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TOP SHEET

Using Form Construction Subcontracts on State and Local Public Projects

By Aaron Silberman

The construction industry, perhaps more than any other, uses standard form contracts. Organizations like the American Institute of Architects (AIA); ConsensusDocs, a coalition of industry groups; and the Engineers Joint Contract Documents Committee (EJCDC) sell these form contracts to owners, contractors, design professionals, and others, which in turn use them either as-is or, more often, with modifications.

The "family" of contracts sold by these organizations typically includes construction prime contracts and subcontracts, design contracts and subconsultant agreements, design-build contracts, and others. Construction prime contracts and subcontracts are widely used in the industry.

The advantages of using these form contracts are obvious. They provide consistency within an organization. In many instances, their provisions have been time-tested and ambiguities eliminated, or at least mitigated, by appellate court decisions. They are efficient, reducing the need to "reinvent the wheel" for every project. This is especially true where the project participants use multiple contracts from the same "family," e.g., the owner–prime contractor, prime contractor–subcontractor, owner-designer, designer-subconsultant, and so forth, agreements for the project are all forms from the same organization; when they do that, there is built-in consistency of most, if not all, key contract terms.

They also have some obvious disadvantages. There is a tendency for parties to resist modification or customization of their form contracts and to rely on those forms without examination of whether they are truly in their or the project's best interest on a particular job. No form contract fits every project and party. Without careful review and modification, these form contracts will not serve the parties' or the project's interests. They may be legally unenforceable, in whole or in part. No form contract fits every jurisdiction's legal and regulatory requirements, and most, if not all, jurisdictions will have some requirements or prohibitions that merit modification of any form contract.

This article discusses particular issues raised by use of form construction subcontracts on state and local public projects. Many prime contractors use these form subcontracts on all of their projects, including those for public entity owners. There are special risks in doing so. Unlike commercial owners, public owners rarely (if ever) use form prime contracts. This means that, where the prime contractor and subcontractor use a form subcontract, they will not enjoy one of the key advantages of doing so—built-in consistency of terms with the family of agreements for the project.

Most Commonly Used Form Construction Subcontracts

Many prime contractors and their subcontractors use form subcontracts from AIA, ConsensusDocs, and EJCDC.

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FORM CONSTRUCTION SUBCONTRACTS

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The AIA released AIA Document A401-2017, Standard Form of Agreement Between Contractor and Subcontractor, in 2017, replacing the A401-2007. ConsensusDocs released the ConsensusDocs 750, Standard Agreement Between Contractor and Subcontractor, in 2011 and issued the current, revised edition in 2016. The EJCDC last revised its Construction (Owner-Contractor) family of documents in 2013, a.k.a. the "2013 C-Series," adding a new form subcontract, the C-523, Subcontract.

Common Issues

While jurisdictions have their own unique or at least uncommon idiosyncrasies, many major issues are common to subcontracting on most public projects. Common issues that should be included in reviewing form subcontracts for use on public projects include incorporation of the prime contract and flow-down clauses; the public owner's consent or prequalification requirements;[1] price and costs; payment and invoicing, including prompt payment, the duty to continue work, and certifications; changes and claims, including pass-through claims; schedule and delays; differing site conditions; limitations of liability and waivers of consequential and other extra-contractual damages; indemnity, insurance, and bonds; warranties; prevailing wage and project labor agreements; terminations; disadvantaged business entity (DBE) requirements; product substitutions ("or equals"); licensure (i.e., when the subcontractor must be properly licensed); procurement integrity and conflicts of interest; disputes, including joinder, choice of venue, alternative dispute resolution (ADR), and prevailing party attorneys' fees; public records; and choice of law. Most, if not all, of these issues may impact the prime contractor–subcontractor relationship differently on public projects than they do on private works.

Two prominent examples—payment and invoicing and terminations—are discussed in detail below.

Payment and Invoicing

While the terms affecting how and when the subcontractor is paid for its work will generally be set forth in the subcontract agreement with the prime contractor, on public projects, the interpretation and enforceability of these subcontract provisions will often be limited by the laws of the state and even locality in which the work is being performed, such as prompt payment statutes and other statutory remedies such as payment bond and stop payment claims.

Payment Timing: Prompt Payment

When payment for work will be made is a key clause in any contract, especially a construction contract. Construction subcontracts typically specify an amount of time in which payment is due from the prime contractor to the subcontractor, conditioned on the subcontractor's satisfactory performance and submission of required documentation and the prime contractor's receipt of payment from the owner or passage of a reasonable amount of time. As described below, these provisions may not meet prompt payment law requirements applicable to state and local public projects in some jurisdictions. As those prompt payment requirements will usually be incorporated in the public owner's prime contract and flowed down to the subcontract, where they are inconsistent with the form subcontract's payment provisions, they will create a conflict. Form subcontracts should be modified to avoid this.

For example, the AIA A401-2017, at Article 11, §§ 11.1 and 11.1.3, requires the prime contractor to make progress payments "no later than *seven working days* after the Contractor receives payment from the Owner" (emphasis added). Likewise, at §§ 11.3 and 11.3.1, it requires the prime contractor to "pay the Subcontractor within *seven days* after receipt of payment from the Owner . . ." (emphasis added). The form does not provide a penalty for the prime contractor's late payment.

