

THE NUTS AND BOLTS OF SUBCONTRACTOR DEFAULTS

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The success of general contractors in completing a construction project is often dependent upon the performance of their subcontractors. Traditionally, the key subcontractors on a project are the electrical, plumbing, HVAC and structural shell subcontractors. Due to the fundamental nature of the work performed by these trades, the risk of defaulting and terminating one or more of them is likely to have a substantial impact on the project.

There will inevitably arise occasions when even a once reliable subcontractor fails to perform and it becomes necessary to invoke the remedies of default and termination. Areas ripe for controversy with subcontractors that often can lead to default and termination routinely involve disputes over change orders and the scope of work, the installation of defective work and back-charges that ensue therefrom. Other areas of conflict arise from ambiguous plans and specifications and the extra work and delays caused by the discovery of unforeseen site conditions.

PREPARATION IS ESSENTIAL

The old saying that an ounce of prevention is worth a pound of cure is especially appropriate when it comes to subcontractor defaults. General contractors will want to be in the best position possible in the event they have to default and terminate a subcontractor. When this occurs, the general contractor's first line of defense is a well written subcontract agreement that clearly spells out both parties' rights and obligations. Therefore, when preparing the document, attention should be paid to clearly defining the scope of work. Also, since time is money on a construction project, equally important is the identification of key project milestones for the completion of critical items of work. Incorporation of a liquidated damages provision should also be included, especially if the prime contract with the owner contains a liquidated damages provision that can be invoked against the general contractor if one of its subcontractors fail to perform.

Effective subcontracts between general contractors and their subs should have a number of additional key features, including:

- A "flow-down" provision, passing through to the subcontractor the obligations that the general contractor has agreed to in its agreement with the owner;
- A provision confirming that compensation for extra work or delay claims will be paid only to the extent the general contractor receives same from the owner.
- Incorporation by reference into the subcontract of the essential terms and conditions of the prime contract.

WHEN DIFFICULTIES ARISE

There are several red flags regarding a subcontractor's poor performance that general contractors need to pay attention to. These include:

- the failure to properly staff the project;
- premature demands for money;
- lien claims or claims of non-payment from suppliers; and
- baseless change orders and requests for additional compensation.

Defaulting and terminating a subcontractor ultimately becomes an exercise in minimizing risk and maximizing reward. Minimizing risk entails ensuring that no further sums will have to be paid to the subcontractor due to an adverse court decision or arbitration award. Maximizing reward involves

recovering money from the subcontractor and/or its surety as compensation for any additional costs that have been incurred. General contractors can help themselves to minimize risks and maximize rewards by consistently documenting all project events while the subcontractor is performing its work on the project. The fact is that in most construction disputes, he who has the best "paper trail" usually wins.

Additionally, with subcontractor disputes, general contractors stand in a precarious position because they are stuck in the middle of trying to appease a project owner while also protecting themselves from subcontractor claims. Therefore, general contractors must perform a careful balancing act by successfully documenting their case against the subcontractor while, at the same time, being careful not create ammunition for the owner to use against you in any upstream dispute. This is not a simple task.

TERMINATION TIME

Properly documenting subcontractor issues also serves the purpose of having a record to support the proper termination of that subcontractor. In the event it does become necessary to terminate, it is imperative that the termination provision of the subcontract be diligently followed. By doing so it minimizes the chances of the subcontractor successfully claiming a wrongful termination. If the subcontractor is bonded, a copy of the default notice and termination notice must also be provided to the surety. An accurate written record of any incomplete and/or defective work, supported by photographs and video, should be made. To the extent that defective work needs to be corrected, the corrective work should not commence until the subcontractor is given an opportunity to inspect it. This prevents later allegations of spoliation of evidence.

CONCLUSION

General contractors walk a fine line when balancing their relationships with owners and subcontractors to effectively deliver projects on time and within budget. Implementing these strategies will facilitate successful project completion and the best possible outcome for your business.



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