catalyst
SURETY PARTNERS

CONSTRUCTION JOURNAL

2018

Key Components of a Good Subcontract

Chip Bruorton
Partner
Rosen, Rosen & Hagood, LLC

151 Meeting Street, Suite 400
Charleston, SC 29401

Office: (843) 577-6726

cbruorton@rrhlawfirm.com

You are awarded a contract with an Owner, and you have your subcontractors all lined up. As the general contractor, you need a contract with your subcontractors that is fair, complies with state and local law, and provides you the protection you need for a successful project. Issues related to project schedule, payment, warranty, indemnification, changes in scope, delay, insurance, notice, termination, alternative dispute resolution, and project closeout all make up the components of a good subcontract. This article examines some of those necessary contract requirements in detail.

Payment

Depending on the state law in which the contract is formed, the obligations for payment may differ. Under South Carolina and North Carolina law, "paid-when-paid clauses" are invalid and unenforceable. The South Carolina Subcontractor Payment Protection Act, codified at S.C. Code Ann. § 29-6-230 and N.C.G.S. Section 22C-2, both provide that a subcontractor is entitled to payment for work it has performed from the party with whom it contracts. Payment by the Owner to the Contractor is not a condition precedent for payment to the construction subcontractor. Any agreement to the contrary is not enforceable. Not all states, however, have such a provision. The Florida Supreme Court has held, so long as the subcontract agreement unambiguously expresses the paid-when-paid intention, the provision will be enforced. The burden of establishing that clear expression within the subcontract agreement is on the general contractor. *Peacock Construction Co. v. Modern Air Conditioning, 353 So.2d 840 (Fla. 1977).* For those jurisdictions, like South Carolina and North Carolina, where a paid-when-paid clause is invalid, the contractor can structure payment, conditioned upon Owner approval, to offset the contractor's risk of having to front payment to the subcontractor without affirmation from the Owner of payment to the Contractor. In addition to setting forth what must be included within a Subcontractor's Payment Application submission, the Contractor can include the following language for progress payments and final payment:

> To the fullest extent permitted by law, Contractor and/or Contractor's surety shall have no liability or responsibility for any amounts due or claimed to be due by the Subcontractor for any reason whatsoever until such time as the Work corresponding to Subcontractor's payment request has been approved by the Contractor and the Owner, or Owner's representative. Conditioned on such approval, Contractor shall make payment to the Subcontractor equal to the value of the completed Work and agreed upon stored Work as of the corresponding monthly billing date, so long as all other conditions of payment under the Subcontract have been met.

Indemnification

All general contractors want to pass liability for claims, damages, and losses down to their subcontractors. Indemnity contemplates reimbursement by one person or entity of an amount of loss or damage sustained by another. Contractual indemnity provisions are important to shift liability risk downstream. But, how far can a general contractor take the indemnity requirement? Under South Carolina law, a contract that purports to indemnify a Contractor from the Contractor's own sole negligence is against public policy and unenforceable. *S.C. Code Ann. § 32-2-10.* North Carolina law goes a step further and disallows a party from seeking indemnification from their own negligence, in whole or in part. *N.C.G.S Section 22B-1.* Some states, like Alabama enforce contractual indemnity provisions except in circumstances where the person seeking indemnity has intentionally acted in a way that created the damage. In general, a contract of indemnity will not be construed to indemnify the one seeking indemnification against losses from its own negligent acts unless such intention is expressed in clear and unequivocal terms within the subcontract. *Federal Pacific Electric v. Carolina Production Enterprises, 378 S.E.2d 56 (S.C. Ct. App. 1989).* To avoid having contractual indemnity obligations scrutinized and invalidated, a general contractor can structure an indemnity provision in a way that clearly sets forth the breadth of the indemnity being agreed to by the parties. An example of such provision would be as follows:

> Subcontractor is required under the Contract Documents to defend, indemnify and hold harmless the Contractor, its agents, officers and employees, from and against any claim, cost, expense, or liability (including attorney's fees and costs) attributable to bodily injury, sickness, disease, death, or damage to or destruction of property (including loss of use thereof), caused by, arising out of, or in any way resulting from the performance of the Work by the Subcontractor, its sub-subcontractors and suppliers. However, Subcontractor's duty hereunder shall not arise if such injury, sickness, disease, death or damage to or destruction of property is caused by the sole negligence of a party indemnified hereunder.