The ConsensusDocs 750, at Article 8, §§ 8.2 and 8.2.5, requires the prime contractor to make progress payments to the subcontractor "no later than *seven (7) Days* after receipt by Constructor of payment from Owner for the Subcontract Work" (emphasis added). Likewise, Article 8, §§ 8.3 and 8.3.3, requires the prime contractor to make final payment to the subcontractor "within *seven (7) Days* after receipt by Constructor of final payment from Owner for such Subcontract Work" (emphasis added). The form does not provide a penalty for the prime contractor's late payment beyond normal interest, Article 8, § 8.4 ("Progress payments or final payment due and unpaid under this Agreement shall bear interest from the date payment is due at the prevailing statutory rate at the place of the Project"), although it does allow the subcontractor to stop work, §§ 8.2 and 8.2.6 (discussed further below).

The EJCDC C-523, at Article 5, § 5.01.C (progress payments), and Article 6, § 6.01 (final payment), requires the prime contractor to pay the subcontractor within *10 days* after the prime contractor's receipt of payment from the owner.

Numerous jurisdictions have prompt payment statutes that require contractors and subcontractors to pay their subcontractors within a specified time period of receiving payment from the public owner, or face penalties.[2] In Arizona, for example, subcontractors must be paid within seven days.[3] The penalty is one percent per month "or a fraction of the month" on the unpaid balance.[4] Some jurisdictions also provide for the recovery of attorneys' fees in any action to recover the unpaid amounts.[5] However, some statutes provide that penalties shall not be due when there is a good faith dispute as to whether payment is owing.[6]

The form subcontract provisions described above do not satisfy prompt payment laws applicable to state and local public projects in many jurisdictions. None of them

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provide for the interest penalties common to such laws, so to the extent such penalties apply, they should be incorporated into the subcontract, e.g., through a specific flow-down provision. The AIA A401-2017 provisions also may not meet prompt payment requirements where state or local law requires payment within seven calendar days, rather than seven business/work days. The ConsensusDocs 750 provisions' seven-day payment requirement, defining days as calendar days (Article 2, § 2.6.3), likely meets most, if not all, jurisdictions' requirements; the EJCDC C-523 provisions' 10-day payment requirement likely does not.

Nonpayment/Duty to Continue Working

Prime contracts for public construction often expressly require the prime contractor to continue performing, even if it contends it is not being paid. To the extent that the form subcontracts do not mirror this requirement and likewise require the subcontractor to keep working, they may put the prime contractor in a very difficult position—pay its subcontractors when it has not yet been paid or risk the subcontractor walking off the job and putting the prime contractor in default of its contract with the owner.

> ***Numerous jurisdictions have prompt payment statutes that require contractors and subcontractors to pay their subcontractors within a specified time period of receiving payment from the public owner, or face penalties.***

The AIA A401-2017, at Article 4, § 4.8, provides that, if the prime contractor fails to pay the subcontractor on time, through no fault of the subcontractor, then "the Subcontractor may, without prejudice to any other available remedies, upon seven additional days' notice to the Contractor, stop the Work of this Subcontract until payment of the amount owing has been received." Article 7, § 7.1, further allows the subcontractor to terminate the subcontract "for nonpayment of amounts due under this Subcontract for 60 days or longer."

ConsensusDocs 750 provides one provision that prohibits the subcontractor from stopping work while a dispute is pending—Article 11, § 11.1 ("Subcontractor shall continue the Subcontract Work and maintain the Progress Schedule during any dispute mitigation or resolution procedure")—but several others expressly permit the subcontractor to stop work for nonpayment by the prime contractor. Specifically, Article 8, §§ 8.2 and 8.2.6, provides: "If Constructor has received payment from Owner and if for any reason not the fault of Subcontractor, Subcontractor does not receive a progress payment from Constructor within seven (7) Days after the date such payment is due, as defined in the subsection immediately above, or, if Constructor has failed to pay Subcontractor within a reasonable time for the Subcontract Work satisfactorily performed, Subcontractor, upon giving seven (7) Days' written notice to Constructor, and without prejudice to and in addition to any other legal remedies, may stop work until payment of the full amount owing to Subcontractor has been received." It further provides, at Article 10, § 10.8, that the subcontractor may, upon seven days' written notice, terminate the subcontract if work has been stopped for 30 days "because Subcontractor has not received progress payments." *See also* Article 7, § 7.7 (the subcontractor may stop work unless and until the prime contractor issues "a Subcontract Change Order" or "written instructions" in accordance with other applicable subcontract provisions).

Under the EJCDC C-523, at Article 11, § 11.05, "if a payment owed to Subcontractor is more than 30 days past due," the subcontractor may stop work upon seven days' written notice, and it may also elect to terminate the subcontract.

Many prime contracts for public contracts require the prime contractor to keep working pending any dispute regarding a delay in payment. On those projects, prime contractors using the above form subcontracts should modify them to make sure that, if they must keep working, so must their subcontractors.

Remedies and Waivers

Because mechanics' liens are generally not available on public projects, all states and many localities have created alternative statutory remedies subcontractors may use to enforce prime contractors' payment obligations. All states have enacted some form of "little Miller Acts," providing certain subcontractors and suppliers a remedy for nonpayment through payment bonds.[7] Some jurisdictions also have enacted statutes providing subcontractors and suppliers with a "stop notice" or "stop payment notice" remedy.[8] Finally, several jurisdictions permit a subcontractor or supplier to lien funds held by public owners under contracts for public improvements, effectively stopping notices under a different name.[9] Parties using form subcontracts for public projects should check those agreements against the applicable payment remedies under applicable state and local laws and conform their agreements to those laws.

