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Standard Clauses in Construction Contracts: A Trap for the Unwary

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Often times, form construction contracts that have been regularly used in the past are simply used or revised for a new project without giving much thought as to why certain provisions have been included in the first place and what the significance and effect these provisions have. You should pay particular attention to the following provisions.

No Damage for Delay

Many construction contracts contain a provision exonerating the owner from responsibility for delay damages. This is called a “no-damages-for-delay” clause. If a contract specifically provides that there will be no damages for delay, the contractor will receive payment for normal delays in the progress of the work and may be entitled to only extensions of time for completion. Florida follows the majority of jurisdictions which hold that no damages for delay clauses are legal and enforceable. There are several exceptions that render a no-damages-for-delay clause unenforceable. The clause will not be enforced if the delay is caused by active interference, concealment, or fraud on the part of the party seeking to enforce the provision. Active interference can involve intentional action, such as where a property owner delays the approval of plans and changes and orders that construction stop until such plans and changes are approved. Active interference can also involve inaction, such as where an engineer has early knowledge of a design floor and subsequently fails to apprise the contractor. A no-damages-for-delay clause can be waived, for example, when a party continues to render performance based upon a verbal assurance that the provision will not be enforced.

“Pay When Paid” and “Pay If Paid”

“Pay when paid” and “pay if paid” clauses are contingent payment clauses.

“Pay when paid” clauses mean that payment from the general contractor to the subcontractor is conditioned upon prior receipt of payment from the owner to the general contractor. Typically, the subcontract provides that that payment is due to the subcontractor within a certain period of time after receipt by the general contractor of payment from the owner. For example, a typical “pay-when-paid” clause might read: “Contractor shall pay subcontractor within seven days of contractor’s receipt of payment from the owner.”

A “pay if paid” provision in a subcontract provides that the general contractor is only obligated to pay the subcontractor if it is paid by the owner. For example, a typical “pay-if-paid” clause might read: “Contractor’s receipt of payment from the owner is a condition precedent to contractor’s obligation to make payment to the subcontractor; the subcontractor expressly assumes the risk of the owner’s non-payment and the subcontract price includes this risk.” If the owner never pays the general, then the general contractor is not required to pay the subcontractors. Therefore, the subcontractor assumes the risk of non-payment by the owner. This type of clause affords the greatest protection to the general contractor.

Florida case law indicates that “pay if paid” provisions are strictly construed and have the best chance of being upheld if they are explicit and clear

and set a condition precedent to payment of the subcontractor, as opposed to merely fixing a reasonable time for payment to the subcontractor. In other words, the pay-when-paid provision must clearly state that the subcontractor will be entitled to receive payment from the contractor only if the contractor receives payment from the owner.

Pay if paid clauses are not enforceable in all states because they may be considered waivers of the contractor’s lien rights. There is a growing legislative and judicial trend finding “pay if paid” provisions against public policy and unenforceable. In those states, contractors must pay subcontractors within a reasonable period of time for their work.

Waiver of Lien and Bond Rights

Although form construction contracts sometimes contain a waiver of lien and bond rights provision, Florida law prohibits waiving the right to claim a lien in advance. It allows a lien right to be waived only to the extent of labor, services, or materials already provided. A waiver made before the labor, services, or materials have been provided is not enforceable.

However, in many states, the waiver of lien and bond rights in advance of payment at the time of contract is enforceable. Contractors, subcontractors and design professionals should never agree to a contractual waiver of lien rights and file appropriate liens or stop notices in a timely manner. Also, if a payment bond exists for the project you should notify the bonding company of non-payment.

Acceptance of Final Payment as Waiver

Under an acceptance of final payment as waiver clause (“acceptance of a final payment

by the Subcontractor shall constitute a waiver and release of any and all Claims by the Subcontractor against the Contractor...), unresolved subcontract claims or change order requests may be inadvertently waived when final payment is received for the original contract sum. Therefore, subcontractors should avoid this provision or be careful not to request payment in full until all claims are resolved. A possible compromise may be to exclude written claims which remain pending when final payment is received.

Change Orders in Writing

Change orders are usually the most contentious issue between the parties on a construction project. Often times there are specific notice and approval provisions for change orders contained in both the subcontract and the prime contract, including requirements that all changes orders be in writing signed by the contracting officer or party.

One of the best ways to achieve early resolution of change order disputes is to maintain good site records to track changes (daily logs, time sheets, cost reports, schedules, etc.) and to keep the lines of communication open between field personnel, the company controller and accounting personnel, and the project supervisor.

Notice Requirements

One of the most common ways a party waive rights to compensation is to fail to provide timely notice as required by the contract for added work, delay or differing site conditions. Notice requirements exist to allow the owner the opportunity to mitigate its damages resulting from an apparent problem. If notice requirements are not met, this opportunity has effectively been taken away from the owner. Courts typically uphold notice requirements with a few exceptions (i.e., exceptions where the owner was constructively notified or aware

of the problem, or if timely notice would have had no impact on the extent of the damages sustained). Field personnel should know the notice requirements in the contract.

Differing Site Conditions

Construction contracts typically require the contractor to investigate and satisfy itself as to the general and local conditions, including patent site conditions; labor and utility availability; normal weather conditions; and the character of equipment and facilities needed to perform the work. If differing site conditions are discovered and the contractor has performed an adequate investigation (with a written report of findings), the contractor may be prohibited from recovering the additional costs relating to the differing site condition. However, if the information provided by the owner is misleading and incomplete and the contractor reasonably relies upon that information, typically the contractor will be entitled to recover its increased costs.

Incorporation by Reference

The subcontract agreement will generally incorporate by reference some or all of the terms of the prime contract and will occasionally incorporate the terms of other contract documents. A provision of this type will bind the subcontractor to the terms of the referenced documents, as well as the terms of its own subcontract. Subcontractors should be aware of the provisions of the prime contract when an incorporation by reference clause is encountered. Sometimes, subcontracts only incorporate the contractor's responsibilities, but not its rights, against the owner.

Integration or Merger

Construction contracts frequently include an integration or merger clause. This clause typically states that the written contract is the final and complete agreement of the parties and supersedes all prior representations and agreements.

Parties who neglect to carefully compare the scope of work in the construction contract and written documents reflecting items agreed to in negotiations could be foreclosed from relying upon the bid proposal and prior negotiations based upon this standard clause. It may be prudent to add the bid proposal or prior negotiated points as an exhibit to the contract to deal with this issue.

Conclusion

You should be aware of the existence of these clauses typically found in construction contracts and understand how they work to ensure that the agreement accurately reflects the parties' respective intentions. Because parties are generally free to negotiate the terms of their contracts, you should also consider modifying these standard clauses with an eye toward allocation of the risks. ■



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