

Subcontractor Negotiating Strategy

American Subcontractors Association of Arizona

BRIAN FLAHERTY

APRIL 17, 2019

SacksTierney P.A.
ATTORNEYS

Schedule of Values for Progress Payments

Importance

Schedule of Values are used to determine progress payments to the subcontractor.

Schedule of Values for Progress Payments

Here is the issue

- A subcontractor may find that its progress payments are tied to a Schedule of Values which it has never seen or approved.
- A subcontractor may find that a single line item in a Schedule of Values represents the combined work of several subcontractors, and thus is of limited value.
- A subcontractor may find that a poorly-conceived Schedule of Values does not include adequate values for earlier portions of the jobsite work.

Schedule of Values for Progress Payments

When a Contractor Says: “Your payment will be tied to the schedule and schedule of values that I prepare from time-to time.”

A Sub Can Say: “It’s in both of our interests to agree upon a schedule of values as part of the subcontract, since my price is based on the schedule that I’ve submitted.”

When a Contractor Says: “Industry practice is that I prepare the schedule of values.”

A Sub can Say: All of the industry’s model documents, including ConsensusDocs and AIA, say that the subcontractor should prepare a schedule of values and attached it to the subcontract. Of course, the schedule of values should be one to which you agree.”

Retainage is more for Subcontractor than Prime Contractor

The contractor will retain 10% of the amount of each progress payment to the subcontractor.

AZ Prompt Pay 32.1129.02 (D)

Contractor shall not withhold retention from a subcontractor in an amount greater than the actual amount of the retention retained by the owner pertaining to the wall of the subcontractor.

Retainage is more for Subcontractor than Prime Contractor

Here's how you negotiate:

When a Contractor Says: It's really none of your business how much the owner retains."

A Sub Can Say: "If the owner felt that we were not entitled to payment, it wouldn't have released the funds for our work."

Payment for Stored Materials

Here's the Issue

- A subcontractor is deterred from purchasing material and equipment ahead of time leading to possible delays.
- A Subcontractor risks escalating prices.
- A subcontractor's cash flow is eroded.
- A subcontractor may suffer the consequences of slow project progress or other impediments that cause a lag between the delivery of materials and the time of installation.

Payment for Stored Materials

Subcontractor shall not be entitled to reimbursement for any Construction Materials that are not incorporated into the completed construction (stored materials off-site) without Contractor's and Owner's prior approval. If approved, Subcontractor will provide with the Subcontractor's Progress Invoice: (1) a bill of sale to Owner and Contractor free and clear of all liens or encumbrances; (2) a Certificate of Insurance evidencing a policy of property insurance covering the materials and site of storage from damage due to fire, flood, rain, theft and other casualty and naming the Owner and Contractor as their interests may appear as additional insured; and (3) a letter addressed to Contractor issued by an officer of the Subcontractor stating that, "All materials stored off site and included in the pay application and certificate for payment have been: (a) securely stored and properly protected from the elements, theft and other casualty; (b) segregated and stored separately from other similar materials, clearly marked at the offsite storage as property of Contractor and Owner; and insured with a policy of property insurance for their replacement value; and (c) are being held for benefit of the Project.

Payment for Stored Materials

Here's how you Negotiate

When a Contractor Says: "It's important that you're ready to start work when we notify you. That means you need to have all equipment and material ready to go."

A Sub Can Say: "Before I'm willing to order materials or tie up my shop fabricating special products, I need to be sure that I'll get paid without delay upon delivery."

When a Contractor Says: "We expect you to start work immediately upon notice."

A Sub Can Say: "I can't afford to front the cost of materials while waiting for a building to reach the point that I can install the materials."

When a Contractor Says: "I can't pay for materials over which I don't have control."

A Sub Can Say: "We're willing to arrange for title to be shifted to you and store the materials anywhere you want."

When a Contractor Says: "Other subcontractors don't ask for this. It isn't standard practice in our industry."

A Sub Can Say: "Payment for properly-stored materials is standard practice in the construction industry. Both the ConsensusDocs and AIA standard subcontracts include payment for stored materials."

Payment Timing

ARS 32-1129.02 (H)

H. If a progress or final payment or release of retention to a subcontractor or material supplier is delayed by more than seven days after receipt of progress or final payment or release of retention by the contractor or subcontractor pursuant to this section, the contractor or subcontractor shall pay its subcontractor or material supplier interest, except for periods of time during which payment is withheld pursuant to subsection C of this section, beginning on the eighth day, at the rate of one and one-half per cent per month or a fraction of a month on the unpaid balance or at such higher rate as the parties agree.

