

Better Manage the Four Types of Subcontractor Risk

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Subcontractor risk takes many forms. Managing the risks is one of the central challenges faced by every general contractor. Here are four types of risk posed by subcontractors and some ways to mitigate those risks.

1. CONTRACTUAL RISK

They say an ounce of prevention is worth a pound of cure. That couldn't be truer than when engaging subcontractors to perform work. Having in place a well-written, clear, and concise subcontract that details the obligations of all of the parties is the foundation of every successful subcontracting relationship. By contrast, a poorly written contract with vague terms and subcontractor's obligations.

As such, subcontracts should use plain language that everyone can understand. The subcontract should clearly define the subcontractor's obligations, the work to be performed, the schedule, and the payment terms. The subcontract should state how and when payments are to be made, how changes are to be addressed and how disputes will be resolved.

Contractors should include "kick the can down" provisions that ensure the subcontractor is delivering exactly what the owner requires from the contractor in the form, quantities, quality, and on the schedule demanded by the owner. For example, the subcontract should include a clause stating that the "subcontractor agrees to assume all obligations

for the work (the subcontract scope) as set forth in the prime contract, the terms of which are incorporated by reference." This type of provision binds the subcontractor to the contractor in the same way the contractor is bound to the owner.

2. PERFORMANCE RISK

Once the obligations of the parties to the subcontract are negotiated and put in writing, the next big challenge is to ensure the subcontractor actually does what it has promised to do. Contractors should include in their subcontract requirements that the subcontractor provide regular updates on the progress of their work, thorough well-documented daily reports, and that it devote adequate resources to quality control to ensure that work is performed correctly and in accordance with the contract requirements.

Contractors may also demand that the subcontractor secure a performance bond from a surety, which guarantees the subcontractor's performance in the event of default or insolvency. If the subcontractor fails to perform or abandons the work, the contractor may have relief against the surety, which will be required to step into the shoes of the subcontractor and complete the work (or pay to have someone else do so).

In addition to, or perhaps in lieu of, requiring that a subcontractor be bonded, contractors have the ability to take out a "subguard" insurance policy, which provides the contractor with certain protections in the event of a subcontractor default.

3. SCHEDULE RISK

The effects of the COVID-19 pandemic will continue to have significant impacts on the construction industry. Many regions that supply needed materials, have made certain raw materials scarce, which has led to price increases. This is a concern for contractors looking to complete work on schedule. Many regions that supply needed materials, have made certain raw materials scarce, which has led to price increases. This is a concern for contractors looking to complete work on schedule.


Contractors should consider including a "No Damages for Delay" clause that limits the recovery of delay damages for causes other than those created by the contractor. The contractor risks creating a "gap" in the contracts where the contractor is saddled with too much COVID-19 risk by the owner without proper recourse from the subcontractor, or vice versa.

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clauses. These states include [California](#), [New York](#), [Wisconsin](#), and, more recently, [Virginia](#). In April 2022, Virginia's Governor Youngkin signed into law Senate Bill 550, which makes pay-if-paid and pay-when-paid clauses unenforceable under most circumstances. Those states that do allow such provisions subcontractor bears the risk of non-payment by the owner.

Before paying a subcontractor, contractors should also insist on receiving lien and claim waivers that release the contractor from any claims by that subcontractor. These waivers should be written broadly and should include a provision that the payment by the contractor "constitutes full and complete payment for all work performed, and all costs or expenses incurred relative to the work or improvements at the property as of the date of this waiver, except for the payment of retainage." They should also include language that the subcontractor "waives, quitclaims and releases any claim for damages due to delay, hindrance, interference, acceleration,]bYZ VYbVYgzc fYI fU'k cf_žcf UbrñhYf'WUJa 'cZUbm_]bX'i]hi may have against the contractor, the owner, or any other person or entity with a legal or equitable interest in the property, as of the due date of this waiver and release." Be mindful that certain states, including Arizona, California, Florida, Georgia, Massachusetts, Michigan, Mississippi, Missouri, Nevada, Texas, Utah, and Wyoming regulate the form and content of lien waivers. For example, [North Carolina recently passed legislation](#) invalidating certain overly broad lien and claim waivers.

Lastly, contractors should consider including broad indemnity clauses that require the subcontractor to "hold harmless" the contractor from claims and liability "arising out of" the subcontractor's work. Contractors should negotiate for the]bWl gjcb'cZWUj gYg'hUhUXXfYgg' fgh dUfm']UV]]mfY'["žWUJa g' by the contractor arising against the subcontractor for its defective work) as well as third-party liability (e.g., providing protection to the contractor against claims brought by others as a result of the subcontractor's work). Well-written clauses will include language that the subcontractor will "indemnify, defend, and hold harmless the contractor from and against UbrñhYf'WUJa 'cZUbm_]bX'i]hiYgž'cggYgž' bYgž penalties, demands, causes of action, suits, costs or expenses, including, but not limited to, attorneys' and professional fees and court costs, arising out of, relating to or resulting from (1) the performance of the work by, or any act or omission of, the subcontractor or anyone directly or indirectly employed by them or anyone for whose acts they may be liable; (2) any breach of the terms of the subcontract; and/or (3) the negligence or tort liability of the subcontractor or anyone directly or indirectly employed by them or anyone for whose acts they may be liable, under any theory."

Engaging with subcontractors is a necessary risk. Employing these strategies can help mitigate that risk. 



About the Author

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