



Subcontractor's Guide to Decreasing Financial Risks

by Scott Wolfe Jr.

The subcontractor sits in a perilous position on a construction job. Suppliers squeeze the subcontractor on credit terms, retainage cuts deep into profit margins, and general contractors play games to “stay ahead” of payment requests. This leaves subcontractors with a lot of financial risk, which is another way of saying that subcontractors can wind up doing a lot of work, incurring a lot of debt, and not getting paid for it.

Defining Financial Risks and Identifying Common Risks

The simple definition for the term “financial risk” is the possibility of not getting paid on a project. In other words, it’s the possibility of losing money on a project.

Subcontractors know this fear well. They start a construction project and pour tons of resources into getting the work done, and then lose sleep over whether they will get paid the amount due to them.

Getting paid too slowly, getting paid too little, or not getting paid at all present the risk that the subcontractor will lose money. And since the subcontractor puts resources into a project before getting paid, the cost of their capital and the availability of cash throughout the job is a risk in itself.

Here are some common financial risks faced by subcontractors on projects:

Not Getting Retainage Payments — General contractors typically withhold 5 percent to 10 percent of the contract price from all subcontractor payments, and hold this money hostage until the end of a project. By the end of a project a lot could go

wrong, including the insolvency of the owner or the premature termination of the project. This can jeopardize whether the money is available to pay the retainage amount; a risk borne mostly by the subcontractor.

Pay-If-Paid and Pay-When-Paid Provisions — The most famous (and troubling) way that general contractors “shift the risk” of losing money onto subcontractors is through contingent payment provisions; commonly referred to as pay-when-paid or pay-if-paid provisions. The central idea is that subcontractors do the work, pouring resources into a project, and then wait for payment from the general contractor. However, even though the subcontractor is owed the money and did the work, if the general contractor doesn’t get paid (for whatever reason, really), the subcontractor doesn’t get paid. According to the contractual terms, in other words, the risk of non-payment is on the subcontractor.

Payment Abuses — Two years ago, Engineering News-Record columnist Richard Korman wrote an article summarizing a vibrant discussion at that year’s Risk Summit — the discussion was over payments. In “Views on Risks Differ Depending on Where You Are in the Payment Flow Chart,” Korman wrote about both sides of the debate.

For GCs, the challenge was to stay ahead of the subcontractors. Subcontractors complained about payment abuses, stating “we must lead the industry kicking and screaming ... to payment reform.” Those making payments can abuse the payment process, and this is a real financial risk for subcontractors.

Unfair Lien Waiver Practices — When a payment is made on a construction project, it is oftentimes

paired with lien waiver requests. These requests can appear benign and standard, and subcontractors are highly motivated (by cash) to meet the request. Lien waiver language can be very ambiguous and controversial, however, leaving subcontractors with unexpected financial exposure.

Policies and Laws That Protect Subcontractors Against These Risks

When it comes to financial risks, there is good and bad news for subcontractors. The bad news is that subcontractors are in an unfortunate negotiation position. Squeezed from the bottom with credit terms and from the top with delayed payments and unfair tactics, subcontractors must stretch their working capital, forcing them to balance every contractual, legal, and negotiation decision with massive cash needs. Even when the subcontractor is right they must confront the well-known and mostly true adage that “possession is nine-tenths of the law.”

The good news for subcontractors, however, is that their poor position isn’t a secret. Courts and legislatures have known about these leverage problems for hundreds of years, and the general public policy behind most laws protect subcontractors against abusive practices. For subcontractors, the secret is knowing and understanding these protections, and being in a position to use them.

Generally speaking, the policy in America is to protect those who provide labor and materials to a project against non-payment. The further away from the money and leverage you go, the stronger the protections will be. Just think about

PODCAST

ESTABLISHING THE RIGHT TO PAYMENT ASSURANCES

The ASA podcast “Establishing the Right to Payment Assurances” explains why payment assurances are a valuable risk management tool for subcontractors.

“Establishing the Right to Payment Assurances” is free for ASA members and comes with an accompanying white paper, both of which are located in the [members-only section](#) of the ASA Web site (member log-in required).

In the podcast, Eric Travers, Esq., Kegler, Brown, Hill and Ritter, Columbus, Ohio, ASA’s legal counsel, warns that a subcontractor “can do everything correctly on the job and still not get paid.” For example, a subcontractor could negotiate a fair contract, successfully complete a project, finish

on-time and on-budget, but if the project financing suddenly dries up, there’s a strong chance it won’t get paid. To reduce the possibility that this will happen, Travers advises that subcontractors obtain payment assurances.

One of the best ways to ensure that a subcontractor will get paid for its work is by obtaining project financing information before the project. Travers says, “Seeing project financing information at the beginning of the project puts your company in a better position to gain information that you can later use. Early knowledge of project financing arrangements is vital because, as you know, your costs (material, labor, etc.) begin accelerating as soon as you step foot on-site. Asking for project financ-

ing information is one of the most underutilized rights that a subcontractor has,” Travers says.

Even though many owners and upper-tier contractors are hesitant to share project financing information, subcontractors should still request it.

The owner’s project financing arrangements *should* be one of first pieces of information a subcontractor gathers when working on a project. By aggressively pursuing disclosure of project financing information, the subcontractor will greatly improve its chances of getting paid. Through regular communication, the subcontractor can discover potential funding problems early on, and this could literally mean the difference between its survival or going bankrupt.

