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Killer Contract Clauses

What to Look for Before You Sign on the Dotted Line

By David Corkum

Contracts are the glue that holds the design and construction industry together. Owners, designers, prime contractors, subcontractors, sureties, insurers and specialty subconsultants each posses a unique resource, skill or ability that must be integrated for the successful execution of a construction project.

This orchestration of the various parties is done through contracts. A contract, of course, is nothing more than an agreement between two parties manifesting an offer and unconditional acceptance of that offer to perform a certain service or work. Unlike a plain old promise, however, that contract carries with it the understanding by both parties that if one party does not perform in accordance with the contractual terms and conditions, then the courts will step in to enforce that agreement. In most jurisdictions, a statute of frauds requires that construction contracts for real property must be in writing to be enforceable. The commercial aspects of that agreement are found in a section of the contract referred to as the "general conditions," "terms and conditions," "general requirements," or, more euphemistically, the "boilerplate."

To the uninitiated, this very small type, awkwardly worded, poorly punctuated, and overly paragraphed boilerplate makes little sense. Those that have been through the fire, however, recognize the significance of the difference between a comma or a period, or the use of the conjunction "and" as opposed to "or." These boilerplate contractual provisions spell out in great detail the rights and responsibilities between the two parties to the contract. It is of no use to complain about the one-sidedness or unfairness of these contract provisions after the agreement has been signed — in the absence of extraordinary circumstances, the courts will enforce those terms and condition exactly as written.

Certain contract provisions in the heavy civil construction industry are recognized as being one-sided and unfair, yet still find their way into the agreements between sophisticated owners, contractors and design professionals. This article explores four of these provisions that should be at the top of any industry executive's checklist when deciding whether to enter into a particular contractual agreement.

Unusually harsh or one-sided terms and conditions promulgated by the party soliciting the service or work should cause those executives to ask themselves whether this is the type of owner or contractor that they want to work for and be bound to for the duration of the project. This question is particularly serious for the underground construction industry, where owners are often infrequent procurers of underground design and construction projects. Unfamiliar with the underground construction industry, these owners seem more willing to consider their procurement as an isolated, single transaction as compared to the continuing relationships established for their bread-and-butter design and construction projects.

Standard of Care

Engineers entering into a contract with an owner to develop a design and prepare drawings and specifications are well aware that they must fulfill their contractual obligations for deliverables in a timely manner and comply with regulatory law governing their profession and the final project's design. They are also aware that they must perform their services in compliance with an applicable "professional

standard of care." This standard of care recognizes that perfection is not the metric by which the design professional's services will be measured. A generalized articulation of the standard of care is: "that level of care exercised by similarly situated professionals of similar training and also practicing in the industry in the area." This long recognized standard of care acknowledges that the design professional performs its work in an environment of uncertainty and cannot possibly account for all potential eventualities or circumstances that might arise during the development of the design and that the engineer is constantly called upon to weigh alternatives and exercise its judgment in preparing its work product.

Owners utilizing the engineer's design and work product in procuring and contracting with a construction contractor, on the other hand, are obligated to provide that construction contractor with perfect documents, (the so-called Spearin Doctrine). This gap between a reasonable level of care required of the design professional and the perfection required of the owner infuriates some owners. ("Why should I have to pay for the errors of my designer?")

There is a rising trend in owner organizations across the country seeking to obligate the design professionals to perform their work in accordance with "the highest level of care," which is a heightened standard that owners believe will entitle them to pass each and every contractor error or omission claim through to the design professional. The problem for the design professional, especially those dealing in underground projects, is that this highest level of care standard may be unachievable. This is particularly true when the error or omission is viewed with the benefit of hindsight. Not only is it unachievable, but in all likelihood it is also uninsurable. Professional liability policies cover the design professional for its negligence, defined as a failure to comply with the standard of care of the average similarly situated design professional, not with the highest level of care. This uninsurability is bad news for the owners as well in that the only practicable source of funding for a particular error may be unavailable.

Owners are quick to point out that they are willing to pay for the best engineering services and thus they should be allowed to demand this higher standard of care, yet their competitively driven designer selection process still carries price as a determinative factor. A better approach to heightening the quality of design services is assuring the designers have adequate time and budget to perform their services, requiring (and paying for) independent peer review, or by the owner's engagement of an independent board of consultants to independently review and comment on the designer's work product.

Differing Site Conditions

This seemingly logical, theoretically simple and marvelously equitable risk allocation provision has become industy's "boogeyman under the bed." Contractors complain that owners do not administer the provision fairly. Owners complain that contractors unfairly leverage borderline DSC situations to cover up what would otherwise be contractor inefficiencies or productivity problems. The engineers recognize that any time a significant dollar value dispute turns on the language it drafted for specifications or geotechnical reports. it could become a target for the cost recovery initiative of the frustrated party in the underlying dispute.

