

Avoiding Unenforceable Terms in Construction Contracts





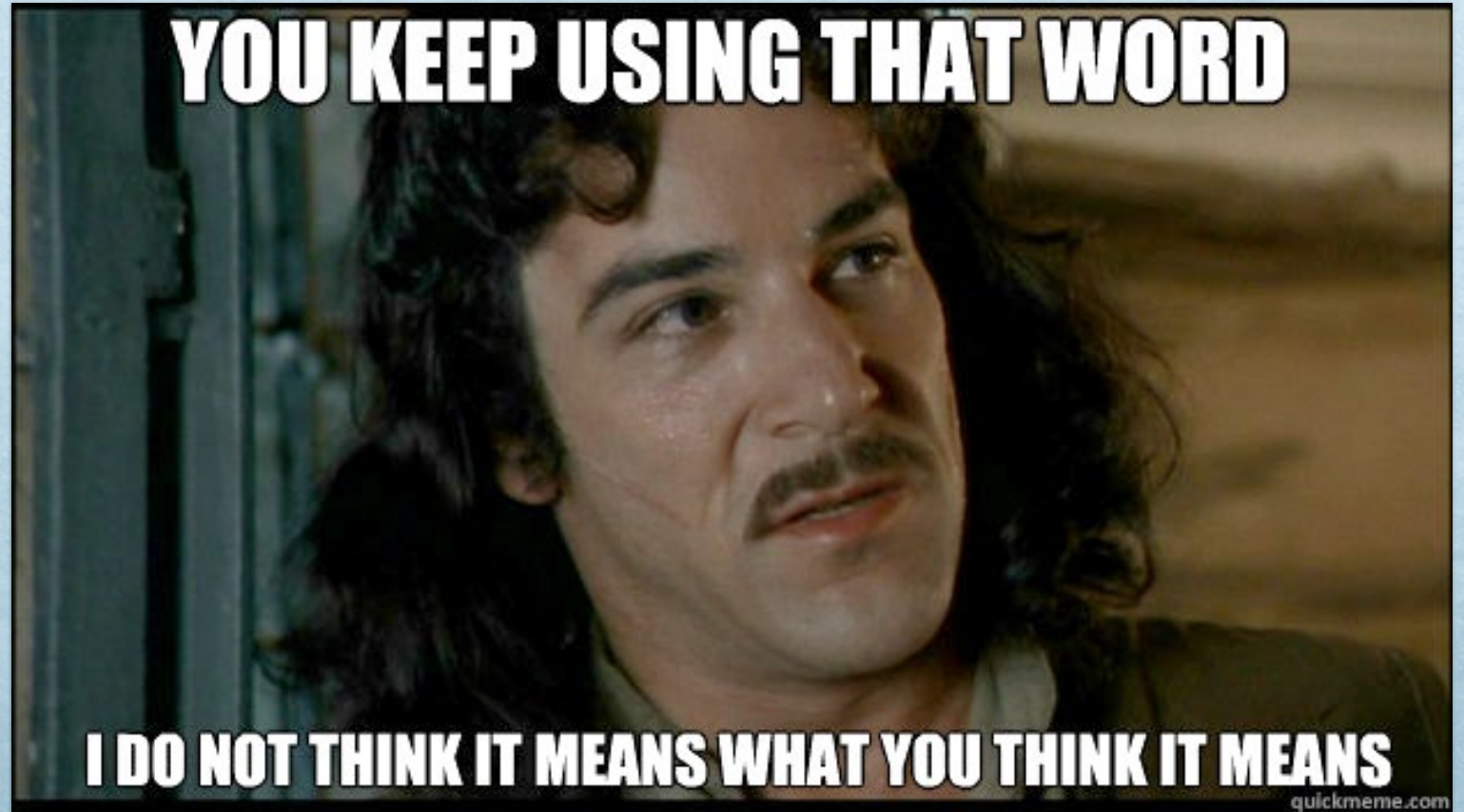
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The Import of Proper Word Choice



What Makes A Contract Provision “Unenforceable”?

