CONTRACT NEGOTIATIONS FROM THE OWNER'S AND THE CONTRACTOR'S PERSPECTIVES

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I. INTRODUCTION

This paper will address some of the more significant contract clauses that are likely to be negotiated between and Owner and Contractor of a construction project. An overview of each type of clause is followed by a brief discussion of concerns raised from the Owner's and Contractor's perspectives.

Reference will be made to form construction agreements issued by the American Institute of Architects (AIA) and the Associated General Contractors of America (AGC). Specific reference is made to the AIA Document A201, General Conditions of the Contract for Construction (1997) ("AIA A201-1997" or "A201") and the AGC 200, Standard Form of Agreement and General Conditions Between Owner and Contractor (Where the Price is a Lump Sum) (2000) ("AGC 200 (2000)").

II. KEY CONTRACT CLAUSES

A. Scope of Work

1. Overview

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)

2. Owner's Perspective

The definition of what is (and what is not) included in the scope of the *Work* is of critical importance to the Owner. In the end, the Owner wants to ensure that the Project meets its specified needs and performance criteria, but must depend on others—the architect and contractor—to define the details and requirements to get the Owner the end result. In most cases, the Owner has only a basic understanding of design and construction.

From the Owner's view point, the AIA definition of the *Work* is more ambiguous since the 1997 version was produced. Despite the use of the words "reasonably inferable" in Section 1.2.1, this language is qualified by the words "as being necessary to produce the ***indicated*** *results."* (Emphasis supplied). In the 1987 version of this Section, the word "intended" was used in lieu of the word "indicated." The Owner would prefer to change the word "indicated" back to "intended." In a world where architects claim that they cannot create a "perfect" or "complete" set of design criteria, and particularly, when the Owner hires a contractor who represents it has specific experience and the contract is negotiated (as opposed to bid), the Contractor should be held to a higher standard and should not be able to use, as an excuse, that an item of work which is typically required was not specifically detailed in the scope description-which was usually prepared by it and the architect.

3. Contractor's Perspective

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 battle will be fought during the course of the project when the Owner and Architect refuse to

grant the Contractor a Change Order for what the Contractor believes is additional work, for which additional compensation is due.

We know that the A201 *Contract Documents* include the Supplementary Conditions, Drawings and Specifications. 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 concerning the Scope of Work within the *Contract Documents*.

B. Payment

1. Overview

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"

2. Owner's Perspective

It is almost always in the Owner's best interest to select a compensation structure that sets or caps the compensation to be paid to the Contractor for the specified scope of Work. If the scope of the Work changes, the AIA and most other contracts provide that the Contractor is entitled to a change order (providing addition time and costs) for any additional work or changes in the Work. Without stipulated sum or cap, the Owner runs the risk of over-paying for work by the Contractor.

If the Contractor is to be paid based on a "Cost of the Work Plus a Fee" (which should include a maximum cap or "Guaranteed Maximum Price"), the Owner should review and understand the definitions of "Cost of the Work" and "Fee". Examples of these definitions are contained in the AIA Form A111. Although many of these definitions appear acceptable, the definitions of allowed costs are fairly broad in a number of categories, and allow the Contractor to charge a number of general operating expenses to the Owner under the guise of a "Cost of the Work."

Unit Prices and Allowances should also be clearly stated, as well as what costs they include or do not include (e.g., overhead and profit, etc.). The smart Owner also

defines a process of handling work beyond the estimated quantities for Unit Price work, as well as firming up the assumptions and costs associated with the Allowances, to avoid surprises.

With regard to payment, the Owner should require certain deliverables with progress and final payments, including lien waivers and, in the case of certain key payments at Substantial Completion and Final Completion, test data, close-out documents, warranties, as-built drawings, and other information required by the Owner for operation and maintenance of the completed Project.

It is important that the Owner hold back an amount from the Contractor's payments through the course of Project, and this is referred to as "Retainage." Owner's have traditionally withheld Ten Percent (10%) of the specified Contract Price until the very last payment. In recent years, Contractors have convinced Owners to withhold less, and release any amounts withheld as Retainage before completion. The 1997 version of the A201 provides, for example, that Retainage will be released at Substantial Completion, as opposed to Final Completion. Although most of the Work is complete at Substantial Completion and the Owner is typically using the Project at this point, the Contractor still is obligated to perform portions of the Work on the "Punch List." Without any Retainage held, the Owner runs the risk that the Contractor will not be motivated to complete all the remaining work items. It is in the Owner's interest to hold as much Retainage, as long as possible, to ensure that all the Work is properly completed and it is protected in the event of damage or delays caused by the Contractor as an offset of its losses.

