CHAPTER 1

Subcontract Terms

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I. Introduction

Construction projects are built upon contracts. A construction project brings multiple parties together, each performing its own portion of the work. For a typical design-bid-build construction project, an owner enters into a contract with an architect to design the building. The architect then contracts with subconsultants to perform some of the design work (such as the engineering). Design in hand, the owner subsequently enters into a contract with a general contractor to construct the building. That general contractor, in turn, then enters into numerous subcontracts and purchase orders to perform discrete portions of the work and supply materials required under the general contractor’s agreement with the owner.

The subcontractor wants to ensure that it is taking on only the scope it agreed to perform and the risk it can control. Because the risk/reward equation is not equal in the general contractor/subcontractor relationship, subcontractors need to be careful not to agree to accept too much risk from the contractor without appropriate compensation for such risk. A typical subcontract includes terms addressing scope, pricing and payment, risk-shifting provisions such as flow-down clauses, site investigations, indemnification, schedule requirements, changes and extra work, damages for delay, warranty, insurance, termination, and dispute resolution procedures, which will be addressed in this chapter.

1. For discussion on project delivery systems, see chapter 18.
II. Form Contract Documents

A subcontractor rarely gets to choose the form of its subcontract. Instead, the general contractor typically provides the subcontract form to the subcontractor for review and signature.

Several national organizations provide standard-form subcontract agreements. The most commonly used forms in the industry are those created by the American Institute of Architects (AIA), ConsensusDocs (formerly AGC), the Engineers Joint Contract Documents Committee (EJCDC), and Design-Build Institute of America (DBIA) have also created families of standard-form construction contracts. Regardless of which form is preferred, whenever possible, the best practice is for the parties to use the same document family for subcontracts that is in use for the other project contracts. This allows the contracts to work together and minimize the potential for gaps in scope or responsibilities.

A. American Institute of Architects

The AIA contract documents have been in circulation for more than 100 years. The AIA’s website provides a wealth of information about the organization, the current contract documents, and detailed descriptions on how to use the forms. The standard set of construction documents (known as the “conventional” construction family) is usually updated every 10 years, with the next update due in 2017. In the construction of buildings (as compared with roads or bridges), these are the most commonly used forms. The industry’s familiarity with the forms (from both a practical and precedential perspective), along with the fact that the architect typically suggests the contract forms to the owner, is likely a major reason for this dominance.

The AIA A401-2007, Standard Form of Agreement Between Contractor and Subcontractor, is the primary contractor-subcontractor document used for conventional design-bid-build projects. This document is meant to be used in conjunction with, and incorporates by reference, the AIA A201-2007, General Conditions of the Contract for Construction. While the A401 is the primary AIA subcontract document between general contractors and subcontractors, the AIA also has modified versions of this form for other types of contracting

2. See www.aia.org.
5. See www.dbia.org.
7. See www.aia.org. The AIA first published a Uniform Contract between an owner and a contractor in 1888.
8. Because the A201 is incorporated into the A401, provisions from both documents will be referenced throughout this chapter.
situations. For example, for design-build projects, the A441-2008, Standard Form of Agreement Between Contractor and Subcontractor for a Design-Build Project, is the primary agreement between the design-build contractor and its subcontractors. These documents complement all other AIA project documents, such as the A312, Performance Bond and Payment Bond, and the G702, Application and Certification for Payment.

B. ConsensusDocs

The ConsensusDocs documents were created in 2007 by a group of industry associations looking to create a fair standard contract to compete with the AIA. Several of the sponsoring organizations, including the Associated General Contractors of America (AGC) and the Construction Owners Association of America (COAA), retired their previous contract document sets in favor of the use of ConsensusDocs forms. At least 40 industry associations were represented in the development of the forms and continue to endorse the documents. Like the AIA document families, ConsensusDocs provides comprehensive families of documents covering all types of contracting common in the current design and construction industry (including traditional design-bid-build construction, design-build projects, construction management projects, and integrated project delivery).

The primary ConsensusDocs subcontract document is the CD 750, Standard Form of Agreement Between Contractor and Subcontractor. This document works seamlessly with other ConsensusDocs agreements, including the CD 706 and 707, Performance and Payment Bonds, and the CD 710, Application for Payment.

