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Negotiating contracts in a bad market

Brad C. Parrott

In normal times, contract negotiation serves at least two key purposes: the first is reduction of risk, and the second is certainty.

The first interest is served by negotiating modifications to unfair contract provisions relating to time of performance, payment, and indemnification. As you well know, most subcontracts contain conditional payment clauses, no-damage-for-delay clauses, and broad-form indemnity, all of which spread risk to subcontractors.

The interest of certainty is a bit different. Certainty is first served by clear definitions of obligations and responsibilities—in other words, the scope of work. As a product of reducing risk, greater certainty is generally achieved. For example, by negotiating a contract to eliminate broad-form indemnity, you are reducing risk while simultaneously eliminating a dispute.

What do I mean? In many instances and in many states, broad-form indemnity clauses are difficult to enforce. In simple terms, broad-form indemnity provides that if the subcontractor is 1% at fault for a damage or event and others are 99% at fault, then the subcontractor is still liable to pay the cost for the entire event notwithstanding that the subcontractor is only 1% at fault.

Even where broad-form indemnity is agreed to, there may be avenues for contesting the enforceability of that clause through litigation. The outcome of litigation is always uncertain. Thus, by clearly eliminating broad-form indemnity, you eliminate reliance on prevailing in litigation (risk reduction) and create certainty because the contract is now clear, regardless of statutory limitations on indemnity clauses.

In the current economic turmoil, subcontractors have little, if any, bargaining power. In the precast concrete industry right now, precasters are taking work at less-than-ideal prices. Thus, the question becomes, can we reduce risk or create certainty through contract negotiations with little or no bargaining power?

First, the reality is that a number of precasters in the United States do not negotiate contracts even in the best of times. There is always a percentage of the competition that will sign anything. In a bad economy, the number of precasters who adopt this sign-anything approach grows exponentially, as is the case with every trade.

Although bargaining power is at an all-time low, the interests of risk reduction and certainty can still be served. As a precaster, the greatest risks beyond your control are payment and others' actions causing your work to be slower or more expensive. Here are some suggestions to reduce risk, or at least understand what risks exist, and create some greater certainty.

Owner solvency

While you may not be able to negotiate favorable terms, you can always investigate and satisfy yourself that the owner can pay for the work. It is important to recognize that general contractors are not banks. Most general contractors cannot fund the cost of a construction project. Thus, even if you are in a state that will not enforce conditional payment clauses, you still must consider owner solvency. If the owner does not pay the general contractor, in most cases the general contractor simply cannot pay its subcontractors.

Most general contractors do not have the financial resources to pay construction costs when an owner defaults. Do not be pacified if you operate in states where conditional payment clauses are not enforced. In serving the interests of risk reduction in a bad economy, the importance of analyzing the owner's solvency becomes heightened.

As a precaster, the greatest risks beyond your control are payment and others' actions causing your work to be slower or more expensive.

Know and understand your state's laws

Some of you may be members of the American Subcontractors Association (ASA). The ASA, in coordination with lawyers in many states throughout the United States, has compiled a set of useful survey summaries that are available to ASA members. They include the following:

- "50 State Lien and Bond Law Summary"
- "50 State Anti-Indemnity Statute Summary"
- "50 State Retainage Survey"
- "50 State Prompt Payment Manual"
- "50 State Survey of Contingent Payment Clauses"

Each of these documents summarizes the relevant laws in each state. They are useful tools for quickly understanding state laws regarding subcontractors.

You can rely on state laws to avoid onerous contract clauses. For example, if a state will not enforce a broad-form indemnity clause, then you might not need to worry about negotiating an amendment. This is true in many states, including South Carolina, North Carolina, and New York, where conditional payment clauses are not enforceable. Many of the contracts in those states continue to have conditional payment clauses. However, if forced, you can beat those clauses in a courtroom.

Notwithstanding the law, I still advise that these clauses be amended so that future disputes may be avoided. As I said previously, general contractors cannot afford to pay the costs of construction of a project. Thus, if the owner does not pay, a general contractor will do what it can, including raising a conditional payment clause in a state where they clearly are not enforced, to avoid having to make payments. Eliminating these clauses eliminates disputes and creates certainty.

In today's market, with the ability to negotiate a contract severely diminished, knowing which clauses are and are not enforceable will help you better assess the risks you take when agreeing to various clauses. This requires a significant amount of diligence on your part. The ASA documents are helpful tools, but when in doubt you should consult an experienced construction lawyer for guidance.

Deal breakers

Even in the current economic climate, several clauses should be viewed as deal breakers or you should at least try to modify them. They are as follows:

- no-damage-for-delay clauses
- broad-form indemnity
- advanced waivers of liens or bond claims

You might be asking why payment terms are not included. In today's market, if you operate in a state that will enforce conditional payment clauses, you will not find a general contractor who will agree to eliminate the conditional payment clause.