Payment Timing

Here's the Issue

Do not alter your Prompt Pay Rights!

SacksTierney P.A.
ATTORNEYS



Payment Timing

Here's how you Negotiate

When a Contractor Says: "I don't always know when I'll get paid, so I can't set a specific time for your payment."

A Sub Can Say: "You have to abide by AZ Prompt Pay rules."

When a Contractor Says: "We can't provide a specific due date when the owner will pay us."

A Sub Can Say: "You have to follow the Prompt Pay Rules."

When a Contractor Says: "I will pay you as quickly as I can after I get paid."

A Sub Can Say: "You will pay me in accordance in Prompt Pay."

When a Contractor Says: "My other subcontractors are willing to accept a pay-when-paid clause. My subcontract is fair."

A Sub Can Say: "Your other subs are stupid."

Pay-if-Paid Clause (Bad)

Notwithstanding any other provisions of the Subcontract Documents, SUBCONTRACTOR agrees that payment by Owner to CONTRACTOR for Work performed by SUBCONTRACTOR will be condition precedent to any payment obligation of CONTRACTOR to SUBCONTRACTOR hereunder. SUBCONTRACTOR expressly agrees that it will not be entitled to receive any payments or retention for Subcontract Work performed in the event that CONTRACTOR is not paid by Owner for that work. SUBCONTRACTOR specifically assumes the risk associated with any failure or refusal of Owner to pay CONTRACTOR. SUBCONTRACTOR expressly agrees that it waives any and all rights to make payment demand on CONTRACTOR directly or on CONTRACTOR's bond for any payment due unless CONTRACTOR has received payment from Owner for the amount due to SUBCONTRACTOR but which has not been paid as required herein.

SacksTierney P.A.
ATTORNEYS

Pay-if-Paid Clause

Here's the issue

- A subcontractor bears the credit risk for the owner.
- A subcontractor may not be able to take legal steps against the owner, because it has no contractual relationship with the owner.
- A subcontractor has no control over or responsibility for owner payment delays.
- A subcontractor's right to sue for payment, assert a claim against a prime contractor's bond or file a lien are jeopardized, because payment theoretically is not due to the subcontractor until the owner pays the contractor.
- There is not a specific time limit on how long a subcontractor can be denied its money, even assuming the owner is solvent.

Pay-if-Paid Clause

Here's how you negotiate

When a Contractor Says: “The subcontractor should share in the risk of owner insolvency.”

A Sub Can Say: “ My credit risk is with you. There's no justification for me to also extend my credit to the owner. I don't have a contractual relationship with the owner. You did the credit check on the owner and your decision to go forward is strictly your responsibility.

When a Contractor Says: “A subcontractor's lien rights and the job's payment bond with offer payment protection.”

A Sub Can Say: “Bonding companies routinely deny claims on pay-if-paid terms, reasoning that no money is owned when an owner fails to pay. Liens also are often challenged using the same logic.

When a Contractor Says: “You should always be willing to wait for your money until I'm paid.”

A Sub Can Say: “I' can't wait until you pay me to issue checks to my jobsite workers, office staff, utility companies and suppliers. If I'm supposed to finance you, I've become a banker, not a builder.”

Pay-if-Paid Clause

- Push for adherence to Arizona Prompt Pay.
- A.R.S. § 32-129.02 (6)
 - Contractor is still responsible to pay subcontractor whose work was not the basis for the owner's withholding for defective construction work.

Suspension of Work for Nonpayment

KNOW YOUR RIGHTS!

SacksTierney P.A.
ATTORNEYS



Suspension of Work for Nonpayment

32-1129.04. Construction contracts; suspension of performance; termination

B. A subcontractor may suspend performance under a construction contract or terminate a construction contract if the owner fails to make timely payment of amounts certified and approved pursuant to section 32-1129.01 for the subcontractor's work and the contractor fails to pay the subcontractor for the certified and approved work. A subcontractor shall provide written notice to the contractor and owner at least three calendar days before the subcontractor's intended suspension or termination unless a shorter notice period is prescribed in the construction contract between the contractor and subcontractor. A subcontractor shall not be deemed in breach of a construction contract for suspending performance or terminating a construction contract pursuant to this subsection. A construction contract shall not extend the time period for a subcontractor to suspend performance or terminate a construction contract under this subsection.