If the Owner will obtain outside financing for the Project, the Owner should discuss the payment procedures and Retainage with its lenders or financing parties to

make sure they are consistent with the loan documents and financing requirements, both from a legal and logistical stand point.

3. Contractor's Perspective

The Contractor minimizes its risk with a "cost plus" or "modified cost plus" contract. When entering a "lump sum" or "unit price" contact, the Contractor must factor into its price the risks of rising material costs, availability of labor, adverse weather, etc.

The Contractor should negotiate for less than ten percent (10%) Retainage, particularly if the Contractor is required to post a payment and performance bond (providing financial protection to the Owner), or must advance significant funds for materials at the start of the project (on which the Contractor cannot withhold Retainage from the material supplier). An alternative is to permit withholding of ten percent (10%) Retainage until the project is 50% complete, with a reduction in Retainage to 5% or even zero thereafter.

If the Owner is permitted to withhold 10% Retainage from the Contractor until Final Completion, the Contractor is going to be faced with payment obligations for Final Completion to some subcontractors before being completely paid by the Owner for the Work. This is going to cause severe cash-flow problems for the Contractor and liens against the property of the Owner.

The Contractor must negotiate its subcontracts in light of the payment provisions in the Owner contract, including Retainage to be withheld from subcontractors. Also, contingent-payment provisions ("pay when paid" clause) that make payment by the

Owner to the Contractor a condition precedent to payment by the Contractor to the subcontractor may provide substantial protection to the Contractor.

C. Changes in the Work

1. Overview

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)

2. Owner's Perspective

Although most Owner's would like to believe that there will be no "changes" or "change orders," most construction contracts are varied at some point during the course of construction, either by Owner requested modifications or changed conditions or circumstances encountered by the Contractor during the performance of the Work. Accordingly, the smart Owner will pay close attention to these provisions when preparing and negotiating the construction contract.

The Owner needs the right to order changes or direct the Contractor to proceed with the Work in the event there is a dispute. This will allow the project to move forward when the parties cannot agree that the work at issue is included in the original scope of the Work or constitutes a "change", or, even if there is an agreement of a "change", the parties cannot agree as to the cost or schedule impact of the changed work. Owners should not accept language from Contractors which requires that the Contractor agree to the Change Order or change before it is obligated to perform the work at issue.

And when the parties agree upon a Change Order, the Change Order should provide for a total resolution of all claims (including time extensions and costs) associated with the changed work, to avoid additional claims or costs in the future arising out of the same set of circumstances.

Owners should also consider adding language to the construction contract which caps or sets the amount of overhead and profit "mark-ups" the Contractor or its subcontractors can charge for changed work. Many unsuspecting Owners are charged high mark-ups if there is a change in work, and the rumor goes this is where Contractor's make their real money!

3. Contractor's Perspective

If the Owner has the contractual right to order changes or to direct the Contractor to proceed with the Work when there is a dispute concerning scope, the changes clause should be drafted to encourage prompt resolution of cost and time extension issues. The Owner's ability to order a unilateral change absent agreement by the Contractor concerning cost and time will likely result in claim arbitration or litigation.

The changes clause should address how the time and cost impact will be determined or calculated if the parties cannot agree, and when payment will be made for the changed work.

The AGC 200 (2000) requires changed work to be performed even if the parties have not agreed upon time and cost impacts. As the Contractor performs the changed work, the Contractor submits its costs for such work with its application for payment. If the Owner disputes the amount, the Owner pays the Contractor fifty percent (50%) of its estimated cost to perform the work, with both parties reserving their rights as to the disputed amount. (§ 8.2.2). This type of clause protects the Contractor from financing the entire cost of the change pending resolution.

D. **Delays and Extensions of Time**

1. Overview

Most construction contracts define when the Contractor must complete the Work, either by specifying a set date for Substantial Completion or by reference to a number of days after the Work commences or an attached Schedule. This is referred to in the AIA documents as the "Contract Time."

Article 8 of the A201 discusses time, and specifically, when the Contract Time may be extended or adjusted.

