

MABX ABOUT CONTACT US WEEKLY UPDATE SHARE



Industry News Business Technology Opinion MABX News Multimedia

Understanding Critical Pass-Through Provisions for Subcontractor Claims

MABX NOVEMBER 20, 2013 0

By: Timothy J. Woolford, Esquire

An increasingly common provision found in subcontract agreements is often referred to as a pass-through liquidating clause. In essence, it is a pay-if-paid clause for changes and extras. Basically, it provides that the general contractor ("GC") will "pass through" the subcontractor's claim to the owner. The subcontractor agrees to be bound by the owner's determination. The goal of the GC is to limit the subcontractor's recovery to the amount the GC recovers from the owner. The level of detail and wording of these types of pass-through clauses can vary tremendously and the language is extremely important. A typical subcontract clause providing for pass-through claims and liquidating, or limiting, them to the amount the GC recovers from the owner, would provide as follows:



In the event Subcontractor asserts a claim and in the event that Contractor in its sole, exclusive and arbitrary discretion submits said Claim to Owner for a decision or determination, then all determinations made by Owner shall be binding upon Subcontractor even though Subcontractor may not be a party thereto. The determination of Owner making the first and/or original decision shall be final and conclusive on Subcontractor except to the extent that Contractor may in its sole, exclusive and arbitrary discretion appeal or commence a proceeding in Court or arbitration or other dispute resolution forum. Then, in such event, Subcontractor agrees to be bound to Contractor to the same extent Contractor is bound to Owner by any final decisions of said other representative of Owner or of a Court of competent jurisdiction or by any final or interim award issued in arbitration or by any final decisions issued in any other dispute resolution forum.

These clauses pose considerable risk for subcontractors. They put the resolution of the claim outside the subcontractor's control. Under the clause above, the subcontractor is bound by the owner's decision even though it never had an opportunity to present the claim itself and may not have ever met with the owner.

Further, the language of the clause is such that the GC can accept the owner's "first and original" decision and that decision is "final and conclusive" on the subcontractor. The risk for the subcontractor is that the GC might not pursue payment of the claim aggressively. The owner's "first and original" position on a change order request is rarely acceptable since owners are usually resistant to extra costs. There are often many volleys back and forth before the owner acknowledges the true cost impact of changes. Thus, being bound by the owner's first and original position may only net the subcontractor pennies on the dollar, if anything at all. Another concern for a subcontractor is that the GC might make a deal with the owner in which it agrees to a low amount on the subcontractor's change order in return for the owner's approval on changes in which the GC has a greater financial stake. Also, some changes are not the type for which the owner would ordinarily be responsible so there is little chance that the owner would pay for them. For example, if a subcontractor had to work overtime because the GC did not have a work area ready earlier in the week, the subcontractor may seek compensation for that overtime. The owner would not be responsible for the GC's failure to coordinate or to provide access, so the owner would not obviously approve the change order. Under the language above, the subcontractor would likely be barred from recovering as a result of the owner's failure to pay.

From the GC's perspective, a pass-through liquidating clause prevents the GC from having to finance additional change order costs that the owner has not paid. GCs view themselves as a middleman between the subcontractor and the owner. It is no different from a pay-if-paid clause and requires all parties to share the risk of the owner's payment decisions.

Search here..



subscribe to the Construx construction industry newsletter

Recent Posts

Purchase Orders and Sales Quotations: Don't Be Caught by Surprise!

Featured Construction Project Contract Awards – February 12, 2014

Five Good Ways To Deal With Social Media

Best Practices for Data Management

Featured Construction Project Contract Awards – February 6, 2014

Several courts have been faced with these pass-through provisions in lawsuits in which the subcontractor argued that, despite the liquidating language, it was not bound by the owner’s determination. The subcontractors argued in those cases that the GC could not rely on the liquidating clause to deny the subcontractor’s change order. Courts have ruled that a GC does not always have the unfettered right to limit the subcontractor’s recovery to the amount paid by the owner. In order to rely upon the liquidating provision, courts have ruled that the GC *must act in good faith* in presenting and pursuing the subcontractor’s claim. If it fails to do so, it cannot refuse or limit payment to the subcontractor based on the contract provision conditioning the subcontractor’s right to payment on the owner’s decision on the claim or change.