While the CD 750 is the primary ConsensusDocs subcontract document between general contractors and subcontractors, ConsensusDocs also has modified versions of this form for other types of contracting situations. For example, the CD 460, Agreement Between Design-Builder and Design-Build Subcontractor, is used between the design-build contractor and its subcontractors on design-build projects.

C. Other Standard Subcontract Forms

As discussed previously, a number of other organizations (including EJCDC and DBIA) have their own standard-form subcontract agreements. The EJCDC includes subcontracts for traditional construction (C-253, Construction Subcontract, and E-562, Agreement Between the Engineer and Engineer's Subcontractor) and design-build contracts (D-521, Suggested Form of Subagreement Between Designer-Builder and Subcontractor for Stipulated Price). Although not providing documents for traditional design and construction, the DBIA provides standard subcontracts for design-build projects. Such contracts include

the DBIA 560, Standard Form of Agreement Between the Design-Builder and Design-Build Subcontractor—Cost Plus Fee with Option for a Guaranteed Maximum Price.

D. Advantages and Disadvantages

The standard-form contracts have distinct advantages, both real and perceived, over “manuscript” or custom contracts. The organizations creating the standard forms get input and feedback from a number of industry groups to review their form contracts during the contract creation and revision phases. In addition to generally being perceived as fair, these standard forms have also been battle-tested in the courts. Parties to an AIA agreement generally know how certain clauses work together and how they are interpreted. Precedent has been set, and there are numerous court decisions clarifying the meaning of various provisions.\(^\text{10}\) If parties are generally comfortable with the content of a particular standard-form agreement, negotiations often go more smoothly and much quicker if the parties opt to use that standard form as a negotiations starting point.

Another advantage is the fact that within the different document families (AIA, ConsensusDocs, EJCDC, etc.), the forms are meant to work together and are kept current. For instance, if the owner is using an AIA agreement between itself and the architect and between itself and the general contractor, those documents complement each other along with the accompanying AIA architect-subconsultant and AIA contractor-subcontractor agreements. Finally, the industry standard forms are regularly updated to reflect best current contracting practices in the construction and design industry and the case law interpreting them.

Disadvantages include perceived bias, cost of use, length, and lack of customization. Many in the industry believe that the forms are inherently biased toward the groups that originated the documents.\(^\text{11}\) While some bias may exist, the primary organizations producing standard-form construction documents work to reflect current industry norms and make their standard forms fair to project participants.

Another disadvantage sometimes cited by smaller contractors is the cost of using the forms. Because the forms are copyright protected, a party must either keep an active license for the software to create the documents or order the documents online one at a time. Such parties cannot (legally) simply photocopy a version of the document and then use it over and over again for all of their projects. However, given the fact that the form contracts are very

\(^\text{10}\) The American Institute of Architects Legal Citator (LexisNexis 2013) provides up-to-date cases that interpret the AIA construction contract provisions.

\(^\text{11}\) For instance, the AIA documents appear to favor architects, and EJCDC documents appear to favor engineers.
III. Standard Subcontract Terms and Conditions

The subcontract will govern the parties’ rights, remedies, and obligations. Regardless of the subcontract forms used, there are certain key subcontract provisions that significantly impact the risk management and allocation affecting the subcontract work.

A. Scope of Work, Payment, and Retention

1. Scope of Work
For the subcontractor, pricing begins with an accurate scope of work. The scope-of-work clause in the subcontract is a critical component in determining the price of the work. A subcontractor will typically want a narrow, detailed scope of work, preferably incorporated from (or incorporating by reference) the subcontractor’s proposal or bid. The general contractor, on the other hand, will generally prefer an expansive scope-of-work clause. In order to avoid creating a gap in scope (i.e., work that is included in the general contractor’s scope but did not get pulled into the subcontractor’s scope), the contractor will include modifiers and catchall language in the scope clause such as “all work necessary” or “all work incidental or implied” or “normally entailed” in performing the given work. Oftentimes, contractors will specify drawing sheets, specification sections, and details relevant to the subcontract work in order to pull in all potential scope items that could be gleaned from the drawings and specifications.

2. Payment Terms
Payment terms can vary widely in subcontracts. Of critical importance to the subcontractor are the administrative requirements to securing payment, the contractual grounds and remedy for withholding payment, and the allocation of risk for nonpayment.