The AIA A401-2017, at Article 12, §§ 12.2 and 12.3.2, requires the prime contractor to provide to the subcontractor upon written request a copy of any payment bond it obtained for the project; it does not require the prime contractor to provide a copy if required by law but not requested by the subcontractor (compare Article 3, § 3.3.6). Article 11, §§ 11.1 and 11.1.1, specifies that the subcontract does not

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"require money to be placed in a separate account and not commingled with money of the Contractor or Subcontractor," "create any fiduciary liability or tort liability on the part of the Contractor or Subcontractor for breach of trust," or "entitle any person or entity to an award of punitive damages against the Contractor or Subcontractor for breach of the requirements of this provision." The form does not mention stop notice or stop payment notices.

The ConsensusDocs 750, at Article 9, § 9.3.4, requires the prime contractor to indicate whether it has provided a payment bond to the owner and, at Article 4, § 4.6, requires the prime contractor to provide to the subcontractor a copy of its payment bond on the project "upon the Subcontract Work commencing." Article 8, § 8.6, requires that "payments received by Constructor for the Subcontract Work shall be dedicated to payment to Subcontractor" but states, "[n]othing in this section creates a fiduciary duty on the Parties, nor creates any tort cause of action or liability for breach of trust, punitive damages, or other equitable remedy or liability for alleged breach."

The EJCDC C-523, at Article 10, § 10.01.I, requires the prime contractor, upon request, to provide a copy of the payment bond to the subcontractor.

Many jurisdictions have also enacted statutes providing subcontractors and suppliers with a stop notice remedy. A "stop notice" is also referred to in some jurisdictions as a "lien on funds" or, in California, a "stop payment notice."[10] Unlike mechanic's liens, which provide subcontractors and suppliers with an interest in real property, these claims are a security interest in construction funds.[11] As creatures of statute, in order to establish a valid payment bond or stop notice claim, a claimant typically must strictly follow any and all procedural requirements, which vary substantially from state to state. None of the form subcontracts above require the prime contractor to provide information the subcontractor may need to enforce its stop notice rights in jurisdictions offering this remedy. Compare the AIA A401-2017, at Article 3, § 3.3.6 (requiring prime contractor to do so for mechanic's liens).

While a payment bond may suffice to protect a claimant on some projects, stop notices can add additional security and leverage for claimants in states with this remedy. For instance, the claimant circumvents typical privity requirements for contract lawsuits and is able to assert a direct right of action against a public owner that disburses funds after the claimant perfects a stop notice against the funds. To the extent that provisions in the form subcontracts discussed above require the subcontractor to direct all communications to the prime contractor, such as the ConsensusDocs 750, at Article 3, § 3.6, those provisions likely will not be enforceable to prevent the subcontractor from pursuing available stop payment rights. Likewise, provisions limiting direct subcontractor claims against the owner will not preclude stop notice claims.[12]

Furthermore, on public projects, the stop notice may provide the only true source of recovery when the public body fails to require a payment bond from the general contractor.[13] However, the owner is only required to hold funds that are currently in its possession. Thus, if the amount of the stop notice exceeds the remaining contract balance or contract funds being held by the owner at the time of perfecting the stop notice, there will be insufficient funds to make the subcontractor whole. In all events, a subcontractor or supplier is well advised to ensure that it strictly and timely complies with its jurisdiction's procedural requirements before all project funds are disbursed.

Other jurisdictions provide effectively a similar remedy by permitting a subcontractor or supplier to lien funds held by public owners under contracts for public improvements.[14] For example, under the New York lien law, a subcontractor can assert lien rights against funds held by state or local contracting authorities.[15] The claimant must file a notice of lien within 30 days of the project's completion with the head of the department or bureau having charge of the construction and the comptroller of the state or other person having responsibility for disbursement of funds.[16] A copy must be served upon the general contractor or any other higher-tier subcontractor.[17] The lien is generally valid for one year, in which time the claimant may petition to enforce the lien.[18]

While New York permits a claimant broad rights to lien any project funds held by any public body at the time that notice is received, other jurisdictions limit liens on funds for public projects. For instance, in New Jersey, a claimant can lien funds held by local public bodies but not funds held by the state or state departments or authorities.[19] In Washington, the claimant is limited to asserting a lien on the retainage withheld by the public owner, not to exceed five percent of the contract price.[20] In general, the requirements to lien public funds differ substantially from jurisdiction to jurisdiction, and typically differ from the requirements for perfecting a lien on a private project.

In these constructive trust jurisdictions, the limitations in the above form subcontracts purporting to prevent creation of trust protections on owner funds paid to the prime contractor for subcontract work (e.g., AIA A401-2017, Article 11, §§ 11.1 and 11.1.1; ConsensusDocs 750, Article 8, § 8.6) may not be enforceable.

Invoicing/Certifications

Many public owners require, as a condition of paying a prime contractor under a construction contract, that the prime contractor certify in each pay application that it has applied prior payments to pay subcontractors and suppliers and will do the same with the current payment. While not as common, some public owners require that the prime contractor obtain similar certifications from its subcontractors regarding payment of second-tier subcontractors and suppliers.

The AIA A401-2017, at Article 4, § 4.2.6, requires for progress payments that the subcontractor "furnish satisfactory evidence, when requested by the Contractor, to verify compliance with" requirements that it "pay for all materials, equipment, and labor used in connection with

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the performance of this Subcontract" for previous payments received from the prime contractor. Article 11, §§ 11.3 and 11.3.2, likewise requires for final payment that the subcontractor upon request submit similar evidence.

The ConsensusDocs 750 requires, at Article 8, § 8.3.2(a), that the subcontractor's application for final payment include "[a]n affidavit that all payrolls, bills for materials and equipment, and other indebtedness connected with the Subcontract Work have been paid, satisfied, or are to be paid with the proceeds of final payment, so as to not encumber Owner's property, Constructor, or Constructor's surety." It does not contain a similar requirement for progress payments.