Delays

How delays are handled in the contract between the general contractor and the Owner likely dictates how delays are handled between the general contractor and the subcontractor. One misguided concept related to delays is liquidated damages. A general contractor will often use liquidated damages as a pass-through provision in their subcontracts to mirror a liquidated damages clause within the general contractor's contract with the Owner. However, a general contractor has the right to impose liquidated damages against its subcontractor irrespective of an Owner's assessment of liquidated damages against the general contractor. *Erie Insurance Co. v. Winter Construction Company, 713 S.E.2d 318 (S.C. Ct. App. 2011).* General principles of contract law allow parties to prospectively set an amount of damages for breach through the inclusion of a liquidated damages provision. *Lewis v. Premium Inv. Corp., 568 S.E.2d 361 (S.C. 2002).* Such provisions are widely used in construction contracts and have been generally enforced as an appropriate remedy for breach. *Tate v. LeMaster, 99 S.E.2d 39 (S.C. 1957); Ledbetter Brothers, Inc. v. N.C. Department of Transportation, 314 S.E.2d 761 (N.C. App. 1984).* Liquidated damages are most commonly accompanied by a waiver of consequential damages clause, which eliminates recovery for the actual damages of lost profit, extended general conditions, and similar other losses. While liquidated damages agreements sometimes limit damages to an amount less than all direct, indirect, actual, and consequential damages, the agreement simplifies the loss calculation and makes it expressly known in advance by the contracting parties. South Carolina and North Carolina both require a liquidated damages clause to be a reasonable and fair liquidated damages amount based on anticipated losses, otherwise the clause can be construed as a penalty and would be unenforceable. A liquidated damages provision within a subcontract agreement can be written as follows:

> Subcontractor agrees that he shall complete the various phases of his Work in time to allow other trades to follow in the sequence of normal construction to complete their work before the completion date. If Subcontractor fails to complete his Work with reasonable diligence, or if the Subcontractor fails to complete his Work in such time as to allow the completion of all Work within the date of Substantial Completion, with all approved time extensions having been credited, Subcontractor shall pay to the Contractor liquidated damages in the amount of $____ per day for each day of delay attributable to the Subcontractor until Substantial Completion is obtained. Subcontractor and Contractor agree that the amount of per day damages set forth herein is a fair and reasonable approximation of the additional costs, expenses, or loss the Contractor would incur in completion of the Work and is not to be construed as a fine or penalty.

Alternative Dispute Resolution

While the forum in which claims can be brought is important, an agreement on the claims handling process is imperative. Whether a claim is to be brought in arbitration or filed in state court, an opportunity to work out the claim prior to becoming entrenched in a legal battle should never be passed over. Opinions differ as to whether arbitration or state court is the more favorable forum for construction disputes; however, viewpoints are consistent that it is in the parties' best interest to try and negotiate a resolution prior to the initiation of legal proceedings. Mediation is a formal settlement conference that brings parties in a dispute together to attempt to negotiate the resolution of a claim with an independent third-party facilitator. Mediation is confidential, and evidentiary rules among the states prevent settlement negotiations from being admissible in court against an adverse party. Including a mediation provision within the subcontract agreement imposes a legal obligation on the general contractor and subcontractor to attempt to negotiate a resolution of the claim prior to either party initiating legal proceedings, including arbitration. A concern held by many contractors is that a mediation requirement prior to arbitration or litigation could jeopardize the contractor's lien rights in jurisdictions with strict compliance lien statutes which limit the time-period a contractor has to file a lien in order to preserve lien rights. The mediation provision should be structured in a way to accomplish both, creating a resolution forum before legal proceedings, and giving the contractor the right to protect its lien rights. Here is an example of a mediation provision that accomplishes those goals:

> Any claims arising out of or related to this Agreement shall be subject to mediation as a condition precedent to arbitration or the institution of legal or equitable proceedings by either party, except where commencement of litigation or arbitration is necessary to preserve lien or similar rights. The parties shall endeavor to resolve their claims by mediation which, unless the parties mutually agree otherwise, shall be submitted in writing to the other party, and held in the location where the Project is located. Agreements reached in mediation shall be enforceable as settlement agreements in any court having jurisdiction thereof.

Arming yourself with the necessary components of a good subcontract can save you time, money and headache, ultimately paving the way for a successful project.

Author Bio

Chip Bruorton is a partner with Rosen Hagood, a Charleston, South Carolina based law firm. His practice focuses on construction law and litigation, employment litigation, commercial business litigation, condemnation, and surety law. In Chip's construction law practice, he has experience in drafting and negotiating contracts, filing and litigating mechanics lien claims, bond claims, construction defect claims and surety indemnification claims. Chip regularly represents private and public owners, architects, contractors, construction managers, subcontractors and bonding companies.