From an administrative standpoint, the payment provisions will define the applicable pay cycle. It should also identify the requirements of the pay application and pay application process, including when it must be submitted to the contractor and what supporting documentation must be provided with...
it. Most clauses will state that failure to timely submit the pay application will delay payment until the following month when the next application is due.

Other requirements may include (1) submitting partial, conditional, or progressive lien waivers tied to an effective date or the payment amount requested; (2) submitting monthly verified lists of sub-subcontractors and suppliers so that the contractor can keep tabs on what parties are providing labor and materials to the project; and (3) updating the schedule of values monthly.

The payment provisions of the subcontract are also likely to set forth grounds for withholding payment. Typical grounds for withholding payment include nonperformance, defective work, failure to execute all required sub-contract documents, delayed performance, and lower-tier claims. The contractor may also include a right to backcharge the subcontractor and/or set off from any amounts otherwise owing the subcontractor the costs to correct any defects in the subcontractor’s work or cure any defaults in the performance of the subcontract. Subcontractors should be wary of clauses that allow setoff from amounts due on other projects it has with the contractor.


From the general contractor’s perspective, the need to make payment conditional or contingent upon first being paid by the owner is obvious. The contractor does not want to finance the project (especially) if the reasons for owner nonpayment are not the fault of the contractor. In other words, the contractor does not want to front the money to pay the subcontractor. From the subcontractor’s perspective, it should also not have to finance the project and should not have to bear the risk of not being paid due to owner insolvency or other upstream dispute.

It is common practice for general contractors to include contingent-payment provisions in their subcontracts or purchase orders stating either (a) that payment will not be made until payment is received from the owner (“pay-when-paid”) or (b) that the obligation for payment will not arise at all unless payment is made by the owner (“pay-if-paid”).

Generally, a contingent payment clause will be interpreted as a pay-when-paid clause when it does not create a condition precedent for payment, but establishes the time and means of payment. It may defer the subcontractor’s payment for a reasonable length of time, but is not an ultimate bar to recovery.
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To be enforced as a pay-if-paid clause, it must include an express condition clearly showing that it is the intention of the parties that payment to the contractor is a condition precedent to the subcontractor’s right to payment and that the subcontractor has assumed the risk of the owner’s nonpayment.14

3. Retention
Nearly all subcontracts will include retention requirements. It is standard practice in the construction industry for an owner to withhold a set amount (typically anywhere from 5 to 10 percent) of a progress billing from the contractor, commonly known as “retainage” or “retention.”15 The retention amounts may be held in an interest-bearing escrow account. Retention is typically released once substantial completion is reached.16 The parties can contractually release retainage before substantial completion, stop withholding additional retainage or partially release accrued retainage past a certain interim milestone date, and/or step down the retainage requirements as the project nears completion.17 Retention is contractually withheld to provide the upstream party with additional financial assurances that the lower-tier contractor will timely complete the work. However, such retention requirements can widely vary and are subject to contractual negotiation.

A “flow down” clause incorporates the upstream owner/general contractor terms, the project general conditions, and supplementary conditions into the subcontract. A flow-down provision means simply that a subcontractor has the same obligation to the contractor as the contractor has to the owner with respect to any given right, remedy, or obligation. From a practical standpoint, it requires the subcontractor to review all of the contract documents in order to understand what obligations it is actually assuming. The typical flow-down provision applicable to the subcontractor is contained in the AIA A401-2007:

\[
\text{The Contractor and Subcontractor shall be mutually bound by the terms of this Agreement and, to the extent that the provisions of the edition of AIA Document A201 current as of the date of this}
\]

