Onerous Contract Clauses

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Introduction

- Onerous subcontract clauses are becoming more and more common in construction contracts.
- These clauses are designed to shift responsibility and / or liability to a contracting party that may not be able to bear the risk of this shift.
- However, it is open to the parties to a subcontract to reduce their agreement to writing in order to establish with specificity and beyond doubt just what the terms of the contract are.

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Introduction

- In reducing the agreement to writing, the parties are free to distribute risk as they see fit, even if such distribution is unfair or contrary to custom or practice in the industry.
- There is no need for a party presenting a document to bring an onerous clause to the attention of the signing party or advise the other party to read the document.
- The court will assume that the party signing the contract intends to be bound by all terms of the contract.

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Topics For Discussion

- Case Study
- Examples of Onerous Clauses:
  - performance based default;
  - pay-when-paid;
  - notice;
  - flow through.
- Conclusion

Overall Court Approach

- The British Columbia Court of Appeal's to interpreting onerous clauses in construction contracts:

> …[T]he answer lies not in judicial intervention in commercial dealings like this but in the industry's response to all-encompassing exclusion clauses. If the major contractors refuse to bid on highway jobs because of the damage to the tendering process, the Ministry's approach may change. Or, the industry may be prepared to accept that the Ministry wants to avoid suits for contract A violations, and the contractors will continue to bid in the hope that the Ministry acts in good faith.

Case Study

Greater Vancouver Water District v. North American Pipe & Steel Ltd., 2012 BCCA 337

- This appeal considered the implications of a contractual warranty that piping supplied by a supplier for a construction project would "conform to all applicable specifications" and a warranty and guarantee that the goods were "free from all defects arising at any time from faulty design".
- The design for the piping was provided by the owner to the supplier.
- The piping supplied was in accordance with the specifications of the owner and in conformity with the owner supplied design.

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Case Study

- However, the pipes contained defects arising from the owner's faulty design. The supplier was liable for the owner's faulty design.
- The Court of Appeal held:
- Clauses in contracts are designed to distribute risk.
- Sometimes the distribution of risk appears unfair, but that is a matter for the marketplace, not the courts.
- Contractors may refuse to bid or, if they do, may build in costly contingencies when faced with an unfair distribution of risk, but that is their choice.
- Those who do not protect themselves from potential risk may pay dearly.

Performance Based Default Clause

- Typically, a subcontractor will be in default of a subcontract where it has breached the terms of the subcontract or has been negligent (i.e. fault based default).
- Performance based default clauses are designed to place a subcontractor in default based on the work being performed, and not based on the subcontractor being negligent or breaching the subcontract.

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Performance Based Default Clause

- Examples of performance based default clauses are:

"In the event that Subcontractor at any time fails in any respect to properly and diligently perform the Subcontract Work."

"If, in the opinion of Contractor, Subcontractor falls behind in the progress of the Subcontract Work, Contractor may direct Subcontractor to take such steps as Contractor deems necessary to accelerate the Subcontract Work, at Subcontractor's expense."

Performance Based Default Clause

- Make default tied to fault based criteria (e.g. negligent act or omission or breach of subcontract).
- Make default criteria mutual meaning that if either party does not “perform” it is in default of the subcontract.
- Tie “performance” back to the other party first fulfilling all of its contractual obligations relevant to the “performance” obligation.
- Ensure there is a contractual default clause dealing with both parties (it is becoming more and more common that the party drafting the contract (i.e. the contractor) does not insert a clause relating to its default).

Pay-When-Paid Clause

- This type of clause makes payment by the owner to the general contractor a condition precedent for payment to a subcontractor.
- Risk of non-payment by owner then falls on the subcontractor, who usually has few means of compelling payment by the owner.
- Canadian courts have upheld pay-when-paid clauses provided the wording is sufficiently clear and unambiguous.

Pay-When-Paid Clause

- An example of a pay when paid clause held to be enforceable is:

"It shall be a condition precedent to the payment by the Contractor to the Subcontractor of any monies due under the Subcontract that the Contractor shall first have received payment in full from the Owner ... unless the non-payment by the Owner shall be due to the fault or neglect of the Contractor. ... The Subcontractor acknowledges that it shall bear the risk of bankruptcy, insolvency or default in payment by the Owner pursuant to the terms of the Prime Contract."

