Viewpoint: Five Construction Clauses To Avoid Litigation

The construction industry experiences some of the highest incidences of litigation. Here are the contractual clauses most often involved in disputes and suggested variations that could help avoid the headaches and costs of litigation.

Delay Claims

Delay claims arise when one or more parties delay the project schedule. Delay damages are frequently catastrophic. For example, an owner might have a drop-dead date to open a retail establishment. The owner's failure to meet this deadline might result in a lease violation, loss of sales, extra carrying costs, etc. For the contractor, the losses can include being unable to start another project with critical deadlines, incurring extended general conditions, over-commitment of workforce, etc.

The parties' damages, however, get even worse when factoring in the legal costs of handling these claims. Delay claims are among the most costly to litigate and despite such high costs, result in the least predictable outcomes. In short, the parties must aggressively manage this risk.

One of the most successful clauses to avoid delay claims is also the most controversial. Specifically, the "No Damage for Delay" clause precludes contractors from recouping delay damages. Instead, the contractor's sole remedy is an extension of time to complete its work.

Without question, these clauses result in some of the most difficult negotiations because contractors, understandably, loathe them. Nonetheless, certain modifications should render these clauses more palatable. For example, the clause can preclude only those damages caused exclusively by the owner. Stated differently, the contractor is entitled to delay damage caused by anyone else.

Another modification involves monetizing the damages in advance perhaps on a per diem basis. In short, the delay clause can mirror a liquidated damage clause (e.g., for every day the owner exclusively delays the project, the contractor shall be entitled to $XXX). One of the greatest benefits of monetizing damages in advance is it drastically reduces the costs of processing these claims. In short, the dispute focuses only on entitlement to damages and not on the calculation of actual damages.

Disputed Work Claims

Disputed work claims can involve an assessment of whether work performed is base contractor work or extra work. In the first instance, the contractor would not be entitled to additional compensation whereas in the second, the contractor would be entitled to additional compensation. To minimize the impact of these claims, the parties should revise the "notice" clause which requires one party to notify the other of a claim. These clauses often give the parties 21 days to provide such notice. It is advisable to modify the notice clause to provide a much shorter notice requirement (e.g., "before the condition giving rise to the claim is disturbed," and "24 hours after first becoming aware of the claim," etc.). Early notice provides the owner with the opportunity to participate in the solution. For example, the owner might elect to delete or change the work resulting in the extra cost. Early intervention enables owners to manage costs more effectively. From the contractor's perspective, early intervention reduces the risks of the owner rejecting the contractor's work.

In addition to modifying the notice provision, the parties should also consider monetizing the claim in advance. Stated differently, the clause should provide a formula for determining the value of the claim in advance (e.g., actual costs plus some percent for profit and overhead). The clause should also provide some form of verification such as requiring the contractor to submit daily slips reflecting hours worked and materials supplied for the disputed work. This verification process enables the owner to ensure only costs attributable to the extra work are included in the contractor's claim.

Inadequate Plans

Architects, like everyone else, make mistakes. Fortunately for architects, their Service Agreements frequently contain limitation of liability clauses that cap the architect's potential damages. As a result of such clauses, damages caused by architects are frequently borne by others. The goal, therefore, is to manage ownership of that risk.

As a general rule, contractors are entitled to rely on the accuracy of plans presented to them. By default, therefore, the risk of loss would typically fall on the owners. One way for owners to reduce this risk is by including a clause stating the contractor shall not rely on the accuracy of any plans provided by the owner. One problem with this approach, however, is that it might render the contractor a design professional—a role most contractors are not suitable to fill. Another problem with this approach is that the contractor's general liability insurance may exclude coverage for losses arising from such design professional services.

A more common approach is to include language stating the contractor is entitled to reasonably rely on the information but shall exercise due diligence in its role as a contractor (not as a design professional) to review the plans and identify errors. If the contractor finds an error, it must immediately report it to the owner.

Incorporation Clauses

Incorporation clauses incorporate other documents (e.g., plans, specifications, etc.) into the contract. The documents incorporated into the contract are the "contract documents."

Problems arise when the contract documents contain inconsistencies. For example, the windows shown in the plans might differ from those shown in the specifications. This situation can cause numerous problems. For example, if the cost of the two windows differ drastically, who owns the cost delta? Alternatively, if the contractor installed the windows shown in the plans, but the owner wanted the windows shown in the specifications, who bears the removal and replacement cost (as well as corresponding delays in the construction schedule)?

There are two basic approaches to inconsistencies. The first approach identifies the document that governs in the event of an inconsistency (e.g., in the event of any inconsistency, the plans govern the contractor's work). The second approach permits an individual to determine which document governs. Contractors often prefer the first approach. The second approach, however, can include language that addresses the contractor's concerns. For example, it could say the architect shall make the decision but must do so reasonably. Further, such a decision would be immediately subject to the dispute resolution process set forth in the contract.

Termination for Cause

The contract must clearly set forth what constitutes grounds for termination, what cure rights are available, and what damages are compensable. One of the greatest sources of litigation, however, involves whether the contract was rightfully terminated. For example, if the owner terminates the contract because it erroneously believes the contractor fell behind the construction schedule but the contractor proves the owner was responsible for the schedule failure, then what happens? Typically, the party that wrongfully terminates the contract is liable for damages.

In order to mitigate against the consequences of such a mistake, owners should consider adding a clause stating that if the contract were wrongfully terminated for cause, then the contractor's damages shall be the

same as if the owner terminated for convenience. If this type of clause is used, the contractor must ensure the remedies available to it in the termination for convenience clause are adequate (e.g., profits on unexecuted work, demobilization costs, a buy-out/kicker sufficient to enable to contractor to fill the void in its construction schedule, etc.).

Construction is a risky business. Carefully crafted contract language can drastically help reduce those risks.

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