14. See, e.g., BMD Contractors, Inc. v. Fid. & Deposit Co. of Maryland, 679 F.3d 643 (7th Cir. 2012) (applying Indiana law); Thos. J. Dyer, 303 F.2d at 661.
15. Many of the standard contract forms include or contemplate retainage requirements. See, e.g., AIA A201-2007, General Conditions, § 9.3.1; CD 200, Standard Agreement and General Conditions Between Owner and Construction, § 9.2.4 (2011). In addition, many states have statutory retention requirements for public and/or private projects.
17. CD 200, § 9.2.4, states that the owner shall cease to withhold retainage once the work reaches 50 percent completion. The owner may then, in its discretion, release or reduce the amount of retainage that it had previously withheld.
Agreement apply to this Agreement pursuant to Section 1.2 and provisions of the Prime Contract apply to the Work of the Subcontractor, the Contractor shall assume toward the Subcontractor all obligations and responsibilities that the Owner, under such documents, assumes toward the Contractor, and the Subcontractor shall assume toward the Contractor all obligations and responsibilities which the Contractor, under such documents, assumes toward the Owner and the Architect. The Contractor shall have the benefit of all rights, remedies and redress against the Subcontractor which the Owner, under such documents, has against the Contractor, and the Subcontractor shall have the benefit of all rights, remedies and redress against the Contractor which the Contractor, under such documents, has against the Owner, insofar as applicable to this Subcontract. Where a provision of such documents is inconsistent with a provision of this Agreement, this Agreement shall govern.18

In effect, flow-down provisions make all notice provisions and other obligations that the contractor has applicable to the subcontractor as well, even though those duties, obligations, and requirements are not expressly stated as bearing upon the subcontractor. As a result, a contractor will generally seek to impose upon the subcontractor a detailed and expansive flow-down provision. However, jurisdictions vary as to what terms are actually flowed down to the subcontract. Some limit the flow-down to only those terms affecting the subcontractor’s scope of work.19 Others require an express flow-down and incorporation in order to enforce the obligation.20

C. Site Investigations

Most construction contracts provide that the subcontractor “acknowledges” its legal and contractual obligation to investigate the job site in order to become totally familiar with all job-site physical conditions. This obligation is set forth in the “site investigation” clause.21

The site investigation clause generally imposes a duty on the subcontractor to investigate the site pre-bid or pre-contracting. It places the risk of discoverable site conditions on the subcontractor. However, site investigation clauses do not

18. Mutual Rights and Responsibilities, § 2.1, art. 2.
21. See AIA A201-2007, General Conditions, § 3.2.
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shield the owner from claims due to undiscovered or unanticipated site conditions. A fairly drafted clause requires only a *reasonable* investigation. The subcontractor is not required to duplicate the owner’s tests, nor is it responsible for discovering hidden and unforeseeable conditions.22 The site-investigation clause acts as a strong forewarning to the subcontractor of its investigation responsibilities.23

D. Extra Work/Changes24

The contractual mechanism in construction contracts for handling contract modifications or changes and claims for extra work in connection with them is the “changes” clause. The changes clause entitles the owner to unilaterally direct changes in the work without the contractor’s consent and without breaching the contract provided the change is within the general scope of the contract. The changes clause in the subcontract permits the contractor to direct the subcontractor to perform changes typically authorized by the owner. For a proposed change to be “within the general scope” of the contract, the change in the work must be regarded as fairly and reasonably within the contemplation of the parties when they entered into the contract.25

In exchange for this right to direct changes, the contractor (and subcontractor, respectively) is entitled to receive additional compensation and time for the changed or extra work. Both the contract price and the contract time to perform the work are subject to adjustment. The changes clause establishes the procedure for the owner to make a change and for the contractor to seek compensation for the changed work to be performed. Once agreement is reached on the change in scope, price, and time, a change order is issued. Under standard changes clauses, such as in the AIA family of documents, there are three instruments by which extra or changed work may be directed: (1) formal change orders (signed by both the owner and the contractor; used when the parties agree on the scope and pricing of the change); (2) constructive change directives (signed only by the owner and need not be signed by the contractor; used when there is not complete agreement on the scope or

22. Farnsworth & Chambers Co. v. United States, 346 F.2d 577 (Ct. Cl. 1965); see also Sornsist Constr. Co. v. Montana, 590 P.2d 125 (Mont. 1978); Wall Street Roofing, VACAB 1373 (1981); Thomsen-Abbott Constr. Co. v. City of Wausau, 100 N.W.2d 921 (Wis. 1960).

