

How to Get Paid in Full, on Every Job

***An Action Program for Increasing
Profits and Preventing Losses***



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SESSION ONE

Introduction and Summary of Action Program

* Taking the time to implement a formal program designed to provide contractual protection to your company and to maximize the leverage the law provides to you pays substantial rewards over time.

* The objectives of the action program taught in this course are:

- Elimination of unpaid accounts
- Increased velocity of collections
- Increased recovery on change orders and claims

* There are four aspects to the author's action program:

-- Establishing a Company Policy on Acceptable Contract Terms

By far the most effective way to succeed in contract negotiations is to prepare pre-printed forms setting forth the terms and conditions on which you are willing to do business. In order to prepare such a form, it is necessary to go through a formal process of assessing the risks inherent in your particular business or trade, and then to make a considered judgment concerning what risks you are willing to bear and what risks are unacceptable to your company.

Your objective when you submit bids should be to obtain the job on your terms.

-- Instituting a Policy Concerning Modification of Lien Waivers

Many claims for changes and extra work are inadvertently waived by contractors in their monthly lien waiver forms. All that is necessary to protect yourself from losses of this nature is to follow a practice of rubber-stamping above the signature block every lien waiver that your company signs. The purpose of the stamp is to modify the lien waiver form to exclude waivers of payment for extra work, claims or contract breaches.

-- Instituting a Policy of Providing Timely
Notice of all Potential Claims

Where potential claims for extra compensation arise, failure to file a timely notice of claim forecloses a later decision to pursue the claim. Adopting a company policy of providing written notice to your contracting party of all impacts on your performance, whether involving cost or time, may result in substantial rewards later in the job.

-- Becoming Familiar With and Using the
Ten Methods of Payment Security

"Payment security" is any method of obtaining payment from a third party where your contracting party is unable or unwilling to pay you. Those ten methods are:

1. Mechanic's Liens
2. Common Law and Statutory Trust Funds
3. Miller Act Bonds (Federal projects)
4. Little Miller Act Bonds (State projects)
5. Private Payment Bonds
6. Joint Check Agreements
7. Contractual Bypass Clauses
8. Novations
9. Accounts Receivable Assignments
10. Personal Liability of Corporate Officers

Use of Legal Leverage to Do Business on YOUR Terms

- * The law provides significant leverage to contractors and suppliers to negotiate favorable terms with their upstream contracting parties.
- * By understanding the law of contract formation, you can learn to take advantage of the leverage the law provides to contractors to do business on your terms.
- * Although the common understanding of the term "contract" is a document signed by the parties, the law actually defines a contract as a legal relationship, which can be written, oral, or partly written and partly oral.
- * A contract exists when each of the elements of an enforceable agreement have been met.
- * If in the process of negotiation the parties determine that their agreement will not become effective until there is a signed document, then there is no contract until the writing is signed.
- * In the construction industry, it is common for a contract to be formed with the oral acceptance of a bid, with the paperwork which memorializes the existence of the contract to be prepared later.
- * The three elements of a contract are offer, acceptance, and consideration.
- * The definition of offer is "the manifestation of willingness to enter into a bargain, so made as to justify another person in understanding that agreement to the proposed bargain is invited, and upon his acceptance will conclude it."
- * In order to qualify as an offer, a proposal must be definite and certain.
- * In order to constitute an offer, all that the other party must do in order to form a contract is to indicate acceptance of your proposed terms.
- * In order to constitute an acceptance, the party to whom the offer is made must accept the material terms as offered.
- * Any material deviation from the offer constitutes a rejection of the offer, and is deemed at law a "counteroffer."
- * When a counteroffer is made, the other party has the choice of either accepting the counteroffer, or making a new offer.

* In construction contracts, the third element of a contract, consideration, is found in the existence of mutual promises. No money needs to be exchanged at the time a contract is formed.

Contract Formation in the Construction Industry

* When a participant in the construction project solicits bids (whether by the owner to general contractors or construction managers, GCs or CMs to subcontractors, etc.,) at law these solicitations are invitations to make offers.

* Bids themselves constitute offers.

* When a bid is accepted a contract is formed.

