

CONSTRUCTION CONTRACT ISSUES

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I. CONTRACT DOCUMENT FAMILIES

AIA A201-1997 – The 1997 edition General Conditions of the Contract for Construction published by the American Institute of Architects

“ . . . frequently adopted by reference into a variety of other agreements, including the Owner-Architect agreements and the Contractor-Subcontractor agreements, to establish a common basis for the primary and secondary relationships on the typical construction project.” (A201-1997, General Information, Purpose)

AGC 200 (2000) – Standard Form of Agreement and General Conditions Between Owner and Contractor (Where the Contract Price is a Lump Sum) published by the Associated General Contractors of America (AGC)

DBIA 535 (1998) – Standard Form of Agreement Between Owner and Design-BUILDER published by the Design Build Institute of America

EJDCA 1910-8 (1990) – Standard General Conditions of the Construction Contract published jointly by the members of the Engineers Joint Contract Documents Committee

CMAA A-3 (2002) – General Conditions of the Construction Contract Between Owner and Contractor published by the Construction Management Association of America, Inc.

AOD 2002GC – The 2002 edition of the Standard Form of Agreement Between Owner and Contractor for a Fixed or Lump-Sum Price published by the Associated Owners and Developers

COAA B-200GC (2000) – Contract for Construction, Chapter 2, Builders Required Services and General Terms and Conditions (General Contractor’s Fixed Price Form) published by the Construction Owners Association of America, Inc.

II. KEY CONTRACT CLAUSES

The Contract Documents

Scope of Work

Payment

Changes in the Work

Limitation of Liability

Warranties and Guarantees of Performance

Terminating Performance

Dispute Resolution

A. The Contract Documents

What documents constitute the agreement?

The AIA A201-1997 provides:

“The *Contract Documents* form the *Contract for Construction*.” (A201-1997, §1.1.2)(emphasis added)

The *Contract Documents* consist of:

The Agreement between Owner and Contractor

Conditions of the Contract (General, Supplementary and other Conditions)

Drawings

Specifications

Addenda issued prior to execution of the Contract

Other documents listed in the Agreement and Modification issued after execution of the Contract

(A201-1997, §1.1.1)

The Contract Documents do not include:

“Unless specifically enumerated in the Agreement, the Contract Documents do not include other documents such as bidding requirements (advertisement or invitation to bid, Instructions to Bidders, sample forms, the Contractor’s bid or portions of Addenda relating to bidding requirements).” (A201-1997, §1.1.1)

B. Scope of Work

Defines what work is to be performed under the agreement. The scope is usually set forth in general terms at the front of the document and detailed in one or more appendices.

The AIA A201-1997 provides:

“The term ‘Work’ means the construction and services required by the Contract Documents . . . and includes all labor, materials, equipment and services provided or to be provided by the Contractor to fulfill the contractor’s obligations.” (A201-1997, §1.1.3)

This includes “all items necessary for the proper execution and completion of the Work” and as “reasonably inferable . . . to produce the indicated results.” (A201-1997, §1.2.1)

We know that the *Contract Documents* include the Supplementary Conditions, Drawings and Specifications.

The problem created by an ambiguous description of the *Work* occurs when the owner interprets the Scope of Work more broadly than does the contractor.

The Supplementary Conditions, Drawings and Specifications should all be thoroughly reviewed to be sure that all *Work* has been properly identified and to attempt to eliminate conflicts within the *Contract Documents*.

C. Payment

The method of payment will typically be:

Lump Sum or Fixed Price

Unit Price

Cost Plus

Modified Cost Plus

Inherent in the method of payment is an allocation of risk between owner and contractor. The method of payment will often dictate the types of disputes most likely to arise between owner and contractor on the project.

Lump Sum – perform the Work for a sum certain

Contractor assumes a significant degree of risk for unknown variables that may or may not occur (rising material costs, availability of labor, weather, etc.)