23. Note that these provisions are routinely revised to shift more risk to the subcontractor for site conditions.

24. Changes are addressed in more detail in chapter 6.

pricing of the change); and (3) field orders (signed by the architect only; used for minor changes in the work that involve no price or time adjustment).26

Most changes clauses contain an express written authorization requirement.27 The lack of written authorization or change order to perform may act as a bar to a subcontractor’s claim for recovering costs of change orders.28 Not all courts, however, strictly interpret the written change order requirement. In attempting to reach more equitable results, courts have used several theories to avoid the written change order requirement. The most common theories utilized have been waiver and subsequent oral modifications of the written change order requirement.29

A subcontractor and its counsel should be aware that the changes clause may not provide payment protection to a subcontractor when it encounters unforeseen site conditions at the project. The right to recovery for such conditions can be found in the differing site-conditions clause.30

E. Delay Damages

Delays may occur in maintaining the construction schedule milestones or in achieving the overall completion date, or more accurately, the date of substantial completion.31 As a general rule, a contractor is liable for all costs incurred by an owner as a result of the contractor’s unexcused delay in completing a project. By extension, a subcontractor will be liable for all costs incurred by the contractor as a result of the subcontractor’s unexcused delay.32 Conversely, subcontractors are entitled to damages for delays caused by others, otherwise known as a compensable delay. The subcontractor is also entitled to a time extension for completion of its work.

1. No Damages for Delay Clauses

In an attempt to shield themselves against the potential for substantial dollar claims for delays, owners and general contractors include a clause in their

27. See, e.g., AIA A401-2007, Standard Form of Agreement Between Contractor and Subcontractor, § 5.2.
30. Differing site conditions are discussed in chapter 7.
31. Substantial completion is defined typically as the date when construction is sufficiently complete so that the project may be occupied by the owner for its intended purpose. See AIA A201-2007, General Conditions, § 9.8.1.
32. Delays are covered more thoroughly in chapter 3.
contracts and subcontracts that provides that, no matter what the cause of the delay, neither contractor nor subcontractor is entitled to recover damages. This clause is known as a “no damages for delay” clause. The effect of such a clause is to provide a time extension as the exclusive remedy to a delayed contractor or subcontractor, thereby eliminating the owner’s (or contractor’s) exposure to delay damages. Depending on the perspective, a no damages for delay clause is viewed as either a major protective device against spiraling construction costs or a major restriction on the ability of an injured party to recover increased costs not reasonably anticipated when the contract was negotiated. In any event, no damages for delay clauses are typically enforced by courts.

Courts, however, have recognized several exceptions to the enforceability of a no damages for delay clause, which may stymie an otherwise well-drafted clause. These exceptions include the following:

1. The delay is beyond the original contemplation of the parties at the time the contract was entered into.
2. The delay is for such a long period of time it becomes, in effect, an abandonment of the contract.
3. The delay results from bad faith, misrepresentation, concealment, or arbitrary action by the owner.
4. The delay is the result of the owner’s active interference.
5. The delay is the result of the owner’s inaction in the face of an implied duty to act (e.g., if the contractor was delayed when the state failed to secure a right-of-way necessary for the construction).

Despite these exceptions, the cases addressing no damages for delay clauses have trended toward their enforceability. In short, in the presence of a no damages for delay clause, a subcontractor should factor the risk of delay into its bid price.

2. Liquidated Damages Clauses

Proving the amount of delay damages is often a difficult task. For that reason, contracts frequently include a provision for “liquidated damages.” Liquidated damages are a contractually fixed amount of damages assessed for each day...
of delay. For example, a subcontractor who is five days late in finishing a project under a contract that has a $1,000-per-day liquidated damages clause will be liable to the owner in the amount of $5,000, regardless of what the contractor's actual damages may be.

Liquidated damages clauses can be very beneficial to an owner or contractor who otherwise may have difficulty in proving precisely its actual losses because actual damages are uncertain or difficult to ascertain, or are of a purely speculative character. Conversely, liquidated damages can be equally useful to the subcontractor by limiting the subcontractor’s exposure for actual delay damages, which can far exceed the per diem agreed amount. Liquidated damages clauses may also serve to cap the takeover surety’s liability for delay damages, shielding the surety against exposure for the owner’s claims for consequential delay damages.41

As a general rule, courts will enforce liquidated damages clauses so long as the damages are not viewed as a penalty.42 Whether the provision is upheld or is deemed to be unenforceable as a penalty depends upon the particular circumstances surrounding each contract, and whether the liquidated damages imposed on the contractor or subcontractor are proportionate to the actual damages sustained by the owner/general contractor.43 If the liquidated damages are grossly disproportionate to the actual damages sustained by the aggrieved party, or are unreasonable or unconscionably in excess of the loss sought to be avoided, the damages are likely to be considered as a penalty and the liquidated damages clause will not be enforced.44