One Pennsylvania case, *Quinn Construction v. Skanska USA Buildings*, demonstrates how the GC’s failure to act in good faith with respect to the subcontractor’s claims prevented it from relying upon the clause. The project involved a science building at Penn State. A concrete subcontractor, Quinn Construction, sued the general contractor, Skanska, seeking payment for several change orders. Although Skanska had presented the change orders to the owner, the owner did not pay for them. When closing out the project, Skanska entered into a comprehensive settlement agreement with the owner which did not address certain of Quinn’s change orders. Skanska waived and released all claims against the owner forever foreclosing on the possibility of recovering on Quinn’s changes. When Quinn demanded payment for the change orders, Skanska cited the subcontract provision arguing that because it did not receive payment from the owner on the changes, it had no obligation to pay Quinn.

The court rejected Skanska’s argument and sided with Quinn ruling that Skanska could not rely on the subcontract clause because it had not acted in good faith with respect to the changes. The court ruled that when Skanska entered into a settlement agreement with the owner releasing the owner from further liability, it constituted a breach of its implied duty not to frustrate the fulfillment of condition precedent (owner payment) under the subcontract. The court did not feel that Skanska pursued Quinn’s claim in good faith and that Skanska was responsible for the fact that the owner did not pay the change order claims.

In another case, *Urban Masonry v. N&N Contractors*, a GC subcontracted masonry work to Urban Masonry who then subcontracted the precast concrete panel installation to N&N Contractors. The subcontract contained a liquidating clause stating that Urban had no duty to pay the precast subcontractor until it received payment from GC, Blake Construction. Like Skanska, Urban met with the GC to resolve numerous disputes between them. Urban and Blake agreed to a settlement pursuant to which each agreed to waive any claim against the other arising out of the project. When N&N pursued its claim for additional costs on the precast work against Urban, Urban asserted the “condition precedent” language in the subcontract arguing that since it had not been paid by the GC for the additional costs, it had no obligation to pay N&N. The court rejected this argument and ruled that Urban could not rely on that clause *because it intentionally frustrated fulfillment of the condition*. When Urban entered into the settlement agreement with the GC, it was aware of the subcontractor’s outstanding claims. The court ruled that Urban breached its implied condition not to frustrate fulfillment of the condition precedent. The court would not allow Urban to benefit from the contract provision when its own conduct hindered fulfillment of the condition precedent. The lesson for GCs is that they need to pursue the subcontractor’s claims aggressively and thoroughly in order to be able to enforce the liquidating provision. GCs cannot just accept an unreasonable decision by the owner. It should press the claim in a commercially reasonable, good faith manner.

In response to these decisions, some GCs have attempted to revise their contracts to fend off arguments that they frustrated the condition precedent. They sometimes state that the subcontractor agrees to be bound by the outcome of the GC resolution of the claim with the owner and allows the GC to exercise its sole discretion in resolving the claim. Such language would give the GC a strong argument that it had the absolute right to settle the subcontractor’s claim with the owner for whatever amount it deems appropriate, and the subcontractor agreed to be bound by it. A clause with such wording is very risky to subcontractors. GCs may wish to include language of this type so that they do not have to face an argument that they failed to pursue the claim aggressively and frustrated fulfillment of the condition precedent.

Many subcontractors erroneously believe that pay-if-paid clauses pertain only to progress payments and have no application to changes in extras. This assumption is incorrect in many cases. The resolution of changes can make or break a project. Carefully read the subcontract to make sure you understand how claims for changes and extras will be resolved. If the owner’s decision on the claim is binding, make sure you know all you can about the owner’s reputation and financial position.

About the Author:

Find us on Facebook



Popular Comments Tags

- 

MABX Executive Director to speak at upcoming BIM event
September 25, 2013, No Comments
- 

Senators Continue to Push for Transportation Funding
August 22, 2013, No Comments
- 

Technology & Excellence in Construction – 2013 TEC Summit
August 22, 2013, No Comments



Timothy J. Woolford,
Esquire

Timothy J. Woolford, Esq. is the founding member of [Woolford Law, P.C.](#), a law firm that provides legal services exclusively to the construction, design and real estate development industries.

Like

POSTED IN [Business, Legal](#)

Related [»](#)



Purchase Orders and Sales Quotations: Don't Be Caught by Surprise!



Featured Construction Project Contract Awards – February 12, 2014



Five Good Ways To Deal With Social Media



Best Practices for Data Management

Leave A Response [»](#)

Name (required)

Comment

Email (required)

Website



CAPTCHA Code

Post Comment