**Construction and Design Law: Managing the Network of Interdependent Relationships**

Carl J. Circo

**Lesson 6: Subcontractors and Suppliers**

For most construction projects, the primary builder (commonly called the “general contractor”) retains subcontractors and suppliers to provide much (often most or even nearly all) the work and services required to construct the project. In turn, subcontractors and suppliers who contract directly with the general contractor often retain others to perform some work, provide certain services, and manufacture, supply, or install special materials and equipment. Indeed, most projects involve multiple tiers of subcontractors and suppliers. Although the law governing these relationships is generally consistent for both subcontractors and suppliers throughout all tiers, if a contract with either a subcontractor or a supplier is primarily for the sale of goods rather than for the performance of services, then a court should apply Article 2 of the Uniform Commercial Code, which favors standards and guiding principles that can be somewhat more flexible than the common law of contracts. See Charles W. Surasky & John S. Tobey, *The Application of the U.C.C*. *to a Contractor’s Relationship with its Suppliers*, 29 Constr. Law. 35 (Fall 2009).

Subcontractors and suppliers share many of the general contractor’s perspectives, concerns, and goals, such as establishing a clear definition of the scope of their work and services, managing changing circumstances, securing or confirming appropriate insurance coverages, and maintaining payment protections. Their circumstances, however, complicate some of these matters and involve others as well. For example, because subcontractors and suppliers normally have no contracts with the project owner or the project architect or engineer, they must rely on their own contracting partner to some extent concerning those relationships.

In previous lessons, you encountered the AIA’s general conditions for a design-bid-build project, A201. This document is “general” in more than the sense that it provides general terms and conditions of the primary construction contract. Under the AIA approach, A201 is also incorporated by reference into most of the general contractor’s subcontracts. Additionally, A201 includes detailed provisions concerning the general contractor’s obligation to pay subcontractors. Read Article 5 and section 9.6 of A201, which address these matters.

Article 5 defines “Subcontractor” broadly enough to include suppliers having direct contracts with the general contractor to perform work on the project site, and it also addresses “Sub-subcontractors” who perform on-site work. Note how section 5.2 involves the owner and the owner’s architect in the general contractor’s award of contracts to subcontractors and suppliers. One of the most significant provisions of Article 5 is section 5.3, which requires the general contractor to bind each direct subcontractor to the terms of the “Contract Documents” for the project to the extent relevant to the work or services under the subcontract, thereby incorporating A201 into each subcontract to that extent. Projects not using AIA documents often rely on similar clauses, commonly referred to as flow-down provisions (as to the subcontractor’s obligations) and flow-up provisions (as to the subcontractor’s rights). While broadly stated flow-down and flow-up features reflect the logical objective of maintaining consistency in terms governing the work, courts and arbitrators sometimes must determine whether or precisely how a contractual obligation or right passes to a subcontractor or supplier. See Phillip L. Bruner & Patrick J. O’Connor, Jr., 2 *Bruner & O’Connor on Construction Law*, § 5:137 (Westlaw Aug. 2023).

Section 5.4 operates as the general contractor’s conditional assignment to the owner of each subcontractor. The condition that triggers this assignment is the owner’s termination of the general contractor. This provision, in effect, allows the owner to take over subcontract relationships upon the occurrence of the general contractor’s material default.

Turning now to section 9.6 of A201 (Progress Payments), note that this section governs the entire process of periodic payments as construction progresses. The purpose of several of its subsections is to help assure that the general contractor makes timely payments to subcontractors and suppliers. Those provisions protect the owner against problems that arise when bills are not being paid, especially the risk that subcontractors and suppliers may enforce applicable construction lien rights against the project to secure payment. At the same time, they address some important concerns that subcontractors and suppliers have relating to payment.

With this background in mind, read *A Subcontractor’s View of Construction Contracts*, 8 Constr. Law. 1 (Jan. 1988), by Stanley P. Sklar. This discussion, written many years ago, paints a popular picture of the subcontractor’s plight and highlights topics that continue to be among the most important for lawyers advising subcontractors. As the article indicates, in many situations, subcontractors operate in a highly competitive environment in which they have relatively little opportunity to negotiate contract terms. Of course, major subcontracting firms will have more bargaining leverage, as will firms that provide the most specialized work, services, and materials. In any event, the topics discussed in this article provide a good checklist and starting point for a lawyer reviewing a contract for a subcontractor. Although the article’s references to specific industry documents are now outdated, the substantive points it makes remain significant under contemporary industry contract forms and practices. Indeed, over the years, contingent payment provisions, no damage for delay clauses, and delegation of design responsibilities have become increasingly more important from the subcontractor’s perspective.

