

Construction Contracts: Best Practices for Payment, Changes and Damages Provisions

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Construction Contracts: Best Practices for Payment, Changes

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Part I: Strategies for Key Payment Provisions

- ❑ Owner v. Contractor Payment Objectives
- ❑ Ways To Address Objectives Through Contract
- ❑ Anticipating Problems and Automating Solutions

Part I: Strategies for Key Payment Provisions

Owner's Perspective:

- Need sufficient time to inspect work
- Only want to pay once for the work
- Lien Waivers / Warranties
- Beware Prompt Pay Laws
- Title Transfers Upon Payment
- Keep Work Progressing

Part I: Strategies for Key Payment Provisions

Contractor's Perspective:

- ❑ Keep Cash Flowing
- ❑ Need to Identify Problems Early
 - ❑ Want to avoid getting too deep into a job without being paid
 - ❑ Want to know whether Owner/Architect objects to work quality
- ❑ Need to Keep Subs Working/Paid

Part I: Strategies for Key Payment Provisions

Goals of Payment Contract Provisions:

- ❑ Must strike balance between Owner's and Contractor's Priorities
 - ❑ Need to give Owner protection from paying too much too soon
 - ❑ Need to give Contractor protection that it will be paid for its work

Part I: Strategies for Key Payment Provisions

Schedule of Values:

- ❑ Breaks down the various elements of work
- ❑ Assigns a payment value to each
- ❑ As project progresses, contractor certifies percentages complete
- ❑ Architect/Owner reviews and confirms/rejects
- ❑ Payment made accordingly

Part I: Strategies for Key Payment Provisions

Retainage:

- ❑ Percent withheld from each Pay Application
- ❑ Retained by Owner to Cover Possible Issues
- ❑ Keeps Contractor Interested and Accountable
- ❑ Typically 10%
- ❑ Modern Trend to Decrease/Release at Milestones
- ❑ Recent Retainage Statutes/Retainage ≠ Ransom

Part I: Strategies for Key Payment Provisions

Contractor Protections:

- Rights to Financial Information
- Rights to Stop Work
- Interest on Unpaid/Delayed Balances
- Warranty Cancellation
- Prompt Pay & Retainage Statutes
- Termination Rights

Part I: Strategies for Key Payment Provisions

Owner Protections:

- Prequalify, Prequalify, Prequalify!
- Partial Lien Waivers From Contractor and Subs
- Payment Shall Not Constitute Waiver
- Warranties Conveyed Upon Payment
- Rights to Offset, Withhold
- Payment/Performance Bond Protections
- Title Transfers Upon Payment
- Termination Rights

Part I: Strategies for Key Payment Provisions

Final Payment:

- Distinction Between Substantial Completion
- Monetized Punch List
- As-Builts
- Warranties
- Operational Manuals
- Final Lien Waivers and Releases

Part I: Strategies for Key Payment Provisions

Damage Control:

- Payor: Lender, Landlord, Tenant?
- Within Control of Contractor?
- Interim Dispute Resolution Clauses
- Initial Decision

II. Drafting Appropriate Changes Clauses

Common Change-Order Questions

- ❑ True Changes or Missed Scope?
- ❑ Inconsistences in Plans and Specifications
- ❑ Construction Change vs. Design Change
- ❑ Foreseeability of Differing Conditions
- ❑ Contractor vs. Owner Initiated Changes

Change-Order Contracting Considerations

- Timeliness of Change Order Submissions/Approval
- Requirement for Written Submission/Approval
- Change Directive v. Change Order Requests
- Confirmation of Existing Conditions
- Negotiate Change-Order Allowance Upfront
- Inclusion of Overhead and Profit Markup

Resolution of Change Order Disputes

- ❑ Provision for Continuation of Work and Partial Payment During Dispute
- ❑ Initial Decision Maker
- ❑ Expedited Arbitration
- ❑ Interim Payments to Subcontractors and Suppliers to Prevent Liens

II.C – Preventing Surprise Claims

1. Hire a good contractor.
2. Avoid bidding incomplete designs.
3. Use a good lien + claim waiver form (see III.A herein).
4. Keep the contract “open book.”
5. Use a good changes clause:

***Changes.** It is specifically understood and agreed that no additional or different services or reimbursables shall be allowed or compensated unless prior written approval is given by Owner for the specific services and reimbursables at issue.*

II.D – What Constitutes a Compensable Change?

