete your work on account of the delay due to your work stoppage. (See the [ASA Subcontractor’s Negotiating Tip Sheet on Inability to Stop Work for Nonpayment.](#))

### 4. Schedule Compliance

**Provisions.** GCs often provide in their subcontracts that the subcontractor agrees to comply with any schedule provided by the general contractor without additional compensation including any schedule revisions. These provisions are dangerous and can be costly because they require the subcontractor to absorb the cost of delays, accelerating work and second shift and/or overtime work. In most cases, your bid price estimates the amount of required labor based on the schedule and a reasonable expectation of work sequences and activity durations. You should agree to work in accordance with the bid schedule, which should be expressly

identified in the subcontract, and the subcontract should be clear that if you are required to deviate from that schedule as a result of delays or disruptions caused by others, additional costs apply. (See the [ASA Subcontractor’s Negotiating Tip Sheet on Project Schedule.](#))

**5. Subcontract Documents.** Many subcontractors incorrectly assume that their proposal is part of the subcontract and is the controlling document regarding their scope of work and other terms. However, in most jurisdictions, the proposal is not part of the subcontract unless the subcontract itself expressly incorporates the proposal. Consequently, your obligations will be controlled exclusively by the GC’s subcontract. Many subcontractors’ proposals contain important limitations, exclusions and clarifications. In all likelihood, the subcontract will not contain the same exclusions, limitations and clarification. Therefore, insist on making your bid, quote or proposal a part of the subcontract in order to ensure that your proposal controls. Also, include a provision that if there is an inconsistency or discrepancy between the proposal and any other term of the subcontract, the proposal controls. Don’t just staple it to the subcontract because physically attaching it will not be sufficient to make it part of the subcontract. There must be language expressly incorporating it. (See the [ASA Subcontract Documents Suite.](#))

**6. Advance Notice of Proposed Backcharges.** Too many subcontractors learn for the first time when they requisitioned for final payment or retainage that the customer intends to offset or reduce the final payment based on previously undisclosed backcharges. Understandably,

subcontractors are frustrated when they learn that charges are being assessed after the costs have been incurred without having been given an opportunity to address the situation themselves. To avoid this problem, insist that before the customer can backcharge you, it must provide you with written notice of the condition or alleged deficiency and a reasonable period of time to address it before the GC spends money to address it and backcharge you. Although these provisions are often absent from subcontracts, many or most reasonable GCs will accept this language. GCs are usually strict in requiring advance written notice before you perform additional or changed work, so it is equally fair that subcontractors get advance notice before charges are assessed to them. (See the [ASA Subcontractor’s Negotiating Tip Sheet on Contractor Backcharges.](#))

**7. Liquidated Damages.** Liquidated damages are always risky and you should seek to limit, reduce or eliminate them. An emerging trend is to assess liquidated damages for multiple interim completion dates or milestones during the project as opposed to just the completion date. Liquidated damages are assessed for failing to achieve any of these milestones or interim completion dates. Consider pushing back on these damages for interim dates and agree only to liquidated damages for an inexcusable failure to achieve substantial completion on time. Also, watch for special requirements for substantial completion. Many subcontracts have long lists of work that needs to be complete and/or documentation that needs to be submitted in order for your work to be considered substantially complete. If you cannot eliminate these additional requirements,

make sure you comply with them so that you don't incur liquidated damages for technicalities, such as late submission of O&M's or written warranties. Know the requirements for substantial completion and eliminate those that will delay the substantial completion date as it will delay your final payment. (See the [ASA Subcontractor's Negotiating Tip Sheet on Limitation on Damages.](#))

**8. Dispute Resolution.** If the payment dispute requires you to invoke the subcontract's dispute resolution procedures, make sure that the process is not unnecessarily burdensome, expensive or time-consuming. Subcontracts often require you to "stay" (or suspend) pursuit of all dispute resolution efforts during the pendency of a dispute between the GC and owner. These provisions are dangerous. Disputes between the owner and GC can drag on for years depending on the method of dispute resolution required by the prime contract. If you agree to stay your claim for payment against the GC until the owner/GC dispute is concluded, you lose all power to enforce your payment rights and might have to wait years to be paid. To make matters worse, these clauses almost always provide that you agree to be bound by the outcome of the owner/GC dispute. Thus, if the GC recovers only half of what you are owed, you are bound to accept that amount on your claim. Plus, the GC usually can further reduce that by a portion of the attorney fees it incurred on your behalf. These provisions are known as liquidating agreements because they liquidate or settle the amount you are entitled to receive to the amount recovered by the GC. Additionally, consider insisting on arbitration as the method of binding dispute resolution, or

some other procedure that is faster and less expensive than litigating the dispute in court. (See the [ASA Subcontractor's Negotiating Tip Sheet on Mediation as Preferred Dispute Resolution Method.](#))

Be wary of subcontracts that require you to resolve disputes in an inconvenient forum. Some jurisdictions will not enforce such provisions, so check your jurisdiction to see if a contract clause that requires disputes to be resolved in another state is enforceable. If so, insist on the dispute being resolved in the state (and preferably the locality) in which the project was constructed. These "forum-selection" clauses are often designed to create a strong disincentive to subcontractors to pursue payment rights by imposing unreasonable costs upon them to do so. (See the [ASA Anti-Forum Selection Clauses in the 50 States.](#))

**9. Avoid Waiving Mechanic's Lien Rights.** Be vigilant about retaining mechanic's liens rights. The ability to threaten or file a mechanic's lien is one of the most powerful weapons a subcontractor has in its arsenal to enforce its payment rights. Many GCs are well aware of this fact, so they will seek to require subcontractors to waive such rights in advance, if such waivers are legally permitted in the jurisdiction. By threatening or filing a mechanic's lien, you can put pressure on the owner of the property who, in turn, may pressure the GC to pay you to eliminate the threat of the lien, or cause it to be withdrawn. (See the [ASA Subcontractor's Negotiating Tip Sheet on Lien Waivers.](#))

**10. Retainage Reduction.** If your customer insists on holding retainage, request that retainage be reduced to 5 percent when your work is 50 percent complete and that half of the retainage

then being withheld be released at that time. Another option is to insist that if the owner reduces the GC's retainage at any time during the project to less than 10 percent, your retainage is reduced to the same extent. Some GCs' standard subcontracts call for retainage of 10 percent throughout the entire project even though under their contracts with the owner, retainage is less than 10 percent from the outset or is reduced during the project. It is unreasonable for the GC to hold a greater percentage on you than the owner is holding on the GC. (See the [FASA Retainage Laws in the 50 States](#) the [ASA Subcontractor's Negotiating Tip Sheet on Retainage for Sub is More than for GC.](#))

An experienced construction attorney can assist you in revising the subcontract. There are many attorneys who are affiliated with ASA and are well-equipped to work with you. You might also consider preparing an addendum to be attached to all subcontracts. Subcontracts are filled with risks that can interfere with your payment expectations. Don't wait until a payment dispute arises to find out what the subcontract says—devoting extra time and effort during negotiation can make all the difference in ensuring a profitable project. (See the [ASA Subcontract Documents Suite.](#))

*Timothy Woolford of Woolford Law, PC, is a construction attorney in Pennsylvania that represents subcontractors and other construction professionals. He is also an Adjunct Professor of Law at the Penn State Law School where he teaches Construction Law to 2<sup>nd</sup> and 3<sup>rd</sup> year law students.*