* Under the doctrine of promissory estoppel, when an upstream party uses your bid in its bid, your bid becomes irrevocable.

* Despite the fact that once your bid is made and relied on you cannot withdraw it, the other party is under no obligation to award you the job.

* If you do not submit proposed terms with your bid, you will be obligated to perform the work on the other party's terms, provided they are reasonable in light of prevailing circumstances in the industry.

The Secrets to Getting Your Own Terms

* When you submit your bid, any terms you attach to your bid become part of your offer.

* If you submit proposed terms with your offer, an acceptance of your bid price means acceptance as well of your terms.

* Any attempt to vary your terms constitutes a counteroffer, and releases you from your obligations under your bid.

* When submitting terms with your bid, you should include on your bid form the following or similar language:

NOTICE: The terms and conditions set forth on the reverse side hereof are a material part of our bid. Notification of acceptance of our bid price constitutes acceptance as well of such terms and conditions, which shall be incorporated by reference into the Contract Documents, and prevail over any contrary terms contained therein.

The Importance of Setting Your Own Terms

* The particular contract terms that are critical to a construction contractor's success vary among the trades.

* It is important for contractors and suppliers to analyze their own operations, and determine for themselves what terms and conditions they require in their contracts in order to protect themselves.

* You should fax your bid terms, which should include a scope of work description, at the same time you call in your bid.

* I also recommend including in bid terms a statement along the following lines:

NOTICE: This bid contains no monies for unforeseen contingencies, including but not limited to performance delays, payment delays, risks of non-payment by the owner, unknown site conditions, and other matters beyond the control of bidder. In the event contractor desires to place additional risks on bidder, there will be a corresponding increase in the bid price for each such risk accepted.

* Another alternative clause that may be helpful to lower-tier parties states:

If Contractor permits bidder to commence any work, bidder's terms and conditions will be deemed accepted in full, and will prevail over any contrary terms in Contractor's standard form contract or other Contract Documents.

* For subcontractors, where you have submitted your terms with your bid, type in at the bottom of your Subcontract Document or Purchase Order:

Subcontractors [or Supplier's] bid terms dated _____
are attached hereto and incorporated herein by reference.

* If you cannot get your contracting party to accept the terms and conditions submitted with your bid and you nonetheless want the job, use as an alternative an addendum which sets forth your most important terms. Your addendum should state that in the event of a conflict, the terms in the addendum take precedence over the other party's terms.

* If you use an Addendum, type in at the bottom of the Subcontract or Purchase Order just above the signatures: "The attached Addendum dated _____ forms a part of this Subcontract [or Purchase Order] and its terms and conditions are incorporated herein by reference."

* Do not attempt to make alterations, deletions, etc. on the other party's contract. Instead, attach to the other party's form either your bid terms and conditions or an addendum.

"Flow Down" Clauses and Incorporation by Reference

* Under what are known as "flow down" clauses, lower-tier contractors can be obligated to perform obligations contained in contracts between upper-tier parties.

* Care must be taken to avoid taking on unintended obligations.

* This can be done in part by a provision in your bid terms which states that your terms prevail over contrary terms elsewhere in the Contract Documents.

* It is also recommended to include a "non-waiver" clause in your bid terms, which states that no term or condition set forth in any Contract Document which is not physically appended to the Subcontract Agreement or Purchase Order shall have the effect of waiving any right to payment or any other substantive right of Subcontractor or Suppliers.

* Another approach is to include in your bid terms a provision that states that there will be no incorporation by reference of any terms that limits subcontractor's or supplier's rights that are not expressly referred to in the subcontract or purchase order.

* Another alternative is to limit incorporation by reference to scope of work matters only.

* Where your contracting party attempts to place additional obligations on you, or to take away your rights, on the basis of a contract clause which it alleges is incorporated by reference into your subcontract agreement, do not be intimidated or fooled. Most such attempts are rejected by the courts.

NOTE: Included in the Appendix are examples of forms which can be used, with modifications to fit your particular trade, as follows:

Appendix 1: Sample Proposal form, for use by a prime contractor on a small job where a more formal contract is not required.

Appendix 2: Sample Subcontractor Proposal, for use in competitive bidding situation. This form is faxed to the prime contractor on bid day.

