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Five Mistakes Subcontractors Commonly Make Before Signing Construction Subcontracts

By Kevin N. Tharp, RBE Partner

Construction subcontractors assume a tremendous amount of risk with each subcontract that they sign with a prime contractor. While much of that risk cannot be avoided, there are some risks that subcontractors can reduce (if not eliminate) by avoiding the following mistakes prior to signing their subcontracts.

1. They Do Not Receive a Copy of the Prime Contract

Subcontracts often include a provision stating that the subcontractor is bound to the prime contractor on the same terms that the prime contractor is bound to the owner (commonly known as the "Flow-Down"). A subcontractor can only know—and abide by—the prime contract terms if the subcontractor obtains a copy of the prime contract before the subcontract is signed. For that reason, upon request, a prime contractor should promptly provide a copy of the prime contract (which may be redacted to protect confidential information, such as the prime contract price). If the prime contractor declines to provide the prime contract, the subcontractor should reconsider whether to do business with that prime contractor.

Too frequently, subcontractors negotiate, sign, and perform their subcontracts without ever seeing the prime contract. Years ago, one of my clients served as a replacement subcontractor on a large commercial project. Construction was well underway whent my client became involved with the project. When I asked the prime contractor for a copy of the prime contract, the prime contractor agreed and stated that none of the other subcontractors—who were onsite performing large scopes of work for which they were charging seven- and eight-figure sums—had asked for a copy of the prime contract, without which the subcontractors could not possibly know all the risks they had assumed.

2. They Do Not Attempt to Negotiate

Generally speaking, construction subcontractors do not enjoy much leverage in negotiations with prime contractors. This frequently leads subcontractors to conclude that it is a waste of time to negotiate the terms of the prime contractor's standard subcontract, so they do not try. This is a mistake for three reasons.

First, the prime contractors' standard subcontract terms are often onerous, and they know it (even if they are not willing to acknowledge it). The prime contractors may be willing to soften some of the more onerous terms if the subcontractors ask. As the adage goes, "If you don't ask, the answer is always 'no.'" Second, suppose the subcontractor has a copy of the prime contract in hand. In that case, the subcontractor knows what the prime contractor's obligations are to the owner and can negotiate subcontract provisions that are less onerous to the subcontractor but are sufficient to allow the prime contractor to satisfy its obligations to the owner (*e.g.*, indemnification, claim notice deadlines, and retainage and other payment terms). Third, even if the prime contractor refuses to make any meaningful concessions, the process of preparing for the negotiation should cause the subcontractor to review carefully and understand the terms of the subcontract and the prime contract before work begins, with the result that the subcontractor will be better positioned to avoid disputes and to resolve amicably those disputes that cannot be avoided.

3. They Allow the "Flow-Down" to Work Against Them But Not For Them

When I am asked to review a draft subcontract on behalf of a subcontractor client, one of the first things I do is look for the "Flow-Down" provision, to confirm that the subcontractor has the same rights against the prime contractor that the prime contractor has against the owner (in addition to owing the prime contractor the same obligations that the prime contractor owes to the owner). If the prime contractor's rights against the owner do not "Flow-Down" to the subcontractor, my first suggestion will be to correct that. There are few circumstances in which a subcontractor should shoulder the burdens of the prime contract without receiving the benefits of that contract.

4. They Do Not Carefully Review the Scope of Work

All contractors are understandably fearful of a "bid bust"—*i.e.*, after they have signed contracts, they learn that their contract prices are not sufficient to allow them to perform the contracted work profitably because (in calculating their bids) they overlooked part of their scope. To avoid this error, good contractors double-check the scope of work as part of their bid preparation. Contractors should use the same care in reviewing the scope of work described in their contracts prior to signing them. This is of particular concern to subcontractors because the prime contractors often take responsibility for preparing and assembling the subcontract documents and (occasionally) add scopes of work to the subcontracts without increasing the subcontract prices. Depending on the circumstances, a subcontractor may have a legal remedy against the prime contractor for the scope error. Still, the subcontractor is better served by not needing such a remedy in the first place.

5. They Agree to Subcontract Provisions They Do Not Fully Understand

In their rush to sign the subcontract and get started on the work, subcontractors will sometimes gloss over subcontract provisions that they do not understand, only to later learn—the hard way—precisely what those provisions mean. This is particularly true with respect to indemnity provisions, which run the gamut from the relatively narrow (*e.g.*, providing indemnity against third-party personal injury and property damages claims typically covered by the subcontractor's insurance) to the relatively broad (*e.g.,* providing indemnity against all third-party claims arising out of subcontractor's work, even if the claim was caused in part by the prime contractor or the owner). Usually, in an hour or less, a seasoned construction lawyer can review and interpret such clauses and provide suggestions for limiting the subcontractors' liability in ways that may be acceptable to the prime contractors.

A well-advised subcontractor reduces its risks by reviewing, understanding, and negotiating before putting its signature on a subcontract.

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About the Author

Kevin Tharp's diverse business and litigation practice focuses on the construction industry. Kevin counsels owners, general contractors and subcontractors, and represents them in disputes involving claims for payment, delay, and design and construction defects, as well as mechanic's liens.

Kevin also counsels clients in the selection and formation of business entities, mergers and acquisitions, business selection planning, and general contractual matters.