Legal Edge

7 Contract Provisions to Never, Ever Overlook

The most dangerous contract provisions revealed.

by Kent J. Pagel

From a legal perspective, there seems to be a recurring theme when it comes to selling components. The same holds true if you are selling installed components (or turnkey). The homeowner gets the home. The builder makes a profit. The suppliers and subcontractors take all the risk. The "take all the risk" part is absolutely the case if the supplier or subcontractor sign without changes, the builder's very one-sided customer contract form.

While some sales are still being done verbally or perhaps on one page contract forms, the norm, especially when selling to big builders, is to be presented a complex contract form. The contract form will cover payment, firm pricing, scope of work, insurance, indemnity, default/delay/back charges, warranty and many other issues in excruciating detail. It is not atypical for a builder contract form to exceed 25 pages with schedules and attachments. One-sided and unfair only begins to describe these contract forms.

Too often we seem mystified by the complex language and overwhelmed by the length of these contracts and sign them without review. This practice is extremely dangerous. With some training our hope is that all of us can recognize the most significant risks readily and have a modest degree of control over the contract terms to which we agree.

In this article, our goal is to help you be more informed as to the meaning of seven of the most problematic provisions that I find in these builder customer contract forms. Please keep in mind that these customer contract provisions are not ranked in order of degree of risk.

1. SELLING PER PLANS AND SPECIFICATONS

Supplier shall furnish the materials and all necessary labor, equipment, supervision, services, taxes, and licenses with regard to the materials as required of Builder and as set forth in the exhibits and in strict accordance with the Contract Documents, including the plans and specifications.

This type of provision is not uncommon to find in a big builder's customer contract form. Here's what you need to understand: it is the intent of the builder to impose EVERY requirement contained in the specifications on its suppliers, including component manufacturers, REGARDLESS of whether the supplier has seen or read the specifications. Issues that may be addressed might include: bracing, installation of bracing, lumber grade and species, inspection, unloading, storing, mold, engineering, and sealed placement plans.

2. DELIVERY & TITLE

Supplier shall commence delivery immediately upon receipt from Builder of a notice to proceed or as otherwise directed by Builder. Supplier's deliveries shall be performed in accordance with those schedules as may be determined by Builder. Title to the materials shall pass to Builder at time of Builder's approval.

I see three major problems with this type of provision. First, the Builder can unilaterally dictate the delivery schedule or changes to such delivery schedule. If the CM is unable to comply, delay damages could be asserted. Second, if the Builder has the right to dictate the schedule, and it delays acceptance of deliveries for some time, what right does the CM have if its lumber costs increase significantly? Third, if title to materials passes only at such time the Builder approves them and not at time of delivery, who bears the risk of loss if the materials are damaged, destroyed or stolen on the jobsite? If the CM is expected to bear such loss, does the CM have insurance in place for such loss?

3. PAYMENT

On or before the 25th day of each month, Supplier shall submit to Builder an application for payment substantially in the form that Builder may require. Supplier agrees that Builder shall never be obligated to pay Supplier under any circumstances, unless and until funds are in hand received by Builder in full, less any applicable retainage. This is a condition precedent to any obligation of Builder, and shall not be construed as a time of payment clause.

We lawyers refer to these types of provisions as "pay-if-paid" or conditional payment provisions. Simply, they mean if the Builder is not paid by a project owner for example, the CM is not entitled to be paid. This is the case even if the CM provided conforming materials and has no responsibility for the Builder not being paid. If the CM has likewise waived its lien rights, (not uncommon in many Builder customer contract forms), the CM has lost every bit of leverage it may have in getting paid. There is only one consolation to CMs in California, New York, North Carolina and Wisconsin, where these pay-if-paid provisions are invalid—although you may have to go to court to prove that fact.

4. WARRANTY

Supplier warrants to Builder that all materials shall be of good quality, free from faults and defects and in conformance with the Contract Documents. Supplier agrees to guarantee the materials against all defects, materials or workmanship for the same period of time as Builder is obligated to guarantee or warrant its work to any project owner or homeowner.

While this is a bad provision altogether, two things bother me the most. First, there is no duration of warranty stated. That means the CM could be providing a warranty for as many as ten years assuming the Builder provided the homeowner with a 10-year structural warranty. Second, the CM is warranting even those products it is simply re-selling and not manufacturing, so why should the CM take on that kind of risk?

5. DISPUTE RESOLUTION

Any dispute between Builder and Supplier and/or its sureties shall be decided by arbitrators in arbitration by the American Arbitration Association (the "AAA") in the city of Builder's office at the sole election of Builder. Otherwise all litigation shall be in the courts in the state of Builder's office and due to the specialized nature of construction litigation, each party hereby waives its right to a trial by jury.

Okay, you figure, "I will make the sale (and hopefully get paid)

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at a glance

- Being aware of the big, bad seven is a step toward establishing a fairly-worded contract instead of a one-sided contract.
- "Pay-if-paid" or conditional payment provisions mean if the Builder is not paid by a project owner, the CM is not entitled to be paid.
- You are likely to see many lengthy insurance requirement provisions in most Builder contract forms.

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and never hear about the project again." Now assume there is a nasty dispute. Guess what, with this type of provision, the Builder decides whether to arbitrate or litigate the dispute. If the Builder chooses litigation, it might be because they know the judge(s) as the lawsuit will be decided by the judge and NOT a jury. Plus, the Builder gets absolute home field advantage whether there is arbitration or litigation.