- ❑ Explicitly Prohibited by Statute;
- ❑ Found to be void/unenforceable by case law; or
- ❑ Enforcement is impractical or not cost effective



The “Usual Suspects” of Unenforceable Provisions:

1. Mechanics Lien Rights and Limitations
2. Penalty Provisions
3. Defense and Indemnity Overreach
4. Forum Selection Clauses
5. Pay-If-Paid Clauses
6. Delegation of ADA Compliance Liability
7. Retention Issues



Mechanics Lien Rights & Limitations



Mechanics Lien Rights & Limitations

- ◆ “No Lien Clause” = Waiver of Contractor’s Mechanics Lien Rights

Typically Unenforceable Language:

“Subcontractor waives and releases any and all rights to assert liens or other security rights against the Owner or the Property for amounts Subcontractor or its sub-subcontractors or suppliers claim to be due.”



Mechanics Lien Rights & Limitations

- ◇ Waiver of lien rights are explicitly unenforceable in most states, including:
 - ◇ Illinois
 - ◇ Indiana
 - ◇ Michigan
 - ◇ Minnesota

- ◇ Only 2 states explicitly allow “No Lien” Clauses:
Colorado & Nebraska



Unenforceable Penalty Provisions



Unenforceable Penalty Provisions

- ◆ Liquidated Damages as a Penalty
- ◆ Liquidated Damages + Actual Damages
- ◆ Penalties for Contractor changes in “Key Personnel”
- ◆ “No Damages for Delay” Clauses



Liquidated Damages as a Penalty

- ❖ LDs are intended to avoid costly litigation to determine damages in the event of a breach or delay on a project.
- ❖ Typically, LDs are calculated at daily rate terminating at substantial completion.
- ❖ LDs are enforceable if:
 - 1) actual damages are difficult or impossible to calculate with certainty
 - 2) the amount of LDs is reasonable with respect to anticipated harm.



Liquidated Damages as a Penalty

- ❖ LD language defining itself as a “penalty” is likely unenforceable
- ❖ LDs that far exceed any reasonable calculation of actual damages are likely unenforceable
- ❖ Contract Negotiation Tip:
 - 1) Ask Owner to explain/calculate how LDs were arrived at
 - 2) Use Owner calculations as a basis to negotiate
 - 3) Try to negotiate early completion bonus



Liquidated Damages + Actual Damages

- ❖ Construction Contract Should “pick your poison”:
- ❖ Owner should not get an option to change from LDs to actual damage
- ❖ Owner should not get both actual damages and LDs



“No Damages for Delay” Clauses



4 — DELAY OF GAME



“No Damages for Delay” Clauses

- ◆ Some states explicitly prohibit these types of clauses
- ◆ Washington (RCW 4.24.360) provides:
 - ◆ Any clause in a construction contract...which purports to waive...the rights of a contractor... to damages...arising out of unreasonable delay...caused by...the contractee...is against public policy and is void and unenforceable.”



“No Damages for Delay” Clauses

- ◆ Similar statutes exist in several states:
 - ◆ Arizona
 - ◆ Oregon
 - ◆ California (public projects)
 - ◆ Minnesota
 - ◆ Colorado
 - ◆ Virginia
 - ◆ Louisiana



Defense and Indemnity Overreach



Defense and Indemnity Overreach

- ◆ Typically, Owners want to allocate all construction risks to Contractor
- ◆ Applicable to personal injuries and property damage arising on a project
- ◆ More and more indemnity provisions are covering breach of contract damages, delays and defective work



Defense and Indemnity Overreach

- ◆ Typically, courts will enforce indemnity for the indemnitor's fault
- ◆ In cases of mixed fault, majority rule favors proportionate indemnity
- ◆ Majority rule denies enforcement of clause requiring indemnity against another party's fault



Defense and Indemnity Overreach

State-Specific Considerations:

- ❖ Wisconsin: a contractor/subcontractor can be compelled to indemnify an indemnitee even if the indemnitee is at fault.
- ❖ Illinois: A contractor/subcontractor cannot be compelled to indemnify an indemnitee if the indemnitee is solely at fault.