In any construction project, the most significant risks come from one of two primary sources.

The first is nonpayment for reasons unrelated to your performance. Obviously, if a precaster properly performs, the precaster ought to be paid for its work. Thus, you must do what you can to reduce the risk of nonpayment. There are three principal ways to do that:

- Analyze the solvency of the owner.
- In a better market, negotiate the conditional payment clause. (This is not an option now.)
- Never waive, release, or otherwise relinquish lien or bond rights.

The other key risk factors arise when the performance of others gives rise to damage to you. That comes in two principal forms:

- Someone else's performance makes your performance more costly.
- In broad-form indemnities, you are required to pay the cost or damage associated with the failure of others where you are also, in part, at fault.

No-damage-for-delay clauses

There is little doubt that no-damage-for-delay clauses are remarkably unfair. These clauses seemed to gain favor with owners during the 1980s and 1990s. A no-damage-for-delay-clause simply states the following:

> *"In the event that a contractor or subcontractor encounters an event that causes its work to take longer or proceed inefficiently or in a sequence originally unintended and the event is not caused in whole or in part by the contractor or subcontractor, then the contractor and subcontractor's sole and exclusive remedy shall be an extension of the time in which to perform the work. In no event and under no circumstances shall the contractor or its subcontractors be entitled to any increase in price associated with any such delays, consequences, or inefficiencies. The contractor and subcontractor expressly agree and acknowledge that delays, consequences, and inefficiencies are foreseeable and that they have considered such potential events in agreeing to the price stated in the prime contract and respective subcontracts."*

These clauses benefit an owner to the detriment of both the contractors and the subcontractors. They are unfair because it is impossible to foresee or to price unknown delay events.

In the classic example, a general contractor begins grading a site and runs into some historic artifact or gravesite, at which point the job completely shuts down, various state or federal bureaucracies take over the jobsite to determine the significance of a fishing boat from 1650, excavate it, and turn the site back over for construction.

It is absolutely impossible to foresee or price such an event. However, no-damage-for-delay clauses are generally enforceable and would preclude any increase in the contract price. Attempt to negotiate a provision stating that if the subcontractor encounters a delay event outside of its control, the subcontractor shall be entitled to an equitable increase in the contract time and price.

Broad-form indemnity

As stated previously, ASA has issued a "50 State Anti-Indemnity Statute Summary." A number of states simply will not enforce broad-form indemnity in some or all circumstances. Thus, you must be familiar with the law of the state in which you operate to determine what, if any, risk broad-form indemnity poses if it is contained in a subcontract form.

The shifting of risk to the subcontractor in broad-form indemnity is unreasonable. There is no middle-ground approach. I recommend that you consider negotiating contracts to eliminate broad form. A typical modification might look as follows:

> *The subcontractor does not agree to any broad-form indemnity. The subcontractor's liability, if any, pursuant to any indemnity in the contract documents is limited to the damage that it causes. If any damage or cost is caused in part by the subcontractor and in part by any other party, including an indemnitee, the subcontractor's liability under all indemnity clauses, the contract documents, and applicable law shall be partial in proportion to the subcontractor's degree of fault or negligence.*

Lien and bond waivers

In many states, lien waivers are not enforceable when given in advance of performing the work. For example, in Georgia, a lien waiver contained in a subcontract agreement is unenforceable because that lien waiver is given in advance of performance. When you see a lien waiver in a subcontract in the state of Georgia, it is not in effect at the time of executing the subcontract.

However, in other states, such as Virginia and Alabama, a lien can be waived at any time. The same is true for private and public bond rights. As mentioned, one of the key risk factors in any job is the receipt of payment for work performed. The tools in your arsenal are lien and bond claims.

Thus, as you review contracts, if you see any lien or bond waivers in the subcontract form itself—in other words, waiving lien and bond claims before any work has even begun—you should strike and eliminate those immediately.

At a minimum, you must review the applicable state law to determine whether those clauses are enforceable. Obviously, if they are unenforceable, you might be able to disregard the provision. Lien and bond rights may be your only salvation in a project that goes bad in today's market. It is impossible to overstate the importance of maintaining and preserving your lien and bond rights.

While we all recognize that today's market eliminates bargaining power, it is no reason to disregard contract terms altogether. Many jobs have thin, if any, margins. Do not compound the challenges of today's market by signing everything presented to you or by losing lien or bond rights. Review your state's laws so that you understand which of the typical onerous clauses are enforceable.

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Synopsis

Today's market diminishes precasters' bargaining power, but it is no reason to disregard contract terms altogether. Precasters must negotiate modifications to unfair contract provisions relating to time of performance, payment, and indemnification.

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Bond waiver, broad-form indemnity, certainty, conditional payment clause, contract, lien waver, negotiation, no-damage-for-delay clause, risk.

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