The EJCDC C-523, at Article 5, § 5.01.A.3, requires that, "[b]eginning with Subcontractor's second progress payment application, each Subcontractor progress payment application shall include a Subcontractor's affidavit stating that all previous progress payments received on account of the Subcontract Work have been paid to persons and entities providing labor, equipment, materials and services on account of amounts received on behalf of said sub-subcontractors, suppliers, and vendors from prior progress payment applications." It contains a similar requirement, at Article 6, § 6.02, for final payment: "Upon the request of Contractor, Subcontractor shall submit, as part of the application for final payment, a final waiver of lien and sworn statement indicating all sub-subcontractors, suppliers, and vendors, their contract amounts, and the final amounts paid to each sub-subcontractor, supplier, and vendor."

The AIA A401-2017 and EJCDC C-523 require the subcontractor to provide information that should be sufficient to allow the prime contractor to make the certifications required under most public owners' prime contracts; it will require revision for those owners that require subcontractor certifications. The ConsensusDocs 750 will likewise be sufficient for final payment but not for progress payments and, as with the A401-2017 and C-523, should be revised where the prime contractor needs certifications from its subcontractors.

Terminations

State and local government contracts typically include provisions that permit the public agency to terminate the contract for cause (often referred to as a "termination for default") or without cause (often referred to as a "termination for convenience"). Some also provide for cancellation, which is typically a termination without cause early in the project or for some specific, anticipated possible event (for example, a failure to obtain appropriations to fund the project or contractor bankruptcy). Prime contract termination provisions do not typically require that the prime contractor flow them down in its subcontracts. Nevertheless, it is usually a very good idea for the prime contractor to flow down such provisions, albeit with revisions, and prime contractors often do so. Industry form subcontracts vary in their approaches to terminations and how well they do or do not match typical prime contracts for public projects.

Terminations with Cause or "for Default"

Public construction subcontracts typically provide that the prime contractor may terminate the subcontract for "cause" or "default" if the subcontractor is in material breach and, upon specified notice from the prime contractor, has failed to cure that breach. Some subcontracts, like prime contracts, may require "notice" before termination and an "opportunity to cure" within the notice period or the commencement of cure where the default cannot be cured within the cure period. Oftentimes, the notice and opportunity to cure language could be improved to clarify whether the subcontract is simply affording notice in advance of the effectiveness of the termination, whether there is a cure period, and whether the cure plan is required and must be acceptable to the prime contractor where a cure cannot be completed within the cure period. Subcontract termination provisions often might benefit from additional clarity on these points.

Many subcontracts will specify the types of breach that justify termination for cause and therefore by definition are material for purposes of termination. For example, the ConsensusDocs 750, at Article 10, §§ 10.1 and 10.1.1, provides that the prime contractor may terminate a subcontract if the subcontractor (1) repeatedly refuses or fails to supply sufficient skilled workers or materials, (2) fails to pay its lower-tier subcontractors or suppliers, (3) violates applicable laws, or (4) substantially breaches the contract documents. The EJCDC C-523, at Article 11, § 11.02.A, contains a similar list of grounds for termination for cause. Both the ConsensusDocs 750 and the EJCDC C-523 also include a "catch-all" provision at the end of the list of grounds for default termination that provides that cause includes "any other substantial or material breach"—ConsensusDocs 750, at Article 10, § 10.1.1 ("or otherwise is guilty of a material breach of a provision of this Agreement"); EJCDC C-523, at Article 11, § 11.02.A.4 ("Subcontractor's failure to perform or otherwise to comply with a material term of the Subcontract"). This approach is likely sufficient to protect the prime contractor, as it will allow it to terminate the subcontractor for most or all breaches that, if not promptly cured, could subject the prime contractor to default termination by the public owner.

The AIA A401-2017, in contrast, only provides a general description of a subcontractor breach as a basis for a default termination, with the only condition being that the breach must occur "repeatedly." *See* AIA A401-2017, at Article 7, § 7.2.1 ("If the Subcontractor repeatedly fails or neglects to carry out the Work in accordance with the Subcontract Documents or otherwise to perform in accordance with this Subcontract . . ."). This provision may be too narrow to protect prime contractors under many public contracts. Many prime contracts allow the public owner to terminate for cause where material breaches have occurred and are not timely cured, even if those breaches have not occurred "repeatedly." So, if a subcontractor commits a single material breach (for example, a willful safety violation), this may give the owner grounds to terminate the prime contractor but may not, under

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the AIA clause, give the prime contractor a termination remedy against the subcontractor.

While some courts will not permit a default termination for any reason that is not specified in the contract clause,[21] the more common approach is to allow default termination for any material breach.[22] Additional material breaches that commonly result in terminations for cause include anticipatory repudiation and abandonment of the contract.[23] Where the subcontract does not define what types of subcontractor breaches will be considered material so as to justify a termination for cause, courts will typically look to the following five factors: (1) the amount of the benefit lost to the injured party, (2) the adequacy of compensation to the injured party, (3) the amount of forfeiture by the breaching party, (4) the likelihood that the breaching party will cure, and (5) the breaching party's good faith.[24] A subcontractor will not be in material breach where it substantially performed.[25]