Owner will likely pay a premium for the unknown variables / contingencies that may or may not occur

Contractor may have a financial incentive to cut corners on quality and quantity to maximize profit margin

An advantage is greater clarity and certainty as to the rights and obligations of the parties

Unit Price – perform a unit of Work for a fixed price, with the total quantity of material and labor being uncertain

Contractor assumes the typical risks of rising costs, availability of labor, weather, etc.

Owner assumes the risk of a higher total cost of construction

Cost Plus – owner pays the contractor for the actual cost of the work, plus a specified amount for overhead and profit

Owner assumes the risk of the unknown variables

Owner does not pay for the unknown variables that do not actually occur, as with Lump Sum

Contractor has no incentive to cut quality or quantity because assured of full payment for all labor and materials that go into the project

Modified Cost Plus – variations to Cost Plus

Cost plus a fixed fee (contractor assumes risk of substantial changes and additional work)

Cost plus a percentage of the cost (owner assumes the risk of unknown variables)

Cost plus a fixed or percentage fee with a guaranteed maximum price (GMP)

Cost plus a fixed or percentage fee with a GMP, but with a cost saving incentive to keep costs to a minimum

Progress Payments

Construction agreements typically call for “progress payments,” usually on a monthly basis, for work completed in the previous month. The owner thus finances the project to completion. The owner protects itself by including in the contract various “conditions precedent” to a progress payment, that is, various conditions that must be met before a progress payment becomes due. These may include:

Inspection of the work before payment is authorized

Right to withhold payment for defective work

Progress payments to be made based upon “milestones” or a schedule of values

Retainage provisions – typically the owner may withhold up to 10% of each progress payment until the work is “substantially complete”

D. Changes in the Work

Changes in the contractor’s work may occur due to any number of reasons, including:

Owner’s changing requirements

Errors and omissions in the design

Differing site conditions

Construction contracts will typically grant the owner the right to unilaterally change the contractor’s work, but only where there is also provision for making fair compensation to the contractor. A properly drafted change order clause will provide for:

The owner’s unilateral right to order a change within the scope of the contract

Obtaining the contractor's cost proposal and assessment of impact upon remaining work

Providing a procedure for determining compensation for the change

The AIA A201-1997, Article 7, provides three procedures for making changes:

Change Order – when the owner, architect and contractor all agree on (1) what constitutes a change in the Work; (2) the amount of the adjustment to contract price, if any; and (3) the extent of the adjustment in contract time, if any

Construction Change Directive – when only the owner and architect agree, and the contractor is directed to proceed, prior to agreement on an adjustment of contract price and contract time

Minor Changes – may be issued by the architect alone if the change does not involve an adjustment in cost or time

If the contractor disagrees with the method for adjustment of contract price, the method and the adjustment shall be determined by the architect using certain procedures set forth in the AIA documents. (AIA A201-1997, § 7.3.6)

E. Limitation of Liability

Liquidated damages for schedule delays

Expressed in terms of daily rate for each day of delay beyond a contractually fixed date

Liquidated damages for performance failures

Usually expressed in terms of a rate for shortfall in performance (e.g., \$/kilowatt)

Overall liability cap

Usually express in terms of dollar amount

Waiver of consequential damages

Contract provision

F. Warranties and Guarantees of Performance

A “warranty” is “a promise that a proposition of fact is true.” (*Black’s Law Dictionary*, 5th Ed. (1979)). Breach of warranty is proven when the proposition of fact is demonstrated to be false.

Under the AIA A201-1997, the contractor essentially provides a three-fold warranty to the owner:

That all materials and equipment furnished are of good quality and new, unless otherwise required or permitted by the contract;

That all “Work” is free from defects not inherent in the quality required or permitted by the contract; and

That the “Work” conforms to the requirements of the contract.

(AIA A201-1997, § 3.5.1)

It should be noted that this warranty provision:

Is applicable at the time of substantial completion; and

Contains no time limitation for enforcement. This will be governed by the applicable statute of limitations.