Documents like the ASA *Addendum to Subcontract (2011)* “set up the contractor’s obligation to provide (financial) disclosure to the subcontractor as a condition precedent to the subcontractor’s performance.” Additionally, the ConsensusDocs forms explicitly obligate the owner to provide the subcontractor with project financing information, upon written request, and also require the owner to give notice of any changes in project financing. The ability to obtain information about project financing after starting work is a key advantage of the ConsensusDocs, over the American Institute of Architect documents.

FASA VIDEO ON-DEMAND

LEARN HOW TO AVOID DANGERS OF RISK TRANSFER

Can you spot contract language that unfairly transfers risks to your subcontracting firm? Don’t be a victim! Learn how to recognize and limit excessive “additional insured” requirements and hold-

harmless contract clauses. Richard Usher, Hill & Usher Insurance and Surety, Phoenix, Ariz., cites case studies and specific clauses. Usher explains why subcontractors need to be on guard against “additional

insured” requirements, which have the same risk transfer effects as broad-form hold-harmless contract clauses, exposing subcontractors to innumerable potential claims unrelated to their work.

“Risk Transfer: Surviving the Circling Sharks”

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all of the protections provided to laborers and corporate employees against non-payment of wages! Analogous protections are available to all subcontractor organizations.

A few examples are:

- Criminalization against contractor misappropriation of funds.
- Retainage restrictions.
- Prompt payment laws.
- Laws invalidating pay-if-paid provisions.
- Laws that mandate lien waiver language.
- Invalidation of waiving lien rights before a project begins.

- Mechanic’s lien and bond claim payment protections.

Subcontractors that survey the legal landscape will find layers of regulations to protect them against non-payment. When they aren’t paid, subcontractors can find themselves entitled to interest, attorney fees, penalties, security rights, and more.

The trick is to know about them and to be in a position to use them.

Best Practices to Decrease Financial Risks

Subcontractors have lots of protections available to them against

financial risks. It’s important that they be in a position to use these protections, however. Following some best practices can help subcontractors avoid losing these protections — and oftentimes, simultaneously losing money they’ve earned.

Keep Lien Rights Alive at All Times — Mechanic’s lien rights are a subcontractor’s north star when it comes to payment protections. These rights were invented more than 200 years ago by Thomas Jefferson and James Madison for the explicit purpose of setting forth an American belief and policy that contractors

should get paid for their work. Subcontractors who stay in control of their lien rights will almost never go unpaid.

Staying in control of lien rights, however, can be a difficult task. These rights vary not only between the states, but also between each project. The rules themselves are convoluted, and extraordinarily technical. It's a best practice for subcontractors to leverage technology products that have been developed to assist them in managing these rights. This way, the rights will always be there, and the subcontractor need not worry about every nook of the lien laws. An example SAAS platform that can help subcontractors stay in control of their lien rights is zlien.com.

Strong Documentation Practices — In the 1992 film "A Few Good Men," Tom Cruise's character famously screamed, "It doesn't matter what I believe. It only matters what I can

prove!" There is nothing about law that is truer than this statement.

In the construction context, there are so many issues and so much communication that transpires across every project. When something goes wrong and parties are squabbling about payment, being able to document a position is usually more important than the truth, or what one party believes is true.

It's a best practice for subcontractors to leverage technology products to keep their documentation and communications in order. An example SAAS platform that can help subcontractors with daily reports, field communications, documentation, and more is fieldlens.com.

Timely Demands Citing Your Rights — When a payment is delayed or a subcontractor is otherwise facing the risk of losing money on a job, it's important for that subcontractor

to act swiftly regarding their rights. Document the situation with a letter that makes the subcontractor's claims and demands, and when possible, cite the specific rights available to the subcontractor. This may include things like prompt pay regulations. Getting these types of matters on paper is the first step to a good documentation of the claim.

Scott Wolfe is CEO of zlien in New Orleans, La., a platform that reduces credit risk and default receivables for contractors and suppliers by giving them control over mechanic's lien and bond claim compliance. Wolfe is a licensed attorney in six states with extensive experience in corporate credit management and collections law, including the use of mechanic's liens, UCC filings and other security instruments to protect and manage receivables. He can be reached at (866) 720-5436, Ext. 700, scott@zlien.com, or [@scottwolfejr](https://twitter.com/scottwolfejr) on Twitter.

ASA EXCELLENCE IN ETHICS AWARDS 2015

ASA will honor selected firms that demonstrate the highest standards of internal and external integrity during an awards ceremony at the ASA annual convention, SUBExcel 2016, March 3-5, 2016, in Miami, Florida.

HELPFUL LINKS

- Watch the Excellence in Ethics Awards [Video](#).
- Download the 2015 Excellence in Ethics Awards [Brochure](#).
- Download the 2015 ASA Excellence in Ethics Awards [Application](#).
- ASA provides useful model documents to help with your submission and your ethics program. View the 2015 Excellence in Ethics Awards [Resource Guide](#).
- Download the 2015 ASA Excellence in Ethics Awards [Timeline](#).

- [ASA's Excellence in Ethics Awards Program Q&A LinkedIn Group](#) — a forum for getting answers to your questions about the award and application process. This

forum includes current award recipients who have been through the application process and are willing to help guide new applicants through their application process.

- Recipients of the 2014 ASA Excellence in Ethics Awards may re-apply for 2015 using the [Re-Certification Form](#).

APPLICATION DEADLINE: DECEMBER 11, 2015

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