Under most circumstances, prime contracts for public projects provide that, as a condition to a default termination, the owner must provide the prime contractor with a written cure notice a specified number of days prior to termination. The required number of days varies. Form subcontracts likewise require the prime contractor to provide this type of notice to the subcontractor. The AIA A401-2017, Article 7, §§ 7.2 and 7.2.1, requires 10 days' notice to terminate, though Article 3, § 3.5, allows the prime contractor to take other remedial measures (such as bringing in a substitute subcontractor) within five working days. ConsensusDocs 750 provides, at Article 10, §§ 10.1, 10.1.1, and 10.1.1.4, that, if the subcontractor (a) is in material breach, (b) is given a first written notice and fails to commence a cure within three work days, and (c) is given a second written notice and fails to commence a cure within two work days, then the prime contractor may, among other things, terminate the subcontract by written notice. The EJCDC C-523, at Article 11, § 11.02, permits the prime contractor, on seven days' written notice (of default), to terminate the subcontract for cause where (a) the subcontractor is in material breach and fails to commence and complete curing the breach within four and 14 days, respectively, after receipt of the prime contractor's notice and (b) the prime contractor gives two days' further written notice (of termination) after the 14-day period.

State courts will typically require strict compliance with default termination notice requirements.[26] Failure to provide notice and a cure period may itself be a material breach by the terminating party.[27] Where the prime contractor provides the notice, and the subcontractor takes sufficient action to cure, the prime contractor may not terminate for default.[28] As a result, the prime contractor should make sure that the subcontract notice durations are sufficiently shorter than those in the prime contract to allow the prime contractor to remedy any default caused, in whole or in part, by any of its subcontractors before the prime contract notice period expires.

Terminations Without Cause or "for Convenience"

Convenience termination provisions are more variable than those for cause. Prime contractors on public projects often must agree in their prime contracts to provisions giving the government broad rights to terminate without cause. These provisions typically do not require the prime contractor to flow them down in their subcontracts. Some subcontracts allow the prime contractor to terminate for convenience, though some only where the owner has terminated the prime contract. Failure to flow down such provisions can create legal exposure to the prime contractor where a public owner terminates the prime contractor for convenience, but the prime contractor has no right, or a much more limited right, to do the same with its subcontractors.

The AIA A401-2017, at Article 7, §§ 7.2, 7.2.2, and 7.2.2.1, provides that, "[i]f the Owner terminates the Prime Contract for the Owner's convenience, the Contractor shall promptly deliver notice to the Subcontractor." It does not expressly allow for subcontract termination where the owner deletes the subcontract work through means other than a complete termination, e.g., through a partial termination or deductive change order. Article 7, §§ 7.2, 7.2.2, and 7.2.2.2, provides that, "[i]n case of such termination for the Owner's convenience, the Subcontractor shall be entitled to receive payment for Work properly executed, costs incurred by reason of the termination, and reasonable overhead and profit on the Work not executed."

ConsensusDocs 750 does not have a termination for convenience provision per se, but it provides, at Article 10, § 10.4, that the prime contractor may terminate the subcontract if the owner terminates the prime contract, in whole or in part (if that part includes the subcontract work). This provision does not require any default by the subcontractor. Like the AIA subcontract, it does not expressly allow for subcontract termination where the owner partially terminates or issues a deductive change order eliminating the subcontractor's scope of work. It limits the prime contractor's liability to the subcontractor to the amount the prime contractor may recover, with the subcontractor's cooperation, from the owner. An exception is where the owner terminates the prime contract for cause, through no fault of the subcontractor, in which case the subcontractor may recover "its reasonable costs arising from the termination of [the subcontract], including reasonable overhead and profit on Work not performed." The latter recovery, of anticipatory profit, is more than a prime contractor or subcontractor would recover under most termination for convenience provisions for public projects.[29]

The EJCDC C-523 provides for two types of termination without cause, i.e., in the absence of a material breach by the subcontractor. It provides, at Article 11, § 11.03, for termination if the owner either (a) terminates the prime contract or (b) rejects the subcontractor in accordance with the prime contract terms. As with the

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other form subcontracts described above, this form does not expressly allow for subcontract termination where the owner deletes the subcontract work through means other than a complete termination. Where § 11.03 applies, the subcontractor's recovery is limited to whatever the prime contractor is entitled to recover from the owner for the subcontractor's work. The EJCDC C-523 provides, at Article 11, § 11.04, that the prime contractor may terminate the subcontract for convenience upon seven days' written notice. In such cases, the subcontractor is entitled to payment for completed work and the costs of work in progress, plus overhead and profit, and for termination expenses, but not for anticipatory profit on unperformed (i.e., terminated) work.

The A401-2017 only allows termination where the subcontractor is not in material breach where the owner has terminated the prime contract for convenience. It states no deadline for a subcontractor to submit a termination claim to the prime contractor. Public prime contracts may contain such a deadline, in which case this could put the prime contractor in a difficult position in which it must submit its claim to the owner before the subcontractor submits its claim to the prime contractor.

The provisions in the AIA A401-2017 and ConsensusDocs 750 limiting the prime contractor's ability to terminate for convenience to only where the owner has terminated the prime contract will be enforced.[30] If a prime contractor is agreeable to such a limitation, it should at least try to make it broad enough to include any action by the owner that eliminates or reduces the subcontractor's scope of work. This should include not only complete terminations but also partial terminations, so long as they impact the subcontractor's work, as well as other owner actions, such as deductive change orders issued by the owner that delete only a portion of the subcontractor's scope of work.