In addition to the general warranties cited above, the contractor also provides a “one year guarantee” which reads as follows:

In addition to the Contractor’s obligations under Section 3.5, if, within one year after the date of Substantial Completion of the Work or designated portion thereof or after the date for commencement of warranties established under Section 9.9.1, or by terms of an applicable special warranty required by the Contract Documents, any of the Work is found to be not in accordance with the requirements of the Contract Documents, the Contractor shall correct it promptly after receipt of written notice from the Owner to do so unless the Owner has previously given the Contractor a written acceptance of such condition. The Owner shall give such notice promptly after discovery of the condition. During the one-year period for correction of the Work, if the Owner fails to notify the Contractor and give the Contractor an opportunity to make the correction, the Owner waives the rights to require correction by the Contractor and to make a claim for breach of warranty. If the Contractor fails to correct nonconforming Work within a reasonable time during that period after receipt of notice from the Owner or Architect, the Owner may correct it in accordance with Section 2.4.

(AIA A201-1997, § 12.2.2.1)

The relationship of the two warranty provisions cited above is the source of some confusion. The one-year guarantee set forth in § 12.2.2.1 does not mean that the general warranties of § 3.5.1 expire one year after substantial completion. On the contrary, such warranties remain enforceable for the period of the applicable statute of limitations, but relate back to the condition of the project at the time of substantial completion. Section 12.2.2.1, on the other hand, applies for one year after substantial completion. Section 12.2.2.1 would cover, for example, a piece of equipment that performed at substantial completion but failed within the first year thereafter.

G. Terminating Performance

With respect to a contract, “termination” refers to an ending, usually before the end of the anticipated term of the contract, which termination may be by mutual agreement or may be by exercise of one party of one of his remedies due to the default of the other party. (*Black’s Law Dictionary*, 5th Ed. (1979)).

Unilateral termination of performance under a construction contract should be viewed as a last resort because of the significant risks it entails. A wrongfully terminated contractor, for example, may be entitled to his consequential damages, including loss of anticipated profits and loss of expected business opportunities.

Termination of contract, under common law, is justified only where the party at fault has “materially” breached the contract. What is or is not a material breach can be quite difficult to define, and often causes parties to act at their peril.

A well drafted construction contract should set forth specific grounds that justify termination, in addition to a general provision providing for termination in the event of a “material breach.” The specific grounds give the parties guidance. A general provision is necessary because it is almost impossible to anticipate every circumstance that could constitute a material breach.

Termination provisions should also provide for notice of intent to terminate, with an opportunity to “cure” by the non-breaching party. Many construction agreements also provide for “termination for convenience,” which allows a party who desires termination to do so without regard to whether the other party is in material breach of the agreement. Such a clause will typically provide that the owner must fully compensate the terminated contractor for all costs and payments due for work performed, but will forbid recovery of lost or anticipated profits as a result of early termination.

The AIA A201-1997 General Conditions provides specific grounds for termination by either the contractor or the owner for cause. In addition, the owner may terminate for convenience.

The owner may terminate employment of the contractor for cause if the contractor:

Persistently or repeatedly fails to supply enough skilled workers or proper materials;

Fails to make payment to subcontractors;

Persistently disregards laws, ordinances, regulations, etc., of a public authority having jurisdiction; or

Substantially breaches the contract.

(AIA A201-1997, § 14.2.1)

The contractor may terminate the contract for cause if:

The “Work” is stopped for 30 consecutive days through no act of fault of the contractor or a subcontractor for any of the following reasons:

order of a court or public authority stopping work;

an act of government stopping work;

failure of architect to issue certificate of payment;

failure of owner to timely make payment;

failure of owner to furnish Contractor, upon Contractor’s request, reasonable evidence that financial arrangements have been made to fulfill the owner’s obligations under the contract; or

Repeated suspensions, delays or interruptions of the entire Work by the owner in the aggregate more than 100 percent of the total number of days scheduled for completion, or 120 days in any 365-day period, whichever is less.