3. Consequential Damages

Oftentimes, contract damages (for breach of contract) are divided into “direct” and “consequential” damages. By traditional definition, direct damages stem or flow directly from the breach, whereas consequential damages flow not from the direct and immediate breach but from the consequences or results of that breach.45 Mutual waivers of consequential damages (whether full or limited) limit the types of recoverable damages available in the event of a breach and can serve to narrow the scope of issues in a dispute, thereby streamlining

42. See 24 WILLISTON ON CONTRACTS § 65:1 (4th ed. 2013); see also, e.g., Raymundo v. Hammond Clinic Ass'n, 405 N.E.2d 65 (Ind. App. 1980), overruled on other grounds by Raymundo v. Hammond Clinic Ass'n, 449 N.E.2d 276 (Ind. 1983).
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the claims-resolution process. Often, however, these clauses do not delineate what types of damages fall within the waiver.46 These types of damages include the owner’s loss of use, rental expenses, loss of income, profit, or financing related to the project, and the subcontractor’s damages for loss of business, financing, profits (related and unrelated to the project), overhead and expenses, and loss of reputation. Defining what types of damages are considered “consequential” is of particular significance in contract negotiation.

F. Indemnification

Standard indemnification clauses included in construction contracts provide that the subcontractor will indemnify the owner and contractor for the subcontractor’s negligence that results in third-party claims of personal injury or property damage. Contractors, however, routinely expand the scope of the subcontractor’s indemnification obligation from only third-party negligence claims to include items such as (1) all claims arising out of the subcontractor’s performance on the project; (2) damage to the work itself or to the existing real property; (3) breach of contract; and (4) economic loss damages.

There are differing degrees or types of indemnity. “Limited indemnity” is the most favorable form of indemnity to the subcontractor and requires indemnification for third-party claims for damages caused by the subcontractor’s sole negligence.48 “Intermediate indemnity” requires indemnification against all losses caused in part by or arising out of the subcontractor’s work even though the other party may also be partly at fault.49 “Broad form indemnity” requires indemnification against liabilities relating to or arising out of the subcontractor’s work, including those caused solely by the party being indemnified.50

In reaction to the harsh and unfair effects of broad-form indemnity, some states have enacted anti-indemnification statutes that prohibit as a matter of public policy clauses in construction contracts that require indemnification against the indemnitee’s own negligence.51

The AIA documents utilize the intermediate form—that is, it requires indemnification against all losses from the one party even though the other

46. See AIA A201-2007, General Conditions, § 15.1.6.
47. Indemnity is covered in depth in chapter 11.
49. Id.
50. Id.
party may be partly at fault also, but it does not require indemnification for losses caused solely by the party being indemnified.\textsuperscript{52}

G. Insurance\textsuperscript{53}

Virtually all subcontract agreements contain provisions requiring a subcontractor to maintain various types of insurance policies and programs for the duration of the project and after completion. The purpose of insurance provisions in subcontracts is to protect the contractor and the owner from liability for subcontractor-caused damages. The policy coverages are in place to provide the subcontractor with the financial ability to pay for its negligence and fault.

Despite the importance of having an adequate insurance program in place, standard-form subcontracts are vague with regard to the types of policies required of subcontractors or the policy limits. For example, AIA A401-2007, the standard-form subcontract, simply states that the subcontractor “shall purchase and maintain insurance of the following types of coverage and limits of liability as will protect the Subcontractor from claims that may arise out of, or result from, the Subcontractor’s operations and completed operations under the Subcontract.”\textsuperscript{54} It then leaves a blank space where the types of coverage and limits may be inserted, but provides no guidance. The provision does not mandate any particular type of coverage or any coverage limits. The AIA 201, General Conditions, is similarly vague. Article 11 lists the types of claims for which coverage is to be obtained, but the kinds of policies or limits required are not listed. The contractor is required only to purchase and maintain “such insurance as will protect the Contractor” from the listed types of claims.