Even under broader convenience termination clauses, like that in the EJCDC C-253, there may be limitations on the prime contractor's ability to terminate without cause. Most jurisdictions prohibit convenience terminations made in bad faith.[31] This limitation is very narrow and difficult to prove, such that subcontractor challenges of convenience terminations are usually unsuccessful.[32] Some challenges of convenience terminations have succeeded, however, even where a bad faith standard was applied.[33] Other courts have been more restrictive regarding the ability to terminate for convenience, requiring a change in circumstances to justify termination.[34] These decisions are in the minority.

Once the prime contractor has effectively noticed the termination for convenience of the subcontract, the parties must determine the recovery to which the subcontractor is entitled, if any. Most subcontract clauses for termination for convenience, including those in the AIA A401-2017, at Article 7, §§ 7.2, 7.2.2, and 7.2.2.2, and EJCDC C-253, at Article 11, § 11.04, provide that, in the event of such a termination, the subcontractor is entitled to the following: (1) costs incurred for work performed at termination, plus a reasonable profit (or loss) on the performed work, and (2) termination expenses. Some subcontracts, including the AIA A401-2017, also allow recovery of anticipated profits on the unexecuted, i.e., terminated, work. *See* Article 7, §§ 7.2, 7.2.2, and 7.2.2.2 ("In case of such termination for the Owner's convenience, the Subcontractor shall be entitled to receive payment for Work properly executed, costs incurred by reason of the termination, and reasonable overhead and profit on the Work not executed"). However, because this recovery is often not allowed under prime contracts on public projects, this provision may put the prime contractor at risk that it will, through no fault of its own, be required to pay the subcontractor more than it may recover from the owner. While the prime contractor may argue that its liability to the subcontractor is reimbursable as a termination expense, it may be prudent to add to the subcontract language conditioning the subcontractor's recovery of anticipatory profit upon the prime contractor's recovery of that profit from the owner. Another approach may be to limit this subcontractor recovery to instances in which the public owner terminates the prime contract for default due to no fault of the subcontractor.

Some subcontract clauses will cap or otherwise limit the subcontractor's recovery for a convenience termination. For example, on federal projects, regulatory requirements, when flowed down, provide that termination settlements—exclusive of settlement expenses—may not exceed the contract price.[35] The AIA A401-2017, at Article 7, § 7.2.2.2, does not cap the subcontractor's convenience termination recovery. The ConsensusDocs 750, at Article 10, § 10.4, limits recovery to the amount the prime contractor recovers from the owner for the subcontractor or, if the owner terminated the prime contractor for cause unrelated to any fault of the subcontractor, limits recovery to costs arising from the termination plus lost profits on unperformed work. And the EJCDC C-253, at Article 11, § 11.04.B, does not allow the subcontractor's termination recovery to include consequential damages.

To the extent that the convenience termination recovery provided in the prime contract is more restrictive than that provided in the form subcontract, the prime contractor should consider adding similar restrictions to the subcontract. A general flow-down may not suffice as some courts have refused to apply to subcontracts the recovery limitations in the prime contract based on such provisions; rather, they will only do so where the subcontract specifically incorporates those limitations.[36]

Thus, prime contractors with limited recovery under the convenience termination provisions in their prime contracts should consider adding similar limitations to their subcontracts, rather than relying upon general flow-down provisions.

All Terminations in Subcontractor Listing Law Jurisdictions

In some jurisdictions, "subcontractor listing laws"

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FORM CONSTRUCTION SUBCONTRACTS

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impose additional requirements before a prime contractor may terminate a subcontractor on a public project. In an effort to protect subcontractors from bid shopping and bid peddling, many state legislatures have enacted such laws requiring contractors bidding for prime contracts for public construction projects to list some or all of the subcontractors they intend to use on those projects and restricting prime contractors' ability to replace their listed subcontractors.[37]

A common feature of subcontractor listing laws is a specific procedure for substituting, with the public entity's approval, a listed subcontractor for specified reasons such as the subcontractor's refusal to perform the work or the subcontractor's inability to perform the work due to bankruptcy.[38] Without these specifics, jurisdictions have found that prime contractors have too easily been able to renege on their commitments and replace subcontractors listed in their bids.[39]

Some listing laws provide a process that must be followed where a prime contractor proposes substitution of a listed subcontractor.[40] Ordinarily, the listed subcontractor must be given notice of the proposed substitution.[41] This enables the subcontractor to contest the request for substitution. This sort of administrative process does not exist on private works projects and affords a significant level of protection against losing a subcontract.

The AIA A401-2017, ConsensusDocs 750, and EJCDC C-523 do not account for such jurisdiction-specific requirements in their termination provisions or elsewhere. For subcontracts subject to these requirements, a broad right to terminate for convenience will not be enforced, and these forms should be modified to specify the statutory requirements that must be met before terminating the subcontractor.

Conclusion

Form subcontracts are useful and, for many prime contractors, familiar and efficient ways of doing business. The three discussed above—the AIA A401-2017, ConsensusDocs 750, and EJCDC C-253—are all carefully and thoughtfully drafted, well-written agreements. But each can be problematic where they do not match up well with the prime contractor's contract with the project owner and/or extracontractual requirements or restrictions under applicable statutes, regulations, or case law. This inconsistency commonly occurs in public contracting, where public entity owners rarely if ever use form prime contracts, so the prime contracts and subcontracts do not come from the same "family" of forms, and there are many more extracontractual requirements than apply to commercial construction projects. For all of these reasons, prime contractors, subcontractors, and their counsel should all apply extra care in evaluating

and, where appropriate, modifying these forms before entering into them for public projects. PL

