

LEGAL ALERT

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CONTRACTING ISSUES FOR 2022

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Contractors learned many lessons from 2020-2022 on material/labor availability, price escalation, and contractual allocations of risk. Prudent contractors will consider this in contracts moving forward.

SHOW ME THE MONEY

Long gone are the days of large projects that are simply private or public. Large projects are multi-layered when it comes to funding. Federal, state, and local funds may be part of the funding for the development, adjacent infrastructure, and nearby improvements. Municipalities are using tax incentives, or forgivable grants, to spur development in their communities.

Contractors need to investigate the source of funds for both potential lien rights and to ensure they understand the project cash flow. Is payment a combination of government funding, company funding, and bank financing? Do upper tier contracts condition payment on release of funds by the lenders and/or government distributions? This requires both contractors to evaluate how long they may be required to perform without payment. Contractors should consider if a “right to stop work” exists relative to delayed payment. If work is suspended or stopped due to payment delays, will the contractor be paid for the delay? Contractors want to ensure such delays are both excusable and compensable.

Understanding the contract/ownership tree is also important to preserve lien rights. Names on contracts may not match actual names of owners. Conversely, owners may be single asset entities to shield the master entity from liability if the project fails. To ensure lien/attested account rights are preserved, contractors’ tiers should evaluate the scope of required Notices of Furnishing and make sure they are served to everyone up the contract chain.

Evaluations must be made of funding sources, including a senior bank mortgage, that have priority over lien claimants. Regardless, even when it appears project equity is limited, liens can still be powerful tools to ensure eventual payment – or at least a seat at the table when litigation or payment discussions ensue. For example, contractors who placed liens on stopped projects, during the 2008-2009 Great Recession, found their phone ringing several years later when the economy improved, projects restarted, and liens needed to be resolved and released.

KEEP YOUR MOUTH SHUT

Contractors involved with the significant projects may see confidentiality provisions in contracts. Confidentiality provisions are becoming more commonplace. Contractors signing contracts with confidentiality provisions must take steps to follow them. It is not simply enough to tell your staff to keep things confidential; instead, the contractor must be proactive to protect information.

Protecting electronic information, including e-mails, in a password-protected database is a critical consideration. Contractors must also investigate their obligations to secure physical copies of documents in a secure manner. Contractors should strictly adhere to contract requirements and, at a minimum, treat confidential information as carefully it protects its most valuable secrets. If contractors fail to do this and information leaks out, contractors may face litigation over the ensuing damages.

Contractors may have to ensure their lower tiers and suppliers follow similar restrictions. Contractors who simply sign and take no action to protect confidential information or trade secrets, do so at their peril.

DO YOU UNDERSTAND ME?

The construction labor shortage is well documented. Ohio contractors are finding more diverse work forces from southern areas, including many native Spanish speakers. Already clients are reporting the need to have Spanish-speaking HR and hiring staff to both attract workers, manage them, and retain them. Non-local workers also incur additional housing and travel costs, and issues such as time for crews to visit their families are a consideration.

Contractor and specialty trades that master the use of available labor will find themselves ahead of those who resist it. With many projects around the state there is risk of cannibalization of workforces from one city in favor of another. Prudent contractors will start recruiting nationally now to ensure adequate workforces.

MATERIAL DELAYS AND PRICE ESCALATION

The impact of delayed materials is evident in many industries, including construction and automotive. The inability to obtain material (including replacement materials) is generally considered a “force majeure” delay, subject to the specific terms of the contract. Owners, contractors, and specialty contractors are getting more sophisticated in allocating these risks in contracts. Consideration must also be given to these delays on third parties. Contract clauses that are clear and consistent are far more likely to be enforced.

For example, if a fundamental piece of material is unavailable due to a supply chain delay, how will it impact the various parties? The responsible contractor will claim a force majeure delay; generally excusable but not compensable. The general contractor will pass this delay up to the owner, also seeking time. But what if the owner cannot tolerate a delay due to manufacturing schedules? If a substitute product is available, who must pay for the additional cost of that material? This should be evaluated and put into the contract.

Finally, there is the obvious risk of material cost escalation. General contractors cannot always lock in the full supply of materials needed at the time of contract, especially where a project is large. Certain contracts are clear – the contracting party owns all the risk of escalated pricing. That forces the contracting party to include a contingency to account for and carry the risk, raising the price. Other contracts include a contingency that is available to parties to account

for some portion of the risk. Still others split the cost of this risk along percentage lines. This should be clearly negotiated in the contract. Inadequate contingencies risk the inability (or unwillingness) to perform by lower tiers, forcing general contractors to supplement and then seek reimbursement; that situation is not ideal – better to negotiate and plan for the risk ahead of time.

IT'S A LOT TO SYNTHESIZE

Contractors and owners need to understand all contract obligations at all levels. Lower tier subcontractors need to have copies of all upper tier contract documents to understand all notice time frames, risk allocations, and the flow of project proceeds. Owners, in turn, want to ensure all upper tier contract requirements are incorporated down to lower tiers.

When we are asked to assist, we create binders with highlighted and tabbed provisions, summaries on key issues, and use that as the primary means to review requirements. Prudent owners, contractors and subcontractors will master these requirements and use them to ensure smooth performance.

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