Appendix 3: Sample Subcontractor Addendum.

SESSION TWO

Introduction -- Doing Business on Your Terms

* One of the keys to success in negotiation of favorable contracts and purchase orders is knowledge of your areas of particular vulnerability, and the creation of contract terms which deal with those specific problems.

* The time for you to determine the terms on which you are willing to do business is when you are in the process of establishing your standard form terms and conditions, not when you are in the midst of negotiating a particular contract.

* Unusual jobs -- such as rehabilitation projects and projects in foreign countries -- may require additional terms designed specifically for that job.

* It is recommended to have a "what if" session in which you review the project, and give consideration to what could go wrong and how you can best protect yourself if it does.

* A checklist of special contract clauses should be prepared, so that you don't overlook anything during the process of contract review.

* Don't expect judges and arbitrators to use a fairness or reasonableness standard in enforcing the contract terms you agree to. The language you accept in your contract terms will be enforced as written, no matter how unfair it may be to you.

PAYMENT TERMS

Introduction

* The most important contract clauses related to payment are those which take away your upstream party's leverage over you, and which provide you with your own leverage with your upstream contractor.

* Strong clauses providing you with assurance of payment are necessary in order to avoid becoming a victim of your upstream contractor.

* There is no fairness and reasonableness standard applicable to the enforcement of construction contracts. The role of a judge or arbitrator, in the event you get into a dispute, is to enforce the contract as written, regardless of the impact on either party.

The Backcharge Bond-Off Clause

* One of the key “leverage” clauses is the backcharge bond-off clause. An example of the clause that I recommend using, which is designed specifically for use by subcontractors but which can be adapted for use by parties at other tiers, states:

If, at any time prior to final payment being made to Subcontractor, Contractor believes in good faith that it has a right to offset any payment as the result of damages caused to Contractor by Subcontractor, or that Contractor has a right to withhold any payment from Subcontractor for any other reason other than non-performance of work, then prior to the date on which such payment would otherwise be payable, Contractor shall notify Subcontractor of the full details of such claim or asserted right, including the amount thereof and the factual basis therefor. Upon receipt of such a notice, Subcontractor shall have the option of posting a surety bond in the amount of the funds proposed to be withheld. Upon the posting of such bond, Contractor shall make the payment in question to Subcontractor. Contractor shall thereafter have 90 days in which to assert its legal and contractual rights with respect to resolving the dispute. Failure to take such action within such time shall cause such claim to be waived. If it is subsequently determined by a court or arbitrator that Contractor’s claim lacks substantial merit, Contractor shall reimburse Subcontractor for the cost of the premium for the bond, and Subcontractor’s attorneys’ fees and costs.

* Appropriate modifications of this clause can be made, of course, for use of the clause by lower-tier subcontractors or suppliers.

* The advantage of this clause is that it alters the balance of power between the parties, and it takes away the Contractor’s leverage to use the withholding of progress payments and/or retainage to force unfair settlements on you.

Three Other “Leverage” Clauses

* Provide in your contract that if dispute resolution procedures are invoked and you prevail, the other party pays your attorneys’ fees.

* Provide for interest to be paid to you in the event of a delay in payments.

* If in your jurisdiction the civil courts are clogged and there are delays in civil trials, provide for arbitration of disputes, under the Construction Industry Rules of the American Arbitration Association.

Pay-When-Paid Clauses

- * There is no such thing as a “standard” pay-when-paid clause. Slight changes in wording can have a major effect on your ability to get paid.
- * There are two main types of clauses:
 - Those that are intended to shift the time of payment until receipt of payment by your customer’s upstream party. Under this type of clause, the delay is only for a “reasonable” time.
 - Those that shift to you the credit risk that your customer’s upstream party will fail to make payment. Under this type of clause, payment to your customer is a condition precedent to your being paid.
- * The first type of clause is reasonable, the second is not.
- * Beware and avoid contingent payment clauses that use the term “condition precedent” or that attempt to shift credit risk on to you.
- * Also avoid payment clauses that permit payments to be withheld for reasons that have nothing to do with your own fault. A harsh contingent payment clause can be a vehicle whereby a contractor passes losses down the chain of contracts for damages caused by its own fault, to parties that are wholly without fault.

