BROUSE McDowell
A Legal Professional Association

Construction & Coverage Law Seasonal Newsletter

Construction Law and Insurance Recovery Experts

With comprehensive construction and insurance recovery practices, Brouse McDowell is uniquely suited to help its clients navigate the complex world of construction contracting and claims.

Our attorneys provide a full complement of legal resources to help at all stages of the construction project, from project conceptualization, design, contract drafting, implementation, monitoring and scheduling, to claims resolution.

And, with five Certified Specialists in Insurance Coverage Law, Brouse McDowell's Insurance Recovery group is one of the most experienced in the nation.

Our attorneys work collaboratively to better shift risk at the contracting stage, and to devise claim and litigation approaches that minimize liability and maximize insurance recovery in the event of a loss.

Killer Clauses in Construction Subcontracts:
Allocating Risk with Subcontractor Agreements

As last week's newsletter mentioned, 2016 is expected to bring continued growth to the construction industry. This growth also brings increased risk. And, it is through the contract and subcontract documents that project participants will try to minimize and shift that risk. As general contractors take on more projects, they will likely find themselves working with new and unfamiliar subcontractors. Whether parties are considering working with a new partner or simply re-evaluating existing relationships with long time partners, the parties should consider how to best allocate the risks associated with each project. What follows are some of the key provisions contractors and subcontractors should understand when evaluating the risks allocated through subcontract agreements.

1. **Flow-Down Clauses**. Flow-Down clauses are provisions that incorporate by reference the terms of the prime contract into the subcontract. Contractors typically use these clauses to pass down the contractual obligations and duties assumed by the general contractor to the subcontractor. Flow-Down clauses not only bind subcontractors to the provisions of the prime contract, but they may also shift liability for substandard or non-conforming work from the general contractor to the subcontractor.

   In Ohio, Courts have enforced Flow-Down clauses that incorporate the owner/contractor contract into the subcontractor agreement by reference. These clauses may however be subject to limitations. Provisions of the owner/contractor contract that are commonly incorporated by reference are scope requirements, performance criteria, payment terms, extra work and claims, schedule requirements, termination and dispute resolution.

2. **Pay-If-Paid Clauses**. Pay-If-Paid clauses are provisions that govern *whether* a subcontractor is paid. In contrast, Pay-When-Paid clauses govern *when* a subcontractor is paid. While "Pay-If-Paid" clauses are

generally disfavored, courts have found such provisions to be binding and enforceable so long as the provision is undeniably clear and unambiguous as to the true intent and meaning of the clause. The Ohio Supreme Court has held that when a subcontract expressly provides that payment by the owner to contractor is a "condition precedent" to payment by the general contractor to the subcontractor, an enforceable "Pay-If-Pay" provision is created. *Transtar Elec. V. A.E.M. Elec. Servs. Corp.*, 140 Ohio St.3d 193, 194 (2014).

3. **Termination.** Termination of a construction contract should be considered a last resort. The risk of lost profits and unabsorbed overhead and fixed costs for wrongful termination can be significant. In order to minimize these costs, construction agreements should address default termination or termination for cause as well as termination for convenience.

   Ohio law provides that if the construction contract contains a termination clause specifying the conditions under which the contract may be terminated, the clause must be strictly followed, and no termination for other causes will be permitted. At a minimum, written notice should be required. Common grounds for termination include refusal or failure to prosecute work, failure to complete on time and the "catch-all" provision, which requires that the deviation be substantial and material.

   Termination for convenience is not a common law right and must therefore be expressly stated in the contract. The clause must establish the right to terminate further performance without cause or an event of default. Such provisions are enforceable, subject to limitations for bad faith, change of circumstance and abuse of discretion. And, to avoid getting caught in the middle, contractors should make sure the termination clauses in the prime contract match those in subcontracts.

4. **Notice Requirement.** As discussed in the first newsletter "Documenting Changes in Your Project," written notice and change order requirements are valid and binding. Claim provisions should detail the form, timing and content of the required notice. Failure to provide notice in compliance with the contractual claims procedure may result in a forfeiture of payment or waiver of claim.

5. **Insurance, Bond and Indemnity Provisions.** Insurance, bonding and indemnity provisions are another mechanism for parties to share the financial risk of the project. The contractor may minimize his risk by retaining the right to approve the surety and bond form, by

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requiring "additional insured" status or by establishing an order of precedence of insurance coverage. These provisions may also be required under a flow down provision incorporating the prime contract insurance coverage requirements by reference.

The Indemnity provisions have a number of limitations that restrict their ability to shift certain risks. For instance, damages resulting from the negligence of the contractor cannot be indemnified under Ohio Rev. Code. § 2305.31. Likewise, workers compensation immunity cannot be waived by an indemnity agreement that is not sufficiently specific. *Kendall v. U.S. Dismantling Co.*, 20 Ohio St.3d 61, 62, 485 N.E.2d 1047 (1985).

6. **Lien Waivers.** Under Ohio Rev. Code. § 1311.07, contractors, subcontractors, material suppliers, and construction managers have a right to file a claim for a mechanic's lien against a property to secure a debt for work performed, or materials furnished, on a construction project. This "lien right" however can be waived and such waiver of lien provisions, are enforceable.

   Similarly lien waivers may be applicable to progress payments and they typically require conditional waivers of liens or claims known and/or asserted through the date of payment. Contractors and subcontractors should make sure that their forms are identified as full or partial/conditional or unconditional as is appropriate to the circumstances.

   For questions or comments regarding this article, please contact James T. Dixon at jdixon@brouse.com or Amanda P. Parker at aparker@brouse.com.

"Lunch and Learn" Opportunities. Brouse McDowell collaborates with its clients and business partners to provide unique opportunities for in-person seminars.

Experienced attorneys from our **Construction Law and Insurance Recovery Group** will meet with individuals in your organization in an informal group setting to provide a legal overview on a variety of topics crucial to your business, including maximizing insurance coverage for your projects, project planning and contracting issues, and dispute avoidance and resolution. Prior to meeting, we will provide a "menu" of options on specific sub-issues within these broad topics for you to select. Feel free to select as many or as few as you like. We can travel to your place of business, meet in a conference room at our office, or reach you over the internet through our unique "webinar" service.

The seminar and lunch are on us! Please contact Amanda Leffler (aleffler@brouse.com) or Jim Dixon (jdixon@brouse.com) to get on the schedule or for more information.