



» General contractors must be consistent in the language they use in the prime contract and subcontracts.

PROPER PROTECTION

A contract provision could be a general contractor's best friend. BY ANDREW L. RICHARDS

There are many times when a general contractor finds itself in a situation where contractual provisions put it in inconsistent positions against the owner and one of its subcontractors. By protecting itself with proper contract provisions, the general contractor can limit its exposure to a subcontractor in the event there is a dispute between the general contractor and the owner concerning the same subject matter as the dispute between the general contractor and the subcontractor.

A common, yet frequently overlooked,

cause of increased project and construction costs occurs when there is a conflict or inconsistency between the terms of the prime contract and subcontract. In an effort to avoid conflicting or inconsistent contractual terms, general contractors often attempt to bind its subcontractors to certain key terms set forth in the prime contract, such as terms concerning payment, procedures for seeking payment for extra work, damages and dispute resolution.

A typical method used by general contractors to protect them is the use of "incorporation by reference" provisions.

Such provisions in the subcontract will contain language stating that certain terms of the prime contract are incorporated into the subcontract as if they had been fully set forth in the subcontract itself.

An Effective Way

If utilized correctly, an incorporation by reference provision is an extremely effective way to eliminate costs, claims and delays arising out of conflicting contract terms. However, if improperly utilized, incorporation by reference provisions could have costly consequences to the general contrac-



tor. There are jurisdictions where general incorporation clauses bind the subcontractor only to the prime contract provisions relating to the: (i) scope; (ii) quality; (iii) character, and (iv) manner of the work to be performed by the subcontractor.

In those jurisdictions, the prime contract's payment limitation and dispute resolution clauses cannot be incorporated into the subcontract by a general incorporation by reference provision and, therefore, the subcontractor cannot be bound to such clauses unless they are specifically incorporated by reference into the subcontract. For example, if the prime contract has an arbitration provision, an express arbitration provision must be set forth in the subcontract.

Courts in many jurisdictions will not bind subcontractors to an arbitration provision contained in the prime contract based on a general incorporation by reference clause. Rather, the courts require that the provision be specifically and expressly incorporated into the subcontract. Thus, certain disputes, such as a subcontractor's claim for extra work which may involve a scope change with the owner, may result in a contemporaneous arbitration with the owner and lawsuit with the subcontractor, which could lead to inconsistent determinations for the general contractor.

In addition, prime contracts between government agencies and prime contractors often contain dispute resolution provisions whereby the prime contractor agrees that it will not commence a lawsuit against the agency seeking payment for extra work performed and, instead, must comply with the agency's internal alternative dispute resolution rules and procedures. In these situations, the general contractor must protect itself by inserting a clause in the subcontract that states that in any dispute which relates to an owner determination, act or omission, the general contractor will prosecute the subcontractor's claim against the owner and the liability of the general contractor to the subcontractor is limited solely to any sums recovered by the general contractor on the

subcontractor's behalf. These contractual clauses are known as liquidating agreements.

While the general contractor admits that it is liable to the subcontractor for the claim, any damages recoverable by the subcontractor against the general contractor are limited to the amounts recovered by the general contractor against the owner. The last thing the general contractor wants is to be bound by the owner's dispute resolution procedures while the subcontractor may arbitrate its claim or litigate an action outside of the owner's dispute resolution procedures. Without the proper clause specifically setting forth that the subcontractor must prosecute its claims through the general contractor against the owner, the general contractor risks having to pay the subcontractor while not being reimbursed by the agency.

Big Mistakes

One of the worst payment requirement mistakes made by general contractors in subcontracts is that they fail to take into account lender requirements for payment in the subcontracts which are contained in their contracts with owners on private improvement projects. There are times when the lender has not yet been identified by the owner, but the owner and general contractor enter into a prime contract which provides that payments may be subject to future lender requirements.

If this is the case, the general contractor must set forth the language in the prime contract directly into the subcontract. Without doing so, the general contractor may find itself in a position where it has to pay the subcontractor within a shorter time period than which the owner must pay the general contractor.

Another typical mistake made by general contractors in subcontracts is their failure to include a termination for convenience provision. Such a provision allows the general contractor to terminate the subcontract for any reason and without cause. Since these clauses are typically contained in a prime contract, if the general contractor does not insert a similar provision in the subcontract, it may find itself in the position of having to pay the subcontractor lost profits on the unperformed work if the prime contract gets terminated for convenience and the prime contract does not provide for lost profits on a termination for convenience. In many instances, prime contracts do not provide for lost profits on unperformed work when the prime contract is terminated for convenience.

The foregoing clauses are typical of those where general contractors fail to protect themselves from inconsistent results between their claims against owners and those set forth against them by subcontractors. While there are so many more contractual provisions that a general contractor should incorporate in their subcontracts in order to best protect themselves, perhaps the biggest mistake by general contractors is failing to retain counsel who can review the contracts and provide the proper advice. ♦

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