Endnotes

1. *See, e.g.*, Oregon Dep't of Transp., Construction Manual, ch. 14 (Subcontracts), at 14-1 (updated Oct. 2010), http://www.oregon.gov/ODOT/HWY/CONSTRUCTION/constructionmanual/cm14.pdf); Mass. Gen. Laws ch. 149, §§ 44D(a), 44D(e), 44D(i) (2006).
2. *See, e.g.*, Ariz. Rev. Stat. § 41-2577; Cal. Bus. & Prof. Code § 7108.5; S.C. Code Ann. § 29-6-30; Wis. Stat. Ann. § 16.528.
3. Ariz. Rev. Stat. § 41-2577(B).
4. *Id.* § 41-2577(E).
5. *See, e.g.*, Cal. Bus. & Prof. Code § 7108.5(c).
6. *Id.* § 7108.5.
7. See 50-state compilation at *Little Miller Act Statutes*, zlien, https://www.zlien.com/bond-claims/miller-acts/.
8. The following jurisdictions permit a claimant to lien the contract funds held by a public owner: Alabama (Ala. Code § 35-11-218), Alaska (Alaska Stat. § 34.35.062), Arizona (Ariz. Rev. Stat. Ann. § 33-1051 et seq.), California (Cal. Civ. Code § 9350 et seq.), Illinois (770 Ill. Comp. Stat. 60/23), Indiana (Ind. Code § 32-28-3-9), Kentucky (Ky. Rev. Stat. § 376.210), Louisiana (La. Rev. Stat. Ann. § 38:2242), Mississippi (Miss. Code Ann. § 85-7-181), New Hampshire (N.H. Rev. Stat. Ann. § 447:15), New Jersey (N.J. Stat. Ann. § 2A:44-125 et seq.), New York (N.Y. Lien Law § 5), North Carolina (N.C. Gen. Stat. § 44A-19), Ohio (Ohio Rev. Code Ann. § 1311.26), Rhode Island (R.I. Gen. Laws § 34-27.1-1), Texas (Tex. Prop. Code Ann. § 53.101 et seq.), South Dakota (S.D. Codified Laws § 5-22-1), Washington (Wash. Rev. Code § 60.28.011), and Wisconsin (Wis. Stat. §§ 779.036, 779.15).
9. *See, e.g.*, California (Cal. Civ. Code § 9356); Illinois (770 Ill. Comp. Stat. 60/23); New York (N.Y. Lien Law § 5); Washington (Wash. Rev. Code Ann. § 60.28.011 (West)).
10. *See* A.J. Setting Co. v. Trs. of Cal. State Univ. & Colls., 119 Cal. App. 3d 374, 381 (1981) ("The stop notice code sections recognize the public interest mandate that public property remain unencumbered by mechanics' liens by only permitting a lien upon funds the public entity is otherwise obligated to pay to the prime contractor."); *In re* Yobe Elec., Inc., 30 B.R. 114, 118 (W.D. Pa. Bankr. 1983) ("[T]he proper filing of a stop-notice has the effect of perfecting a lien against funds in the hands of the owner.").
11. *See, e.g.*, A-1 Door & Materials Co. v. Fresno Guar. Sav. & Loan Ass'n, 61 Cal. 2d 728, 732 (1964); Cal Sierra Constr., Inc. v. Comerica Bank, 206 Cal. App. 4th 841 (2012).
12. *See, e.g.*, EJCDC C-523, § 12.01.B ("Except as provided by applicable lien, bond, or prompt payment laws, Subcontractor shall not make any claims against Owner for compensation or additional compensation for performance of the Subcontract Work.").
13. Some states have recognized direct actions against a public entity that fails to ensure that the prime contractor provides a payment bond. *See, e.g.*, N.V. Heathorn, Inc. v. Cty. of San Mateo, 126 Cal. App. 4th 1526 (2005).
14. *See, e.g.*, Cal. Civ. Code § 9356; 770 Ill. Comp. Stat. 60/23; N.Y. Lien Law § 5; Wash. Rev. Code Ann. § 60.28.011 (West).
15. *See* N.Y. Lien Law § 5; *see* Canron Corp. v. City of New York, 89 N.Y.2d 147, 158–59 (1996).
16. *See* N.Y. Lien Law § 12.
17. *See id.* § 11-c.
18. *See id.* §§ 18, 60.
19. *See* N.J. Stat. Ann. § 2A:44-125 et seq.
20. *See* Wash. Rev. Code § 60.28.011.
21. *See, e.g.*, Cty. of La Paz v. Yakima Compost Co., 233 P.3d 1169, 1180–81 (Ariz. Ct. App. 2010).
22. *See, e.g.*, Pettinelli Elec. Co. Inv. v. Bd. of Ed. of City of N.Y., 391 N.Y.S.2d 118 (1st Dept.), *order aff'd*, 401 N.Y.S.2d 1011 (1977).

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23. *See, e.g.*, Mometal Structures, Inc. v. T.A. Ahern Contractors Corp., 09-CV-2791, 2013 U.S. Dist. LEXIS 27797 (E.D.N.Y. Feb. 28, 2013) (applying New York law); BloomSouth Flooring Corp. v. Boys' & Girls' Club of Taunton, Inc., 800 N.E.2d 1038 (Mass. 2003).

24. *See, e.g.*, L.L. Lewis Constr., L.L.C. v. Adrian, 142 S.W.3d 255, 260 (Mo. Ct. App. 2004).

25. Norberto & Sons, Inc. v. Cty. of Nassau, 16 A.D.3d 642, 643 (N.Y. App. Div. 2005) (finding a subcontractor had substantially performed when 95% of the work was completed).