Section 8.3 of the A201 provides the Contractor will have the right to a time extension for "an act or neglect of the Owner or Architect, or of an employee of either, or of a separate contractor employed by the Owner, or by changes ordered in the Work, or by labor disputes, fire, unusual delay in deliveries, unavoidable casualties or other causes beyond the Contractor's control, or by delay authorized by the Owner pending mediation and arbitration, or by other causes which the Architect determines may justify delay, then the Contract Time shall be extended by Change Order for such reasonable time as the Architect may determine."

Section 4.3 of the A201 specifies the time period for providing notice to the Owner for claims for extensions of the Contract Time (21 days), and also discusses the claims related to "adverse weather" delays.

Section 8.3.3 states that this Section 8.3 "does not preclude recovery of damages for delay by either party under other provisions of the Contract Documents."

2. Owner's Perspective

This is a key provision for the Owner, especially if the schedule and timely completion are critical to the success of the Project. From the Owner's point of view, this provision is too broad—both in terms of the definition of what is an "excused delay" entitling the Contractor to a time extension, and the relief granted to the Contractor in the event of an excused delay.

It is recommended that this provision (or any provision drafted to cover time extensions) specifically enumerate those *force majeure* events and causes that will be considered "excused" delays. The Owner should also consider deleting from the definition items such as "labor disputes" and "unusual delay in deliveries" as these risks are best borne by the Contractor. Additionally, the Contractor should be required to demonstrate an "impact" to the Contract Time as a result of an excused delay. There may be an event of an excused delay (e.g., adverse weather), but no impact to the Contractor's performance of the Work, either because the item was not included on the Schedule's critical path or the delay event does not relate to the condition of the Work at the time.

Section 8.3.3 should be modified as well to limit (or eliminate) the Contractor's right to costs in addition to a time extension. Without any limitations, the door is wide open for cost claims from the Contractor for alleged delays. It is suggested that an Owner include a "no damage for delay" clause, which provides for a time extension only where the delay does not involve a change in the Work scope. Alternatively, the parties should define what "costs" will be permitted in the event of delay and how these costs will be calculated.

The Owner should also consider reducing the time period for notice of claims for time (and for costs as well) from 21 days to a shorter time period. And the Owner should review whether or not (and to what extent) adverse weather should be considered an "excused delay". If the Project is for an interior build-out, for instance, weather should not be included as an "excused delay."

3. Contractor's Perspective

The key question is: if the Contractor is delayed for reasons beyond the Contractor's control, is the Contractor entitled to both an extension of time and damages resulting from the delay ("compensable delay"), or only an extension of time ("non-compensable delay"). Owners want to limit compensation for delays. Contractors want to all delays beyond the Contractor's control potentially compensable.

Compensable delays might include the Owner's failure to make the site available for the Contractor to start Work, late delivery of drawings and specifications, and unforeseen site conditions.

Section 8.3 of the A201 provides an acceptably broad itemization of excusable delay events for the Contractor, and the Contractor should resist narrowing this scope. An Owner's insistence that the Contractor be able to demonstrate an "impact" to the Contract Time in order to obtain a time extension is generally not unreasonable. Delay to non-critical items, that do not impact the Contractor's ability to complete on time, generally do not justify a time extension.

The AIA A201 provides for twenty-one (21) days notice from the Contractor of a delay event. The AGC 200 (2000) requires notice within fourteen (14) days. Anything less than fourteen (14) days is generally unreasonable.

The Contractor must resist the "no damage for delay" clause. The most widely used form construction contracts (AIA, AGC, etc.) do not contain "no damage for delay" clauses. When coupled with a waiver of consequential damages in the construction contract, the Contractor may be completely barred from recovering for any damages caused by the Owner's delay. If forced to accept a "no damage for delay" clause, the Contractor must at least make certain the clause is mirrored in its subcontracts.

E. Limitation of Liability

1. Overview

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

This provision usually states that both parties "mutually waive" consequential damages against each other. For example, the A201 form states:

> § 4.3.10 Claims for Consequential Damages. The Contractor and Owner waive Claims against each other for consequential damages arising out of or relating to this Contract. This mutual waiver includes:
>
> .1 damages incurred by the Owner for rental expenses, for losses of use, income, profit, financing, business and reputation, and for loss of management or employee productivity or of the services of such persons; and
>
> .2 damages incurred by the Contractor for principal office expenses including the compensation of personnel stationed there, for losses of financing, business and reputation, and for loss of profit except anticipated profit arising directly from the Work.