Remedies for Non-Payment

- * Your standard form contract terms should contain a clause which gives you the right to stop work if you are not paid.
- * Sample clauses can be found in the AIA A401 contract (Paragraph 7.1.1), and in the standard form subcontract issued jointly by the ASA, AGC and ASC (paragraph 14.2.8).

Stored Materials

- * Payment for stored materials should be made as part of the payment requisition for the month in which the materials are placed into storage.
- * An inspection clause should be included where storage is in the manufacturer or fabricator’s own yard.

Retainage

- * Always insist on line-item release of retainage, that is, release of your retainage upon completion and acceptance of your work, rather than waiting until the completion of the job.

- * Also insist on reduction of your retainage when your upstream party has its own retainage reduced.

Requirement of Architect's Certificate

- * Where a contract stipulates that final payment shall be due and payable upon the issuance of an architect's certificate of completion, it is essential to allege compliance with this condition in order to maintain a lawsuit for the collection of the balance due, or to enforce a mechanic's lien.

- * However, this condition will be excused where the other party renders it impossible to obtain the required certificate -- for example, where the contractor is kicked off the job.

Set-Off

- * Where a downstream contractor fails to perform its work properly, thereby requiring the upstream party to perform the work itself or sub the work out to another contractor, the upstream party has a right under the law to withhold payment as an offset. No contract clause permitting set-off is required.

- * There is no general notice requirement before a backcharge can be levied against a lower-tier contractor.

- * As a general rule, when a suit is brought to collect monies due on a particular project, the defendant, in addition to claiming off-sets arising out of claims on that project, can also claim an off-set for monies due it on another project.

- * It is also permissible, under most subcontracts, to withhold payments from a subcontractor in amounts necessary to satisfy claims against the general contractor made by a subcontractor's unpaid downstream subs and suppliers -- particularly where the claimants have live mechanic's lien or bond rights.

- * But... withholding a progress payment where there is no off-set due, in order to coerce a downstream contractor, is a breach of contract.

Lien Waivers

* Care must be taken not to inadvertently give up rights you intend to keep when signing partial and final lien waivers.

* Forms which appear on their face to only release mechanic's liens, when examined more closely, often contain language which has the effect of waiving payment rights for changes and claims.

* On waivers signed as part of your monthly progress payment requisitions, the effective date should be the date of the period covered by the requisition, not the date of the payment.

* Modify your final lien waiver to provide for the non-release of any pending or known claims.

* The most effective way to modify a lien waiver is by a rubber stamp, with the stamp being placed immediately above the signature block.

* The stamp should contain language similar to the following:

**This release does not apply to retainage, pending
change orders or claims for breach of contract.**

Timely Notice of Claims

* Valid claims for extra compensation and time extensions are frequently lost due to failure to give timely notice.

* In many cases, a time extension can protect your from an assessment of liquidated damages, and can be as important as an award of extra compensation.

* Simply as a matter of course, notice should be given to your contracting party of all events which impact your job performance, whether caused by your contracting party, third parties, or events beyond your control and without your fault.

* It is helpful to the timely filing of claims to analyze your contract's notice requirements, and to set forth such requirements on a brightly colored sheet of paper, which can be placed on the inside cover of your contract file, for ease of reference.

SESSION THREE

Introduction

* The Purpose of payment security is to provide an alternative source of payment, when your contracting party becomes insolvent, bankrupt, or refuses to pay.

* Even where your contracting party is financially able but slow in paying you, by starting the process of exercising your rights under one of the forms of payment security, you exert leverage which often leads to prompt payment.

* For example, merely giving notice of an intent to file a bond claim or mechanic's lien claim is often sufficient in order to obtain a payment that has been delayed.

* In discussing the topic of payment security, there will be frequent references to the "chain of contracts" and to "upstream" and "downstream" parties. From the top down the normal chain of contracts is owner to either general contractor or construction manager, GC or CM to first tier subcontractors, then subs to sub-subs and suppliers. The owner is "upstream" to the general contractor, the general contractor is "upstream" to the first-tier subs, etc.