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Pay-When-Paid Clause

- Tie payment to submission of a proper invoice and reasonable length of time.
- Modify the pay-when-paid clause pursuant to which:
- the contractor is excused from paying the subcontractor for an agreed duration where the owner has not paid the contractor;
- contractor has placed the owner in default under the prime contract; and
- contractor suspends performance of the prime contract until payment is made.

Notice Clause

- The purpose of notice clauses, for delay, claims or otherwise, is generally to enable a party to consider a claim and its financial consequences, and take measures to protect its own position, including such things as information gathering and mitigating steps.
- Some notice clauses are drafted in such a manner so as to make it difficult, if not impossible, for the subcontractor to meet the notice requirements.
- Notice clauses are generally interpreted as containing a “failing which” consequence meaning that if the subcontractor misses a notice period it losses its claim.

Notice Clause

- An example of an onerous notice clause is:

"Subcontractor shall give written notice of a delay no later than five (5) Working Days from the date such delay is first experienced or two Working Days shorter than any similar notice required under the Prime Contract. This notice shall specify: … . Submission of this notice containing all of the foregoing elements shall be a condition precedent to Subcontractor's right to receive an extension of the Subcontract Time and/or adjustment to the Subcontract Price."

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Notice Clause

- Increase the duration of the notice requirement.
- Do not tie the notice period to notice under the prime contract.
- Tie the consequences for failure to give notice as specified to a reduction in the extension and / or costs recoverable based on the prejudice actually suffered by the Contractor due to incomplete or untimely notice.

Flow Through Clauses

- It is not uncommon for a general contractor to want the terms and conditions found in the prime contract to be incorporated into its subcontract with a subcontractor.
- The incorporation of such documents into a subcontract ensures that the subcontractor's obligations to the general contractor with respect to the subcontract work will correspond with the general contractor’s obligations to the owner.
- However, not all flow through clauses are created equally.

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Flow Through Clauses

- An example of an onerous flow through clause is:

"The parties acknowledge their mutual intent, and hereby agree that all obligations and liabilities of Contractor arising under the Prime Contract in relation to the performance of the Subcontract Work be assumed, performed and discharged by Subcontractor under this Subcontract. The Prime Contract is incorporated into this Subcontract by reference, with the same force and effect as if the same were set forth herein, and Subcontractor and its subcontractors and suppliers (the "Sub-subcontractors") will be and are bound by any and all of said Prime Contract insofar as they relate in any part or in any way, directly or indirectly, to the Subcontract Work."

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Flow Through Clauses

- Get a copy of the prime contract documents prior to agreeing to a flow through clause so that the subcontractor knows what additional obligations are being agreed to.
- Modify the flow through clause to expressly state which specific obligations are being flowed down to the subcontractor other than those dealing directly with the subcontract work.
- Have the terms of the subcontract take precedence over the terms of the prime contract where there is inconsistency.

Conclusion

- As the Supreme Court of Canada has written:

> The construction industry in British Columbia is run by knowledgeable and sophisticated people who bid upon and enter … contracts with eyes wide open. … So long as contractors are willing to bid on such terms, I do not think it is the court's job to rescue them from the consequences of their decision to do so.

Conclusion

- The courts will not save you from an unfair contract. You may have:
  - needed the work;
  - been told that the written contract was just a formality; or
  - simply not read the contract.

- Regardless, you will be stuck with your contract, no matter how unfair it is.

Conclusion

- Read and understand your subcontract.
- Identify the risks.
- Price the risks, if possible.
- Review standard form contracts (e.g. CCDC / CCA) as examples of what is generally considered “fair” in the industry.
- Negotiate.
- Understand the other side and anticipate its position.
- Know your bottom line.

Conclusion

- Point out to the other party that every risk has a price. Besides the quantifiable amount associated with each onerous clause, there are other costs associated with same including:
- the cost of a reduced number of bidders;
- the cost of increased disputes and / or claims;
- the cost of hiring and / or replacing a lower quality subtrade who did not understand the onerous contract (and who's abandoned the job or been terminated);
- the cost of an adversarial working relationship.

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Conclusion

- A fair and equitable distribution of risk in construction contracts leads to more positive overall project performance and outcomes, reduced claims and better working relationships.
- However, depending on the party you are contracting with, a fair and equitable distribution of risk may not be possible.
- Either way, it is up to you to protect your interests.

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