Defense and Indemnity Overreach

◆ Key Considerations:

- ◆ Duty to indemnify for indemnitor's own fault?
- ◆ Duty to indemnify for parties' mixed or concurrent fault?
- ◆ Duty to indemnify for other party's sole fault?
- ◆ Duty to defend, regardless of fault



Defense and Indemnity Overreach

- ◆ State laws can vary significantly
- ◆ Duties to indemnify and defend are separate contractual obligations
- ◆ It's desirable to have clarity on who will step in to defend third party claims



Defense and Indemnity Overreach

Contract Drafting Tip – Proposed Edits:

Subcontractor's indemnity obligation hereunder does not include any claims, demands, judgments, suits, actions, expenses, losses and liabilities, including costs and attorney's fees, which are caused by the negligent acts or omissions, gross negligence or willful misconduct of General Contractor, Architect, Owner or their agents, consultants or employees. Subcontractor's indemnification obligations are limited to this Contract, and shall not assume or incorporate any indemnification obligations contained elsewhere in the Contract Documents.



Forum Selection Clauses



Forum Selection Clauses

- ◊ Most states require that a litigation dispute involving a construction project in the state must be in the court of that state
- ◊ Typical statutory language: “Provisions making the contract subject to laws of another state or requiring litigation, arbitration or other dispute resolution process on the contract to occur in another state....”
 - ◊ IL: 816 ILCS 665/10
 - ◊ IA: ICA § 537A.6
 - ◊ WI: Wisc. Stat. Ann. §779.135(2)
 - ◊ IN: Ind. Code §32-28-3-17
 - ◊ MN: Minn. Stat. §337.10(1)



Pay-if-Paid Provisions



Pay-if-Paid Provisions

- ❖ Contractor's obligation to make a payment to Subcontractor is conditioned upon first receiving the corresponding payment from Owner, the receipt of which is a condition precedent to Contractor's obligation to make payment to Subcontractor.



Pay-if-Paid Provisions

The only way “Pay-If-Paid” is enforceable in Illinois:

- 1) contract contains specific language that plainly and unambiguously establishes that payment by Owner is a condition precedent to contractor’s obligation to pay downstream Subcontractors; and
- 2) contract contains clear language that Subcontractor intends to assume the risk of non-payment by Contractor.

Beal Bank Nevada v. Northshore Center 2016 Ill. App. 1st 151697 (2016)



Pay-if-Paid Provisions

State-Specific Considerations for Public Projects:

- ◊ IL and WI: “pay-if-paid” clauses are allowed
- ◊ MI, IN and IA: “pay-if-paid clauses are not allowed



Pay-if-Paid Provisions

State-Specific Considerations for Private Projects:

- ◊ IL, WI and IN: “pay-if-paid” clauses are allowed
- ◊ MI and IA: “pay-if-paid clauses are not allowed