Principles of Collections Management

* Construction company managers often let their payment security rights expire, by failing to give timely notice, out of fear that the giving of such notice might do damage to customer relationships.

* By advising your customer that you have a policy with respect to all customers of always keeping your payment security rights in effect until final payment is received, you can soften the impact of your actions.

* Where you are concerned with maintaining a good customer relationship, first make a friendly telephone call to your customer to warn that the notice is coming, and then send a cover to the legal notice explaining that the customer should not take the matter personally or as a hostile gesture, that you value the relationship, that company policy requires that you maintain your rights, etc.

* Prior to payment problems arising, you should establish a personal relationship with the individual within your customer's company who handles payments.

* As soon as you perceive that a payment problem is arising, attempt to get as much information as possible why the problem exists.

* A personal meeting concerning payment problems is preferable to telephone calls and letters.

* There is nothing inconsistent with attempting to use more than one payment security device at a time, nor is there anything inconsistent about attempting to negotiate directly with your customer while pursuing a payment security option at the same time.

The Unique Problems of Dealing With a Customer Bankruptcy

* The "standard" response to a customer bankruptcy is to file a claim in the amount you are owed with the bankruptcy court.

* There are two major classes of creditors in a bankruptcy. "Secured" creditors have a pre-existing interest in specific property of the debtor, and in many cases recover a high percentage of their debt. "Unsecured" creditors basically share in the assets which are left once the secured creditors are paid first.

* Trade debt is an unsecured type of debt.

* In a Chapter XI Bankruptcy, where the bankrupt company reorganizes its finances and continues in business, recovery by unsecured creditors of five or ten cents on the dollar is considered a good recovery. In many cases there is nothing at all left for unsecured creditors.

* In a Chapter VII Bankruptcy, where the bankrupt company is liquidated, unsecured creditors rarely receive any significant percentage of their debts.

* Your objective when your customer files for bankruptcy is to bypass the entire bankruptcy court procedure, and to get paid by a third party.

Arbitration and Payment Security Devices

* Where there is an arbitration clause in your contract or purchase order, use of arbitration as a method of determining how much is owed does not preclude you from exercising your rights with respect to payment security against another source of ultimate payment of that amount.

* DO NOT WAIT until the conclusion of the arbitration proceeding to start the process of exercising your payment security rights, since by then it will probably be too late.

* Even where there is an arbitration clause in your contract, file all notices and file suit in court on a timely basis, then ask the court to stay the proceeding pending completion of the arbitration.

* Once it is determined, through arbitration, that your primary debtor owes you a specific sum, you can then obtain payment from a third party source through the pending bond or mechanic's lien lawsuit.

Supplemental Statutory Protection for Unpaid Contractors

* There are a number of federal and state statutes which provide leverage to contractors, and particularly lower-tier parties, in getting paid.

* On Federal construction projects, the Federal Prompt Payment Act requires Government contractors to promptly make payment to their subcontractors and suppliers. On Federal jobs, the prime contractor's payment application specifies the amount of work performed during the pay period on a line item basis. The approved pay application then governs the prime contractor's distribution of the proceeds of the Government's payment to the prime.

* Under the Federal Prompt Payment Act, if a prime contractor intends to withhold payments from a subcontractor or supplier for defective or delayed performance, the prime contractor is required to notify the Government of such intent, and then the Government can in turn withhold such monies from the prime.

* Most states have similar prompt payment acts, applicable to state procurement.

* In 2000, Arizona amended its Prompt Pay Law to add a new section making the Act applicable to private as well as public procurement.

* The Arizona Prompt Pay Law for Private Construction requires that the prime contractor certify and approve monthly pay applications of its subcontractors or material suppliers, and then to make progress payments to subcontractors and suppliers within seven days (unless another period is agreed upon). If there is a failure to make such a payment, the subcontractor or supplier is permitted to suspend performance. If a lawsuit is required to enforce the subcontract or purchase order, the unpaid party is entitled to interest, costs of suit and attorneys' fees.

* In July 2002, New York enacted a Prompt Payment Law applicable to private construction contracts in excess of \$250,000. Under the New York Act, the prime contractor is given 12 days to approve or disapprove invoices from subcontractors or material suppliers.