

# **Five Contract Clauses You Can't Live Without**

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The contract forms used by my clients range from one page hand-written proposals to 50 page standard form contracts published by AIA, AGC and EJCDC. Whether your form agreement is home grown or standardized, there are a handful of essential provisions which are routinely omitted from construction contracts. Consult with your counsel to determine whether including the 5 clauses described below is appropriate for you.

## **I. Recovery of Legal Fees and Collection Costs**

In the event you are forced to incur the expense of hiring an attorney and instituting litigation to enforce payment provisions, or other terms of your contract, it is wise to include a clause which preserves your right to recover these substantial expenditures from the opposing party. Absent such a clause, New Hampshire courts follow the "American Rule" which requires each litigant to pay its own fees and costs, even where the litigant prevails. This contrasts with the "English Rule" which allows the prevailing party in the litigation to collect its costs and fees from the unsuccessful party.

One well recognized exception to the American Rule applies under circumstances where a state law, or the contract itself, specifically entitles one party to recover its attorneys fees and collection costs. In other words, when a contract clause expressly authorizes recovery of costs and fees from the opposing party, the courts will enforce the clause in accordance with its terms. As a result, it is important to include a cost recovery provision in every contract you sign. The recovery clause can take a more one-sided form which allows only one side to claim reimbursement, or it can take the form of a "prevailing party" clause which gives the victor in the litigation the right to recover its fees from the opposing party.

## **II. Suspension of Work for Late Payment**

In most standard contract forms, the only effective remedy for a payment default is termination. If you decide to terminate based on delinquent payment, the standard forms often require the default to continue for 30 to 60 days before termination is contractually available to you. By the time you can exercise your termination rights, the bulk of your work may be complete and you may no longer have sufficient leverage over the owner or contractor to induce it to make payment.

As an alternative to termination, consider adding a clause which allows you to suspend your work until delinquent payments are brought current. This remedy avoids the finality of termination and gives you the leverage to induce the owner or contractor to pay at an earlier stage of the default. If possible, the suspension right should become effective when payment is between 7 and 14 days late and continue until payment is brought current. The suspension clause should also provide a mechanism for you to receive additional compensation and schedule extensions when the suspension causes compensable delays. In many cases, the mere threat of a suspension during critical work periods will keep payments flowing and the project on track.

### **III. Differing Site Conditions**

It is important for all contracts to contain a clause which provides you with an independent evaluation, as well as the opportunity to request schedule extensions and additional compensation, when you encounter subsurface conditions which differ materially from those indicated by test pits, geotechnical reports or surface observations available at bid time. These provisions are commonly referred to as "Differing Site Conditions" or "Changed Conditions" clauses. In the absence of such a clause, the contractor or subcontractor will typically own the subsurface conditions as part of its original pricing structure. This can result in devastating cost overruns where changed conditions are encountered at the site.

Differing site conditions clauses should set forth clear procedures to be followed when unforeseen subsurface conditions are found. At a minimum, these procedures should include inspection by a third party to determine whether the conditions are materially different than those anticipated or reported at bid time and a mechanism for you to request schedule extensions and additional compensation for dealing with the changed conditions. Although most standard forms contain changed conditions clauses, they are often omitted from forms drafted in house. The financial impact of omitting this clause can be significant. Adding it to your contract form is well worth the investment in drafting costs.

### **IV. Phased Retainage Reduction**

It is commonplace for contractors to sign agreements which allow the owner to withhold full contract retainage until the project reaches final completion. Retainage is often held at percentages which equal or exceed 10 percent of the contract value. This fosters scenarios where front end subcontractors remain unpaid for extended time periods following the completion of their work and owners wield too much power over contractors at the end of the project by holding balances which are vastly disproportionate to the value of the contractor's incomplete work.

The impact of this imbalance can be reduced considerably by including contract clauses which require phased retainage reduction over the life of the contract. These clauses can take the form of a single retainage reduction when the project reaches 50 percent completion, or multiple reductions when defined milestones are reached. I support including at least two reductions, at 50 percent and 75 percent completion. The goal is to ensure that, by substantial completion, the value being held by the owner or contractor more closely aligns with the value of the contractor's incomplete work.

Keep in mind that drafting these clauses can be tricky. For example, assume that 10 percent retainage has been held by the owner on a commercial project. Further assume that the contract provides that "at 50 percent completion, retainage shall be reduced by 50 percent." Consider this language carefully. Does it mean that the owner will actually pay out all of the retainage previously held when the project is half done and then continue to hold 10 percent going forward? Does it mean that retainage will be held at 10 percent until the project is half done and thereafter it will be held at 5 percent, but no retainage will be released until the end?

Judges and arbitrators have imposed both interpretations on this very language, as well as other interpretations. As a result, you must be sure that your counsel very clearly expresses your intent when drafting a phased retainage reduction clause.

## **V. Proof of Worker's Compensation Coverage**

Over the past ten years, the law has been interpreted in a manner which blurs the line between employees and independent contractors. Consequently, it has become risky to hire subcontractors or independent laborers who cannot show proof of worker's compensation coverage in the amounts required by State law. Without certified proof of coverage, an audit by your insurance carrier might result in the assessment of worker's compensation premiums to your company for all lower tier subcontractors who did not provide you with a valid certificate confirming worker's compensation coverage. In short, if you cannot produce a certificate from your subcontractor at the audit, your carrier may assume that its workers are your employees and charge you premiums accordingly.

In light of the above, your contract should contain a provision which requires all subcontractors and independent laborers to purchase and maintain worker's compensation coverage for the duration of the project and to provide a certificate of insurance evidencing the nature and extent of the coverage.

### ***Drafting Advice:***

The process of drafting contract clauses, including those described in this article, requires attention to the specific needs of the contractor and the requirements of the project. As a result, I have not proposed, and I do not typically recommend, standard boiler plate language for clients to use in any circumstance. I suggest that you talk with your counsel, keeping the above goals in mind, and work together to convert these concepts into language which suits your unique needs and those of the project.

*Kelly Gagliuso is a founding member of Gagliuso & Gagliuso P.A. Her practice is heavily concentrated in construction law, contracts and dispute resolution. Her client base includes designers, contractors, subcontractors, suppliers and the trades. Kelly serves on the Board of Directors of the New Hampshire/Vermont Chapter of Associated Builders and Contractors, as well as its Education and Recruitment committees. She is the current President of the New Hampshire Good Roads Association and serves on the Board of Directors of the Granite State Chapter of the National Association of Women in Construction. Kelly is also an active member of the American Bar Association's Forum on the Construction Industry and a frequent lecturer on construction law topics.*