The lack of specificity of the form subcontracts is intended to provide flexibility, allowing each project’s insurance program to be tailored to suit the size, complexity, and risks unique to it. Nonetheless, most subcontracts require the subcontractor to obtain fairly standard coverages. A typical subcontract will require the following types of coverages: workers’ compensation, commercial general liability (CGL), automobile liability, and umbrella excess liability. Coverage limits for the CGL and automobile liability policies are generally set at $500,000 per occurrence and $1 million in the aggregate; the umbrella coverage is usually set at $1 million. Workers’ compensation coverage is set to meet the statutory requirements, which vary from state to state.

Subcontracts also contain other terms relating to the policies. First, the provisions require that the contractor, and sometimes the owner, be named as “additional insureds” on the liability policies. By doing so, the owner and general contractor avoid financial liability for the acts of the subcontractor up to the amount of the coverages obtained and maintained by the subcontractor. The

\begin{footnotes}
\item[52] AIA A201-2007, General Conditions, § 3.18.
\item[53] Insurance is covered in chapter 13.
\item[54] AIA A401-2007, art. 13.
\end{footnotes}
additional insureds are added through use of additional insured endorsements added to the policy. These endorsements are forms that vary according to the type of policy to which they are added and according to the specific insurer.

Many subcontracts also require the subcontractor to grant a waiver of subrogation in favor of the general contractor and the owner. Subrogation is a legal concept that allows an insurer to “stand in the shoes of” its insured subcontractor to seek to recover from a third party money the insurer has paid out on behalf of the subcontractor where the third party caused the loss. For example, if the project owner’s employee accidentally causes a fire that damages a subcontractor’s office trailer, the subcontractor’s insurer will pay for the loss, but has the right, through subrogation, to pursue recovery from the owner of the amount it paid to the subcontractor. Such scenarios do not foster project harmony. By waiving, or giving up, subrogation rights, claims and suits among the parties to the project are reduced or eliminated, at least to the extent of insurance coverage.55

H. Warranties

The warranty provision is the contractual representation made by the subcontractor as to the quality of its work. Typically, the subcontractor warrants to the owner and contractor that the work will be free from defects and will conform to subcontract documents.56 As a corollary to the warranty provision, most subcontracts also have a separate correction of work obligation, which requires the subcontractor to correct all defective work if given notice by owner or contractor within one year from substantial completion.57

From a negotiation and drafting standpoint, a subcontractor will want to consider (1) the length of the warranty; (2) whether the warranty period begins at substantial completion versus final completion; (3) the potential gap in coverage between a manufacturer’s warranty and the start of the warranty under the contract documents; and (4) whether implied warranties (such as workmanlike construction or fitness for a particular purpose) should survive the contractual warranty clause or warranty period.

I. Dispute Resolution

Dispute resolution clauses provide a mechanism for resolving disputes. These clauses are varied and should be negotiated. The AIA forms provide for the selection of arbitration or litigation to resolve disputes that arise on the project. There may be requirements prior to arbitration or litigation, such as project-level review or mediation (often as a condition precedent to

55. See AIA A401-2007, art. 13, for an example of a mutual waiver of subrogation clause.
56. See AIA A401-2007, § 4.5; AIA A201-2007, General Conditions, § 3.5.
57. See AIA A201-2007, General Conditions, § 12.2.2.
moving forward with the arbitration or litigation). Additional common features of dispute resolution provisions include forum selection clauses and applicable/controlling law requirements that establish where a dispute will be resolved and under which state’s laws. Some provisions will also provide for the award of attorneys’ fees for the prevailing party.

J. Terminations

The termination provisions of the subcontract are negotiated terms and vary from contract to contract—from delineating the events of default triggering the termination procedure to the required notice provisions under those procedures. Termination may be either for convenience or for default. A termination for convenience clause allows the owner to terminate the contract for convenience and without cause. Upon such termination, under the AIA documents, the contractor is entitled to receive payment for the work completed and the costs incurred by reason of the termination, along with reasonable overhead and profit on the work not executed.\(^\text{58}\) Frequently, however, entitlement to reasonable overhead and profit on the work not executed is excluded from the subcontract.