> This mutual waiver is applicable, without limitation, to all consequential damages due to either party's termination in accordance with Article 14. Nothing contained in this Section 4.3.10 shall be deemed to preclude an award of liquidated direct damages, when applicable, in accordance with the requirements of the Contract Documents.

2. Owner's Perspective

This subject is of critical importance to the Owner, as it directly impacts the Owner's rights to collect damages for the Contractor's breach, including for defective work or delayed completion. As a general starting point, the Owner should, if at all possible and depending on its leverage, avoid or refuse to agree to any provision which limits its right to collect damages for the Contractor's breach, negligence or bad acts.

If the Owner must agree to some limitations, the Owner should make sure that any damage caps or limitations exclude certain types of damages or claims—especially those involving personal injury or property loss since these items are covered by insurance in most cases. Claims for disclosure of confidential information or misappropriation of intellectual property should also be carved out of any waiver, along with claims for gross negligence or fraud.

If the Owner agrees to limit its recovery to specified liquidated damages, the Owner should carefully consider the amount to be specified. In order to be enforceable, most states require that that liquidated damages bear some reasonable relationship and are a reasonable approximation of the amount of damage or loss that the Owner will suffer as a result of the failure of performance (e.g., the loss of revenue for each day or interest carry if the Contractor is late.) If drafted carefully, liquidated damages do have the benefit of setting the damages that the Owner can recover (without further proof).

The Owner should resist including a consequential damage waiver, if possible, and particularly if it agrees to limit its rights to damages by an overall cap or through liquidated damages. As mentioned above, there should be carve-outs or exceptions for certain claims.

3. Contractor's Perspective

Under traditional common law, parties to a contract are liable for all losses that either arise naturally from their breach or are reasonably within their contemplation at the time of entering the contract as a probable result of the breach. Damages include both direct and consequential losses caused by a breach.

The Contractor will want to limit the consequential damages that may be suffered, and recovered, by an Owner if the Contractor delays the project. Such damages include increased financing costs, extended rental expenses, loss of reputation, extended involvement of project personnel, lost profits, lost rental or sales income, or inability to deliver occupancy to leasehold tenants.

Waiver of consequential damages' clauses commonly provide that each party waives the right to recover consequential damages from the other. The Owner will waive any claim for extended financing costs, lost income or profits. The Contractor will waive extended home office overhead or loss of productivity.

Since the Owner typically has more concrete damages for delay, extended financing costs, for example, the Contractor generally has more to gain with a mutual waiver of consequential damages clause. Contractors will, therefore, typically favor a mutual waiver, particularly if the potential consequential damages to the owner exceed the contract price.

In consideration for a mutual waiver, the Owner will generally seek an agreement from the Contractor to pay "liquidated damages," usually in a per diem amount for each day of unexcused delay beyond an agreed date. The Contractor's liability for liquidated damages will be expressed as an exception to the Owner's waiver of consequential damages and will be the Owner's exclusive remedy for Contractor's delay.

Another option for limiting damages is a cap or limitation of liability. The clause might also define what specific types of damages are not recoverable for delay or some other breach. In the event of an Owner-caused delay to the Contractor, the Owner may seek to limit the Contractor's recovery to extended "general conditions," the costs incurred by the Contractor in maintaining a presence on the site, and exclude home office overhead, off-site personnel expenses, and lost profits from other jobs. The Contractor will seek to exclude liability to the Owner for losses arising out of the Owner's ability to sell the project or to deliver the project to prospective tenants on time, or the Owner's lost profits for not being ready for commercial operation.

F. Warranties and Guarantees of Performance

1. Overview

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 statue of limitations. In addition to the general warranties cited above, the contractor also provides a "one year guarantee" which reads in part as follows:

> [I]f, within one year after the date of Substantial Completion of the Work . . . 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 . . . 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.

(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.

2. Owner's Perspective

From the Owner's view point, the warranty provisions in the AIA provisions work for most circumstances. With a more complex project, however, the parties should review the warranty provisions to make sure they work (and the time periods are right) for specified equipment, machinery or software for example. The 1997 version of the A201, however, did eliminate the Owner's "self-help" right, and the Owner should consider adding this back to the AIA documents in the event the Contractor fails to take corrective action after notice.