Our firm recently became involved in a hotly contested arbitration in Florida where the Builder's contract provided, before it was reviewed, revised and signed by the CM, that the Builder had the choice to litigate or arbitrate and if it chose litigation, the trial was to be held in an obscure Florida county where the lawyer for the Builder officed. Plus, there was a waiver of all rights to a jury. You can guess what the outcome of that dispute would have been had we not obtained through contract negotiation the right to arbitrate in the city of the largest population in Florida.

6. INDEMNITY

Supplier agrees to indemnify, defend and hold harmless Builder from and against all claims, damages, losses and expenses including, but not limited to, attorneys' fees arising out of or resulting from the materials or the performance of the Supplier's Work under this Agreement, provided that any such claim, damage, loss or expense (i) is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property, including the loss of use resulting therefrom, and (ii) is caused in whole or in part by any negligent act or omission of the Supplier, anyone employed by Supplier or anyone for whose acts the Supplier may be liable, regardless of whether or not it is caused in part by a party indemnified hereunder. Such obligation shall not be construed to negate, abridge or otherwise reduce any other right or obligation of indemnity which would otherwise exist as to any party or person described in this paragraph. With respect to any claim resulting from injury or loss to an employee of Supplier, Supplier agrees to indemnify and hold harmless Builder from the entire amount of such claim, including liability for injury or loss caused by the negligent acts or omissions of Builder which result in harm to such employee (unless Builder was solely negligent) and Supplier hereby expressly waives any provision of any applicable workmen's compensation act which would otherwise provide to Supplier immunity from such indemnity.

Ah, my favorite—the indemnity clause. With this type of language, the Supplier is assuming a great deal of risk. Imagine selling roof trusses. I know sales are down dramatically, but just humor me. The Builder hires its own installer. A person is injured on the jobsite. The person injured was climbing through the roof trusses using the webs as a ladder and a web pulled away laterally from the truss, causing the person to fall to the ground. His injuries resulted from the fall. The injured person sues only the Builder for his injuries and claims the Builder allowed and even encouraged that the trusses be used by jobsite laborers this way. If the Supplier agreed to this type of indemnity provision, the Builder would demand that the manufacturer defend the Builder from the lawsuit and pay whatever sums are required to resolve the lawsuit. If the manufacturer refuses, the Builder would file its own lawsuit against the manufacturer. This is the case even though the manufacturer is without fault as the trusses were being used for other than their intended purpose. Truss webs are clearly not designed for this kind of lateral force. By agreeing to the indemnification provision the manufacturer now becomes directly involved in defending and resolving the injured person's lawsuit filed against the Builder. In fact the builder may be the only party at fault and may be 99% responsible for allowing and encouraging the trusses to be used in the manner that leads to the fall and injury. Nevertheless because of agreeing to the broad indemnification provision, the manufacturer now essentially becomes the responsible party instead of the Builder.

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7. INSURANCE REQUIREMENTS

Supplier agrees to carry and provide Builder with an insurance certificate setting forth Commercial General Liability coverage of not less than:

Each Occurrence: $1,000,000
Products/Completed Operations Aggregate: $2,000,000
General Aggregate Per Project: $2,000,000

The Commercial General Liability policy must include:

- ***An Additional Insured Endorsement (equivalent to ISO form CG 20 10 11 85) naming Builder as additional insured and shall be endorsed to be primary and non-contributory to any insurance which may be maintained by or on behalf of Supplier. In addition, Commercial General Liability Insurance Coverage, including additional insured coverage for Builder, shall be maintained in force until expiration of the applicable statute of limitations for claims related to latent defects and construction improvements for real estate.***
- ***Supplier warrants that the design and engineering of its product is covered by Commercial General Liability insurance.***
- ***Supplier agrees to carry and provide Builder with an insurance certificate setting forth Professional Liability insurance in the amount of $1,000,000 for each occurrence.***

Let me count the ways that this insurance requirements provision is problematic, and keep in mind this is only part of what you will typically see in terms of insurance requirements in most Builder customer contract forms. First, the language that the Supplier will maintain "General Aggregate Per Project" limits under its Commercial General Liability (CGL) policy, a provision we are seeing more and more, is bad news as CMs don't have this type of coverage. The others relate to the type of additional insured endorsement that is required and the length of time the Supplier will maintain such additional insured coverage. Last, warranting that the design and engineering of its products is covered by the CGL policy is dangerous as I wrote in an SBC article published in Jan/Feb 2008. Similarly, most Suppliers do not carry Professional Liability insurance and to agree to do so in a contract could lead to a breach of contract claim.

My intent is not to scare you. Rather, I hope to empower you to be watchful of these provisions the next time you have a 25+ page contract in front of you. Being aware of the big, bad seven is a step toward establishing a fairly-worded contract instead of a one-sided contract. SBC

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You've read why certain contract clauses should be eliminated before you sign on the dotted line, but where should you start? Brush up on the goal of contract negotiating and learn effective negotiation techniques with *O*Risk, WTCA's online risk management course.

Twenty modules within *O*Risk take you through the process of when, why and how to negotiate potentially dangerous contract provisions (like those presented in the article). *O*Risk is designed to help component manufacturers approach the negotiation process from a position of fairness for all parties involved. This approach is important for ensuring that the risk assumed by your company is minimized.

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