(AIA A201-1997, §§ 14.1.1, 14.1.2)

If any one of these conditions is met, the contractor may, upon 7 days written notice, terminate the contract and recover from the owner payment for work

executed and for loss with respect to materials, equipment, and tools, including reasonable overhead, profit and damages. (AIA A201-1997, §§ 14.1.3).

In addition, if the “Work” is stopped for a period of 60 consecutive days through no act or fault of the contractor or a subcontractor because the owner has persistently failed to fulfill his obligations under the contract, the contractor may, upon 7 additional days’ written notice, terminate the contract and recover from the Owner as provided above. (AIA A201-1997, §§ 14.1.4).

The Owner may also terminate the contract for convenience and without cause. (AIA A201-1997, § 14.4.1). In the event of the owner’s termination for convenience, the contractor is entitled to receive payment for “Work” executed, and costs incurred by reason of such termination, along with reasonable overhead and profit on the “Work” not executed. (AIA A201-1997, § 14.4.3).

H. Dispute Resolution

A well-drafted construction contract should address the method for resolving disputes. Dispute resolution clauses commonly include compulsory mediation and/or arbitration.

For many years the alternative dispute resolution (“ADR”) method of choice for the construction industry has been mandatory arbitration under the Construction Industry Rules of the American Arbitration Association (“AAA”). A typical arbitration clause, as recommended by the AAA, might read as follows:

Any dispute arising out of or relating to this contract, or the breach thereof, shall be finally resolved by arbitration administered by the American Arbitration Association under its Construction Industry Rules, and judgment upon the award rendered by the arbitrators may be entered in any court having jurisdiction. The arbitration will be conducted in the English language in the city of Atlanta, Georgia, in accordance with the United States Arbitration Act (known as the Federal Arbitration Act). There shall be three arbitrators, named in accordance with such Rules.

Until recently, arbitration was commonly seen as faster and less expensive than litigation for resolving disputes. While this may still be the majority view for most construction disputes, arbitration is no longer automatically accepted as the dispute resolution vehicle of choice. Experience teaches that arbitration, particularly in large, complex disputes, may save neither time nor money over litigation. Moreover, numerous procedural tools and evidentiary safeguards afforded in litigation are absent from the arbitration process.

The proposed 2007 revisions to the AIA A201-1997 General Conditions would eliminate mandatory arbitration, something AIA documents have required since

1888. The proposed 2007 AIA agreements require the owner and contractor to select among arbitration, litigation or some other method of binding dispute resolution for any dispute they cannot settle in mediation. Both mediation and arbitration, unless the parties agree otherwise, will be administered by the AAA. The owner and contractor will be asked to select the binding dispute resolution procedure through the use of a checkbox similar to the following:

BINDING DISPUTE RESOLUTION If the parties do not resolve their dispute through mediation pursuant to Section 15.2 of AIA Document A201-2007, General Conditions of the Contract for Construction, the method of binding dispute resolution should be as follows:

(Check the appropriate box. If the Owner and Contractor do not select a method of binding dispute resolution below, or do not subsequently agree in writing . . . the dispute will be resolved in a court of competent jurisdiction.)

- Arbitration pursuant to Section 15.3 of AIA Document A201-2007, General Conditions of the Contract of Construction
- Litigation in a court of competent jurisdiction
- Other (Specify)

The proposed 2007 revisions to the AIA A201-1997 will also modify the traditional role of the architect in making initial decisions on claims between the owner and contractor as a condition precedent to mediation, arbitration or litigation. Owners are not pleased when architects make decisions against them. Contractors have long voice the opinion that architects cannot be impartial. And architects do not always enjoy being caught in the middle.

To address these issues, the 2007 revisions to the A201 General Conditions will ask the owner and contractor to identify a neutral third-party Initial Decision Maker (IDM). The architect will act as the IDM if the owner and contractor do not identify someone else. An initial decision by the IDM is a condition precedent to mediation, and mediation is a condition precedent to any other form of dispute resolution.