Delegation of ADA Compliance Liability

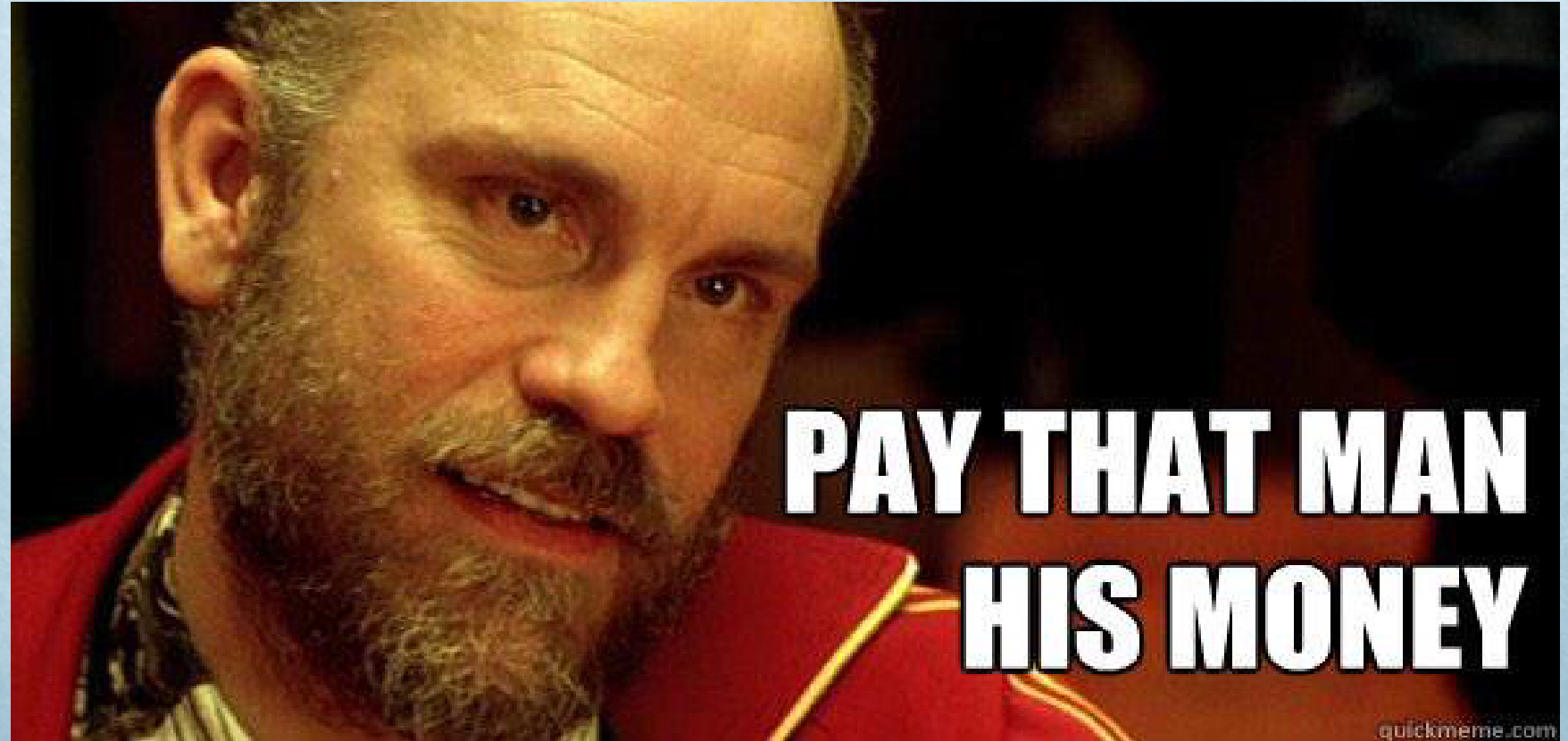


Delegation of ADA Compliance Liability

- ❖ Owner's duty to comply with ADA accessibility requirements cannot be delegated to a design professional or contractor
 - ❖ Owner cannot place this responsibility on another through contract
- ❖ Owner's cannot insulate themselves from liability by requiring design or construction of a project that complies with ADA accessibility standards.
- ❖ If Owners get sued, they do not have recourse against its design team or contractor for indemnity or contribution.



Retention Issues



Retention Issues

New City of Chicago Ordinance (effective 8/25/17):

- ◆ Eliminates withholding of retainage from prime contractors on most City projects and prohibits prime contractor retainage downstream. *See Chapter 2-92-250 of Municipal Code, Ordinance 2017-3858*
- ◆ Also, look out for proposed IL legislation known as “Illinois Contractor Prompt Payment Act”
 - ◆ 10% retention until 50% complete; 5% thereafter
 - ◆ Vetoed by Governor Rauner but will likely be re-introduced



Retention Issues

- ◆ Key Considerations and Action Items:
 - ◆ Check your prime contracts with City of Chicago
 - ◆ Review downstream contracts for boilerplate retention language that may not be enforceable



Retention Issues

Other Relevant State Statutes:

◆ Wisconsin (public projects):

- ◆ State may retain no more than 5% until 50% completion and 0% after unless progress is not satisfactory. If progress is unsatisfactory, State may retain up to 10%.

Wis. Stat. § 16.855

◆ Indiana (public projects):

- ◆ State may retain up to 6% until 50% completion; or
- ◆ State may retain up to 3% until substantial completion, and 200% of value of unfinished items at point of substantial completion.

Ind. Code §§ 4-13.6-7-2 to 4-13.6-7-3