Some owners have attempted to eliminate the differing site conditions clause completely, reasoning that it is their prerogative to draft a tight contract according to which they will enjoy price certainty for their project at the cost of paying the contractor's contingency amount for an unencountered condition. Other owners seek to curtail or condition DSC recovery to limited circumstances or magnitude of disruption. This assignment of subsurface risk to the construction contractor is acceptable and common in the vertical construction or building industry. In all but a very few select cases, however, it is an inappropriate approach for underground construction projects.

A responsible construction contractor bidding the work and attempting to include contingencies to cover the range of the potential differing site conditions that would impact his cost to perform the work would soon place his bid outside the competitive range. Indeed, all other things being equal, the low bidder for the project will likely be the contractor with the least experience, least imagination or otherwise willing to accept the greatest risk. While this transfer of risk may look good to the owner at the initial stages of the project, that view will change upon encountering the differing site conditions. The owner's comfort in relying on its bulletproof contractual risk allocation of the DSC will quickly turn to distress if the contractor's attempt to deal with that DSC begins to threaten abutting property owners, or if contractor insolvency or inability to finance dealing with the DSC begins to threatening project completion.

The obvious consequence of completely eliminating the DSC clause is that the owner will probably limit the contractors bidding the work to those contractors looking to break into the industry, with little or

no experience, capability and expertise. The more desirable contractors will simply not bid the work.

No Damage for Delay Clause

Time is money. On a complex underground construction project, where 25 to 30 percent of a contractor's daily operating costs can be indirect labor costs, the money is significant. Nevertheless, no damages for delays clauses have proliferated throughout the country. Owners contend that the clause is the embodiment of risk sharing for those risks beyond the control of either party: the contractor bears the risk of its increased costs, and the owner bears the delay associated with that risk. For certain risks, those usually termed "force majeure" or acts of god, this risk sharing apportionment makes sense. The apportionment becomes unfair when the owner attempts to apply the provision to issues that it is in a better position to at least influence if not downright control.

The no damage for delay provision becomes flatly onerous when the owner attempts to pass the risk of its own inefficiency or inability to timely perform its obligations on to the contractor. Perhaps the most egregious example is where Contractor A on a multiple prime construction project is delayed by Contractor B, an element of whose work Contractor A is dependant upon for further progress.

Owners across the country are finding that for long delays amounting to significant additional incurred costs, contractors are pushing back and litigating denied delayed claims. Courts appear more than willing to find circumstances and reasons to not enforce the clause especially in those circumstances where owners are seeking exculpation of itself for its own inefficiency and misadministration. Just like when an owner refuses to include a differing site condition clause, an owner could easily be faced with a situation where it has paid a higher price for the work by requiring contractors to include a contingency for the no damage for delay clause and then paying for that delay a second time if its clause is found to be unenforceable by the courts.

Payment Provisions

In many ways, subcontractors on a construction project are like the free end of a rope being whipped about in the wind. Subcontractors are generally required and bound by all of the provisions in the general conditions between the owner and general contractor. On top of those sit the terms and conditions between the contractor and its subcontractor. Certain conditional payment provisions, such as "pay when paid" or its nastier brother "pay if paid" clauses present significant hardships to subcontractors. The general contractor's rationalization for including such clauses is that it is a matter of cash flow. The general contractors rightly argue that they are not in the business of financing the work and that unless and until they have payment from the owner from which to pay their subcontractors, they should not be called upon to front the money for their subcontractors. Subcontractors are typically willing to go along with this argument up to a point.

When the failure of an owner to pay for an item of work is because of a failing or deficiency of the general contractor or one of its other subcontractors, that subcontractor who performed adequately is much less willing to wait for its payment. Many subcontractors are simply incapabable of waiting and carrying on the work. With regard to the risk of absolute nonpayment, in accordance with a paid if paid clause, general contractors typically say they are looking for their subs to share the risk of owner nonpayment with them. If the owner nonpayment is because of less than satisfactory performance by the subcontractor, then the clause makes sense. However, if nonpayment is because of owner financial problems or malfeasance having to do with other non-subcontractor related issues on the project, why should the subcontractor bear the burden of nonpayment? The general contractor is in a much better position to influence owner payment, and to investigate the owner's ability to pay in advance of calling out the subcontractor. While payment bonds and statutory subcontractor payment requirements, if available, offer some level of protection, the subcontractor may not survive long enough to avail itself to these protections.

A Partner in the Professional Practices Group at Donovan Hatem, David Corkum is a construction attorney intimately familiar with every aspect of the planning, design, and construction of heavy civil and underground construction projects. His practice is concentrated in the defense of architects, engineers and construction managers. He also advises clients on risk management practices and procedures throughout the various stages of a design and construction project. David has participated in resolution of numerous disputes between owners, designers, and contractors, including claims for differing site condition and defective design. Prior to joining Donovan Hatem in 2001, he spent 23 years as a geologist and construction manager on large-scale and vital energy and infrastructure projects. David can be reached at 617-406-4532 or dcorkum@donovanhatem.com.