3. Contractor's Perspective

It is important to the Contractor that the Owner invoke the warranty call-back mechanism to provide notice of a perceived problem and then grant the contractor an opportunity to address the defect. The two elements are: (1) providing notice and (2) providing an opportunity to correct the problem.

Under the A201 § 12.2.2.1 provision, if during the one-year period for correction of the work, the Owner fails to notify the Contractor and give the Contractor an opportunity to make the correction, the Owner waives the right to require correction by the Contractor and to make a claim for breach of warranty.

When negotiating the call-back remedy, the Contractor will want to resist lengthening the one-year call back period or moving the trigger of the call-back remedy to final (rather than substantial) completion of the Work.

The Contractor should also be wary of "quality" warranties that may encompass issues other than quality, particularly *design*. For example, if the warranty requires the Contractor to perform the Work in accordance with all codes, laws, rules, and

regulations, the Owner has arguably converted the warranty into a design warranty, and made the Contractor responsible for confirming that the design is code compliant. The Contractor should insist that code compliance is the responsibility of the design professional.

Most construction contracts will contain provisions requiring the Contractor to perform the Work in accordance with all legal requirements, but those provisions do not rise to the level of a warranty.

The Contractor *does not impliedly warrant* that the architect or engineer's design, when executed, is sufficient to meet the Owner's requirements. In fact it is the Owner who impliedly warrants the sufficiency of plans and specifications to the Contractor under the *Spearin* doctrine. *United States v. Spearin,* 248 U.S. 132 (1918).

G. Terminating Performance

1. Overview

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 <u>owner may terminate</u> employment of the contractor <u>for cause</u> 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 <u>contractor may terminate</u> the contract <u>for cause</u> 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 <u>in the aggregate</u> 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 <u>without cause</u>. (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).

2. Owner's Perspective

Depending on the project specifics, the Owner should consider increasing the time periods specified in A201 Sections 14.1.1 and 14.1.2, which trigger the right of the Contractor to terminate for cause.

In 1997, the AIA finally added a provision providing the Owner the right to terminate for convenience if it needed to abandon the Project. Although it is fair to pay the Contractor for work completed in this circumstance, the Owner should delete the language in Section 14.4.3 which allows the Contractor to recover "reasonable overhead and profit on the Work not executed." This provision can create a windfall for the Contractor, particularly when the contract is terminated early in the Project, and the Contractor incurred no or little risk in its performance of the Work.

3. Contractor's Perspective

The construction contract should address the termination rights of both the Owner and the Contractor. With respect to the Owner's right to terminate, the Contractor will want sufficient notice of the grounds for termination, and a right to cure the default.

The contract should set forth the grounds upon which the Contractor may terminate. The Contractor's right to terminate is commonly conditioned upon nonpayment or stoppage of the Contractor's work through no fault of the Contractor.

If the contract contains a termination for convenience clause, permitting the Owner to terminate the Contractor's performance "at will," the contract should address whether the Contractor will be paid for reasonable overhead and profit on the "Work" not executed.

The AGC – 200 (2000) permits the Contractor to be paid for the Work performed to date and for any proven loss, cost or expense in connection with the Work, including all demobilization costs and a premium. The premium is an amount to be agreed upon by the parties, at contract signing, to compensate the Contractor for lost profits on Work not yet performed at termination. (AGC – 200 (2000), § 11.4.2).

The Contractor should be sure that its subcontracts provide it with the same termination for convenience rights granted to the Owner in the prime contract.

H. Dispute Resolution

1. Overview

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.)
>
> o 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.

2. Owner's Perspective

The Owner should carefully consider the dispute procedures in light of its business concerns and preferences. Whether by mediation, arbitration or litigation, the dispute resolution procedures should be carefully coordinated with dispute resolution requirements in your architect agreement, as well as any other related documents (such as those with purchasers or lenders).

3. Contractor's Perspective

The Contractor must also carefully coordinate the dispute resolution procedures mandated in the Owner agreement with the dispute resolution procedures contained in

its subcontracts. A “pass-through” clause will incorporate the terms of the agreement between Contractor and Owner into the Contractor’s subcontracts. The Contractor does not want to arbitrate with the Owner the same issues it must litigate with its subcontractors. The Contractor will generally want the ability to adjudicate related disputes in one forum with all parties.