SacksTierney P.A.
ATTORNEYS

Suspension of Work for Nonpayment

C. A subcontractor may suspend performance under a construction contract or terminate a construction contract if the owner makes timely payment of amounts certified and approved pursuant to section 32-1129.01 for the subcontractor's work but the contractor fails to pay the subcontractor for the certified and approved work. A subcontractor shall provide written notice to the contractor and owner at least seven calendar days before the subcontractor's intended suspension or termination unless a shorter notice period is prescribed in the construction contract between the contractor and subcontractor. A subcontractor shall not be deemed in breach of a construction contract for suspending performance or terminating a construction contract pursuant to this subsection. A construction contract shall not extend the time period for a subcontractor to suspend performance or terminate a construction contract under this subsection.

Suspension of Work for Nonpayment

D. A subcontractor may suspend performance under a construction contract or terminate a construction contract if the owner declines to approve and certify portions of the contractor's billing or estimate pursuant to section 32-1129.01 for that subcontractor's work but the reasons for that failure by the owner to approve and certify are not the fault of or directly related to the subcontractor's work. A subcontractor shall provide written notice to the contractor and the owner at least seven calendar days before the subcontractor's intended suspension or termination unless a shorter notice period is prescribed in the construction contract between the contractor and subcontractor. A subcontractor shall not be deemed in breach of a construction contract for suspending performance or terminating a construction contract pursuant to this subsection. A construction contract shall not extend the time period for a subcontractor to suspend performance or terminate a construction contract under this subsection.

Suspension of Work for Nonpayment

E. A contractor or subcontractor that suspends performance as provided in this section is not required to furnish further labor, materials or services until the contractor or subcontractor is paid the amount that was certified and approved, together with any costs incurred for mobilization resulting from the shutdown or start-up of a project.

F. In any action or arbitration brought pursuant to this section, the successful party shall be awarded costs and attorney fees in a reasonable amount.

G. Written notice required under this section shall be deemed to have been provided if either of the following occurs:

1. The written notice is delivered in person to the individual or a member of the entity or to an officer of the corporation for which it was intended.

2. The written notice is delivered at or sent by any means that provides written, third party verification of delivery to the last business address known to the party giving notice.

Suspension of Work for Nonpayment

Here's the issue

- A subcontractor is left with an ambiguous and unpredictable “common law” right to stop work and only if nonpayment constitutes a material breach by the contractor.
- Suspending work can be extremely risky without specific language because of courts’ wide-ranging views.
- Suspending work can be risky if the subcontract prescribes liquidated damages for unexcused delays.
- Arizona Prompt Paid Act allows subs to stop work for non-payment.

Suspension of Work for Nonpayment

Here's how you negotiate

When a Contractor Says: "I can't worry about you stopping work."

A Sub Can Say: "Why worry that I have the right to stop my work for nonpayment? If you pay on time, this becomes academic anyway."

When a Contractor Says: "This is an unreasonable request."

A Sub Can Say: "I've agreed to give you all sorts of rights if I foul up. I need the same right if you default."

When a Contractor Says: "I just don't get why you think you need this."

A Sub Can Say: "I don't have enough money to throw 'good money after bad' if payments dry up or if the job shuts down."

When a Contractor Says: "This isn't industry practice."

A Sub Can Say: "What I'm asking is in line with what both the ConsensusDocs and AIA documents say is fair, and these forms reflect current industry practice and competes with AZ Law."

No Interest for Late Nonpayment

Here's the issue

- A prime contractor may have a reduced incentive to pay the subcontractor in a timely manner.
- A prime contractor may have a reduced to insist on or collect interest from the owner.

No Interest for Late Nonpayment

Here's how you negotiate

When a Contractor Says: “Why should I pay interest to you if I don’t collect it?”

A Sub Can Say: “I expect you to get a reasonable rate of interest from the owner, and I need the same.”

When a Contractor Says: “You’re just using interest to increase your profit margin.”

A Sub Can Say: “Interest is not a profit item. It’s just a way for me to get back what I have to pay my bank to pay my employees and suppliers when I have to wait to get my money from you.”

A Sub Can Say: “Arizona Prompt Pay entitles me to 18% a year.”

Payment Set Off

Sample provision (bad)

4.5 Right of Offset. Contractor may offset against any sums due Subcontractor under this Agreement the amount of any obligations of Subcontractor to Contractor, whether or not arising out of this Agreement. Offset may be used against Subcontractor, Officers, DBA, subsidiaries, or assigns.