1. Determination of Compensable change =
 - 33% contract language
 - 33% facts
 - 34% trier of fact
2. Timeliness
 - a. Does it meet the contractual deadline?
 - b. Does failure to meet deadline cause “prejudice” to upstream party?

II.D – What Constitutes a Compensable Change? (cont.)

3. The Source Matters

- a. Owner Directive
- b. Abnormally bad weather (not just bad weather)
- c. Design errors or omissions
- d. Bidding errors
- e. Jurisdictional changes (anticipated or unanticipated?)

4. Compensable to Subcontractor ≠ Compensable to Contractor

III. Strategies for Waivers, Damages, and Dispute Resolution Clauses

III.A – Lien Waiver Forms (Are They Worth The Paper They Are Written On?)

1. NO → If contractor waives lien for the amount just paid
2. YES → If contractor waives lien (and other claims) for:
 - a. all work performed up to payment application date
 - b. including delay and cumulative impact claims, negligence, breach, etc.
 - c. excluding retention and pending change orders already delivered

III.B – Pros and Cons of CD Waivers

Pros

- ❑ Provides some protection to both sides
- ❑ Reduces price (in theory)
- ❑ Fosters better initial relationship

Cons

- ❑ Purported “mutuality” is a stretch
- ❑ Contractor benefits much more than Owner
- ❑ Waiver includes waiver of insurance proceeds (which you paid for)
- ❑ In many cases, lost revenue can be significant

III.B – Pros and Cons of CD Waivers (cont.)

Alternate approaches:

1. No CD waiver (my favorite).
2. Waiver of CDs capped at \$_____ (the “ceiling”).
3. Waiver only for CDs in excess of \$_____ (the “floor”).
4. Waiver only applies to CDs not covered by insurance.
 - a. “beyond stated limits.”
 - b. “beyond actual proceeds.”
5. Waiver is “mutualized.”
 - a. Contractor waives profit on the project.
 - b. Owner waives CDs only to extent they exceed Contractor’s profit on project.

III.C – Generalized Waivers for Indirects, Consequential, Exemplary & Punitive Damages

1. Upstream party should avoid waivers
2. At least make them mutual
3. Enforceability varies by state law
4. Same alternates apply (see CD waiver options)

III.D – Limits of Liability (LOLs)

1. Upstream party should avoid (or pass forward)
2. At least make them mutual
3. Some states won't enforce LOLs
4. Public agencies usually disallow
5. Don't believe "... it's required by our insurer"
6. Don't believe "... it's standard in the industry"
(Exception: low-fee work relative to high risk endeavor –
e.g., soils testing)

III.D – Limits of Liability (LOLs) (cont.)

Alternatives:

1. Bare minimum, LOL to the amount of provider's insurance.
 - a. to stated dollar limits of insurance, or
 - b. to actual proceeds of insurance + \$_____.
2. LOL applies only to immediate provider, not its subs.
3. LOL does not apply if...
 - a. provider fails to make subcontracts assignable
 - b. provider fails to give notice of other claims against its insurance
 - c. provider fails to give notice of actual reduction in available limits
 - d. provider fails to maintain required insurance
- e. For uninsured claims, LOL is \$_____.

III.E – 5 Key Ingredients to Dispute Resolution Claims

1. Avoid arbitrary time limits (notice in 30 days or claim is waived)
2. Achieve consolidation
 - a. in arbitration, or
 - b. in bench trial, or
 - c. in jury trial (last resort)
3. Use same clause in all contracts on a Project
4. Incorporate “fail safe” if cannot agree on mediator/arbitrator
5. Address the attorney fee issue
 - a. either “prevailing party” clause, or
 - b. “no attorney fee” clause
 - c. Owners should not leave it blank

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