In contrast, termination for cause (i.e., for default under the terms of the subcontract) relieves both parties of their contractual obligations, but does not relieve the defaulting party of liability for damages caused by its default. If the termination for cause is wrongful or improper, the termination constitutes a breach of the contract and may result in the terminating party being liable for damages to the non-breaching party.\(^\text{59}\) The causes justifying termination are normally described in the contract.\(^\text{60}\)

K. Lien Waivers\(^\text{61}\)

The requirement to waive a subcontractor’s lien rights may be expressly included in the subcontract document but nearly all payment provisions require the subcontractor to provide a lien waiver with its payment application.\(^\text{62}\) The scope and impact of these lien waivers vary by jurisdiction. In some jurisdictions, lien rights can be prospectively waived. In jurisdictions where lien rights cannot be prospectively waived, the subcontractor will submit a partial, conditional, or progressive lien waiver that is tied to an effective date or the payment amount requested. In such jurisdictions, the waiver is effective upon receipt of payment.

\(^{58}\) See id., § 14.4; AIA A401-2007, art. 7.

\(^{59}\) Counsel should be aware that subcontract provisions commonly convert a wrongful termination for cause into a termination for convenience.

\(^{60}\) See AIA A401-2007, art. 7; AIA A201-2007, § 14.2.

\(^{61}\) Lien waivers are also discussed in detail in chapter 5.

\(^{62}\) Waiver language may also be included in other project documents, such as the change order form.
Most lien waivers will include the waiver of liens as well as any and all other claims through the date stated or the payment amount. Many jurisdictions will treat such lien waivers as standard release documents and will enforce clear and unambiguous lien waiver language to preclude downstream subcontractors from making claims against upstream project participants (including the owner).63

L. Implied Subcontract Terms

1. Covenant of Good Faith and Fair Dealing

Every contract contains implied duties and obligations that, although not expressly stated, are binding on the parties. Implied obligations arise generally out of the obligation, inherent in every contract, to perform in good faith and fair dealing. For example, parties have a duty to cooperate with each other and not hinder the other’s performance. A breach of the owner’s duty of cooperation can be manifested in the owner’s active interference.64 Conversely, a contractor or subcontractor can breach the duty of good faith and fair dealing by unreasonably delaying asserting a claim even where there is no explicit timing provision for doing so.65

2. Owner Implied Warranty of the Sufficiency of the Plans and Specifications

One of the most important implied contract terms for the subcontractor’s benefit is the owner’s implied warranty of the sufficiency of the plans and specifications. This implied warranty is referred to as the Spearin doctrine.66 The owner warrants that if the plans and specifications are followed, a satisfactory product will result. If a subcontractor or contractor has to perform extra work or incurs extra costs to achieve a satisfactory result as a result of defects in the plans or specifications, it can recover those costs from the owner by establishing proof of the defect. Because it is a warranty provision, the subcontractor need not establish any negligence or fault on the owner’s part—it need only establish that the plans or specifications were defective in order to recover.

65. See, e.g., All-Am. Poly Corp., GSBCA 7104, 84-2 BCA ¶ 17,682 (denying relief where contractor delayed making claim until after contract was completed where it discovered mistake when it received contract award).
66. United States v. Spearin, 248 U.S. 132 (1918) (in which the implied warranty was first recognized). This doctrine is discussed in chapter 10.
IV. Conclusion

As noted at the outset, contracts define the relationships between the parties to a construction project; they not only set the scope, nature, and price of the project, but also allocate the risks each of the parties will bear. To assist the parties in that task, various construction industry organizations have developed sets of contract documents for use in virtually every conceivable type of project. They provide a framework for addressing all the issues common to every project, such as payment, changes, insurance, indemnification, bonding, and dispute resolution, as well as those unique to any given project. The parties can, of course, create their own contract documents to achieve those same ends.

No matter whether standard form or manuscript contracts are used, the very nature of the contractual relationship means that subcontractors are rarely, if ever, in a position to control the risk allocation process. It is all the more important, then, that subcontractors appreciate the risks they are being asked or assigned to undertake. To do so requires a fundamental knowledge and understanding of the terms and provisions of subcontracts and the legal principles on which they are based.

This chapter has discussed many of the critical provisions currently used in subcontract documents. It is intended, though, as only an introduction. In the chapters that follow, a number of these provisions, and the concepts that underlie them, will be examined in depth. This examination will serve to provide the knowledge that will give subcontractors the power to understand, assess, and, more importantly, better control the risks they undertake.