Payment Set Off

Here's the Issue

- A subcontractor's cash flow could be severely impacted if a customer offsets a claim on one job against payment for all other jobs.
- A customer with its own cash flow problems may fabricate reasons to hold payment on all of a subcontractor's jobs.
- A customer could hold payments on all jobs as leverage to force a subcontractor into a compromised position on a dispute.

Payment Set Off

Here's how you negotiate

When a Contractor Says: “You’re working on multiple projects for us. We see it as one big picture.”

A Sub Can Say: “Each job should stand on it’s own.” 32-1129.02 (c) – Contractor must pay sub every dime it received from owner.

When a Contractor Says: “Each of these jobs is fairly small. If you create a major problem, we need to be sure you have enough skin in the game.”

A Sub Can Say: “We have substantial amounts of insurance and net worth to offset any problem on a project.”

When a Contractor Says: “Filing and getting paid on an insurance claim can take some time. We need to keep this job moving.”

A Sub Can Say: “If you hold back my pay on other jobs for a problem on this job, it could severely impact my company’s cash flow, making it harder for me to perform. Robbing Peter to pay Paul won’t achieve what you want.”

When a Contractor Says: We need to be sure that you’ll expeditiously correct any problems that arise.”

A Sub Can Say: “My company has never failed to correct a problem or pay for damage that we caused.”

Closeout Documentation

Here's the issue

- A subcontractor may find that its customer's closeout procedures amount to a "renegotiation" of the subcontract after its work is completed.
- A subcontractor may discover that its customer has established extra, and perhaps difficult, steps that the subcontractor will have to take before being able to collect final payment.

Closeout Documentation

Here's how you negotiate

When a Contractor Says: "I'll have various closeout procedures that I'll expect you to follow at the end of the project."

A Sub Can Say: "I'm sure that I'll be able to follow any procedures that you establish, but I need you to spell them out prior to my signing the subcontract."

When a Contractor Says: "Again, these are just routine forms that are necessary to close out the job."

A Sub Can Say: "I understand that your procedures and forms are just routine, so you've certainly documented them. I just need to know that they are before I agree to the subcontract."

Assignment of Subcontract

Here's the issue

- A subcontractor may find itself working for a prime contractor with which it would not otherwise bid or work.

Assignment of Subcontract

Here's how you negotiate

When a Contractor Says: “We’re in a rapidly changing industry. If I or the Owner needs to make changes, you have to stay flexible.”

A Sub Can Say: “I bid to you considering your financial capacity, business practices and management style. The price that I gave to you would not be the same price that I would have given to another prime contractor.”

When a Contractor Says: “The Owner needs to have the right to take over this Subcontract in the unlikely event it terminates my firm.”

A Sub Can Say: “I can agree to assignment language to the extent that it’s conditioned on rights of a surety under your bond, that I’m notified in writing, and that all of the rest of the terms of our negotiated subcontract stay in place. I can’t let you assign my subcontract to someone else at your whim.”

When a Contractor Says: “Broad assignment of subcontract language is standard industry practice.”

A Sub Can Say: “What I’m asking is in line with what both ConsensusDocs and AIA documents say is fair, and these forms reflect current industry practice.”

Choice of Law and Forum

Here's the issue

- A subcontractor may have to comply with laws and regulations with which it is not familiar and be held accountable for failure to comply.
- In the event of a dispute, the subcontractor may have to bear the expense of litigation in a distant location.
- A subcontractor may not be able to access witnesses or provide other evidence to support its position in a dispute.

Choice of Law and Forum

Here's how you negotiate

When a Contractor Says: My company does business all over the country. It's just easier for us to take care of everything at home."

A Sub Can Say: "My company doesn't have any presence in Alaska. On the other hand, your company certainly has a presence here. Having to cope with all sorts of laws and codes from another state will just be confusing for both of us. On balance, it's much more equitable for us to resolve any disputes here where the project is.

When a Contractor Says: "The laws in our home state are much more representative of the construction industry than those here."

A Sub Can Say: "The construction team in this state has worked together to enact laws that are fair to everyone. I'm sure that neither of us agree with everything. But at least we both know what the law is here."

When a Contractor Says: "I just don't get why you think you need this."

A Sub Can Say: "In the unlikely event that we have a dispute, we'll both need to produce documents and witnesses to prove our case. All of that is here, not in your home state. I can't justify a long trip with my people and records for legal actions away from the evidence of the job."

When a Contractor Says: "This isn't industry practice."

A Sub Can Say: "What I'm asking is in line with what both ConsensusDocs and AIA documents say is fair, and these forms reflect current industry practice."

Why is this an Issue?

Federal Preemption

- Federal Law trumps Arizona Law