Conditional payment provisions, commonly characterized as either pay-when-paid or pay-if-paid clauses, deserve special mention because the courts continue to debate and refine both how to interpret these clauses and the extent to which public policy considerations should limit their enforceability. The distinction between the two types turns on whether the provision means that the general contractor’s obligation to pay the subcontractor becomes due only *when* the owner makes the corresponding payment to the general contractor, which arguably gives the general contract no more than a right to delay payment for a reasonable time, or only *if* the owner makes the payment, such that the general contractor may have a complete defense if the owner never pays the amount in dispute. See Phillip L. Bruner & Patrick J. O’Connor, Jr., 3 *Bruner & O’Connor on Construction Law*, §§ 8:54-8:57 (Westlaw Aug. 2023).

A sampling of cases

Lawyers representing subcontractors must be prepared to address all the issues mentioned so far, along with others. To conclude this overview, read the following cases.

* Drennan v. Star Paving Co., 333 P.2d 757 (Cal. 1958).

This seminal case, written by a renowned Justice of the California Supreme Court, announced an expansive view of the promissory estoppel doctrine. In holding a subcontractor bound to honor a theoretically revocable bid on the basis that the general contractor reasonably and detrimentally relied on the bid, the opinion established a classic application of an exception to contract law’s offer and acceptance doctrine. Most important for our purposes is the highly contextual judicial analysis by which the court used specific features of competitive bidding practices in the construction industry to justify the result. While courts often apply the promissory estoppel theory in similar circumstances to deny bidders the right to withdraw a bid that has not been formally accepted, each case must be analyzed on its specific facts, especially concerning the reasonable and detrimental reliance factors. See C.G. Schmidt, Inc. v. Permasteelisa North America, 825 F.3d 801 (7th Cir. 2016) (holding for the subcontractor where the evidence showed the parties engaged in extended negotiations after the subcontractor submitted its bid).

* Associated Mech. Contractors, Inc. v. Martin K. Eby Constr. Co., 271 F.3d 1309 (11th Cir. 2001).

This case, which covers several issues that often arise in disputes between general contractors and subcontractors, is especially important for its consideration of the subcontract’s procedural requirements governing the subcontractor’s claims for delay damages and for release of retainage. The court’s detailed analysis of the subcontract’s terms, including its flow-down clause, and of the evidence relating to when the relevant delaying events may have occurred, demonstrate how important it can be for the contracting parties to follow contractual claims procedures precisely.

* Rich & Whillock, Inc. v. Ashton Dev. Inc., 157 Cal. App. 3d 1154 (Cal. Ct. App. 1984).

In addition to highlighting an interesting question about negotiating ethics, this case demonstrates how, in the most extreme circumstances, the economic duress theory might protect a subcontractor when the general contractor takes unfair advantage of its superior bargaining power. Subcontractors cannot, however, take much comfort from the result because strong evidence persuaded the court that the general contractor’s behavior went so far beyond hard bargaining that it constituted bad faith.

For Review and Discussion

1. Review section 3.1 of ConsensusDocs 755, *Standard Master Subcontract Agreement Between Constructor and Subcontractor* (2019), reproduced below. How does section 3.1 compare to section 5.3 of AIA 201?

3.1 OBLIGATIONS. The Parties are mutually bound by the terms of this MSA. To the extent the terms of the prime agreement apply to the Subcontract Work, then Constructor assumes toward Subcontractor all the obligations, rights, duties, and redress that Owner under the applicable prime agreement assumes toward Constructor. In an identical way, Subcontractor hereby assumes toward Constructor all the same obligations, rights, duties, and redress that Constructor assumes toward Owner and Design Professional under the prime agreement.

1. Does section 5.4 of A201 provide any valuable protection or assurance to the owner’s construction lender?
2. Assume that a lawyer represents the general contractor throughout its dealings with the subcontractor as described in *Rich & Whillock, Inc. v. Ashton Dev. Inc.* What principles of professional responsibility do you believe that representation would implicate?