26. *See, e.g.*, Allstate Contractors, Inc. v. Marriott Corp., 652 N.E.2d 1113, 1119 (Ill. App. Ct. 1st Dist. 1995).

27. Barham Constr. of Riverbank, 2011 Cal. App. Unpub. LEXIS 5959, at *26–*28, *35–*39 (Aug. 8, 2011) (unpublished California appellate decisions may not be cited as authority).

28. Cty. of La Paz v. Yakima Compost Co., 233 P.3d 1169, 1179–81 (Ariz. Ct. App. 2010).

29. *See, e.g.*, State of Cal. Dep't of Gen. Servs. (DGS), Document 00 72 00, General Conditions of the Contract for Construction § 2.4.2 (Oct. 2011 ed.), *available at* https://www.documents.dgs.ca.gov/resd/arra/007200generalconditionsrevoct2011.pdf.

30. Experimental Eng'g, Inc. v. United Tech. Corp., 614 F.2d 1244 (9th Cir. 1980).

31. *See, e.g.*, Questar Builders, Inc. v. CB Flooring, LLC, 978 A.2d 651 (Md. 2009); Handi-Van, Inc. v. Broward Cty., 116 So. 3d 530 (Fla. Dist. Ct. App. 4th Dist. 2013); Capital Safety, Inc. v. State Div. of Bldgs. & Constr., 848 A.2d 863 (N.J. App. 2004); RAM Eng'g & Constr., Inc. v. Univ. of Louisville, 127 S.W.3d 579 (Ky. 2003); Harris Corp. v. Giesting & Assocs., Inc., 297 F.3d 1270, 1272–73 (11th Cir. 2002) (applying Florida law); A.J. Temple Marble & Tile, Inc. v. Long Island R.R., 659 N.Y.S.2d 412 (1997); EDO Corp. v. Beech Aircraft Corp., 911 F.2d 1447 (10th Cir. 1990) (applying Kansas law).

32. *See, e.g.*, Vila & Son Landscaping Corp. v. Posen Constr., Inc., 99 So. 3d 563 (Fla. Dist. Ct. App. 2d Dist. 2012); A.L. Prime Energy Consultant, Inc. v. Mass. Bay Transp. Auth., 479 Mass. 419, 95 N.E.3d 547 (2018); *see also* Modern Cont'l Constr. Co., Inc. v. City of Lowell, 391 Mass. 829, 840, 465 N.E.2d 1173, 1179 (1984).

33. *See, e.g.*, *Questar Builders, Inc.*, 978 A.2d 651.

34. *RAM Eng'g & Constr., Inc.*, 127 S.W.3d 579; Linan-Faye Constr. Co. v. Housing Auth., 49 F.3d 915 (3d Cir. 1995). *See also* Smart, Inc. v. V.I. Hous. Auth., 320 F. Supp. 2d 332 (D. V.I. 2004) (constructive termination for convenience limited to changed circumstances).

35. FAR 49.207; Okaw Indus., Inc., ASBCA No. 17863, 75-2 BCA ¶ 11,571.

36. *See, e.g.*, Encon Utah, LLC v. Fluor Ames Kraemer, LLC, 210 P.3d 263 (Utah 2009); AMC Demolition Specialists, Inc. v. Bechtel Jacobs Co., 3:04-CV-466, 2006 WL 2792401 (E.D. Tenn. Sept. 26, 2006); United States *ex rel.* EPC Corp. v. Travelers Cas. & Sur. Co. of Am., 423 F. Supp. 2d 1016 (D. Ariz. 2006).

37. Alaska Stat. § 36.30.115 (2008); Ark. Code Ann. § 22-9-204 (2004); Cal. Pub. Cont. Code § 4104 (West 2004); Conn. Gen. Stat. Ann. § 4b-93 (2007); Del. Code Ann. tit. 29, § 6962 (2010); Fla. Stat. Ann. § 255.0515 (West 2009); Haw. Rev. Stat. § 103D-302 (2006); Idaho Code § 67-2310 (2008); Iowa Code Ann. § 8A.311(15) (2011); Kan. Stat. Ann. § 75-3741 (2005); La. Rev. Stat. Ann. § 38:2212 (2012); Mass. Gen. Laws Ann. ch. 149, § 44A (2010); Nev. Rev. Stat. Ann. § 338.141 (West 2011); N.J. Stat. Ann. § 40A:11-16 (West 2010); N.M. Stat. Ann. § 13-4-34 (2011); N.Y. Gen. Mun. Law § 101 (McKinney 2012); N.C. Gen. Stat. § 143-128 (2008); Or. Rev. Stat. § 279C.370 (2003); S.C. Code Ann. § 11-35-3020 (2009); Tenn. Code Ann. § 62-6-119 (2008); Utah Code Ann. § 63A-5-208 (West 2011); Wash. Rev. Code § 39.30.060 (2012); W. Va. Code § 5-22-1 (2012); Wis. Stat. Ann. § 66.0901 (West 2010); *see also* S. Calvert, Presentation at ABA Forum on the Construction Industry Annual Meeting: Preference Programs in Public Projects: The Future Is Now, April 2013, *available at* http://www.americanbar.org/content/dam/aba/directories/construction_industry_knowledge_base/dp_plenary_2_2.authcheckdam.pdf.

38. *See, e.g.*, Cal. Pub. Cont. Code § 4107; Utah Code Ann. § 63A-5-208(3)(d).

39. *See, e.g.*, Finney Co. v. Monarch Constr. Co., 670 S.W.2d 857, 858, 863 (Ky. 1984).

40. *See, e.g.*, Cal. Pub. Cont. Code § 4107.

41. *Id.*

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